ICLG

The International Comparative Legal Guide to:

Lending & Secured Finance 2016

4th Edition

A practical cross-border insight into lending and secured finance

LSTA

Morgan Lewis

Contributing Editor
Thomas Mellor, Morgan, Lewis & Bockius LLP

Sales Director
Florjan Osmani

Account Directors
Oliver Smith, Rory Smith

Sales Support Manager
Toni Hayward

Sub Editor
Sam Friend

Senior Editor
Rachel Williams

Chief Operating Officer
Dror Levy

Group Consulting Editor
Alan Falach

Group Publisher
Richard Firth

Published by
Global Legal Group Ltd.
59 Tanner Street
London SE1 3PL, UK
Tel: +44 20 7367 0720
Fax: +44 20 7407 5255
Email: info@glgroup.co.uk
URL: www.glgroup.co.uk

GLG Cover Design
F&F Studio Design

GLG Cover Image Source
iStockphoto

Printed by
Stephens & George
Print Group
April 2016

Copyright © 2016
Global Legal Group Ltd.
All rights reserved
No photocopying

ISBN 978-1-910083-90-1
ISSN 2050-9847

Strategic Partners

Editorial Chapters:

1	**Loan Syndications and Trading: An Overview of the Syndicated Loan Market** – Bridget Marsh & Ted Basta, Loan Syndications and Trading Association	1
2	**Loan Market Association – An Overview** – Nigel Houghton, Loan Market Association	7
3	**An Overview of the APLMA** – Janet Field & Katy Chan, Asia Pacific Loan Market Association	12

General Chapters:

4	**An Introduction to Legal Risk and Structuring Cross-Border Lending Transactions** – Thomas Mellor & Marcus Marsh, Morgan, Lewis & Bockius LLP	15
5	**Global Trends in Leveraged Lending** – Joshua W. Thompson & Caroline Leeds Ruby, Shearman & Sterling LLP	20
6	**Similar But Not The Same: Some Ways in Which Bonds and Loans Will Differ in a Restructuring** – Kenneth J. Steinberg & Darren S. Klein, Davis Polk & Wardwell LLP	26
7	**Yankee Loans – "Lost in Translation" – a Look Back at Market Trends in 2015** – Alan Rockwell & Martin Forbes, White & Case LLP	32
8	**Commercial Lending in the Developing Global Regulatory Environment: 2016 and Beyond** – Bill Satchell & Elizabeth Leckie, Allen & Overy LLP	40
9	**Acquisition Financing in the United States: Will the Boom Continue?** – Geoffrey R. Peck & Mark S. Wojciechowski, Morrison & Foerster LLP	45
10	**A Comparative Overview of Transatlantic Intercreditor Agreements** – Lauren Hanrahan & Suhrud Mehta, Milbank, Tweed, Hadley & McCloy LLP	50
11	**A Comparison of Key Provisions in U.S. and European Leveraged Loan Agreements** – Sarah M. Ward & Mark L. Darley, Skadden, Arps, Slate, Meagher & Flom LLP	57
12	**The Global Subscription Credit Facility and Fund Finance Markets – Key Trends and Forecasting 2016** – Michael C. Mascia & Wesley A. Misson, Cadwalader, Wickersham & Taft LLP	66
13	**Recent Trends and Developments in U.S. Term Loan B** – David Almroth & Denise Ryan, Freshfields Bruckhaus Deringer LLP	69
14	**The Continued Migration of US Covenant-Lite Structures into the European Leveraged Loan Market** – Jane Summers & James Chesterman, Latham & Watkins LLP	74
15	**Unitranche Financing: UK vs. US Models** – Stuart Brinkworth & Julian S.H. Chung, Fried, Frank, Harris, Shriver & Jacobson LLP	77
16	**Recent Developments in Islamic Finance** – Andrew Metcalf & Leroy Levy, King & Spalding LLP	82
17	**Translating High Yield to Leveraged Loans: Avoiding Covenant Convergence Confusion** – Jeff Norton & Danelle Le Cren, Linklaters LLP	86

Country Question and Answer Chapters:

18	**Albania**	Tonucci & Partners: Neritan Kallfa & Blerina Nikolla	91
19	**Andorra**	Montel&Manciet Advocats: Audrey Montel Rossell & Liliana Ranaldi González	97
20	**Argentina**	Marval, O'Farrell & Mairal: Juan M. Diehl Moreno & Diego A. Chighizola	103
21	**Australia**	King & Wood Mallesons: Yuen-Yee Cho & Richard Hayes	112
22	**Bermuda**	MJM Limited: Jeremy Leese	120
23	**Bolivia**	Criales, Urcullo & Antezana: Andrea Mariah Urcullo Pereira & Daniel Mariaca Alvarez	130
24	**Botswana**	Khan Corporate Law: Shakila Khan	137
25	**Brazil**	Pinheiro Neto Advogados: Ricardo Simões Russo & Leonardo Baptista Rodrigues Cruz	145
26	**British Virgin Islands**	Maples and Calder: Michael Gagie & Matthew Gilbert	153
27	**Canada**	McMillan LLP: Jeff Rogers & Don Waters	160
28	**Cayman Islands**	Maples and Calder: Tina Meigh & Nick Herrod	169

Continued Overleaf →

Further copies of this book and others in the series can be ordered from the publisher. Please call +44 20 7367 0720

Disclaimer
This publication is for general information purposes only. It does not purport to provide comprehensive full legal or other advice.
Global Legal Group Ltd. and the contributors accept no responsibility for losses that may arise from reliance upon information contained in this publication.
This publication is intended to give an indication of legal issues upon which you may need advice. Full legal advice should be taken from a qualified professional when dealing with specific situations.

glg
global legal group

Country Question and Answer Chapters:

29	**Chile**	Carey: Diego Peralta & Elena Yubero	176
30	**China**	King & Wood Mallesons: Jack Wang & Stanley Zhou	183
31	**Costa Rica**	Cordero & Cordero Abogados: Hernán Cordero Maduro & Ricardo Cordero Baltodano	190
32	**Cyprus**	E & G Economides LLC: Marinella Kilikitas & George Economides	198
33	**Czech Republic**	JŠK, advokátní kancelář, s.r.o.: Roman Šťastný & Patrik Müller	206
34	**Dominican Republic**	QUIROZ SANTRONI Abogados Consultores: Hipólito García C.	212
35	**England**	Allen & Overy LLP: Philip Bowden & Darren Hanwell	219
36	**France**	Freshfields Bruckhaus Deringer LLP: Emmanuel Ringeval & Cristina Radu	227
37	**Germany**	King & Spalding LLP: Dr. Werner Meier & Dr. Axel J. Schilder	237
38	**Greece**	KPP Law Offices: George N. Kerameus & Pinelopi N. Tsagkari	248
39	**Hong Kong**	King & Wood Mallesons: Richard Mazzochi & David Lam	255
40	**Indonesia**	Ali Budiardjo, Nugroho, Reksodiputro: Theodoor Bakker & Ayik Candrawulan Gunadi	262
41	**Ireland**	McCann FitzGerald: Fergus Gillen & Martin O'Neill	270
42	**Japan**	Anderson Mori & Tomotsune: Taro Awataguchi & Yuki Kohmaru	278
43	**Mexico**	Gonzalez Calvillo, S.C.: José Ignacio Rivero Andere & Samuel Campos Leal	286
44	**Norway**	Advokatfirma Ræder DA: Marit E. Kirkhusmo & Kyrre W. Kielland	293
45	**Peru**	Miranda & Amado Abogados: Juan Luis Avendaño C. & Jose Miguel Puiggros O.	302
46	**Puerto Rico**	Ferraiuoli LLC: José Fernando Rovira Rullán & Carlos M. Lamoutte-Navas	312
47	**Romania**	Reff & Associates SCA: Andrei Burz-Pinzaru & Mihaela Maxim	319
48	**Russia**	Mosgo & Partners: Oleg Mosgo & Anton Shamatonov	327
49	**Singapore**	Drew & Napier LLC: Valerie Kwok & Blossom Hing	334
50	**Slovenia**	Brulc, Gaberščik in Kikelj o.p., d.o.o.: Luka Gaberščik & Mina Kržišnik	343
51	**Spain**	Cuatrecasas, Gonçalves Pereira: Manuel Follía & María Lérida	352
52	**Sweden**	White & Case LLP: Carl Hugo Parment & Tobias Johansson	361
53	**Switzerland**	Pestalozzi Attorneys at Law Ltd: Oliver Widmer & Urs Klöti	368
54	**Taiwan**	Lee and Li, Attorneys-at-Law: Hsin-Lan Hsu & Cyun-Ren Jhou	377
55	**Turkey**	Paksoy: Sera Somay & Esen Irtem	385
56	**Ukraine**	CMS Reich-Rohrwig Hainz: Anna Pogrebna & Kateryna Soroka	392
57	**UAE**	Morgan, Lewis & Bockius LLP: Ayman A. Khaleq & Amanjit K. Fagura	399
58	**USA**	Morgan, Lewis & Bockius LLP: Thomas Mellor & Rick Eisenbiegler	410
59	**Venezuela**	Rodner, Martínez & Asociados: Jaime Martínez Estévez	421

EDITORIAL

Welcome to the fourth edition of *The International Comparative Legal Guide to: Lending & Secured Finance*.

This guide provides corporate counsel and international practitioners with a comprehensive worldwide legal analysis of the laws and regulations of lending and secured finance.

It is divided into three main sections:

Three editorial chapters. These chapters are overview chapters and have been contributed by the LSTA, the LMA and the APLMA.

Fourteen general chapters. These chapters are designed to provide readers with a comprehensive overview of key issues affecting lending and secured finance, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in lending and secured finance laws and regulations in 42 jurisdictions.

All chapters are written by leading lending and secured finance lawyers and industry specialists and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editor Thomas Mellor of Morgan, Lewis & Bockius LLP for his invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The *International Comparative Legal Guide* series is also available online at www.iclg.co.uk.

Alan Falach LL.M.
Group Consulting Editor
Global Legal Group
Alan.Falach@glgroup.co.uk

PREFACE

Welcome to the 2016 edition of *The International Comparative Legal Guide to: Lending & Secured Finance*. Morgan, Lewis & Bockius LLP is delighted to serve as the *Guide*'s Contributing Editor.

Cross-border lending has increased dramatically over the last few decades in terms of volume of loans, number of transactions and number of market participants.

There are many reasons for this: the globalisation of business and development of information technology; the rise of emerging economies that have a thirst for capital; and the advancement and sophistication of global lending markets, which has led to a dramatic rise in the number of global lending market participants. These market participants search for the optimal mix of return and risk, a search that often leads to cross-border lending opportunities. For these reasons it is increasingly important to maintain an accurate and up-to-date guide regarding relevant practices and laws in a variety of jurisdictions.

The *Guide*'s first three editions established it as one of the most comprehensive guides in the practice of cross-border lending. Building on that success, this fourth edition, with contributions from the LSTA, the LMA and the APLMA, covering 42 jurisdictions and with useful overview chapters exploring certain topics in-depth, serves as an even more valuable and authoritative source of reference material for lenders, global business lenders, in-house counsel and international legal practitioners.

We hope you find the *Guide* useful and practical, and we encourage you to contact us with suggestions to improve future editions.

Thomas Mellor
Morgan, Lewis & Bockius LLP
Contributing Editor
The International Comparative Legal Guide to: Lending & Secured Finance 2016
thomas.mellor@morganlewis.com

Loan Syndications and Trading: An Overview of the Syndicated Loan Market

Bridget Marsh

Loan Syndications and Trading Association

Ted Basta

In the past 25 years, the art of corporate loan syndications, trading, and investing has changed dramatically. There was a time when banks lent to their corporate borrowers and simply kept those loans on their books, never contemplating that loans would be traded and managed by investors like stocks and bonds in a portfolio. In time, however, investors became drawn to the attractive features of loans – unlike bonds, loans were senior secured debt obligations with a floating rate of return – and, over the years, an institutional asset class emerged. Today, such loans are not only held by banks but are also typically sold to other banks, mutual funds, insurance companies, structured vehicles, pension funds, and hedge funds. This broader investor base has brought a remarkable growth in the volume of loans being originated in the primary market and subsequently traded in the secondary market. The syndicated loan market represents one of today's most innovative capital markets.

In 2015, total corporate lending in the United States fell just short of $2 trillion.[1] This figure encompasses all three subsectors of the syndicated loan market – the investment grade market, the leveraged loan market, and the middle market. In the investment grade market total lending – or issuance – stood at approximately $872 billion in 2014. Most lending in the investment grade market consists of revolving credit facilities to larger, more established companies. The leveraged loan market, where loans are made to companies with non-investment grade ratings (or with high levels of outstanding debt), represented $783 billion.[2] Leveraged loans are typically made to companies seeking to refinance existing debt, to finance acquisitions, leveraged buyouts, or to fund projects and other corporate endeavours such as dividend recapitalisations. Although investment grade lending and leveraged lending volumes are roughly comparable, leveraged loans comprise the overwhelming majority of loans that are traded in the secondary market. Then there is the middle market. As traditionally defined, middle market lending includes loans of up to $500 million that are made to companies with annual revenues of under $500 million.[3] For these companies, the loan market is a primary source of funding. In 2015, middle market lending totalled approximately $250 billion, with $142 billion of that amount considered large middle market deals.[4]

Of these three market segments, it is the leveraged loan market that has evolved most dramatically over the past 25 years. Attracted by the higher returns of the loan asset class, the investor base has expanded significantly and become more diverse. This, in turn, has fuelled demand for loans, leading to a commensurate rise in loan origination volumes in the primary market. For the loan market to grow successfully, for the loan asset class to mature, and to ease the process of trading and settlement, these new entrants to the market have needed uniform market practices and standardised trading documentation. In 1995, in response to these needs, the Loan Syndications and Trading Association ("LSTA" or "Association") was formed, and its mission since inception has included the development of best practices, market standards, and trading documentation. The LSTA has thus successfully spearheaded efforts to increase the transparency, liquidity, and efficiency of the loan market; in turn, this more standardised loan asset class has directly contributed to the growth of a robust, liquid secondary market.

The LSTA's role has expanded to meet new market challenges. After the global financial crisis of 2008, the LSTA assumed more prominence in the loan market, regularly engaging with the U.S. government and its regulatory bodies on recent legislative and regulatory initiatives. Policymaking in the wake of the financial crisis had included sweeping changes to the financial industry, including to the loan market, even though the regulatory impact on the loan market was sometimes an unintended byproduct of reform legislation aimed somewhere else. The LSTA has, therefore, dedicated substantial time and energy since the crisis to building awareness among regulators about the loan market and how it functions, seeking to distinguish it from other markets and, at times, persuading policymakers to exempt the loan market from particular legislative measures. With most of the comment periods for those regulatory changes having expired, the LSTA will move into a second phase of its regulatory outreach programme, where it plans to maintain a dialogue about the loan market with regulators and to promote the many benefits of a vibrant leveraged loan market for US companies.

This chapter examines: (i) the history of the leveraged loan market, focusing on the growth and maturation of the secondary trading market for leveraged loans; (ii) the role played by the LSTA in fostering that growth through its efforts to standardise the practices of, and documentation used by participants active in, the secondary loan market to bring greater transparency to the loan asset class; and (iii) the regulatory challenges faced by the loan market in a post-financial crisis environment, which our members believe is the most important concern for the loan market.

Growth of the Secondary Market for Leveraged Loans

The story of the leveraged loan market starts more than 25 years ago in the United States, with the first wave of loan market growth being driven by the corporate M&A activity of the late 1980s. Although a form of loan market had existed prior to that time, a more robust syndicated loan market did not emerge until the M&A deals of the 1980s and, in particular, those involving leveraged buy-outs (LBOs), which required larger loans with higher interest rates. This had two significant consequences for the loan market. First, because

© Published and reproduced with kind permission by Global Legal Group Ltd, London

banks found it difficult to underwrite very large loans on their own, they formed groups of lenders – syndicates – responsible for sharing the funding of such large corporate loans. Syndication enabled the banks to satisfy market demand while limiting their own risk exposure to any single borrower. Second, the higher interest rates associated with these large loans attracted non-bank lenders to the loan market, including traditional bond and equity investors, thus creating a new demand stream for syndicated loans. Retail mutual funds also entered the market at this time and began to structure their funds for the sole purpose of investing in bank loans. These loans generally were senior secured obligations with a floating interest rate. The resultant asset class had a favourable risk-adjusted return profile. Indeed, non-bank appetite for syndicated leveraged loans would be the primary driver of demand that helped fuel the loan market's growth.[5]

Although banks continued to dominate both the primary market (where loans are originated) and the secondary market (where loans are traded), the influx of the new lender groups in the mid-1990s saw an inevitable change in market dynamics within the syndicated loan market. In response to the demands of this new investor class, the banks, which arranged syndicated loans, began modifying traditional deal structures, and, in particular, the features of the institutional tranche or term loan B, that portion of the deal which would typically be acquired by the institutional or non-bank lenders. The size of these tranches was increased to meet (or create) demand, their maturity dates were extended to suit the lenders' investment goals, and their amortisation schedules tailored to provide for only small or nominal instalments to be made until the final year when a large bullet payment was scheduled to be made by the borrower. In return, term loan B lenders were paid a higher rate of interest. All these structural changes contributed to a more aggressive risk-return profile, which was necessary in order to attract still more liquidity to the asset class.

A true secondary market for leveraged loans in the United States emerged in the 1990s. During the recession of the early 1990s, default rates rose sharply, which severely limited the availability of financing, particularly in transactions involving financing from regional and foreign banks. Interest rates to non-investment grade borrowers thus increased dramatically. Previously, banks had carried performing loans at par or face value on their balance sheets, while valuations below par (expected sale prices) were only generally assigned to loans that were in or near default. During the credit cycle of the early 1990s, however, a new practice developed in the banking industry. As banks in the U.S. sought to reduce their risk and strengthen their balance sheets, they chose to sell those leveraged loans which had declined in value since their syndication, rather than hold the loans until their maturity date as they had in the past. In so doing, a new distressed secondary market for leveraged loans emerged, consisting of both traditional (bank) and non-traditional (non-bank) buyers. Banks were not simply originators of these loans but now were also loan traders, and thus, in their role as market makers, began to provide liquidity for the market.

Although leveraged lending volume in the primary market had reached approximately $100 billion by 1995, trading activity was still relatively low, standing at approximately $40 billion.[6] The early bank loan trading desks at this time initially acted more as brokers than traders, simply brokering or matching up buyers and sellers of loans. As liquidity improved and the lender base expanded, investors began to look to the secondary market as a more effective platform from which to manage their risk exposure to loans, and eventually active portfolio management through secondary loan trading was born. With the advent of this new and vibrant secondary loan market, there naturally was a greater need for standard trading documents and market practices which could service a fair, efficient, liquid, and professional trading market for commercial loans – a need reflected in the LSTA's creation in 1995. (The LSTA and its role in the development of a more standardised loan market is discussed more fully below, under "The Standardisation of a Market".)

Around the same time, the loan market acquired investment tools similar to those used by participants in other mature markets; for example, a pricing service, bank loan ratings, and other supporting vendor services. In 1996, the LSTA established a monthly dealer quote-based secondary mark-to-market process to value loans at a price indicative of where those loans would most likely trade. This enabled auditors and comptrollers of financial institutions that participated in secondary trading to validate the prices used by traders to mark their loan positions to "market". Within a few years, however, as leveraged lending topped $300 billion and secondary trading volume reached $80 billion, there was a need to "mark-to-market" loan positions on a more frequent basis.[7] In 1999, this led to the LSTA and Thomson Reuters Loan Pricing Corporation jointly forming the first secondary mark-to-market pricing service run by an independent third party to provide daily U.S. secondary market prices for loan market participants. Shortly thereafter, two other important milestones were reached, both of which facilitated greater liquidity and transparency. First, the rating agencies began to make bank loan ratings widely available to market participants. Second, the LSTA and Standard Poor's together created the first loan index, the S&P/LSTA Leveraged Loan Index (LLI), which has become the standard benchmarking tool in the industry. Just as the market's viability was on the rise, so was its visibility. In 2000, the Wall Street Journal began weekly coverage of the syndicated loan market and published the pricing service's secondary market prices for the mostly widely quoted loans. All these tools – the pricing service, the bank loan ratings, the loan index, and the coverage of secondary loan prices by a major financial publication – were important building blocks for the loan market, positioning it for further successful growth.

At about this time, the scales tipped, and the leveraged loan market shifted from a bank-led market to an institutional investor-led market comprised of finance and insurance companies, hedge, high-yield and distressed funds, loan mutual funds, and structured vehicles like collateralised loan obligations or "CLOs". Between 1995 and 2000, the number of loan investor groups managing bank loans grew by approximately 130% and accounted for more than 50% of new deal allocations in leveraged lending. By the turn of the millennium, leveraged lending volume was approximately $310 billion and annual secondary loan trading volume exceeded $100 billion as illustrated in the chart below. With these new institutional investors participating in the market, the syndicated loan market experienced a period of rapid development that allowed for impressive growth in both primary lending and secondary trading.

Chart 1

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Unfortunately, as the credit cycle turned and default rates increased sharply in the early 2000s, there was a temporary lull in the market's growth, with secondary loan trading stalling for a number of years. By 2003, however, leveraged lending (and trading) volumes quickly rebounded as investor confidence was restored.

Even the most bullish of loan market participants could not have predicted the rate of expansion that would take place over the next four years, from 2003–2007. Once again, this growth was driven by M&A activity and large LBOs. Increasing by nearly 200% in that four-year period, leveraged loan outstandings were more than half a trillion dollars and secondary trading volumes reached $520 billion. Although hedge funds, loan mutual funds, insurance companies, and other investor groups played a large part in this phase of the loan market's expansion, the growth of the past five years had only been possible because of the emergence of CLOs; this type of structured finance vehicle changed the face of the leveraged loan market and was responsible for its revival after the Global Financial Crisis.

The global financial crisis in 2008 led to a recession in the United States, a contraction of global supply and demand, and record levels of default rates. Several years passed before leveraged lending issuance was restored to pre-crisis levels, finally reaching $665 billion in 2012. Although secondary trading activity had been in steady decline from 2008 through 2012, the asset classes' investment thesis (senior secured, floating rate, high risk-adjusted return) coupled with all the investment tools put in place years earlier and the standardisation of legal and market practices would fuel the market's next phase of expansive growth which began in 2013.

Record levels of refinancing activity drove leveraged lending volumes in 2013 to an all-time high of $1.1 trillion – surpassing 2012's prior record by almost 50%. On the institutional side, lending reached $639 billion, surpassing 2012's prior record by almost 90%. Lenders also financed a substantial amount of new loans in 2013 and, as a result, the size of the secondary loan market not only returned to its pre-crisis size but surpassed its previous record high set back in 2008 by almost $100 billion (LLI outstandings totalled $682 billion by year-end 2013). In the secondary market, trading volumes for 2013 totalled $517 billion, a post-recession high that just fell short of 2007's all-time high of $520 billion. In 2014, loan trading volumes ran even higher, reaching a new high of $628 billion as the size of the market continued to expand to fresh all-time highs (LLI outstandings reached $831 billion in loans outstanding by year-end). At a time when other fixed income markets were reporting lower levels of trading activity, the loan market continued to exhibit a significant rise in liquidity.

The year 2015, though, turned into quite the disappointment for loan investors as many managers were predicting a coupon driven return – at worst. Little did they anticipate the contagion that would spread as the price of oil plummeted and global economies weakened. In loan land, the month of December marked the seventh consecutive month of red ink for the LLI – a record streak for the loan market. All told, LLI returns came in at negative 0.7% on the year, marking only the second time in the LLI's 19-year history that annual returns were reported in the red. (The other time, of course, was 2008.) Loans, though, were not alone in their seven-year nadir. Both the equity (the S&P 500) and high yield bond markets also suffered their worst annual performances since 2008. While equities delivered a 1.41% gain, HY bond investors suffered a painful 4.64% loss on the year.

Risk-aversion was, in fact, the name of the game in 2015. Investors looked to shed risk and acquire better rated assets, particularly as the year wore on and credit concerns mounted. As a result, double B rated loans, which currently constitute more than one third of LLI outstandings, returned 2.23% on the year compared to the negative 0.82% return on single-B loans (which constitute a larger market share at 45%). Furthermore, loans rated in the triple-C range reported an 8.43% loss while defaulted paper was rocked for a 42.86% loss. On the industry front, the beaten down oil and gas sector was the worst performer of the year at negative 29.5%. Fortunately, the overall jolt to the broader market was muted as the sector only accounted for roughly 4% of outstandings. Even still, oil and gas loans pressured the market's default rate, which increased to a nine-month high of 1.54% by amount and a two-year high of 1.19% by number, according to S&P Capital IQ. In total, oil and gas loans accounted for almost 40% of 2015 defaults (by count).

In dissecting the loan market's return of negative 0.7%, S&P Capital pointed out the LLI's 4.6% in interest accruals across the year could not offset its market value loss of 5.3%. To that point, the LLI's average bid level in the secondary market sank 466 basis points in 2015, to a four-year low of 91.26. In total, for every one loan price that advanced in 2015, 1.5 declined. And, as prices grinded lower in the secondary, the market's average bid-ask spread gapped out 31 basis points to 142 basis points by year-end. But despite the prolonged sell-off in the secondary market, trading levels remained robust. Annual secondary loan trade volumes totalled $591 billion in 2015 – just a 6% decline from 2014's all-time high of $628 billion. In looking back across all four quarters of 2015, trading volumes ebbed and flowed alongside shifting technicals (supply and demand levels) and waning investor sentiment. The year will basically be remembered as a tale of two halves – well, almost. The year 2015 started strong as the secondary market rebounded off its December 2014 lows. As a result, loan prices rallied by almost 150 basis points through May, reaching a 2015 high water mark of 97.4. At that point, the LLI had returned 3.24%. But midway through June, the capital markets began to trade off considerably as risk was re-priced up and down the capital structure. What transpired next was seven straight months of negative loan returns as a cornucopia of micro (loan market technicals and credit quality) and macro concerns (weaker global economies including China and the U.S., the plummeting of oil prices and finally the uncertainty around U.S. interest rate hikes) pressured loan prices lower through year-end.

The Standardisation of a Market

No regulatory authority directly oversees or sets standards for the trading of loans in the United States, although, of course, loan market participants themselves are likely to be subject to other governmental and regulatory oversight. Instead, the LSTA leads the loan market by developing policies, guidelines, and standard documentation and promoting just and equitable market practices. The LSTA's focus is attuned to the distinctive structural features of the loan market which stem from the fact that corporate loans are privately negotiated debt obligations that are issued and traded subject to voluntary industry standards. Because the LSTA represents the interests of both the sellers and buyers of leveraged loans in the market, it serves as a central forum for the analysis and discussion of market issues by these different market constituents and thus is uniquely placed to balance their needs and drive consensus.

Loan market participants have generally adopted the standardised documents and best practices promulgated by the LSTA. Although the LSTA is active in the primary market, where agent banks originate syndicated loans, it is most prominent in the secondary market, where loan traders buy and sell syndicated loans. Over the years, the Association has published a suite of standard trading documents: forms or "trade confirmations" are available to evidence

© Published and reproduced with kind permission by Global Legal Group Ltd, London

oral loan trades made by parties and form agreements are available to document the terms and conditions upon which the parties can settle those trades. The adoption of the LSTA's standard trading documents by the market has directly contributed to the growth of a robust, liquid secondary market.

It is customary for leveraged loans to be traded in an over-the-counter market, and, in most instances, a trade becomes legally binding at the point the traders orally agree the material terms of the trade. Those key terms are generally accepted as including the borrower's name, the name, facility type, and amount of the loan to be sold, and the price to be paid for the loan. For commercial reasons, most U.S. borrowers choose New York law as the law governing their credit agreements, and for similar reasons, the LSTA has chosen New York as the governing law in their trading documentation. Since 2002, loan trades agreed over the telephone, like agreements relating to derivatives contracts and certain other financial instruments, have benefitted from an exemption from a New York law which would otherwise require them to be set forth in a signed writing to be enforceable. Because of the LSTA's lobbying efforts, the applicable New York law was changed in 2002 to facilitate telephone trading. Thus, provided both parties have traded together previously on LSTA standard documentation, even if one party fails to sign a confirmation evidencing the terms of the trade, the loan trade will be legally binding and enforceable, if it can be shown that the parties orally agreed the material trade terms. This was a critical legislative reform that contributed to legal certainty in the loan market and harmonised its status with that of other asset classes.

After agreeing the essential trade terms, loan market practice requires that parties then execute a form of LSTA trade confirmation (the legislative change discussed above merely makes it possible legally to enforce an oral trade even if a confirmation has not been signed). Loans can be traded on what is referred to as par documentation or on distressed documentation. Two forms of trade confirmations are available for this purpose and the choice of which one to use is a business decision made at the time of trade. Performing loans, where the borrower is expected to pay in full and on a timely basis, are typically traded on par documentation which means that the parties evidence their binding oral trade by executing an LSTA Par Confirmation and then settling the trade by completing the form of Assignment Agreement provided in the relevant credit agreement (the term par is used because performing loans historically traded at or near par). Alternatively, where a borrower is in, or is perceived to be in, financial distress or the market is concerned about its ability to make all interest payments and repay the loan in full and on a timely basis, parties may opt to trade the borrower's loans on distressed documentation. In this case, the trade is documented on an LSTA Distressed Confirmation, and the parties settle the transaction by executing the relevant assignment agreement and a supplemental purchase and sale agreement. The LSTA has published a form agreement for this purpose which has been refined over the years and is generally used by the market. This agreement includes, amongst other provisions, representations and warranties, covenants, and indemnities given by seller and buyer. The adoption of standard documents in this regard, particularly for distressed debt trading, significantly contributed to a more liquid loan market, because market participants, knowing that an asset is being traded repeatedly on standard documents, can then uniformly price the loan and more efficiently settle the trade.

When a loan is traded, the existing lender of record agrees to sell and assign all of its rights and obligations under the credit agreement to the buyer.[8] In turn, the buyer agrees to purchase and assume all of the lender's rights and obligations under the credit agreement. The parties must then submit their executed assignment agreement to the administrative agent which has been appointed by the lenders under the credit agreement. The borrower's and agent's consent is typically required before the assignment can become effective. Once those consents are obtained, the agent updates the register of lenders, and the buyer becomes a new lender of record under the credit agreement and a member of the syndicate of lenders.[9]

If, for some reason, the borrower does not consent to the loan transfer to the buyer, the parties' trade is still legally binding under the terms of the LSTA's Confirmation and must be settled as a participation.[10] The LSTA has published standardised par participation agreements and distressed participation agreements which may be used to settle par and distressed trades respectively where loan assignments are not permissible. Under this structure, the seller sells a 100% participation interest in the loan to the buyer and retains bare legal title of the loan. Although the seller remains a lender of record under the credit agreement and the borrower will not typically be aware that a participation interest in the loan has been sold, the seller must pass all interest and principal payments to the buyer for so long as the participation is in place. The transfer of a participation interest on LSTA standard documents is typically afforded sale accounting treatment under New York law. Thus, if the seller of the participation becomes a bankrupt entity, the participation is not part of the seller's estate, and the seller's estate will have no claim to the participation or the interest and principal payments related thereto.

The LSTA continues to expand its suite of trading documents and has increasingly played a more active role in the primary market. In 2014, the LSTA released new versions of its primary documents, including an expanded publication of its Model Credit Agreement Provisions which now include language addressing refinancing mechanics, "amend and extends" whereby certain lenders may extend their loan's maturity date in exchange for a higher margin (pursuant to this post-financial crisis credit agreement development, only those lenders participating in the extension need consent to it), sponsor and borrower acquisitions of loans on the open market or through a "Dutch Auction" procedure, and guidelines regarding the borrower's creation and updating of a list of entities and competitors it seeks to ban from joining the syndicate of lenders or acquiring participations in the loan.

Regulatory Challenges

The financial crisis and the myriad financial reform regulation it spawned has forced the loan market to confront and respond to a number of regulatory challenges. The LSTA has pioneered advocacy efforts on behalf of loan market investors, such as CLOs and mutual funds, and on behalf of secured lenders and the syndicated loan market as a whole. In 2015, not only did these advocacy efforts continue, but the LSTA also provided thought leadership to the loan market on a new regulatory development – Article 55 of the EU's Bank Recovery and Resolution Directive (BRRD).

As CLOs and loan mutual funds comprise more than 60 of the institutional loan investor base, the regulatory pressure confronting these two demand streams could reverberate through the U.S. loan market. One of the first regulatory challenges to face the market was the risk retention rules implemented under the Dodd-Frank Act of 2010. The rules, adopted in December 2014 and effective in December of this year, do not appropriately address CLOs and could adversely impact U.S. CLO formation. In response to the final rules, the LSTA filed a case under the Administrative Procedures Act against the Securities and Exchange Commission (SEC) and the Board of Governors of the Federal Reserve System regarding the application of these rules to CLOs and a decision is expected later this year. 2015 also ushered in a new threat to the market. In September 2015, the SEC proposed new liquidity rules for open-end

© Published and reproduced with kind permission by Global Legal Group Ltd, London

mutual funds, that if adopted as currently written, would challenge the market's $100 billion of open-end loan mutual funds. The LSTA submitted a comment letter in January 2016 supporting the objective of the proposal, yet suggesting a true top-down principles-based approach rather than the often prescriptive nature of the proposed rules. The year 2016 will hopefully bring successful resolution on the CLO front while the market may have to wait until 2017 to see the SEC's final liquidity rules.

Looking at the broader market, 2015 saw further regulatory developments. First, the U.S. banking regulators' Guidance on Leveraged Lending (Guidance), which affects both the origination and distribution of leveraged loans, has been the dominant challenge facing the market over the last two years and confounded many market participants when it went effective in 2013. However, 2015 saw the industry begin to determine what is acceptable under the Guidance and learn to live within its strictures. Second, the LSTA released its response to the Final Report and Recommendations (Final Report) published by the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 (ABI Commission). The 200-page Final Report proposed reforms that would remediate the perceived problem of secured creditors exercising too much control over Chapter 11 cases and the inefficiencies brought to the bankruptcy process by the distressed debt markets. The Final Report introduced many alarming proposals that would undermine the fundamental rights of secured creditors and could dramatically affect secured creditors' expectations of recovery in default scenarios. To wit, the Commission proposed: that adequate protection of secured creditors should be artificially based on the "foreclosure value" of the collateral securing the loan rather than its going concern value; no "rollups" of pre-bankruptcy petition debt into Debtor-in-Possession (DIP) loans by pre-petition lenders unless the lender extends substantial new credit on terms better than any alternative and the court finds it is in the best interest of the estate; the unenforceability of intercreditor agreement provisions restricting junior creditors' ability to provide a DIP loan; and the elimination of a U.S. bankruptcy code requirement that an accepting impaired class accept a reorganisation plan, thereby facilitating debtors' cramdown of plans over the objection of certain secured creditors. The LSTA's response offers robust empirical evidence refuting many of the ABI Commission's propositions and showing the constructive role of secured creditors in the bankruptcy process. It also highlights the potentially disastrous consequences for the bankruptcy process and the broader credit markets if bedrock principles of the U.S. bankruptcy code, such as absolute priority, are overturned. The Final Report was delivered to the U.S. Congress, but legislative change is unlikely at this time. The more immediate threat comes from activist judges where we have already seen a number of decisions try to chip away at secured creditors' rights in recent years. The LSTA continues to address such decisions through the filing of *amicus curiae* briefs and, of course, through promotion of the LSTA's response to the Final Report. Finally, the newest regulation to impact the U.S. loan market actually comes out of Europe. The EU's bail-in rules generally took effect on January 1, 2016. Under the new rules, European banks may become subject to bail-in (outside of an insolvency situation) by their relevant resolution authority under which certain of their unsecured liabilities will be cancelled, written-down, or converted into equity in order to recapitalise the affected institution. Article 55 of the BRRD also requires that, when such institutions enter into contracts governed by non-European law (such as agreements governed by New York law), the affected institution will be required to include a "contractual recognition provision" pursuant to which they must give notice to their counterparties that any such liabilities arising under their agreement are potentially subject to compromise in a bail-in and to obtain the counterparties' acknowledgment of, and agreement to be bound by, any such bail-in. In December, the LSTA published a form provision for use in New York law governed primary market loan documents and a separate form provision for use in LSTA secondary market documents. Although loans in the U.S. loan market are generally always secured, the bail-in rules are still very relevant because it may well be the unsecured liabilities of a European lender in a syndicate lending to a U.S. borrower (for example, their commitment to lend under a revolver or their obligation to indemnify other contractual parties) which could potentially be the subject of a bail-in and thus require the inclusion of a "contractual recognition provision" in the relevant credit agreement. Interestingly, the failure to obtain a counterparty's acknowledgment can result in sanctions and/or fines for the European institution, but there is no such "stick" applicable to the counterparties. The beginning of 2016 has already seen market participants engage in robust negotiations regarding inclusion of the contractual recognition provision.

Conclusion

Today's loan market certainly looks very different from that before the financial crisis. We are experiencing a new and more challenging period, not only for investors but also for the LSTA. Loan prices are now said to be closely correlated to, and no longer shielded from, the daily price fluctuations of other asset classes. Although the risk-adjusted returns of leveraged loans are still advantageous, today's returns come with a higher level of volatility. In this environment, the LSTA remains committed to promoting a fair, efficient, and liquid market for loans and maintaining its position as the market's principal advocate.

Endnotes

1. Thomson Reuters Loan Pricing Corporation.
2. Thomson Reuters Loan Pricing Corporation. "Leveraged" is normally defined by a bank loan rating by Standard & Poor's of BB+ and below (by Moody's Investor Service, Ba1 and below) or, for non-rated companies, typically an interest rate spread of LIBOR + 125 basis points.
3. For a more detailed description on the loan market sectors, see Peter C. Vaky, Introduction to the Syndicated Loan Market, in THE HANDBOOK OF LOAN SYNDICATIONS & TRADING, 39 (Allison Taylor and Alicia Sansone, eds., 2007); Steve Miller, Players in the Market, in THE HANDBOOK OF LOAN SYNDICATIONS & TRADING, *supra*, 47.
4. Thomson Reuters Loan Pricing Corporation.
5. For a more detailed description of the history of the loan market, see Allison A. Taylor and Ruth Yang, Evolution of the Primary and Secondary Leveraged Loan Markets, in THE HANDBOOK OF LOAN SYNDICATIONS & TRADING, *supra*, 21.
6. Thomson Reuters Loan Pricing Corporation.
7. Thomson Reuters Loan Pricing Corporation.
8. For a detailed comparison of assignments and participations, see Richard Wight with Warren Cooke & Richard Gray, THE LSTA'S COMPLETE CREDIT AGREEMENT GUIDE, 507-508 (McGraw-Hill 2009).
9. For further information on the structure of assignments, see *id.* at 508–522.
10. For further information on the structure of participations, see *id.* at 522–527.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Bridget Marsh
Loan Syndications and Trading Association
366 Madison Avenue, 15th Floor
New York, NY 10017
USA

Tel: +1 212 880 3000
Fax: +1 212 880 3040
Email: bmarsh@lsta.org
URL: www.lsta.org

Bridget Marsh is Executive Vice President and Deputy General Counsel of the Loan Syndications and Trading Association (LSTA). Bridget heads the LSTA's Primary Market Committee and Trade Practices and Forms Committee and leads the legal projects for the development and standardisation of the LSTA's documentation. She is responsible for responding to and addressing secondary loan market trading disruptions and ensuring that the LSTA's primary market and trading documentation reflects current market practices. Bridget regularly speaks on the loan market at American Bar Association events.

Prior to joining the LSTA, Bridget practised as a corporate finance attorney at Milbank, New York, and as a lawyer in the corporate/M&A department of Simmons & Simmons, London, and completed a judicial clerkship for The Honorable Justice Beaumont of the Federal Court of Australia. Bridget Marsh received a B.A. *magna cum laude* from Georgetown University, a law degree with first class honours from Sydney Law School, the University of Sydney, and a Master's in Political Science from the University of New South Wales. She is admitted as an attorney in New York, England & Wales, and New South Wales, Australia.

Ted Basta
Loan Syndications and Trading Association
366 Madison Avenue, 15th Floor
New York, NY 10017
USA

Tel: +1 212 880 3000
Fax: +1 212 880 3040
Email: tbasta@lsta.org
URL: www.lsta.org

Ted Basta is Senior Vice President of Market Data & Analysis for the LSTA, where he manages key strategic partnerships and products of the LSTA, including the LSTA's trade and settlement data initiatives, the LSTA/Thomson Reuters LPC Mark-to-Market Pricing Service and the S&P/LSTA Leveraged Loan Index. In addition, Ted manages the LSTA's Market Data and Analysis team which is responsible for the Association's analytical and reporting initiatives all of which enhance market visibility, transparency and liquidity. Those efforts include the continued development, expansion and distribution to loan market participants of market analytics and secondary trading and settlement data.

Prior to joining the LSTA, Ted was Vice President and Director of Global Pricing with Loan Pricing Corporation (LPC), where he managed the LSTA/LPC Mark-to-Market Pricing Service. Ted received an M.B.A. from the Zicklin School of Business at Baruch College and a B.A. in Accounting from Long Island University.

Since 1995, the Loan Syndications and Trading Association has been dedicated to improving liquidity and transparency in the floating rate corporate loan market. As the principal advocate for this asset class, we aim to foster fair and consistent market practices to advance the interest of the marketplace as a whole and promote the highest degree of confidence for investors in floating rate corporate loans. The LSTA undertakes a variety of activities to foster the development of policies and market practices designed to promote just and equitable marketplace principles and to encourage coordination with firms facilitating transactions in loans and related claims. For more information, please visit www.lsta.org.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Loan Market Association – An Overview

Loan Market Association

Nigel Houghton

Loan Market Association

Founded in 1996, the Loan Market Association ("LMA") is the trade body for the syndicated loan market in Europe, the Middle East and Africa (EMEA).

The LMA's principal objective is to foster liquidity in the primary and secondary loan markets, a goal which it seeks to achieve by promoting efficiency and transparency, by the establishment of widely accepted market practice and by the development of documentation standards. As the authoritative voice of the syndicated loan market in EMEA, the LMA works with lenders, law firms, borrowers and regulators to educate the market about the benefits of the syndicated loan product, and to remove barriers to entry for new participants.

The purpose of this chapter is to give the reader insight into the background and development of the LMA, the scope of its work, and recent and current initiatives.

Background to the LMA

Banks have bought and sold loans for decades but standard market practice is still relatively recent.

Growth in borrowing requirements in the 1970s had seen loan facilities traditionally provided on a bilateral basis, increasingly replaced by larger credit lines from a club of lenders, and then by loan facilities syndicated to the wider market. In the US in the 1980s, a more formal secondary market evolved in parallel with demand on banks' balance sheets and into the 1990s also with the proliferation of non-bank lenders hungry for assets. Proprietary loan trading began to increase and crossed the Atlantic into Europe initially via London-based units of US banks.

By the mid-'90s, the secondary market in Europe had itself evolved to become of increasing importance to banks looking to manage their loan book more proactively, be it for single client exposure reasons, return on equity or otherwise. Proprietary trading added to its growing relevance. Despite this, it was evident to practitioners that the market, as it was at the time, lacked any standard codes of practice, and was inefficient and opaque. In response, a group of banks agreed to form a market association tasked with promoting transparency, efficiency and liquidity and, in December 1996, the LMA was formed.

Initial Focus and Development

Within a few years of inception, the LMA had introduced standard form secondary trade documentation for performing loan assets and distressed debt, proposed standard settlement parameters and built out a contributor-based trading volume survey. Based on the success of the Association's secondary market initiatives, its remit was then broadened to cover primary, as well as secondary, loan market issues.

Just two years after it was founded, LMA membership had grown from an initial seven founding bank practitioners to over 100 institutions. Steady growth since then has seen the membership base expand to 621 in 2015, including banks, non-bank institutional investors, law firms, ratings agencies and service providers from 55 countries. The African Loan Market Association was integrated with the LMA from January 2014.

The evolution of the market from the mid-'90s to today and the requirements of its increasingly diverse membership have seen the LMA's work become broadly subdivided into the following categories:

- Documentation.
- Market practice and guidelines.
- Advocacy and lobbying.
- Education and events.

An overview of each category, a brief market overview and outlook summary are given below.

Documentation

From secondary to primary

Following widespread adoption of the LMA's secondary trade documentation as the European market standard, focus was turned to primary documentation. A recommended form of primary documentation was developed by a working party which included LMA representatives and those of the UK-based Association of Corporate Treasurers (ACT), the British Bankers' Association (BBA), as well as major City law firms, with documents first launched in 1999. Involvement of the ACT and BBA from the outset played a major role in achieving broad acceptance of the LMA recommended forms among borrowers and lenders alike. This success was complemented by the subsequent addition of other forms of primary documentation, including a mandate letter and term sheet.

Following the English law recommended forms in terms of format and style, French law (2002) and German law (2007) versions of investment grade primary documentation were later developed, further broadening general acceptance of LMA standards.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

From corporate to leveraged and beyond

The increasing importance of the European leveraged loan market in the early 2000s saw the Association also focus on the development of standardised leveraged loan documentation, with recommended forms agreed in early 2004.

All proposed forms of documentation produced by the LMA are to be regarded as a starting point for negotiations, with the expectation that the more complex the transaction, the more tailoring will be required. This notwithstanding, the fact that all documents have been developed after extensive consultation with market practitioners has led to the recommended documents being viewed as a robust framework upon which to base subsequent individual negotiations. This is particularly true of the leveraged document, where significant input was also sought from non-bank investors within the membership via an institutional investor committee.

As the financial crisis of 2007 began to bite, work commenced on a recommended form of intercreditor agreement, a document generally bespoke to the structure of each transaction. Launched in 2009, the document met with market-wide acclaim again as a robust framework and as the product of comprehensive discussion by market practitioners. As the leveraged market evolved post-crisis, so did the suite of LMA template documents. The year 2013 saw the launch of an intercreditor agreement and super senior revolving credit facility for use in conjunction with a high yield bond. These were complemented in 2014 with a second super senior intercreditor agreement, for use alongside a super senior RCF, senior secured note and high yield note structure.

Historically, the LMA's principal focus has been on documentation relating to corporate investment grade and leveraged loans, alongside a full suite of secondary loan trading documentation. However, in recent years, and in response to member demand, the association has significantly expanded its coverage, both from a product and geographical perspective, the latter particularly with developing markets in mind.

In 2012, a commercial real estate finance document for multi-property investment was launched, as well as a facility agreement for developing markets and a pre-export finance facility agreement. 2013 saw the launch of a single property development finance facility agreement and four further facility agreements intended for use in developing markets transactions. The LMA continued to expand its suite of documentation in these areas in 2014, with the publication of a real estate finance intercreditor agreement, as well as facility agreements for use in South Africa, Kenya, Tanzania, Uganda and Nigeria.

In early 2014, the association published a guide to *Schuldschein* loans, the result of extensive collaborative work by a working party based in Germany. Appropriately the guide was published in German with an English translation. An updated version is currently being drafted for publication in 2016.

Following positive feedback from members on the *Schuldschein* project and in response to member demand, work commenced on the production of a standard form private placement document, with documents in both loan and note format launched in January 2015. The project benefitted from the involvement of the International Capital Market Association (ICMA) and the ACT. This provided valuable input particularly on the note format (developed in coordination with ICMA) and on borrower/issuer concerns (in the case of the ACT).

The LMA initiative is a significant contribution to the development of a European private placement market particularly when seen in the context of the current work of the Pan-European Private Placement Working Group coordinated by ICMA, which also includes the Euro PP Working Group (composed of all relevant professional organisations and participants in the French market). The Euro PP Working Group has also produced French law private placement documents to complement the French Charter for Euro Private Placements released in 2014.

Recent documentation initiatives include a term sheet for use in pre-export finance transactions released in February 2015, a secured single currency term facility agreement governed by South African law launched in June 2015 and a real estate finance German law facility agreement launched in November 2015. Most recently, the LMA published a recommended form of clause for inclusion in non-EU law governed facility agreements to the extent required by Article 55 of EU Directive 2014/59, the Bank Recovery and Resolution Directive.

Review and development

In response to member feedback, market developments, legislation and regulation, the LMA's document library is constantly reviewed and updated. Primary and secondary recommended forms have undergone several revisions and seen some significant amendments, a notable example being the combination of secondary par and distressed trading documents in 2010, updated once again in 2012. Continuing the theme, terms and conditions for secondary loan trading were subject to a full "Plain English" review in 2013 with the goal of making these more navigable, particularly for those whose native language is not English. Further revisions to secondary terms & conditions were agreed in 2015, including, *inter alia*, clarification of treatment of notary fees. In November 2014, revised primary facility agreements were published, *inter alia*, to facilitate the use of non-LIBOR interest rate benchmarks following the discontinuance of certain tenors and currencies. In 2015, antitrust amendments were incorporated into mandate letters and the confidentiality and front running letter for primary syndication. A financial covenant cure rider for use alongside the real estate finance investment property facility agreement has also recently been published.

Market Practice and Guidelines

LMA guidelines are widely regarded as defining good market practice and typically address those aspects of loan market business not specifically documented between parties. Guidelines produced include those covering the use of confidential information, a guide to waivers and amendments and transparency guidelines.

The first in a series of market guides, Regulation and the Loan Market, published late 2012, met with considerable interest from the membership. This publication has subsequently been updated on several occasions to reflect ongoing regulatory developments. Other guides in the series include Insolvency in the Loan Market, Using English Law in Developing Markets, Guide to Syndicated Loans and Leveraged Finance Transactions, Glossary of Terms for Transfers of Interests in Loans and a Guide to Agency Protections. Latest publications include a Guide to Secondary Market Transactions and a Guide to Secondary Market Liquidity.

As the market has evolved so has the investor base and with it the LMA's role in the provision of market guidance. Where new sources of liquidity are sought, the LMA can provide such guidance and reassurance in a private and unregulated market.

Advocacy and Lobbying

The LMA seeks to maintain a dialogue with regulators and government bodies wherever new or revised regulatory proposals

© Published and reproduced with kind permission by Global Legal Group Ltd, London

may impact the loan market, whilst also proactively promoting the market as a core funding source in the corporate economy. Since the financial crisis of 2007, this area of the Association's work has grown in importance as the number of regulatory proposals has dramatically increased. Policy decisions underlying the new proposals are largely to be supported, the overarching aim being a more robust financial system better able to shoulder economic shock and withstand periods of stress. The LMA's lobbying focus has been on the potentially negative implications of these proposals for the loan market, both intentional and unintended, and the effects on its members.

Clearly, with Basel III coming into legislative force, there has been market-wide discussion of the potential impact of the new Liquidity Coverage Ratio and Net Stable Funding Ratio proposed by the Basel committee, with banks' balance sheets likely to be constrained by the restrictive regulation. Recent regulatory developments are manifold, however, and the LMA has sought to make representations on behalf of its membership on all relevant issues.

Over recent years, the LMA has actively lobbied regulators in the UK, EU and US on various proposals potentially impacting the loan market. Responses to regulatory bodies are too numerous to list. Examples of activity in this field are submissions to the Internal Revenue Service in the US regarding certain provisions under the Foreign Account Tax Compliance Act ("FATCA"), and to the European Commission ("EC") relating to the drafting and interpretation of the Capital Requirements Directive IV, as well as the EC's consultation on shadow banking.

Proactive lobbying has led to tangible results, including confirmation from the Securities Exchange Commission and the Commodity Futures Trading Commission that US derivatives regulations under Dodd-Frank were not intended to capture LMA-style participations, also confirmation from the European Banking Authority that risk retention requirements in new Collateralised Loan Obligations are to be kept at 5% (*cf.* Article 394 CRD IV, previously referred to as Article 122a).

Other notable dialogue includes a response to an EC consultation to request that the list of eligible assets under Article 50 of the UCITS IV Directive be expanded to include certain types of loan. Also, following consultation with a working party comprising a cross-section of its membership, the LMA responded to an EC consultation on the need to overcome barriers to long-term financing and diversify the system of financial intermediation for long-term investment in Europe. In July 2014, the LMA responded to an ECB and Bank of England consultation on a better functioning securitisation market. Also in 2014, the LMA led highly constructive dialogue over several months with the UK Treasury and Financial Conduct Authority following the decision in the *Fons Hf v Corporal Ltd and another (2014)* case, resulting in confirmation from the FCA that the decision would not affect their regulatory treatment of loans.

In June 2015, the LMA submitted a response to the OECD's consultation on its "BEPS" (Base Erosion and Profit Shifting) Project, having earlier commented on initial recommendations in 2014. Recent dialogue also includes a response to the EC consultation on European Capital Markets Union, responses to the Financial Stability Board, EC and EBA consultations on strengthening oversight and regulation of both banking and shadow banking, a response to the HMRC consultation *re* tax deductability of loan interest payments and a response to the EC's proposed regulation for securitisation. Most recently in January 2016, a response was submitted to the ESA consultation on anti-money laundering and counter-terrorist financing measures (Article 17 and 18(4) of Directive (EU) 2015/849).

Significant progress has been made by the LMA in reducing the impact of regulation on the loan market and its participants; however, undoubtedly, changes in the regulatory and fiscal landscape will continue to present challenges. The LMA remains committed to play a pivotal role in tracking these changes and their potential impact on the loan product.

Education and Events

As a core objective, the LMA seeks to educate members and others regarding documentation and legislative, regulatory, legal, accounting, tax and operational issues affecting the syndicated loan market in EMEA. As the industry's official trade body, the LMA is the ideal education and training resource for what has become an increasingly technical market. Relationships with the key players in the market afford the LMA access to some of the leading experts in their field and as such the credentials of contributors can be guaranteed.

Evening seminars and documentation training days are regular calendar events in the UK. Also, to reflect the multi-jurisdictional membership base, seminars, training days and conferences are held in many other financial centres, including Frankfurt, Paris, Amsterdam, Brussels, Milan, Madrid, Stockholm, Istanbul, Moscow, Dubai, Nairobi, Lagos, Johannesburg and New York.

In September 2015, over 900 delegates attended the LMA's 8th annual Syndicated Loans Conference in London, the largest loan market event in EMEA. Additionally, the LMA now also runs a joint LMA/LSTA Conference in London, an annual Developing Markets Conference in London, an annual Real Estate Conference in London and Munich, and conferences in East and South Africa. In total over 7,000 delegates attended LMA events across EMEA in 2015.

In 2005, the inaugural LMA Certificate Course was held in London. Consistently oversubscribed, the course is now entering its 10th year and will be run four times in 2015. Held over five days, the course covers the syndication process through to secondary trading, including agency, portfolio management, pricing and mathematical conventions, terms sheets and an introduction to documentation.

The Syndicated Loans Course for Lawyers is a two-day programme, designed specifically for those working in the legal profession, providing detailed tuition on all aspects of the primary and secondary loan markets.

In 2011, the LMA published *The Loan Book*, a comprehensive study of the loan market through the financial crisis, with contributions from 43 individual market practitioners. To date, over 10,000 copies of *The Loan Book* have been to date since publication. In 2013 the association published *Developing Loan Markets*, a volume dedicated to the analysis of various regional developing markets, both from an economic and loan product perspective. Adding to the series, the *Real Estate Loan Book* was published in May 2015.

In August 2015 the LMA launched a webinar programme, offering members across the globe access to training on demand, with concise and comprehensive tutorials across a range of topics presented by senior industry professionals. The programme will continue to expand in terms of coverage in 2016 to include sessions in French, German and Spanish.

Other Initiatives

Operational issues have long been raised by LMA members as an area of concern, particularly around administrative agency and the potential for significant settlement delays in the secondary market. Syndicate size alone can lead to process overload when waivers and amendments are combined with transfer requests. The LMA has a dedicated Loans Operations Committee focused on identifying roadblocks, communicating issues and promoting best practice solutions. Several

© Published and reproduced with kind permission by Global Legal Group Ltd, London

administrative "quick-wins" have been implemented across top agency houses in 2014 as a direct result of the Committee's work. Since Q4 2014, the LMA has consolidated and published secondary trade settlement statistics from major European trading desks in order to help benchmark efficiency gains going forward.

In June 2015, the LMA held its inaugural Loans Operations Conference to showcase the work of the committee and highlight issues faced by operations teams across the market. Representatives from the LMA spoke at the LSTA operations conference in April 2015 and the LSTA reciprocated at the LMA event in June to underline the global nature of the issues involved.

Maintaining the spotlight on secondary settlement and operations in general is a core strategic aim for the LMA into 2016 and beyond.

Market Overview

A detailed study of the development of the syndicated loan market in EMEA, particularly post the financial crisis of 2007–2009, is beyond the scope of this chapter. *The Loan Book*, as mentioned above, gives a practitioner's overview and includes a detailed reference guide. It goes without saying, however, that the crisis sparked by the US sub-prime mortgage market had a significant impact. Fuelled by an abundance of liquidity, particularly from institutional investors in the leveraged market, primary volumes in EMEA soared in the years building up to the crisis. The liquidity crunch saw primary issuance fall dramatically by 2009 to barely one-third of the record $1,800BN seen in 2007. Volumes recovered some ground through to 2011 but dipped again in 2012 against the backdrop of the Eurozone sovereign debt crisis and the US "fiscal cliff". In contrast, 2013 saw markets rebound and loan issuance increase substantially. Policy intervention and specifically the Outright Monetary Transactions programme announced by the ECB in the 2nd half of 2012 was a significant driver of confidence. In 2013, issuance volumes reached $1,000BN, some 33% higher year-on-year. In 2014, EMEA loan market volumes grew once more to $1,290BN and 2015 saw overall EMEA loan issuance top $1,400BN for the first time since the crisis. The year 2015 also saw the single largest loan financing on record globally, with $75BN of facilities raised to support the acquisition of SABMiller by AB Inbev.

Leveraged finance has also recovered strongly post crisis. Demand for the leveraged loan product in particular has spread across a broader investor base than seen prior to 2007. Credit funds and managed accounts have nearly doubled their share of the institutional market over the period. A significant driver of demand within leveraged finance pre-crisis, the CLO returned to European markets in 2013 with new vehicle issuance volume of €7.4BN, compared with virtually zero since 2008. European CLO issuance nearly doubled in 2014 to €14.5BN but did not match growth expectations in 2015 with *ca.* €14BN of issuance.

Institutional investors have also become more visible in other loan asset classes, such as real estate and infrastructure finance. Several funds have been set up to lend directly to small and medium companies, particularly in the UK. Retrenchment by banks immediately post crisis opened the door to alternative sources of finance across the loan market, and many institutions are now established participants.

The Way Forward

Results from a survey of LMA members at the end of 2015 suggest that market participants are cautiously optimistic about prospects into 2016. Some 49% of respondents expect loan market volumes across EMEA to be flat year-on-year, with 35% expecting growth of 10% or more, *versus* only 16% predicting lower volumes. Global economic and/or geopolitical risks were cited as the single biggest potential influence on the market in 2016, closely followed by competitive pressure. Respondents show continued faith in corporate M&A activity for financing opportunities in the short term, according to the survey. Asked how much financial regulatory change has impacted their business over the last five years, some 72% have seen a significant or material impact.

Indeed, regulatory issues remain high on the agenda, and the LMA's focus on lobbying and advocacy will continue unabated. Other trends will also determine the focus of the LMA's work into 2016 and beyond. With bank capital constraints in mind, we have seen borrowers access funding sources on an increasingly global basis and the LMA will continue to work to promote further cross-border liquidity. The institutional investor base will continue to grow and non-bank finance will increase in importance across loan asset classes, be it in parallel with banks in syndicated lending, in a bespoke bank/fund partnership, via unitranche or other forms of direct lending. More borrowers from developing markets will require funding from beyond domestic boundaries; the LMA will continue and expand its work in these markets to promote the acceptance of regional standards. We expect the focus on operational efficiency to intensify and the LMA will continue to work with partners and practitioners across the market to identify issues, find solutions and broker change.

The LMA's principal objective some 19 years ago was to promote greater liquidity in the loan market, an objective which remains as, if not more, relevant today.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Nigel Houghton

Loan Market Association
10 Upper Bank Street
London E14 5JJ
United Kingdom

Tel: +44 20 7006 1207
Fax: +44 20 7006 3423
Email: nigel.houghton@lma.eu.com
URL: www.lma.eu.com

Nigel is Managing Director at the LMA. He has over 20 years' experience in loan markets, from origination and structuring through to sales, trading and workout. Prior to joining the LMA in 2012, Nigel was at GE Capital in London for seven years where he was head of secondary sales & trading for the European leveraged finance business. In 10 years at Commerzbank, Nigel ran the London-based distressed portfolio and was a founding member of the bank's London structured finance & loan syndications team. He served as an LMA Board Member for several years during this time. Nigel began his City career via a graduate programme at Deutsche Bank following training at Coopers & Lybrand Deloitte. Nigel has a BA (Hons) from the University of Durham.

The Loan Market Association (LMA) has as its key objective improving liquidity, efficiency and transparency in the primary and secondary syndicated loan markets in Europe, the Middle East and Africa (EMEA). By establishing sound, widely accepted market practice, the LMA seeks to promote the syndicated loan as one of the key debt products available to borrowers across the region.

As the authoritative voice of the syndicated loan market in EMEA, the LMA works with lenders, law firms, borrowers and regulators to educate the market about the benefits of the syndicated loan product, and to remove barriers to entry for new participants.

Since the establishment of the LMA in 1996, the Association's membership has grown steadily and now stands at 621 organisations covering 55 nationalities, comprising commercial and investment banks, institutional investors, law firms, service providers and rating agencies.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

An Overview of the APLMA

Janet Field

Katy Chan

Asia Pacific Loan Market Association

Founded in 1998, the APLMA is a pan-Asian not-for-profit industry association dedicated to promoting growth and liquidity in the primary and secondary loan markets of the Asia Pacific region, and advocating best practices in the syndicated loan market.

The APLMA is headquartered in Hong Kong with branches in Singapore and Australia. Due to the size and diversity of the Asia Pacific region, the operations of the APLMA are decentralised. In addition to the branch network, the APLMA has a number of offshore committees in China, Taiwan, Malaysia, India and New Zealand. We aim to continue to establish new chapters in the key markets of the region, as well as forging working relationships with other associations across Asia.

The APLMA has over 270 institutional members from Asia Pacific, Europe, the US and the Middle East. Membership includes commercial and investment banks, non-bank financial institutions, law firms, rating agencies, financial information service providers and online trading platforms. There are also 11 honorary members comprising regional regulators and trade associations.

The APLMA represents the common interests of the many different institutions active in the syndicated loan markets across Asia. The Association's key objectives are to:

- provide leadership in the syndicated loan industry and act as the collective voice of the members;
- promote growth and liquidity in Asia's primary and secondary loan markets;
- facilitate the standardisation of primary and secondary loan documentation;
- develop and promote standard trading, settlement and valuation procedures;
- develop the secondary market for loan sales and trading;
- promote prudent banking practices;
- serve as a liaison between major loan market players and regional regulators;
- monitor legislative, regulatory and market changes for their impact on the syndicated loan market;
- enhance industry education through seminars, conferences and training courses; and
- provide a dynamic, professional pan-Asian networking forum.

The APLMA works together with its sister associations in Europe and North America to advocate common market standards and practices with a view towards improving global loan market liquidity. Through its close contact with the Loan Market Association (LMA) in London, the Loan Syndications and Trading Association (LSTA) in New York, and multiple associations across Asia, the APLMA monitors global market trends as part of its efforts to more closely integrate the Asian loan markets into an increasingly globalised loan market.

Standard Documentation

The APLMA has produced standard primary and secondary documentation for syndicated loan transactions in the Asia Pacific markets. These documents have become the market standard for Asia.

In addition to the English law and Hong Kong law documents, the APLMA has produced Australian law and Singapore law standard templates, as well as a Chinese translation (for reference purposes only).

As well as the primary facility agreements, the APLMA has developed a number of templates to provide alternative wording for use by members.

These include a sample Asia arbitration clause with a litigation option for a hybrid dispute resolution process, which provides various options under which arbitration can be administered.

A suite of standard term sheets, mandate letters and confidentiality letters includes templates for primary syndication and for sale/sub-participation/CDS under both English law and Hong Kong law.

Documentation Updates

In 2015, the APLMA revised and published a number of document templates including:

- Chinese translations (both Traditional and Simplified Chinese) of the Hong Kong law HKD Single Borrower Term Facility Agreement (not for execution).
- Mandate Letters for secured and unsecured transactions (Hong Kong and English law).
- Confidentiality Letters (Hong Kong and English law) for Primary Syndication and Loan Sales/Sub-participation respectively.

The updates were made to incorporate wording driven by the new Hong Kong Competition Ordinance (effective 14 December 2015).

The APLMA has also finalised a review, in tandem with its Agency Committee, of the revisions to the interest provisions including slot-in benchmark rates, intra-day rate fixing under ICE Error Policy and interest rate fallback (in the event of unavailability of rates) made by the LMA to its suite of documents.

The sample wording for Asian arbitration clauses was updated during the year to reflect changes in arbitration laws. The clauses provide for a hybrid dispute resolution process (under which both parties are required to submit all disputes to arbitration) and with various options as to the institution (HKIAC, ICC and SIAC) under which the arbitration can be administered.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Following concerns raised in Asia resulting from the decision in a recent case in the lower Hong Kong court that a Hong Kong law-governed facility agreement (reportedly modelled on the LMA forms) did not give an individual lender an independent debt claim in respect of outstanding loans, the LMA developed drafting to supplement its recommended forms to further emphasise (though it was felt not necessary from a legal perspective) the individual nature of a lender's right to payment of all amounts due. The wording (which has been agreed by the LMA and the APLMA) was incorporated in the updated APLMA templates in November 2015.

In Singapore, the APLMA published an updated version of the single borrower, single guarantor, single currency term facility agreement governed by Singapore law. The updated document tracks the form of the equivalent Hong Kong law facility agreement with key changes and additions to certain terms including interest mechanics, currency, third party rights, FATCA, events of default, PDPA, etc. A seminar outlining the key changes to the documents was held for APLMA members.

In Australia, the mandate letters, confidentiality undertaking, front running letter for primary syndications and bilateral facility agreement were all updated during the year. The syndicated term and multicurrency secured facility agreement was revised along with the loan deed poll and subscription finance agreements.

In August 2015, the APLMA Australian Documentation Committee also published, for the first time, a bilateral facility agreement with a letter of credit facility, a term sheet for the bilateral facility agreement and a syndicated term and multicurrency revolving facility agreement with a letter of credit facility.

An important rider containing model clauses for obligors who are trustees of unit trusts or entities of management investment schemes was published in September 2015, which fills an important gap in the suite of primary documents for Australia. The APLMA Australian Documentation Committee also completed the drafting of an industry standard security trust deed which was published and launched in November 2015.

Practice Notes

The APLMA released a new FATCA note in May 2015 which replaced the two previous APLMA FATCA Notes (in July 2014 and January 2015). This note includes guidance on the documentation approach which lenders might consider under different scenarios, as well as guidance for Agents operating in an IGA Model 2 jurisdiction (i.e.: Hong Kong, Japan and Taiwan). It also includes an update on the status of Asia Pacific in terms of IGA signing and the banks' position in respect of the underlying risk allocation.

In the last quarter of 2015, the APLMA also published a Sanctions Note which provides an overview of the legal basis of US and EU sanction regimes and highlights transactional concerns and potential protections that APLMA members may wish to consider including in loan documentation.

Major Projects 2016

The APLMA is currently reviewing the impact of recent major regulatory changes to the loan markets, including:

- Hong Kong Contracts (Rights of Third Parties) Ordinance (effective 1 January 2016).
- EU Bank Recovery and Resolution Directive ("BRRD") (to be implemented by EU members by 1 January 2016).

Agency Issues

The APLMA Agency Committee has conducted a comprehensive review of the various amendments made by the LMA to the interest provisions, in particular the interest fallback mechanism. The new fallback option, which has now been incorporated in the APLMA templates, allows the agent to apply a new intermediate interest rate fallback "Historic Screen Rate" before quoting from the Reference Bank cost of funds.

The committee has also reviewed the new E-Communications provisions in the LMA templates, and has decided to maintain its Guidance Note on E-Communications and Use of Deal Sites which provide a more elaborate sample provision on the Use of Deal Sites.

A set of common Agency practices (such as CPs confirmation by the Agent) were reviewed during the year and the APLMA is considering issuing an Agency Guidance Note on some of these practices.

The APLMA Agency Committee is also reviewing the training requirements of Agency teams in addition to hosting an Agency conference in 2016 in Hong Kong and Singapore.

Market Practices and Regulatory Issues

The APLMA has drafted a set of non-binding guidelines on best practice in the Asian cross-border syndicated loan market. Recently published guidelines relate to:

i) fee sharing among MLAs with different final holds;

ii) listing of banks in communications such as tombstones, information memoranda and cover pages of facility agreements;

iii) confidentiality undertakings;

iv) amendments and waivers; and

v) information exchange.

With the new Hong Kong Competition Ordinance coming into full effect on 14 December 2015, the APLMA has published two guidance notes on the new Ordinance (APLMA Competition Law Guidelines DOs and DON'Ts and APLMA Compliance Policy on Syndicated Loans). Separate seminars were hosted in Hong Kong, Singapore and Australia during the year to ensure all APLMA members in different jurisdictions understand the implications of the relevant ordinances on syndicated loans.

In August 2015, in response to the new guidance note on credit risk management issued by the Hong Kong Monetary Authority ("HKMA"), the APLMA submitted a paper to the HKMA together with the Hong Kong Association of Banks ("HKAB") on the implications for the syndicated loan market, following which the HKMA published a list of FAQs which has been circulated to all banks.

New APLMA App

In April 2015 the APLMA launched a new mobile phone app to enable Members to register for APLMA events, access event information and view the APLMA database of loan syndications contacts using a mobile device. Members can download the app free of charge from the App Store (iPhone) or Google Play Store (Android). For assistance on downloading the App, please contact kit.chui@aplma.com.

Education and Training

As part of its commitment to enhancing industry education and providing a vibrant pan-Asian professional network, the APLMA

© Published and reproduced with kind permission by Global Legal Group Ltd, London

holds over 80 seminars, conferences, training courses and networking events each year in all the major financial centres, most of which are free of charge.

Events for 2016 include:

- The Global Loan Market Summit – 27–28 January 2016.
- The 4th Annual Syndicated Loan Market Awards – 28 January 2016.
- The Annual APAC Syndicated Loan Market Conference – 1–2 June 2016.
- A one-week Syndicated Loan Certificate Course.
- Documentation training courses.
- Regulatory seminars.
- Overseas conferences in China, Taiwan, India, Indonesia, Thailand, Vietnam, etc.
- The Quarterly Young Leaders' series.
- The Quarterly Women's series.

APLMA China

With the Chinese banks continuing to boost their Asia Pacific lender share, the APLMA established closer cooperation with the CBA Loan Syndication and Trading Association in China. In 2015, the APLMA hosted its Annual China Loan Market Conference in Beijing in collaboration with the CBA. The conference included presentations by the China Banking Regulatory Commission ("CBRC"), as well as sessions on offshore RMB finance, cross-border lending and China's Free Trade Zone.

Recognising the importance of Chongqing as the financial hub for western China, the APLMA also hosted its inaugural loan market seminar in Chongqing in October. The seminar featured a keynote address by the Chongqing Municipal People's Government as well as sessions on China's "One Belt, One Road" initiative, Chinese SOE case studies and a bankers' roundtable discussion.

Looking Ahead

Documentation will continue to be a core focus in 2016. In response to member demand, the APLMA has been expanding its documentation coverage in recent years to include local laws and practices.

The APLMA will also continue to monitor fiscal and regulatory developments in the region and publish market and legal guidance notes for members as required.

A full calendar of over 80 events is planned for 2016. For details, please refer to the APLMA website: https://www.aplma.com.

Janet Field
Asia Pacific Loan Market Association
32/F, Jardine House
One Connaught Place, Central
Hong Kong

Tel: +852 2826 3500
Fax: +852 2825 8800
Email: janet.field@aplma.com
URL: www.aplma.com

Janet Field is the Managing Director of the Asia Pacific Loan Market Association (APLMA). She is based in Hong Kong and oversees all operations of the APLMA across Asia Pacific. She heads up a team responsible for the development of standard primary and secondary loan documentation for a number of different jurisdictions, guidance notes, best market practices, lobbying, and organising educational seminars, conferences and networking events across the region.

Katy Chan
Asia Pacific Loan Market Association
32/F, Jardine House One
Connaught Place, Central
Hong Kong

Tel: +852 2826 2462
Fax: +852 2825 8800
Email: katy.chan@aplma.com
URL: www.aplma.com

Katy Chan joined the APLMA in June 2014 as a Director. Katy is responsible for developing the APLMA's presence in China and Taiwan and building up the APLMA's presence in new markets in Asia. She is also focusing on membership and working with the APLMA committees.

Before joining the APLMA, Katy was with Standard Chartered Bank's Wholesale Banking Division. She also worked in Project and Structured Finance at ANZ from 2008 to 2011 and prior to that she was a Director at HSBC where she worked from 2000 to 2008 in various roles including project finance, government advisory and principal investments.

Founded in 1998, the APLMA is a pan-Asian not-for-profit industry association dedicated to promoting growth and liquidity and advocating best practices in the primary and secondary loan markets of the Asia Pacific region. Its main tasks include:

- providing standard loan documentation templates;
- formulating guidelines on market practices;
- organising seminars, trainings and networking events;
- monitoring legislative, regulatory and market changes for their impact on the syndicated loan market; and
- serving as a liaison between major loan market players and regional regulators.

The APLMA is headquartered in Hong Kong. It has branches in Australia and Singapore and offshore committees in China, India, Malaysia, New Zealand and Taiwan. Currently it has over 270 institutional members from Asia Pacific, Europe, the US and the Middle East. Membership comprises commercial and investment banks, non-bank financial institutions, law firms, rating agencies and financial information service providers.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

An Introduction to Legal Risk and Structuring Cross-Border Lending Transactions

Thomas Mellor

Morgan, Lewis & Bockius LLP

Marcus Marsh

1 Introduction: The Rise of Cross-Border Lending

Increase in Cross-Border Lending. For lenders and lawyers who practice in the cross-border lending area, whether in the developed economies or the emerging markets, this is a dynamic and exciting time. Cross-border lending has increased dramatically over the last couple of decades in terms of volume of loans, number of transactions and number of market participants. According to the Bank for International Settlements, the amount of outstanding cross-border loans held by banks worldwide was approximately $7.2 trillion in 2014, an increase from $1.71 trillion in 1995. There are many reasons for this increase: the globalisation of business and development of information technology; the rise of emerging economies that have a thirst for capital; and the development of global lending markets, especially in the US, which has led to a dramatic rise in the number of market participants searching for the right mix of yield and risk in the loan markets, a search that often leads to cross-border lending opportunities.

Challenges of Cross-Border Lending. In addition to understanding the creditworthiness of a potential borrower, the overlay of exposure of a lender to a foreign jurisdiction entails analysis of a myriad of additional factors, the weighting of which will vary from country to country. This mix of political, economic and legal risks, bundled together, is referred to collectively as *country risk*. Understanding country risk is imperative for lenders and investors to be able to compare debt instruments of similarly-situated companies located in different countries.

Examination of Legal Risk. This first overview chapter of the *Guide* provides some observations on an element of country risk that is closest to the hearts of lawyers: *legal risk*. Together with tax considerations, understanding legal risk is important for structuring cross-border loan transactions. But what exactly is legal risk? Can legal risk be measured? What tools do lenders traditionally use to mitigate legal risk? Do these tools work? Finally, we complete this chapter with some observations on how conventional notions of legal risk are being challenged.

2 Legal Risk in the Cross-Border Lending Context

What is Legal Risk? Young lending lawyers are taught that when a loan transaction closes, "the borrower walks away with a pile of the lender's money and the lender walks away with a pile of paper *and the legal risk*". If the borrower refuses to pay the money back, then the lender must rely on the *pile of paper and the legal process*, in order for the money to be returned. This notion helps drive the point home that legal risk is primarily something that keeps lenders (rather than borrowers) awake at night. While there is no settled description of legal risk, it can be thought of as having a number of components, starting with *documentation risk*, which is mitigated by having competent counsel ensure that legal documentation correctly reflects the business arrangement and is in the proper form. In a cross-border lending context it is useful to think of legal risk as having two additional related and sometimes overlapping components: (1) *enforcement risk*; and (2) *the risk of law reform*.

Enforcement Risk. Lenders prefer to enter a lending transaction knowing that a number of "enforcement components" are in place to allow for enforcement of loan documentation (that *pile of paper*) and to resolve disputes and insolvency in a predictable way. These components include a well-developed body of commercial law, an independent judiciary and an expedient legal process. In a cross-border lending context, especially if a borrower's primary assets are located in a foreign jurisdiction, there is typically some reliance by a lender on the laws, legal institutions and legal process of that foreign jurisdiction.

For example, a US lender seeking to enforce a loan agreement against a foreign borrower could do so in one of two ways. Assuming the borrower has submitted to the jurisdiction of New York courts, the lender could file suit in New York against the borrower, obtain a judgment from a New York court, and then seek to have that judgment enforced against the assets of the borrower in the borrower's home country. In the alternative, the lender could seek to enforce the loan agreement directly in the courts of the foreign jurisdiction. In either case, there is reliance on the laws, institutions and legal process in the borrower's home jurisdiction.

If the foreign jurisdiction's local law is not consistent with international norms, or its legal institutions are weak, corrupt or subject to undue political influence, then *enforcement risk* may be considered high. It should be noted that enforcement risk may be high even in a jurisdiction that has modernised its commercial laws if legal institutions have not also matured (the latter taking more time to achieve).

Law Reform Risk. Lenders also want to know that the laws they are exposed to in connection with a loan to a borrower will not arbitrarily change to the lender's detriment. This aspect of legal risk is closely associated with political risk. Law reform risk detrimental to lenders is at its highest when a country is undergoing some sort of systemic crisis. For example, in 2002 during Argentina's financial crises, the government of Argentina passed a law that converted all obligations of Argentine banks in US dollars to Argentine pesos. Given that pesos were only exchangeable at a fixed rate that did not accurately reflect a true market rate, this change in law had the effect of immediately reducing the value of the lenders' loans.

Why Legal Risk Matters. If enforcement risk is high, this weakens a lender's negotiating position in the case of a workout of a loan

© Published and reproduced with kind permission by Global Legal Group Ltd, London

(as compared to a similarly situated borrower in a country where enforcement risk is low). If law reform risk is high, lenders risk a multitude of unsettling possibilities, some examples of which are described below. In each case, this increased risk should be reflected in increased pricing. In cases where the risk and/or pricing of a loan is considered too high, then a loan transaction may be structured in order to attempt to mitigate the legal risk and/or reduce pricing. Lenders have a number of tools at their disposal in order to mitigate legal risk. In this way, loan transactions that might otherwise not get done, do get done.

3 Can Legal Risk be Measured?

Before examining ways to mitigate legal risk, it is interesting to examine the extent to which legal risk can be measured. Measuring legal risk is not an exact science, though it nevertheless can be a useful exercise to consider yardsticks that might provide a sense of one country's legal risk relative to another's. A threshold challenge is that while there are many tools available to measure *country risk*, *legal risk* is only one component of country risk. Nevertheless, there are some tools that may be helpful. In terms of measuring legal risk, the conventional wisdom is that developed economies have stronger legal institutions and less legal risk when compared to emerging market jurisdictions.

The Usefulness and Limitations of Sovereign Ratings. Sovereign ratings measure the risk of default on a sovereign's debt. These ratings are useful to get a "systemic" view of how a country is doing economically. A country that has a high sovereign debt rating is likely to be financially stable. A country that is financially stable is less likely to undergo systemic stress, at least in the short term, and therefore less likely to undergo *law reform* adverse to lenders (remember the link between systemic stress and law reform noted above).

But does it follow that there is a correlation between a sovereign's rating and *enforcement risk* against private borrowers in the sovereign's jurisdiction? A sovereign's risk of default on its debt instruments may be low because the country has extensive state-owned oil production that fills the country's coffers. This would not necessarily indicate that a country's legal institutions would fairly and efficiently enforce a pile of loan documents against a borrower in that jurisdiction – the legal institutions in such a country might be corrupt and/or inefficient. While a quick review of sovereign ratings suggests that there is at least some correlation between ratings and enforcement risk, there are also some outliers (for example, at the time of writing, Bermuda and China have similar long-term sovereign ratings, though international lenders probably consider enforcement risk to be more significant in China than in Bermuda).

Sovereign Rate Spreads and Sovereign Credit Default Swap Prices. One of the simplest and most widely used methods to measure *country risk* is to examine the yields on bonds issued by the country in question compared to a "risk-free" bond yield (still usually considered the US, notwithstanding the recent credit downgrade). A comparison of sovereign debt credit default swap prices provides a similar measure. As with sovereign ratings, this tool is useful to obtain a measure of potential systemic stress and *law reform risk* but seems less useful in terms of measuring *enforcement risk* of a borrower in that jurisdiction for the same reasons provided above.

Recovery After Default Analysis. A type of analysis performed by ratings agencies that might be considered useful for measuring legal risk from country to country is corporate default and recovery analysis. A reasonable hypothesis might be that the average recovery for creditors after a borrower default would be higher countries with low legal risk: stronger institutions means higher recoveries for creditors. But a review of the data suggests there is little or no such correlation. Why is this? There are a few possible explanations: recovery rates depend on a variety of factors other than legal risk, including the severity of default and the makeup of the individual borrowers subject to the analysis. It also is probable that lenders in a country with strong legal institutions (and low risk) may be more willing to make "riskier" loans (based on a portfolio theory of investment) given that they have confidence in the jurisdiction's strong legal institutions to resolve defaults and insolvency in a predictable manner.

World Bank "Doing Business" Rankings. The World Bank publishes an interesting study each year entitled the *Ease of Doing Business Rankings*. These rankings rate all economies in the world from 1 to 185 on the "ease of doing business" in that country, with 1 being the best score and 185th the worst (see http://doingbusiness.org/rankings). Each country is rated across eleven categories, including "enforcing contracts", "resolving insolvency" and "protecting investors" categories. The rankings provide a helpful tool for comparing one country to one another. While there is not space to detail the methodologies of the rankings in this chapter, the methodologies can produce some strange results. For instance, in the 2015 rankings, each of China, Belarus and the Russian Federation have a better "enforcing contracts" score than the United Kingdom. Nevertheless, these rankings can be a useful benchmark and are worthy of mentioning.

Subjectivity. Ultimately, in addition to the data described above, a lender's perception of the legal risk of lending into a particular country will be driven by a number of geographic, historical, political, cultural and commercial factors peculiar to the lender and the country in question. For example, as a general matter, French lenders seem more comfortable than US lenders when lending to borrowers in Africa, while US lenders seem generally more comfortable than French lenders lending to borrowers in Latin America. (English lenders seem comfortable lending anywhere!) Lenders will measure legal risk differently based on their institution's experience and tools at hand to work out a loan should it go bad.

4 Tools Used to Mitigate Legal Risk

The fact that a borrower is located in a jurisdiction with a high level of legal risk does not mean that a loan transaction cannot be closed. Lenders have been closing deals with borrowers in far-off lands since the Venetians. Today, lenders use a number of tools to help mitigate legal risk, both in terms of structuring a transaction and otherwise. These concepts are used in all sorts of financings, from simple bilateral unsecured corporate loans to large, complicated syndicated project financings with a variety of financing parties. The question of which of these tools will be available to a lender will depend on a variety of factors, especially the relative negotiating positions of the borrower and lender for a particular type of transaction.

Governing Law. As a starting point, the choice of governing law of a loan agreement is important because it will determine whether a contract is valid and how to interpret the words of the contract should a dispute arise. The governing law of most loan agreements in international transactions has historically been either New York or English law. This is primarily because these laws are considered sophisticated, stable and predictable, which lenders like. Also, lenders generally prefer not to have a contract governed by the law of a foreign borrower's jurisdiction, since lawmakers friendly to the borrower could change the law in a way detrimental to the lender (law reform risk). As part of any cross-border transaction, lending lawyers spend time ensuring that the choice of governing law will be enforceable in the borrower's jurisdiction, often obtaining coverage of this in a legal opinion delivered at closing.

It should be noted that that while a loan agreement may be governed by New York or English law, the collateral documentation (the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

documentation whereby the borrower pledges assets as collateral to secure the obligations under the loan agreement) is almost always governed by the law where the assets are located – often that of the borrower's home jurisdiction. As a general matter, courts generally have the power to adjudicate issues relating to property located in their jurisdiction. Sometimes local laws require that the collateral documentation be under local law, though in any event local courts are more efficient interpreting and enforcing collateral agreements that are governed by their own law.

Recourse to Guarantors in a Risk-Free Jurisdiction. A lender to a borrower in a jurisdiction with high legal risk may require a parent, subsidiary or other affiliate of the borrower in a "risk-free" jurisdiction guarantee the loan. In this type of situation, the lender would want to ensure that the guaranty is one of "payment" and not of "collection", since the latter requires a lender to exhaust all remedies against a borrower before obligating the guarantor to pay. In a cross-border context, this could result in a lender being stuck for years in the quagmire of costly enforcement activity in a foreign and hostile court. While almost all New York and English law guarantees are stated to be guarantees of payment, it is nevertheless always wise to confirm this is the case, and especially important if the guarantee happens to be governed by the laws of another jurisdiction.

Collateral in a Risk-Free Jurisdiction. With secured loans, if the legal risk of a borrower's home country is high, lenders will often structure an "exit strategy" that can be enforced without reliance on the legal institutions of the borrower's jurisdiction. This has been a classic tool of project finance lenders for decades and has contributed to the financing of projects in a variety of countries that have high legal risk.

a. *Offshore Share Pledge*. For example, a lender often requires a share pledge of a holding company that ultimately owns the borrower. This type of share pledge may be structured to allow for an entity organised in a risk-free jurisdiction to pledge the shares of the holding company, also organised in a risk-free jurisdiction, under a pledge document governed by the laws of a risk-free jurisdiction. Such a pledge, properly structured and vetted with local counsel, is a powerful tool for a lender, allowing a lender to enforce the pledge and either sell the borrower as a going concern to repay the loan or to force a replacement of management. In the case of such a pledge, it is important to ensure that the borrower's jurisdiction will recognise the change in ownership resulting from enforcement of such a pledge under its foreign ownership rules. When preparing such a pledge, it is important to carefully examine the enforcement procedures to ensure that the pledge can, to the maximum extent possible, be enforced without reliance on any cooperation or activity on the part of the borrower, its shareholders or directors.

b. *Offshore Collateral Account*. Another classic tool is to require a borrower to maintain an "offshore collateral account" in a risk-free jurisdiction into which the borrower's revenues are paid by its customers. In project finance structures, lenders will often enter into agreements with the borrower's primary customers requiring that revenues be paid into such an account so long as the loans are outstanding. It is important to point out that these accounts will only be as valuable as the willingness of customers to pay revenues into them. Creditworthy, offshore customers from jurisdictions where the rule of law is respected are likely to provide more valuable credit enhancement than customers affiliated with the borrower and located in the same jurisdiction.

c. *Playing Defence and Offence*. It should be noted that, in the case of a secured transaction, offshore collateral should not be viewed as a substitute for the pledge of the borrower's local assets. In such a case, a pledge of local assets is also vitally important since, at least theoretically, it preserves the value of the lender's claim against those assets against third party creditors. To use a football analogy, collateral can be thought of as having an "offensive" component and a "defensive" component: the pledge of local assets to the lender is a "defensive" move because this keeps other creditors from obtaining prior liens in these assets, while an equity pledge might be considered an "offensive" tool, allowing the lender to foreclose and sell a borrower quickly and efficiently in order to repay a loan with the proceeds.

Partnering with Multilateral Lenders or Export Credit Agencies. A multilateral development bank is an institution (like the World Bank) created by a group of countries that provides financing and advisory services for the purpose of development. An export credit agency (ECA) is usually a quasi-governmental institution that acts as an intermediary between national governments and exporters to provide export financing. Private lenders to borrowers in risky jurisdictions are often comforted when these government lenders provide loans or other financing alongside the private lenders to the same borrower, the theory being that the "governmental" nature of these institutions provides additional leverage to the lenders as a whole given these entities are considered to be more shielded from possible capriciousness of a host country's legal and political institutions.

Reputation in the Capital Markets. A borrower or its shareholders may be concerned with their *reputations* in the capital markets in connection with a long and contentious loan restructuring exercise. This may be particularly true in the case of family-owned conglomerates in emerging markets, especially if other parts of the business need to access international financing. If access to the capital markets is not considered to be important, they may be willing to weather the storm. *See* T. DeSieno & H. Pereira, *Emerging Market Debt Restructurings: Lessons for the Future*, 230 N.Y.L.J. 39 (2003). In sovereign or quasi-sovereign situations, a government *seeking foreign investment* or striving to *maintain good relations with the international capital markets* may be less likely to be heavy-handed in a dispute with international investors.

Personal Relationships. The value of personal relationships should not be overlooked in mitigating legal risk. While personal relationships are important in both the developed and emerging markets, personal relationships play a particularly special role in those countries that do not have well-developed institutions and processes to resolve disputes. Some institutions, when working out problem loans in emerging markets, often turn the loan over to different personnel than those who originated the loan. In certain cases, it may be helpful to keep those with the key personal relationships with the borrower involved in these negotiations.

Political Risk Insurance and Credit Default Swaps. A lender may purchase "insurance" on a risky loan, in the form of political risk insurance or a credit default swap. Rather than mitigating risk, this instead shifts the risk to another party. In any event, this is a good tool to have in the lender's toolbox.

Why Good Local Counsel is Important. Finally, the value of high-quality local counsel in a cross-border loan in a high-risk jurisdiction cannot be overstated. This value comes in three forms: knowledge of local law and which legal instruments provide the most leverage to lenders in an enforcement situation; providing local intelligence on where other "leverage points" may be; and finally, by being well-connected to the local corridors of power and thereby being able to predict or "deflect" law reform in a manner helpful to clients. When choosing local counsel in a high-risk jurisdiction, spending more for the best counsel is usually worth the investment.

5 Recent Developments and Anecdotes that Both Support and Challenge the "Conventional Wisdom"

Legal Reform Risk in Developed Economies? As mentioned above, the conventional wisdom suggests that legal risk is higher in the emerging markets compared to the developed economies. But

© Published and reproduced with kind permission by Global Legal Group Ltd, London

consider what happened to creditors in Ireland and Greece a few years ago. In both cases, lawmakers in these countries *changed the law* in a manner that materially and adversely impacted the rights of creditors. In Ireland, Irish lawmakers changed the bank resolution rules *to favour equity over debt.* In Greece, lawmakers changed Greek law in a way that allowed for collective active mechanics in a form that did not exist previously, effectively forcing minority shareholders to be bound by a majority vote. *See* T. DeSieno & K. Dobson, *Necessity Trumps Law: Lessons from Emerging Markets for Stressed Developed Markets?* (Int'l Ass'n of Restructuring, Insolvency and Bankruptcy Professionals, International Technical Series Issue No. 25, 2013). These and other examples make clear that even in the so-called developed economies, law reform can be a risk to creditors, especially when economies are under systemic stress.

Why New York or English Law is Still a Good Choice. In the Greek situation mentioned above, the majority of Greek bonds were issued under Greek law and some bonds were issued under English law. Bondholders holding English law governed bonds did not suffer the same consequence of the change in Greek law (since Greek lawmakers could not change English law). In this instance at least, the conventional wisdom held true.

Why Local Law May Sometimes be a Better Choice. In a recent transaction in the emerging markets, lenders were provided with a choice to have a guarantee governed by either New York law or local law. Conventional wisdom would suggest the lenders should opt for New York law. However, on the advice of a top local law firm, the lenders opted for the guarantee to be governed by local law. Why? Because after considerable weighing of risks and benefits (including the law reform risk associated with the choice of local law) it was determined the local law guarantee would provide considerably more leverage against the guarantor in the event of enforcement. It could be enforced more quickly and efficiently in local courts than a New York law guarantee (used by other creditors under other facilities) thus potentially providing an advantage to its beneficiaries. This notion of local law being better is probably more often going to be the exception rather than the rule.

Are Offshore Share Pledges Really Risk-Free? Even in cases of offshore pledge agreements that are perfectly documented as described above, lenders who have tried to enforce these pledges have sometimes run into difficulties. In jurisdictions with high legal risk, borrowers and their shareholders can prevent lenders from being able to practically realise on the value of their collateral in a number of ways: they may use the local legal system to their advantage by making baseless arguments that the change of ownership should not be legally recognised, they may transfer assets to other affiliated companies in violation of contractual obligations, or engage in countless other activities unimaginable to lenders when the loan was closed. This "hold-up" value effectively gives the borrower and its shareholders leverage not available in risk-free jurisdictions, even when the equity is "out of the money".

Does Teaming Up With Government Lenders Help or Hurt Private Lenders? As mentioned above, private lenders are often comforted when government lenders co-lend to a borrower. Is this comfort warranted? Government lenders may have motivations during a workout that extend beyond debt recovery to other goals. These goals may be maintaining good relationships with the foreign country in question, maintaining employment at home (in the case of ECAs), or instituting environmental, anti-terrorism or other policy goals. Experience with government lenders in restructuring exercises suggests that government lenders may be less willing to engage in difficult negotiations with foreign borrowers and, in the eyes of at least some private investors in certain restructuring exercises, their inclusion in a transaction has led to decreased recoveries. While government lenders can certainly be helpful to a workout process under the right circumstances, private lenders should be clear-sighted on the benefits government lenders provide.

Challenges to New York and English Law? As transaction and insolvency laws in emerging markets are modernised and become more uniform, and as legal and political institutions develop and mature, many local borrowers may push harder for local law to govern their loan agreements. At a recent syndicated lending conference focused on Latin America, local lenders in the region made clear they thought they had a competitive advantage over international lenders because they had an ability to make loans under local law, something local corporate borrowers seemed to value. The extent to which the market would soon see syndicated loans governed by local law was much discussed. While this phenomenon likely may not occur on a significant scale in the near term, it does seem that the choice of governing law may be one consideration that is increasingly in play when lenders are competing for lending mandates.

6 Final Thoughts

With the world becoming smaller, emerging markets developing and lenders searching for yield, more lenders will seek opportunities in cross-border lending. As a result, the question of legal risk will be one of increasing relevance, and local knowledge will be of increasing importance.

Lenders have a number of useful tools available to help mitigate legal risk. Ultimately, it may not be possible to reduce risk to that of a "risk-free" jurisdiction. Lenders should be careful to not overestimate the comfort certain structural tools will ultimately provide. A borrower and its shareholders in a jurisdiction where the rule of law is weak typically enjoy a significant advantage over a foreign lender in a debt restructuring exercise.

Focus on structural tools should not overshadow perhaps the most important mitigant of all: the best protection against legal risk is to make a good loan to a responsible borrower with "sound commercial fundamentals". In the case of a cross-border loan to a borrower in a high-risk jurisdiction, "sound commercial fundamentals" goes beyond looking at a borrower's financial statements, projections and understanding its strategies. The most forward-thinking lenders will strive at the outset of a transaction to understand the full array of leverage points it may have against a borrower and its shareholders, including the need for future financing and/or access to the capital markets, and of the consequences of default for a borrower and its shareholders.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Thomas Mellor

Morgan, Lewis and Bockius LLP
101 Park Avenue
New York, NY 10178-0060
USA

Tel: +1 212 309 6995
Email: thomas.mellor@morganlewis.com
URL: www.morganlewis.com

Thomas Mellor is a partner in Morgan Lewis's Banking and Leveraged Finance Group, Project Finance Group and Financial Restructuring Group. Tom has extensive experience representing banks and other financial institutions in structuring and negotiating a variety of debt finance transactions both in the United States and globally, including syndicated, club and bilateral lending transactions (investment grade and leveraged), as well as project finance and restructuring transactions. Tom is particularly experienced in cross-border financings (especially in Latin America, Europe and Asia) as well as financings with structural or other sorts of complexity. Tom is listed as *a leading lawyer in banking and finance* in *Chambers Global*, *Chambers USA*, *Chambers Latin America*, *The Legal 500 Latin America*, *IFLR 1000* and *Latinvex*. Tom is author of "*China's Investment in Latin America: Themes, Challenges and Future Trends*", which appeared in the Winter 2012 issue of *Global Infrastructure*.

Marcus Marsh

Morgan, Lewis and Bockius LLP
101 Park Avenue
New York, NY 10178-0060
USA

Tel: +1 212 309 6143
Email: marcus.marsh@morganlewis.com
URL: www.morganlewis.com

Marcus Marsh is an associate in Morgan Lewis's Banking and Leveraged Finance Group and represents banks, business development companies, and other institutional lenders and hedge funds in a variety of financing transactions, including acquisition financings, senior and mezzanine financing arrangements, and debt restructurings. Marcus also advises clients in matters related to structured finance transactions, including the use of derivatives in securitisations.

Morgan Lewis

Morgan Lewis's market-leading practices are focused on global financial services firms and Fortune 100 companies. We have approximately 2,000 lawyers in 29 offices in the US, Europe, the Middle East and Asia, including financial centres such as New York, London, Paris, Moscow, Frankfurt, Dubai, Singapore, Beijing and Tokyo. Our diverse practice covers a wide range of debt financings, including syndicated lending, leveraged and investment grade financings, cash flow and asset based financings, private note placements and multicurrency and cross-border financings.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Global Trends in Leveraged Lending

Joshua W. Thompson

Shearman & Sterling LLP

Caroline Leeds Ruby

The year 2015 saw periods of intense and robust deal flow with stable credit markets, but also periods of malaise and instability during which credit markets were overwhelmed by a "maelstrom of fears". Macro, market and regulatory challenges have caused the leveraged loan market to be at times a deep and liquid haven for prudent investors, but also a market in which investors have sold off heavily when faced with spikes in risk or relative value opportunities. The regulatory environment has reduced incentives for bank market makers to hold significant loan inventory and investors have faced periods of illiquidity for harder-to-trade loans. Longer term principal debt investors have, in turn, taken advantage and driven market terms during the most intense periods of dislocation. We discuss below specific trends in leveraged lending from 2015.

1. Maelstrom of Fears

The end of the Fed "put" finally occurred. Since 16 December 2008, the Fed had kept its benchmark interest rate (i.e., federal funds target rate) at a range between zero and one-quarter percent. "Liftoff" (as the Fed called it) occurred on 16 December 2015, but in the teeth of softness in manufacturing and mixed signals on US growth and employment. Did "liftoff" play into investor fears that there are only unfavourable monetary headwinds ahead? Yes. Was "liftoff", from a purely mathematical perspective, relevant for US dollar leveraged loans? No, virtually all US dollar loans have LIBOR floors of 1.00%, and typical LIBOR periods have rates below that floor. For certain credit strategists, monetary policy fears were overplayed by the credit markets and the Fed's measured approach to the unwind of its easy-money policies was predictable in light of macro-economic conditions (e.g., solid growth, low to moderate inflation and strength in employment numbers).

The US credit markets reopened for business after the summer and, for only relatively brief periods, had stability. The high-yield market was a "slow-moving train wreck" during that period, as observed by Bank of America Merrill Lynch credit analysts. The energy sector led the charge; heavily indebted energy companies faced heavy selling (as has been widely observed, it is expected that energy sector default rates will materially increase in 2016 given sustained low oil and gas prices and challenging conditions for attractive asset sales).

Concern over the financial health of commodity businesses and the impact of rate rises, together with numerous other fears (e.g., combusting emerging markets and China's declining growth, political uncertainty, regulatory overhang, continued concerns about a Greek euro exit, Middle East instability, etc…), led to a spiral of pessimism in the last quarter of 2015. The leveraged loan market experienced a significant slowdown and material upward repricing, reflecting, in part, moderate price contagion across credit markets in the fourth quarter. Several significant deals were unable to be sold within their predicted price bands and/or had to be restructured or otherwise modified in order to be sold. Certain well-publicised deals were pulled from the market and held over into 2016. Upward price flex massively outpaced reverse (i.e., pro borrower) flex in the fourth quarter. However, although the markets are signalling a challenging 2016 for leveraged finance, views remain divided over whether the financial market turbulence signals the onset of a recession. Certain long-term, extremely successful, debt investors have aggressively taken advantage of the sell-off to increase exposure to credit assets.

2. Loan Volumes

Over the 12-month period, leveraged loan volumes in the US in 2015 fell by over 17% compared with 2014. This was coupled with a drop in acquisitions by private equity companies and a fall in CLO issuance. Nonetheless, 2015 was still the third best year on record for the US leveraged loan market. European volumes were broadly flat, likely as a result of having less exposure to commodities, benefits flowing from European quantitative easing and an increase in new money deals (mainly in the corporate sector).

Global leveraged loan volumes fell by around 13% to just over USD $1 trillion. Overall leveraged lending volumes in North America in 2015 are reported to have declined by over 17% from 2014 (i.e., totalling around USD $780 billion), but still represented the third best year by volume on record. The most active sectors were technology, healthcare and retail. The volume of institutional term loans (such as TLBs) was reported to be down 36%, but the volume of pro rata loans (revolving credit facilities and amortising term loans (such as TLAs) more likely to be provided by banks) rose 1%. Reports indicate that US second-lien loan issuance more than halved, falling to USD $13 billion from USD $28 billion in 2014, and middle-market leveraged volumes in the US dropped by around 30% to USD $142 billion. Sponsor US-leveraged loan issuance also dropped by 17% to USD $253 billion, most of which was not related to new LBOs. US high-yield volumes were reported to have declined by around 18% from 2014 levels, totalling USD $253 billion, and there was a drop in average rating with around 40% of issuers having a single-B rating. However, US investment-grade corporate bond debt increased by 8% to USD $1.2 trillion in 2015, the best year ever.

In the US primary market, average contractual loan spreads for new issues in the last quarter of 2015 were reported to be 400 bps for large corporate loans and 533 bps for middle-market deals. Average new-issue yields for large corporate issuers were nearly 6% and over 7% for middle market deals. This compares with average European contractual loan spreads at the end of the year reported to be just over 460 bps for sponsor-backed Term Loan B (i.e., so close to US pricing).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

European leverage loan issuance was reported to total USD $216 billion for 2015 but was down from 2014. Some reports suggest the drop was around 20% whereas other reports suggest there was almost no drop. AFME reports suggest the drop was down over 15% but other reports suggest there was almost no drop. Volumes were upheld partly due to the increase in sponsor and corporate new money to USD $100 billion. However European high-yield volumes are reported to have dropped by around 14% from 2014 to approximately EUR 90 billion and covenant quality also continued to drop. Analysis earlier in the year by rating agencies showed that more than half of European transactions financed by leveraged finance by volume were financed by high-yield bonds in 2013 but this trend reversed as loan markets strengthened and, in 2015, Term Loan Bs overtook high-yield bonds as the instrument of choice.

Asian leveraged loan issuance remained a small portion of the global-leveraged loan issuance. High-yield issuance dropped 32% year-on-year to just under USD $17 billion, comprising mostly Asian currency bonds.

3. Fourth Quarter Syndication Challenges

Secondary market prices for multi-quote institutional term loans in the US dropped to around 93 cents in the dollar towards the end of 2015, close to prices in 2011, with oil and gas loans (apart from downstream loans) being bid much lower. The drop in secondary market prices in the US made it harder for banks to syndicate new deals. The secondary market for European loans was much stronger, with the European Lev40 finishing the year at 99.13.

Terms had to be flexed to make them more lender-friendly (reverse flex became virtually non-existent). Discounts were offered, loans downsized, covenants tightened and pricing increased. A USD $820 million first-lien portion of loans to finance the acquisition of Full Beauty Brands by Apax Partners was reportedly sold at 93 cents, and a USD $345 million second-lien tranche was reportedly offered at 87 cents in Q4 of 2015. The market volatility led to a number of deals being financed by large commercial bank groups with very little debt being initially syndicated. The difficult markets forced certain banks to pull out of the financing of the approximately USD $5.5 billion buyout of software firm Veritas by Carlyle in November, and the Veritas deal was held over into the new year.

Due to the choppy markets, the difference in interest rates and the narrowing of pricing between the European and US markets, some issuers switched from the US markets to Europe to raise debt. Swissport's proposed dollar term loan was switched for a EUR 660 million term loan governed by New York law, and Azelis added a EUR loan in the euro equivalent of USD $135 million to its proposed all USD term-loan package. Several US blue chip companies also issued corporate bonds denominated in euro in the European markets in 2015. They were able to lock in lower interest rates and swap euros to dollars. However, swap costs are reported to have increased by 46 basis points in 2015 to their highest levels for three years, and this may dampen the popularity of this trend. There was a significant drop in EMEA borrowers seeking to syndicate loans in the US as interest rates remain low in Europe.

Volatile market conditions offered opportunities for direct lenders (i.e., those lenders looking to buy and hold, and who are less immediately dependent on demand in the secondary market). Direct lenders are now looking at bigger deals which they can sign on a club basis. In Europe Hayfin, ICG, Highbridge and Sankatay provided a USD $400 million loan to back Chiltern's acquisition of Theorem Clinical Research. Goldman Sachs' mezzanine/junior capital fund was particularly active in the US market in the fourth quarter. Direct lending financing packages in Europe continue to increase in sophistication and complexity.

4. Liquidity and CLO Issuances

US CLO issuance in 2015 was reported to be USD $98.5 billion, representing a drop from the 2014 level of USD $124 billion, but remained the third highest year ever. European CLO issuance was EUR 13.8 billion, up slightly from EUR 13 billion in 2014; as a general matter, weakness in European CLO issuance remains a structural limitation to the success of, and liquidity in, the European markets.

US CLO issuance was particularly strong in the first half of the year, averaging nearly USD $10 billion a month. A variety of factors combined to make the second half of the year much different, as activity dwindled to an average of just USD $6.3 billion a month. Issuance in 2016 is expected to extend the trend from the second half of 2015, with full-year estimates in the range of USD $60 billion to USD $70 billion.

A meaningful portion of the reduction in issuance may be attributable to the lack of supply of loans resulting from leveraged lending guidance and general credit concerns, both of which are expected to continue to impact the market in 2016. In addition, the secondary market for CLO equity declined, taking the new issuance market with it, and there remains a relative scarcity of AAA investors in the market, despite relatively wide spreads in the AAA tranches (in the range of 150–165 basis points). In turn, these pricing levels have focused equity investors on risk retention-compliant structures that allow for repricing of the AAA tranche following the expiration of the typical two-year non-call period (risk-retention rules for CLOs become effective on December 24, 2016, meaning that a repricing of a CLO that initially closed on or after December 24, 2014 would be impacted). According to Standard & Poor's Leveraged Commentary & Data ("LCD"), approximately 27% of CLOs closed in 2015 were structured for risk retention, though this figure includes those with manager fee rebates and other "incentives" to implement a compliance strategy. Investor risk appetite declined markedly at the end of 2015, a trend that is continuing into the early part of 2016. It will be interesting to watch CLO tranche pricing in 2016 to see if risk retention and other features will increase the demand for conservatively structured AAA tranches – thereby tightening spreads – or whether the scarcity of AAA investors will continue to drive spreads wider to the point that banks and other investors that face significantly increased hurdle rates due to the Basel III leverage ratio (which does not reflect credit quality thereby disproportionately impacting demand for highly rated securities) will re-enter the market.

Loan funds outflows in the US were USD $21 billion, with USD $5.4 billion exiting in December as investors looked to de-risk. Whilst US CLO assets under management increased to USD $427 billion, US loan mutual fund and ETF assets under management fell to USD $115 billion at the end of 2015. European CLO assets under management fell slightly. The CLO share of US institutional loans has increased slightly from 2014 to just over 50%, whereas the share of loan mutual funds and ETFs has fallen to 13%. IPO prepayments in the European market and elsewhere further reduced the paper available for CLOs.

For the third year running, there was a net outflow from US high-yield funds. There was significant sell-off of high-yield assets amid market volatility in December, and high-yield issuance that month fell to USD $3.5 billion with higher yields. As mentioned above, moderate pricing contagion occurred across credit markets during the fourth quarter.

5. Rise in Corporate Acquisitions and Sponsor Exits but Drop in Sponsor LBO Activity

In the US, new money deals were reported to be up 3%. Refinancing volumes were down 31%, with a particular drop in refinancings

© Published and reproduced with kind permission by Global Legal Group Ltd, London

using institutional debt. In Europe, new money deals were up, representing just under half of European leveraged finance deals, and refinancings were down by over 25% to just over USD $113 billion.

Whilst US non-LBO issuance was up significantly, US LBO issuance was reported to have fallen by 22% in the US to USD $73 billion, representing just under 10% of the US-leveraged loan market as sponsors struggled to match the prices offered by strategic buyers. LBO issuance in Europe remained flat. Corporate M&A leveraged loans increased significantly in the US, up 49% to well over USD $250 billion and in Europe by 35% to USD $122.3 billion.

Sponsor buyout activity has remained fairly flat since 2010, although world economies have recovered significantly since the financial crash. A report by one sponsor suggested that the number of sponsor LBO transactions (rather than the volume) was less than 5% more in 2014 than in 2010. In 2015, strong stock markets increased sale and IPO valuations, and the abundance of capital and cheap credit resulted in steep competition, which drove up prices for targets and dampened LBO activity. Average purchase price multiples in the US were reported to be just under 10 times for broadly syndicated loans and around 10.6 times for middle-market deals (levels often seen at the height of a credit boom). Regulatory pressures on banks and a concern to avoid overleverage has limited the average leverage for LBOs to just below six times and slightly less for large LBOs or corporate deals. The average equity check for sponsors has increased to nearly 40% (compared to 30% before the financial crisis), which is likely to reduce returns for sponsors during this investment cycle.

Recent research has shown that high target valuations and competition is preventing a growth in LBOs that would otherwise occur from the availability of cheap credit and improving investor confidence as sponsors do not want to overpay despite the pressure to invest. As a result, equity dry powder is increasing which, in turn, triggers more competition for attractive assets. In contrast, corporate strategic acquisition activity is not so impacted by higher prices as they often require lower rates of return and can exploit potential synergies more easily. Accordingly, corporate buyers were more willing to buy at higher valuations in 2015.

Many funds have concentration constraints on the relative amount that a fund can make in a single portfolio company (e.g., often 15%). The increasing size of the equity check required for an acquisition, these fund limitations and the reluctance of sponsors to invest in consortia after the credit crunch all operated as a constraint on the size of the deal that sponsors would pursue in 2015. Sponsors with greater fund flexibility (e.g., often the most well-known and seasoned top-tier sponsors) and/or the ability to round up a club of investors (whether institutional/pension investors, fellow PE funds and/or strategic corporate partners) had a strong competitive edge in 2015.

On a positive note, the high valuations meant that it was another excellent year for exits with strong returns, such as through an IPO or sale to a trade buyer. For instance, Worldpay Group plc, owned by Advent International Corp. and Bain Capital, raised over GBP 2 billion in its London listing. Recent reports suggest that the median holding period for exits in 2015 was close to six years rather than the three-year period before the credit crunch (of course, dividend recaps have often allowed sponsors to take money off the table during this period).

6. Cov-lite Loans Down Other Than for Institutional Large Deals

Overall cov-lite loan issuance dropped in the US to USD $337 billion, but still represented the third biggest year on record. However, nearly three quarters of institutional loan issuance in the large corporate market was cov-lite, up slightly from 2014.

In Europe there was a rapid increase in cov-lite issuance in 2014 but (save for larger loans) issuance trended downwards in 2015, and "cov-loose" loans appear to be the new norm. Over half of all rated European TLBs were cov-loose in 2015, with the majority of these having only a leverage maintenance covenant, and about a quarter of such loans were cov-lite. However, just under half of all rated loans over EUR 500 million were cov-lite. Investors appear to be more willing to accept cov-lite terms for loans which are large and liquid, allowing lenders to trade out if the borrower's financial performance deteriorates. Rating agency research has shown no direct correlation in Europe between the prevalence of cov-lite and the credit rating of the borrower. The EUR 1.54 billion loan for Apollo Global Management's acquisition of Verallia from Saint Gobain was the largest European new money cov-lite loan for a new issuer.

The slowdown in cov-lite in Europe is not the whole story. Although a leverage maintenance covenant still usually applies to term loans or drawdown facilities, the actual level of protection afforded by financial covenants in Europe has generally weakened in relation to headroom and EBITDA add backs. Covenant headroom is now 30–35%, and there is uncapped ability to net cash and/or increased EBITDA add-backs. If, as is common, the initial leverage level is just below six times, in order to give 30–35% headroom the leverage covenant will need to be set at such a level that the borrower may increase its leverage well above six times and still meet the covenant. Similarly, if the borrower has significant opening cash and cash equivalents and is permitted to net this off against its debt, even if the cash is trapped (e.g., the cash is in a jurisdiction which would impose significant cash taxes upon repatriation of the funds to the borrower), the borrower can nonetheless meet the leverage covenant even though its EBITDA may have dropped significantly. Add-backs to EBITDA are also increasing. Previously pro forma add-backs for synergies and cost savings associated with acquisitions and likely to be realised within 12 months were permitted but were capped, whereas these add backs are now sometimes uncapped or capped per acquisition. Also, liberal add-backs for restructurings, integration, project cost savings and other matters are now becoming common.

Increasing EBITDA by add backs will not only allow a borrower to meet a financial covenant but will also increase grower baskets in negative covenants set by reference to EBITDA and, therefore, weaken other protections. Where the loan is cov-lite, the only restrictions on matters such as debt incurrence, acquisitions, payment of dividends, investments and prepayments of junior debt will be through the negative covenants. In Europe, basket capacity in negative covenants such as debt incurrence, investments and liens was typically capped by a fixed cap, but grower baskets became much more common in 2015. Initially, European grower baskets were typically the greater of a fixed amount and a percentage of total assets, but baskets that are the greater of a fixed amount and a percentage of EBITDA are now becoming very common.

EBITDA cures have crept into the European market. In Europe, a borrower was typically required to apply a cure amount to reduce debt. However, it has become very common to permit the borrower to add the cure amount to EBITDA and not require it to repay debt, as is common in the US. Like the US, EBITDA cures may be limited to three to five times over the life of the facilities. However, unlike the US, overcures are often permitted and some sponsors made use of this permission in Europe last year. An overcure allows a sponsor to effectively cure for potential future financial covenant breaches and side step the usual limits on the frequency of cures.

7. Terms – Convergence Continues

The growth in cov-lite and grower baskets are just two examples of the continued convergence in Europe between high-yield bond terms and loan terms and between the US loan market and the European loan

© Published and reproduced with kind permission by Global Legal Group Ltd, London

market in 2015 particularly with regard to flexibility to raise more debt or refinance. There has been an increase in incremental debt capacity, with rating agency research indicating that around 60% of European rated loans in 2015 incorporated capacity to incur incremental facilities. The ability to incur incremental debt is usually subject to satisfying a leverage test and, if secured, a secured leverage ratio ("ratio debt test") plus, if a facility is subject to financial covenants, pro forma covenant compliance. Such research also indicated that, on average, borrowers can incur aggregate incremental facilities up to around 0.5 times EBITDA, but this capacity remains much lower than the average capacity that a high-yield bond issuer would have to incur additional debt, which was estimated to be 4.2 times during 2015. Freebie baskets (i.e., which permit the borrower to incur debt up to a capped amount even if it cannot meet the relevant leverage test for debt incurrence) are also becoming common in Europe. Sidecar incrementals allowing debt to be incurred under a different document have also been seen in Europe; European borrowers also have more flexibility to incur refinancing debt by refinancing all or part of their existing facilities with new tranches under the existing facilities or new refinancing debt.

In the US, it is usual to prevent the borrower from incurring an incremental facility that has a yield in excess of 0.5–1% of the yield on the term loan for a sunset period of 12–18 months unless the yield on the term loan is correspondingly increased, which provides some repricing protection and control on the incurrence of expensive pari passu debt. The sunset may be removed under a syndication flex so this MFN (most favoured nation) protection lasts for the life of the facilities. In Europe, this provision is not so consistently applied and the sunset may be six months, and/or a flex may not apply.

The flexibility to incur an incremental facility may lead to some risks in Europe that are not mirrored in the US, as a result of the European bankruptcy law generally being less favourable to creditors than Chapter 11. Where the incremental debt is to be secured on the collateral for the existing facilities, it may be necessary to release the existing security and re-grant it for both the existing facilities and the new incremental facility on a shared basis, as second ranking security may not be recognised as a concept in some European jurisdictions. This may lead to the start of new insolvency hardening periods of potentially several years in duration. It is also usually necessary for the holder of the secured incremental debt to be party to the intercreditor agreement, as it may not be possible to sell the collateral free of the incremental debt on an enforcement under European bankruptcy laws unless the holder has contractually agreed to release the debt on an enforcement subject to fair value protection. Similarly, no stay on enforcement may apply under local bankruptcy laws and so a contractual stay and payment blocks may be required.

The increased flexibility in loan agreements to incur debt has also led to a focus by European lenders on the implications of the borrower borrowing unsecured debt if the unsecured lenders are not subject to the intercreditor agreement or incurring structurally senior debt or the existence of unrestricted subsidiaries in the group. Such debt may restrict lenders from being able to enforce a single share pledge at the top of the group and sell the group (a single point of enforcement sale) which is often the favoured strategy given the lack of an equivalent to Chapter II in Europe. In some cases, there may be a limit imposed on borrowing of unsecured debt which is not regulated by an intercreditor agreement, and/or a limit on borrowing debt in subsidiaries which are not borrowers or guarantors of the secured facilities. The borrowing of incremental debt by guarantors may also raise challenges. If, as is common in Europe, upstream and cross-stream guarantees and security are limited by local law to an amount less than the total secured facilities, then the claims of unsecured creditors may reduce the share of recoveries of secured creditors in a bankruptcy.

In Europe, a change of control triggers a mandatory prepayment which can only be waived by all lenders, unlike in the US, where a change of control triggers an event of default waivable by the majority lenders. The European mandatory prepayment requirement is sometimes being replaced by the put option seen in European investment-grade deals, only requiring prepayment if a lender requires it (or sometimes only if the majority lenders require it). The change-of-control provisions may provide that a change of control occurs if control is not retained by permitted holders of equity (which may include a wide class of affiliates and other persons). Alternatively, a change of control may only be triggered when someone other than permitted holders gains control. Portability is occasionally seen in Europe, but is not common.

European loans typically limit acquisitions by reference to a fixed cap which can sometimes be increased, where the acquisition is funded by retained excess cash or new equity. However, it is becoming common for acquisitions to be limited primarily by a leverage ratio. This means that if the borrower can meet the leverage ratio to make the acquisition, and to incur more incremental debt, then it can carry out a buy-and-build strategy without refinancing. Such flexibility can allow the borrower to materially change the business, mix of currencies in which cash is generated and structure of the group. This flexibility has been quite commonly permitted in the US market. Similarly, European loans now typically allow a borrower flexibility to refinance all or part of its existing loans with new tranches under its existing facilities or new refinancing debt with no greater security or guarantees and no shorter maturity.

Other features of the US market, such as asset-based or EBITDA-based grower baskets, permission to incur acquired debt or contribution debt and ability to reclassify debt into different baskets are being seen more often in the European market. The restrictions on dividends and other restricted payments, acquisitions and disposals in European loans vary with the larger loans often following the high-yield market and the smaller deals continuing to follow the more conventional European approach.

Cross-acceleration and cross-payment default sometimes replaces the classic European cross-default. Under the classic test, an event of default is triggered if there is a default under other debt even if the creditors of that other debt have taken no action in order to give the lenders a seat at the table at an earlier stage.

8. Leveraged Lending Guidance

The year 2015 saw a harsher period in the enforcement of the March 2013 leveraged-lending guidance (a jointly issued set of regulatory guidelines for regulated banks in the United States). After a February conference call jointly hosted by the regulators (i.e., the Federal Reserve, Office of the Comptroller of the Currency and the FDIC) that attracted over 1,500 market participants, during which regulators answered questions, the regulators brought a renewed vigour to their enforcement. The regulators have indicated that "examiner red flags" or weak loan characteristics will lead to deeper probing of credits. While the existence of red flags does not mean death for the credit (i.e., it does not automatically lead to "non-pass" or unfavourable ratings by the examiners), the regulated banks nonetheless confront the real risk that too many unfavourable ratings will lead to significant enforcement penalties from regulators. This cold wind has been blowing in the face of the leveraged lending markets (that have at times been overheated because of easy monetary policy) for some time, but, for many regulated banks, 2015 saw this cold wind turn into an arctic blast. Non-bank lead arrangers, who are not regulated, theoretically obtain a regulatory arbitrage at the outer envelope of the leveraged-lending

© Published and reproduced with kind permission by Global Legal Group Ltd, London

guidance. The year 2015 saw a flood of opportunities for these non-bank entities, but limited capital and other constraints meant that these unregulated entities could not replace the banks. The year 2015 underscored that the scale and depth of the unregulated market is simply too small to meaningfully replace the regulated banks and that, at most, non-regulated entities will expand their market share by several percentage points (but on a selective basis). A question for 2016, and for the regulators going forward generally, is whether the guidance and/or the enforcement of the guidance is appropriate in a normalised interest rate environment. At a high level of generality, the leveraged lending guidelines (which are a counter-cyclical stabiliser) have less compelling policy logic and/or necessity if credit markets are constrained and/or credit markets are appropriately priced in a normalised yield-curve environment. The leveraged lending markets continue to face into 2016 the twin dangers of overzealous enforcement and/or regulatory creep.

The Bank of England undertook a review of the UK leveraged-loan market in 2015, focusing on underwriting standards. The Financial Policy Committee of the Bank of England announced in March 2015 that the UK banking system appeared to be resilient to stress in the leveraged-loan market, and that action was not needed to mitigate risks in the market at the time. Noting that underwriting standards might continue to loosen, which would increase the risks for major banks in stressed and illiquid market conditions, the Committee announced that it would continue to assess the standards on a regular basis.

9. Bail-In

In Europe, certain Member States chose to phase-in the requirement to include bail-in clauses in loan documentation governed by the laws of a non-EU country which, under the EU Bank Recovery and Resolution Directive, had to be implemented by 1 January 2016 at the latest. Creditors of EU banks need to agree to and recognise that liabilities of the banks may be subject to bail-in (i.e., the liability may be subject to write-down or conversion into equity if the bank goes into resolution). The UK Prudential Regulation Authority first applied the requirements to unsecured debt instruments, additional Tier-1 instruments and Tier-2 instruments from February 19, 2015 (phase 1), and to all other relevant liabilities from January 1, 2016 (phase 2). The UK Financial Conduct Authority applied the requirements to all relevant liabilities from January 1, 2016. However, late in 2015, both regulators took a step back and have allowed firms, on application, to delay the application of the requirements to relevant liabilities other than unsecured debt instruments, additional Tier-1 instruments and Tier-2 instruments to June 30, 2016. To obtain the waiver, firms must show that compliance would be impracticable, mere inconvenience being insufficient. Banks, their clients and the buy-side are still grappling to understand the scope of the requirements.

10. Investment Grade Loans

The investment-grade market remained strong in 2015. The volume of EMEA-syndicated loans overall matched that of 2014, and US investment-grade lending volume was nearly USD $873 billion, the best year on record. High-grade acquisition financing increased as corporates took advantage of low interest rates and strong liquidity. Refinancings fell by a quarter as many companies had already refinanced, although companies continued to take advantage of favourable market conditions to do amend-and-extend deals, and some US blue chips chose to take advantage of the market arbitrage and raise euros in Europe.

AB InBev borrowed USD $75 billion (including USD $40 billion of bridge loans) to finance the purchase of SABMiller from 21 relationship banks, which was the largest deal of the year. Teva Pharmaceuticals also borrowed USD $31.5 billion to acquire Allergan Generics and refinance an existing credit facility. The financing included a USD $22 billion bridge loan and a USD $6.75 billion equity bridge loan from the underwriting banks. Other large acquisition financings include Air Liquide's USD $12 billion bridge loan to acquire Airgas, Royal Dutch Shell's GBP 10.07 billion bridge loan to acquire BG Group, ChemChina's EUR 6.8 billion bridge loan to buy Pirelli, Deutsche Annington's EUR 6.25 billion loan to acquire Gagfah, Borealis's USD $4.7 billion loan to acquire Fortum, Solvay's USD $5.8 billion loan and Heidelberg Cement's USD $4.4 billion loan.

11. Trends in the Asia Pacific Loan Market

As with other regions, unease based on the weaker Chinese economy and subsequent currency devaluation caused a substantial slump in the Asia Pacific loan market (e.g. Japan). Asian (e.g. Japan) syndicated loan volume and related fee revenue was down; in part reflecting lower M&A activity across the region and strong competition for deals among the banks, especially among blue chip names. However, despite the market uncertainty around China's economic growth prospects, Chinese lending led regional loan volumes; e.g., the biggest Chinese take-private deal was the USD $9.3 billion LBO of Chinese internet firm Qihoo 360, which was backed by a USD $3.4 billion-equivalent jumbo (single lead arranger) loan from China Merchants Bank. Macau, the Philippines and Taiwan showed positive growth. With volumes 40.4% lower compared to 2014, Australian loans totalled USD $79.9 billion from 186 transactions in 2015; a noteworthy deal was Macquarie Bank's two-year USD $4.3 billion bridge loan to fund the acquisition of ANZ's vehicle finance portfolio Esanda, marking the largest loan in the region in the fourth quarter. Overall Japanese syndicated lending for 2015 reached USD $225.8 billion from 2,054 deals, a 1.6% increase in proceeds and a 3.1% increase in deal count compared to 2014. The number of issuances marked the highest total since 2008. In a noteworthy trend, Japanese loan cross-border transactions for non-Japanese borrowers significantly increased in 2015, with USD $11.7 billion from 45 deals, compared to USD $5.6 billion from 40 deals in 2014; a highlight being Ichthys LNG Pty Ltd's USD $5 billion deal arranged by Bank of Tokyo-Mitsubishi UFJ, Mizuho Bank, and Sumitomo Mitsui Banking Corp in September.[1]

Endnote

1 Figures taken from reports by Thomson Reuters and AFME.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Joshua W. Thompson
Shearman & Sterling LLP
599 Lexington Avenue
New York, NY, 10022-6069
USA

Tel: +1 212 848 8703
Fax: +1 646 848 8703
Email: joshua.thompson@shearman.com
URL: www.shearman.com

Joshua W. Thompson, Co-Head of the Global Finance Group and Co-Head of the Leveraged Finance Group, is resident in the New York office. He focuses his practice on complex financings, including acquisition financings and other leveraged lending (including leveraged buyouts, tender offers and other going-private transactions), structured financings, second-lien financings and mezzanine investments. In addition, he has extensive experience representing debtors, creditors, management and investors in complex restructurings, work-outs, bankruptcies and acquisitions of troubled companies. As counsel for lead arrangers and private equity sponsors, he is involved in all aspects of deal structuring, negotiation and documentation. Josh is recognised as a leading practitioner for bank lending by *IFLR 1000* and *The Legal 500*, which notes that "clients are 'happy to put trust and faith' with the 'excellent' team head".

Josh also is the former general counsel of Jefferies Finance.

Caroline Leeds Ruby
Shearman & Sterling LLP
Broadgate West, 9 Appold Street
London, EC2A 2AP
United Kingdom

Tel: +44 20 7655 5944
Fax: +44 20 7655 5500
Email: cleedsruby@shearman.com
URL: www.shearman.com

Caroline Leeds Ruby, a partner of the firm, is resident in the London office. She represents banking and corporate clients and private equity and fund investors in complex cross-border financings in developed and developing markets, including acquisition financings, leveraged lendings of all types (including going private transactions, mezzanine and PIK loans), financings to funds, receivables financings, debt buy-backs, multinational restructuring transactions, work-outs, distressed purchases and defaulting loans. As counsel for lead arrangers and investors or corporate borrowers, she is involved in all aspects of deal structuring, transaction management, negotiation and documentation.

Caroline is ranked as a leading lawyer by *Chambers UK 2013*. "A range of impressed clients note that Caroline Leeds Ruby is 'really first-class,' 'stays cool under pressure' and has 'excellent business acumen'."

SHEARMAN & STERLING LLP

Shearman & Sterling's Leveraged Finance Group is a leader in the high yield and leveraged bank market. Noted for their in-depth understanding of the business and legal considerations involved in leveraged credits, their lawyers offer a combination of market experience and a broad range of capabilities in the capital markets and the syndicated lending marketplace. They represent commercial banks, investment banks, mezzanine and second-lien providers, private equity sponsors and corporate borrowers. The team includes lawyers from the global Capital Markets and global Finance teams based in New York, London, Paris, Frankfurt, Milan, Singapore, Hong Kong and Abu Dhabi, working in close collaboration with members of the Bankruptcy & Reorganization and Project Development & Finance teams when needed. Shearman & Sterling's Leveraged Finance team delivers sophisticated, market-recognised advice and deal management for acquisition and other leveraged financings across a wide range of industries, financial sectors and jurisdictions.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Similar But Not The Same: Some Ways in Which Bonds and Loans Will Differ in a Restructuring

Kenneth J. Steinberg

Davis Polk & Wardwell LLP

Darren S. Klein

Introduction

Much ink has been spilled over the last several years about the ongoing convergence of the U.S. institutional Term Loan B market with the high-yield bond market, including by our firm.[1] The attention has been justified and the predictions of a continuing trend have been borne out. Changes in market practice, sometimes gradual and occasionally sudden, have resulted in increasing similarity of covenants and other deal terms found in these debt instruments that were once quite distinct and – partly as a result of this greater common ground – of the sales, trading and distribution processes for these two products and the groups of buyers who hold them. However, market participants should not allow this convergence to blind them to the reality that bank loans and debt securities (and the associated credit agreements and indentures) remain different in important respects. Some of those differences may come to the fore in the crucible of a restructuring, workout or other distressed credit situation.

With the leveraged loan default rate at a two-year high (measured by number of defaults) at the beginning of 2016 – and no shortage of predictions of credit troubles in multiple industries – now is a good time to think about some of these differences and how they may impact tomorrow's restructurings.

The purpose of this article is not to undertake an exhaustive review of the legal differences between loans and securities. Instead, we will highlight certain differences that can impact (and, in certain cases, have effectively blocked) attempted "out-of-court" restructuring transactions. As out-of-court restructurings themselves become more and more prevalent, providers and buyers of bank and bond financing (as well as borrowers/issuers) would be well advised to understand how these differences can affect their legal rights and shape the form and terms of, or impose limits on the ability to effectuate, certain transactions.

The key differences that we will discuss are:

- the Trust Indenture Act, applicable to many indentures (but not credit agreements or loans), which provides certain protections to "hold-out" bondholders;
- the differing contractual roles and responsibilities between a trustee under an indenture and an administrative agent under a credit agreement;
- the impact of *pro rata* "sharing" provisions that are common in term loans, but generally non-existent in bond indentures; and
- the use of "material non-public information" and the related role of U.S. securities laws governing insider trading.

Impact of the Trust Indenture Act

The Trust Indenture Act of 1939 (the "TIA") supplements the U.S. Securities Act of 1933 (the "Securities Act") in its application to certain debt securities. With certain exceptions, the TIA prohibits the sale of bonds unless they have been issued under a qualified indenture, which must contain various provisions and for the most part cannot be contracted around. Although bonds subject to an exemption from registration under the Securities Act need not be issued under a qualified indenture, investors and issuers should be aware that many non-qualified indentures incorporate the TIA by reference, or explicitly import certain provisions of the TIA or track the language of the TIA into the contractual provisions of the indenture, which leads to the same outcome as if the TIA had been incorporated by operation of law.

In the context of out-of-court restructurings, Section 316(b) of the TIA ("Section 316(b)") has been the subject of two recent decisions out of the U.S. Federal District Court for the Southern District of New York ("S.D.N.Y."). Section 316(b) provides in relevant part:

> Notwithstanding any other provision of the indenture to be qualified, the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder…

In published case law prior to the recent S.D.N.Y. decisions, judges interpreting Section 316(b) had generally found that it was intended to protect a bondholder's legal right to payment, but not the bondholder's substantive ability to get paid. For example, transactions or indenture amendments permitted on the face of the indenture that imposed subordination and payment block provisions,[2] or that permitted the issuer to transfer substantially all of its assets without assuming the bond obligations,[3] have been held to not violate the TIA. The two recent S.D.N.Y. decisions, *Marblegate*[4] and *Caesars Entertainment*,[5] however, have cast doubt on the limited "legal right" view of Section 316(b), providing a more expansive interpretation of that clause of the TIA to protect a bondholder's substantive right to payment, or the issuer's financial ability to make payments due on the bonds.

In the first transaction, Education Management – a provider of post-secondary education – had secured bank debt of $1.3 billion and unsecured notes in the principal amount of $217 million. The unsecured notes were guaranteed by the parent holding company, though the disclosure document used to initially offer the notes stated that this parent guarantee was solely to satisfy reporting requirements by the parent and was not meant to provide value to

© Published and reproduced with kind permission by Global Legal Group Ltd, London

creditors. The bond indenture provided that the parent guarantee could be released by a majority vote of the bondholders, or automatically in the event that the secured bank debt released its own parent guarantee.[6]

Education Management began facing financial distress but was effectively unable to file for an in-court Chapter 11 bankruptcy proceeding, which would have removed its eligibility for federal student loan funding. Education Management therefore negotiated an out-of-court restructuring with holders of more than 80% of the secured loans and unsecured bonds. The transaction involved (i) the secured lenders (i.e., the bank debtholders) releasing the parent guarantee, thereby releasing the parent guarantee of the bonds, (ii) those secured lenders foreclosing on Education Management's assets and selling those assets to a new subsidiary of the parent, and (iii) distributing new debt and equity to consenting creditors. Non-consenting creditors, in effect, would be left as creditors of an empty shell company and without a parent guarantee. This transaction technically complied with the terms of the bond indenture, but holders of more than a majority of the bonds also consented to the transaction, providing an independent path to releasing the guarantee.

Holdout bondholders, representing less than 10% of the bonds, sued, arguing that the transaction violated Section 316(b). To the surprise of most practitioners, the court agreed. Breaking from most past court opinions on the topic, the court held that Section 316(b) prevented not only the modification of an indenture's payment terms on the basis of a majority vote, but also protected a bondholder from any impairment of such bondholder's right to payment through a non-consensual majority restructuring otherwise expressly permitted by the applicable contractual terms. In effect, the court held that the holdout bondholders had to be paid off, or the restructuring would have to be effectuated through an in-court bankruptcy proceeding – again, not an economically viable alternative for Education Management. In contrast, had one of Education Management's secured bank lenders objected to this same restructuring, it would have had no right to comparable protection under Section 316(b), since the TIA does not apply to loans or other bank debt.

If more courts adopt the broad reading of Section 316(b) of the TIA, out-of-court restructurings of companies with SEC-registered bonds – or unregistered bonds issued under indentures that incorporate the provisions of the TIA by their terms – will become more challenging to structure. The court in *Caesars Entertainment* adopted the same substantive analysis of the *Education Management* decision, and that decision is subject to continuing litigation and appeals. If nothing else, these recent decisions may provide holdout bondholders with additional leverage to extract consideration from a company in financial distress and undertaking a restructuring (and, given the limited pool of resources available for debt holders implicit in the typical restructuring, increasing their share at the expense of other creditors of the company).[7]

It is interesting to note that a growing practice is emerging in newly issued unregistered notes transactions to expressly avoid incorporating Section 316(b) of the TIA by contractual reference and not tracking such wording in the indenture governing such notes, in an attempt to prevent such recent case law from applying to these unregistered notes by analogy.

Trustee or Administrative Agent – Why It Matters

A customary indenture for an offering of debt securities will include the appointment of an institution – generally a trust company with a substantial "indenture trustee" business – to act as "Trustee" for the holders of the underlying securities. Similarly, a credit agreement for a syndicated term loan will customarily include the appointment of a bank or trust company to act as "Administrative Agent" for the lenders.[8] Customary "boilerplate" language will invest the Trustee or Agent with the authority to act on behalf of the "holders of the notes" or the "lenders", and will provide the Trustee or Agent with customary indemnification (by the company and by the holders/lenders). While the Trustee/Agent acts on behalf of the group of holders/lenders as a whole, it is generally the case that the Trustee/Agent is authorised to take direction from – and is fully protected in relying on – instructions given by a majority of the holders/lenders.

However, as between a Trustee and an Agent, it is generally understood that the Trustee's role is more passive – after all, the Trustee generally has no separate relationship with the noteholders for whom it acts, nor has the Trustee usually had any role in arranging the financing in question. Rather, the Trustee's function is almost exclusively ministerial in nature, and largely involves collecting payments from the issuer and disbursing funds to the holders of the notes. The Agent, however, is often an affiliate of one of the arrangers of the bank loan facility in question and, if the facilities include a revolving credit facility that was arranged at the same time as a term loan and as part of the same documentation (as is often the case), the Agent itself or one of its affiliates will typically hold commitments under that revolving credit facility. Because of its relationship with the syndicate lenders and its holdings of revolving credit facility debt, and because credit agreements typically require more in the way of ongoing consents and deliverables than indentures (convergence notwithstanding), the Agent is typically more involved in day-to-day administration of the facility and will generally have one or more employees that monitor the credit and interface with the borrower and the lender syndicate on a regular basis.

As a result, an Agent will generally be actively involved in a credit facility and will spend time understanding the implications of any action it is being asked to undertake on behalf of one party or another under the facility. In recognition of the more limited role of a Trustee and of the practical reality that Trustees tend to seek clear, mandatory instruction rather than discretion, indentures generally provide that it is a condition to the taking of any action by the Trustee that the issuer provide it with an officer's certificate (and often an opinion of counsel) to the effect that the requested action is authorised under the indenture. And the exculpatory provisions of the indenture usually provide that the Trustee will incur no liability for any action it takes in reliance on such a certificate and/or opinion.[9] No such parallel provision authorising an Agent to act based on a certification/opinion from the borrower exists in a typical syndicated credit agreement.[10] Rather, when asked to take actions – which can range from execution of simple amendments or acknowledgement of joinder documents to approving the forms of new intercreditor agreements or the form and substance of additional permitted financings and amendments effecting a complicated restructuring – the Agent will typically review the credit agreement (often with its counsel) and then make its own determination as to whether the action in question is permitted and/or required. In close cases, the Agent may seek input from the lenders to bring itself within exculpation provisions that expressly apply to actions taken "with the consent of" or "at the direction of" a majority of the lenders.

The converse to the general principle that an Agent can act with the consent of or direction from the majority of the lenders is that it would be rare for an Agent to act *against* the express wishes of a majority of the lenders.[11] Given the Agent's role as a representative of the lenders, an Agent acting contrary to the majority of the lenders would likely risk removal or other consequences. However, in today's environment of increasingly complex capital structures and diverse lender bases, it can sometimes be difficult or even impossible

© Published and reproduced with kind permission by Global Legal Group Ltd, London

to get a majority of lenders to agree on anything, including a distressed borrower's proposed amendments. Consequently, the Agent might be stuck in a precarious position between conflicting sub-groups of lenders. One can easily envision such a contentious scenario, where a substantial minority of lenders wants the Agent to undertake a certain action, such as executing an amendment or joinder agreement, but a majority group of lenders stands in opposition. Stuck between opposing lenders, even in cases where the Agent would be permitted to act in its own discretion, the Agent might err on the side of inaction. In extreme cases, an Agent could even resign to avoid any consequences under such a scenario.

The example above underscores the tension between the Agent's role as administrator and the requirement of its participation – again, often styled as ministerial or confirmatory – in effecting a substantive amendment or permitting the borrower to issue new debt or take other consequential actions, which can become manifest when the action in question is the subject of lively disagreement within the lender group. On the other hand, a similar scenario involving a Trustee would seem unlikely in practice, since – as noted before – the signature of the Trustee on any required documentation could likely be procured on the basis of a certification from the issuer that the transaction was authorised (potentially with an opinion of counsel). While existing noteholders could perhaps instruct the Trustee otherwise, an indenture does not typically afford discretion but does specify where a clear right to indemnity lies. Thus, such a scenario sheds light on a key difference between the roles of a Trustee and an Agent.[12]

The *Pro Rata* Sharing Provision and its Effect on Syndicated Term Loan Restructurings

Buried away in most syndicated credit agreements is the "*pro rata* sharing" provision, a provision that is not found in bond indentures.[13] A customary formulation – taken from the Loan Syndication and Trading Association's "Model Credit Agreement Provisions" – is as follows:

> If any Lender shall, by exercising any right of setoff or counterclaim or otherwise, obtain payment in respect of any principal of or interest on any of its Loans or other obligations hereunder resulting in such Lender receiving payment of a proportion of the aggregate amount of its Loans and accrued interest thereon or other such obligations greater than its pro rata share thereof as provided herein, then the Lender receiving such greater proportion shall (a) notify the Administrative Agent of such fact, and (b) purchase (for cash at face value) participations in the Loans and such other obligations of the other Lenders, or make such other adjustments as shall be equitable, so that the benefit of all such payments shall be shared by the Lenders ratably in accordance with the aggregate amount of principal of and accrued interest on their respective Loans and other amounts owing them.[14]

A quick bit of history might be helpful. It is generally understood that the *pro rata* provision was incorporated into credit agreements (when loans tended to be provided almost exclusively by relationship banks) to address the risk that a borrower would – if faced with financial difficulties – attempt to consummate transactions that would favour one or more of its lenders under a particular facility with which it has a better or economically more important relationship at the expense of other lenders under that facility. This concern makes sense if the lending syndicate is viewed as being collectively exposed to the Borrower, and if the syndicated loans are viewed as a single loan that has been divided up among multiple lenders (as opposed to multiple loans having, at least initially, the same terms).[15]

The effect of this provision – which often requires a 100% vote (or a vote of all affected lenders) to amend – is to require any lender that benefits from receiving a payment (or other consideration) on account of its loans that exceeds its *pro rata* share of all payments in respect of loans made by the Borrower to purchase participations in the loans of other lenders, so as to ensure that all payments are received by the lenders on a ratable basis. Importantly, the "or otherwise" language brings into the ambit of the *pro rata* sharing provision many transactions that to the casual observer might not appear to be a "payment", including the exchange of a loan for some other consideration.

Indeed, when finance lawyers are asked to structure an exchange offer involving term loans under a syndicated credit agreement, one of the first things they think about is whether the proposed transaction requires only the consent of the exchanging lenders, or whether an amendment to the credit agreement to address any potential issues under the *pro rata* sharing provision will be required. As noted above, it is generally understood that the exchange of loan principal for other consideration is a "payment" in respect of that loan principal and, as a result, implicates the *pro rata* sharing provision. If the exchange offer is structured so that each existing lender (or each existing lender of the applicable class) participates and exchanges the same proportion of existing loans of the applicable class, then issues under the *pro rata* sharing provision will generally not arise.

However, particularly in a distressed context (a common scenario for exchange offers), there is often a sub-group of creditors that negotiate for the right to exchange their own debt for some other consideration – in other words, the deal itself is structured so as to permit the participation of only a chosen few creditors. Over the past year or so, there have been a number of exchange offers, with creditors generally being offered the opportunity to exchange existing debt at a discount (i.e., creditors have been offered the right to exchange 100% of unsecured or junior debt for a lesser principal amount of a new obligation that ranks higher in the capital structure, with the effect of improving the exchanging creditor's prospects of recovery, albeit on a smaller principal amount, while simultaneously diminishing the borrower/issuer's overall debt burden). These "up-tier" exchanges, involving the repurchase of existing notes and the issuance of new notes, have in most cases been permitted by the express provisions of the indenture without the need for consents to amend the restrictive covenants.

It is interesting, and not coincidental, that in all of the recent up-tier exchanges sponsored by a sub-group of the creditors of which we are aware, the existing debt obligation that was exchanged was a security and not a term loan, as a *pro rata* sharing provision is not a customary feature of indentures. Companies (and debtholders) have substantially less flexibility to structure and effectuate such an exchange offer where the obligation being exchanged is a term loan. Because of the *pro rata* sharing provision, such a transaction involving only a sub-group of lenders will likely only be permissible if the *pro rata* provision could be amended, which, as noted, would require the consent of at least a majority (and often 100%) of the lenders, thus effectively eliminating the ability of the borrower to negotiate only with the chosen few.

MNPI and the Public/Private Split

The U.S. securities laws impose restrictions on the use of "material nonpublic information" ("MNPI") in the purchase or sale of securities by parties in the market, with certain types of trades viewed as "insider trading" under Rule 10b-5.[16] For those restrictions to apply, however, the instruments being traded must be "securities" under the U.S. securities laws.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Interests in bank loans have typically not been considered securities. Although this assumption is not free from doubt – and has generated some scepticism around institutional bank loans of the sort considered in this article, particularly as convergence moves this market closer to the bond market in many respects – it continues to be the operating assumption of market participants that Rule 10b-5 will not apply to trading in loans. This does not mean, however, that a lender receiving MNPI in its capacity as a lender will be free to use that MNPI in trading bonds or other securities that the borrower may have outstanding. The tension inherent in this distinction has been the subject of loan market responses but also a continuing degree of uncertainty, enhanced in the context of a workout or restructuring where even small differences in information about an issuer can create significant differences in the price of its debt.

Large financial institutions have developed and maintain elaborate internal procedures to allow certain of their employees to receive MNPI while effectively insulating employees in other groups. So, for example, an agency group of a bank may receive MNPI in the ordinary course of its discussions with a borrower and the administration of its loan, while traders working at that same bank or an affiliate make and maintain trades in its bonds without sharing that MNPI. But not all institutional investors in loans want or are able to implement these sorts of controls – in fact, it may be the case that the same person making the decision to purchase loans on one day will decide to purchase or sell that same company's bonds tomorrow. These loan investors will typically opt to be "public-side" lenders, specifically waiving any right to receive MNPI sent to other, "private-side", lenders and the Agent. A public-side lender receives assurance that it is not in possession of MNPI that could compromise its ability to trade in the company's securities.

Absent information walls and similar procedures of the type described above, a private-side lender will generally avoid trading in bonds absent reliable assurance that it is not in possession of MNPI at the time of the trade. However, there is no Rule 10b-5 restriction on buying or selling from a public-side lender;[17] when trading with a lender that may be at an informational disadvantage, a private-side lender will rely on protections and waivers in the operative documents or on separate "big boy" letters in which the public lender acknowledges and waives any right to complain about any superior information that its counterparty possesses. While it is beyond the scope of this article to address the efficacy of these waivers, trading of this sort does occur among sophisticated parties.

Even in the context of bonds – clearly viewed as securities – the law of insider trading can introduce some confusion into the restructuring process. A company engaged in restructuring its debts will often engage in discussions with representative committees of its creditors, testing possible ideas and giving information in advance of release to a broader group. These discussions often are done under the protection of a non-disclosure agreement that provides both that the debt holder will not trade in the company's securities for a specified period and that, at the end of that period, the company will "cleanse" any MNPI that the creditor obtained in those discussions by making the information public. Debt holders have typically been willing to rely on a company's view that any information divulged by the company to the creditor is no longer MNPI with respect to the company.

In 2011, however, in a decision denying confirmation of a Chapter 11 bankruptcy plan of Washington Mutual, Inc. ("WaMu"), the United States Bankruptcy Court for the District of Delaware gave investors engaging in these sorts of discussions reason to reevaluate this practice.[18] In the *WaMu* decision, the bankruptcy court determined that even creditors who might not be classic "insiders" of WaMu could be "temporary insiders" with MNPI as a result of their participation in prospective settlement discussions, and could not rely, without a duty of further inquiry, on WaMu's commitment to disclose all MNPI at the end of an agreed confidentiality period, or on WaMu's judgment that the information actually disclosed comprised all MNPI that those creditors possessed.

The intersection of the law of insider trading; the asymmetry of information between different groups of lenders (on the one hand) and between lenders and bondholders (on the other); and the possibility that the bankruptcy process may impose equitable requirements more stringent than those of Rule 10b-5 are all contributing to continuing uncertainty for traders in distressed debt, and to different ways in which a company in distress can interact with its lenders and bondholders.

Conclusion

Despite the convergence between the terms and markets for high-yield bonds and Term Loan B bank debt, differences in contractual and other legal rights remain. These differences have shown themselves to be important during out-of-court restructurings. Given recent decisions in the S.D.N.Y. regarding the scope of the TIA, non-consenting bondholders will have relatively more leverage than their bank lender counterparts during certain types of out-of-court restructurings. The role of the bank Agent *versus* a bond Trustee could impact the restructuring a company can implement out of court, if the company requires the signature of the Agent or Trustee on even a seemingly innocuous document. *Pro rata* sharing provisions in bank loans could effectively prohibit a non-*pro rata* deal that might be achievable if the debt were issued under a standard high-yield indenture, and sensitivities surrounding access to MNPI and differences between the standards governing communication among and between "public-side" and "private-side" creditors impose their own challenges to restructuring negotiations. Investors in distressed companies should carefully consider these differences (and the impacts they could have) when weighing possible restructuring solutions.

Endnotes

1. Meyer C. Dworkin & Monica Holland, "Recent Trends in U.S. Term Loan B", 2 *The International Comparative Guide to Lending & Secured Finance 2014* 26 (2014).
2. *UPIC & Co. v. Kinder-Care Learning Ctrs*., 793 F. Supp. 448 (S.D.N.Y. 1992).
3. *YRC Worldwide Inc. v. Deutsche Bank Trust Co. Americas*, 2010 U.S. Dist. LEXIS 65878 (D. Kan. July 1, 2010).
4. *Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Corp.*, 2015 U.S. Dist. LEXIS 81395 (S.D.N.Y. June 23, 2015).
5. *Meehancombs Global Credit Opportunities Funds, LP v. Caesars Entm't Corp.*, 80 F. Supp. 3d 507 (S.D.N.Y. 2015).
6. At the time the bonds were issued, the parent did not guarantee the secured bank debt. However, as part of a later amendment to that credit agreement, a parent guarantee was put in place.
7. Holders of bank debt, however, have no TIA rights to appeal to, so their rights are governed exclusively by the contractual language of the relevant agreements. In response to these decisions, attempts have recently been made to introduce legislation in the United States Congress to amend and expressly narrow Section 316(b) to its understood meaning.
8. The "Administrative Agent" or "Trustee" will also typically act as "Collateral Agent" if the relevant financing is secured. For purposes of this article, references to "Administrative Agent" or "Trustee" include the collateral agent role. In addition, we use the term "Agent" rather than "Administrative Agent" for simplicity.
9. The indenture will also typically provide that the Trustee can refuse to take any action that, in the opinion of its counsel, would expose it to liability.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

10. As noted below, the Agent will typically be exculpated and be entitled to indemnification for any action taken with majority lender consent.
11. While this is also true for a Trustee, bank lenders are much better positioned to coordinate and communicate with each other than bondholders are, due largely to the existence of Intralinks and similar websites that facilitate lender communication. So it is more difficult to get a majority of noteholders to agree to anything, absent an express solicitation by the issuer.
12. It is worth noting that this issue is by no means limited to a restructuring context. For example, what if a borrower wanted to incur new term loans in a "plain-vanilla" exercise of the "incremental facilities" (or accordion) option that is common to many credit agreements, outside a restructuring context, in a transaction where the conditions to issuance were clearly met, but the Agent was directed by a majority of the lenders not to sign the relevant documentation? In such a case, it would seem that the borrower would have difficulty (or at least a delay) in getting the transaction executed. Do borrowers that have expressly bargained for the flexibility inherent in an accordion exercise (specifically, the right to NOT have to get the consent of the Required Lenders) really expect that the Required Lenders could nonetheless join together to frustrate that transaction? Litigation would almost certainly follow if such a situation was to arise, and the borrower might ultimately prevail. But we wonder whether borrowers in general understand that they are exposed to this potential hold-up risk merely because the Agent is required to perform what has generally been assumed to be the largely ministerial task of executing a joinder.
13. Bond indentures sometimes, but not always, have a "payment for consent" provision prohibiting non-*pro rata* payments in return for consents under an indenture. Such a provision is far more limited in application than a *pro rata* sharing provision as repurchases of notes do not necessarily involve solicitation of consents.
14. The provision goes on to set forth a few exceptions, none of which are relevant for our purposes.
15. One of our colleagues at Davis Polk has taken to referring to this view as the "shared taxicab model," i.e., we are all heading to the same destination and will get there (or not) at the same time and with the same economic return.
16. Rule 10b-5 under the United States Securities Exchange Act of 1934, as amended (the "Exchange Act"). Although other provisions of the Exchange Act can be relevant to questions of insider trading, 10b-5 is the centrepiece of the thinking and case law on the subject.
17. Note that the absence of 10b-5 liability does not mean absence from *all* liability. A buyer or seller of loans could still allege common law fraud, just to use the simplest example, against its counterparty.
18. *In re Wash. Mut., Inc.*, 442 B.R. 314 (Bankr. D. Del. 2011).

Acknowledgment

The authors would like to thank law clerk, Joseph Luizzi, for his contributions to this article.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Kenneth J. Steinberg
Davis Polk & Wardwell LLP
450 Lexington Avenue
New York, New York 10017
USA

Tel: +1 212 450 4566
Email: kenneth.steinberg@davispolk.com
URL: www.davispolk.com

Mr. Steinberg is a partner in Davis Polk's Corporate Department, practising in the Credit Group. He represents lenders and borrowers on a variety of credit transactions, including leveraged acquisition financings and asset-based financings.

In addition, he has substantial experience in both in-court and out-of-court restructuring and financing transactions, including debtor-in-possession financing and bankruptcy exit financings, representing both senior secured lenders and borrowers.

He joined Davis Polk in 2005 and became a partner in 2012. He is admitted to the bar of New York and U.S. District Court for the Southern District of New York.

Mr. Steinberg graduated, *summa cum laude*, from the University of Pennsylvania, The Wharton School, in 1987. He received his M.B.A. from Columbia Business School in 1992 and J.D., *summa cum laude*, from Fordham University School of Law in 2005.

Darren S. Klein
Davis Polk & Wardwell LLP
450 Lexington Avenue
New York, New York 10017
USA

Tel: +1 212 450 4725
Email: darren.klein@davispolk.com
URL: www.davispolk.com

Mr. Klein is an associate in Davis Polk's Corporate Department, practising in the Insolvency and Restructuring Group. He has substantial experience on a wide range of restructurings and bankruptcies, both in-court and out-of-court, representing lenders, investors and companies.

He joined Davis Polk in 2007. He is admitted to the bar of New York, U.S. District Court for the Eastern and Southern Districts of New York.

Mr. Klein graduated from the University of Michigan in 1999. He received his M.A. from the University of Michigan School of Business in 2000 and his J.D. from Harvard Law School in 2007.

Davis Polk

Davis Polk Credit Practice

We are among the world's most experienced law firms in advising banks and other financial institutions and borrowers on LBOs and other leveraged and investment-grade acquisition financings, structured financings, project financings, debt restructurings, bridge loans, recapitalisations and many other types of transactions involving the use of credit. We are also one of the leading advisers to banks providing debtor-in-possession, exit financings, rescue financings and other distressed or bankruptcy-related transactions in their various forms.

The Firm

Davis Polk & Wardwell LLP (including its associated entities) is a global law firm with offices strategically located in the world's key financial centres. For more than 160 years, our lawyers have advised industry-leading companies and global financial institutions on their most challenging legal and business matters. Our firm ranks among the world's preeminent law firms across the entire range of our practice.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Yankee Loans – “Lost in Translation” – a Look Back at Market Trends in 2015

White & Case LLP

Alan Rockwell

Martin Forbes

Introduction

This chapter takes a look at market trends for Yankee Loan issuance in 2015. “Yankee Loans” are US dollar denominated term loans that are syndicated in the US Term Loan B market to institutional investors and provided to European and Asian borrowers, based on New York law credit documentation.

Historically, European and Asian borrower groups sourced most of their financing needs through local European and Asian leveraged finance markets and would only seek to raise financing in the US leveraged finance market to match US dollar denominated financing against US dollar revenue streams or in certain more limited circumstances where there was insufficient liquidity in local markets to finance larger transactions.

Since the beginning of 2010, the depth and liquidity of the institutional investor base in the US Term Loan B market has proved at times to be an attractive alternative source of financing for some European and Asian borrower groups. It was a key source of financing liquidity to such borrowers in the early years following the 2008–2009 financial crisis, when financial conditions at the time in local markets affected availability of financing for borrowers in Europe and Asia. In more recent times, as local markets have continued to recover and the European Term Loan B market has started to develop, European and Asian borrowers have looked to tap US markets on a more opportunistic basis in a search for better pricing and terms (after factoring in currency hedging costs) in leveraged finance transactions, whether new acquisition financings, recapitalisations or repricings.

Market views on the outlook for Yankee Loans in 2016 continue to be varied but factors that will determine future issuance volume in 2016 and beyond will include supply/demand metrics in the US and European leveraged loan markets, the impact of regulatory oversight in both markets, whether US pricing rebounds to become more attractive again relative to pricing terms available from lenders in Europe and Asia, and whether the institutional investor base for European Term Loan B continues to increase in depth and liquidity, so that the European market gradually shifts away from the more traditional “buy and hold” approach from bank investors and moves towards a more liquid secondary trading market.

This chapter considers, firstly, some of the key structuring considerations for Yankee Loans. Secondly, it looks at how some differences get “lost in translation”, by comparing certain key provisions that differ between the US and European and Asian leveraged finance markets and exploring the differences that need to be taken into account for Yankee Loans, focusing on negative covenants, conditionality and transaction diligence.

A Look Back at 2015

The year 2015 was mixed for Yankee Loan issuance volume in the US loan markets. Overall, volume remained solid with 139 total Yankee Loans (including 42 Yankee Term B Loans and 6 Yankee Term A Loans). Of those deals, 32 Yankee Loans were done on a covenant-lite basis.[1] Yankee Loans were issued to borrowers in a broad number of non-US jurisdictions (including Australia, Austria, Belgium, the Czech Republic, France, Germany, Ireland, Luxembourg, the Netherlands, Switzerland and the United Kingdom).

However, as US loan market conditions started to deteriorate in the second half of 2015, the number of non-US issuers looking to tap capacity in the US loan markets dropped significantly, as those issuers looked to take advantage of better pricing and liquidity in their own local markets. Additionally, the convergence of terms on both sides of the Atlantic (as noted below in more detail) means that non-US borrowers (especially those based in Europe) are now increasingly able to negotiate for the inclusion of all or some of the more flexible US-style terms (in particular negative covenant flexibility) for European-based loan transactions.

Structuring Considerations

When looking at “Yankee Loan” deals, it is important to remember that there are a number of key structuring issues (driven primarily by location of the borrower(s) and guarantors) that need to be considered which may not apply in domestic US or in traditional European or Asian transactions.

(Re)structuring is key

The primary focus of senior secured lenders in any leveraged finance transaction is the ability to recover their investment in a default or restructuring scenario. The optimal capital structure minimises enforcement risk by ensuring that senior secured lenders have the ability to control the restructuring process, which is achieved differently in the US and in Europe and Asia.

Due to these differences, the US and European and Asian leveraged finance markets start from very different places when it comes to structuring leveraged finance transactions.

In the US, a typical restructuring in a leveraged finance transaction is usually accomplished through a Chapter 11 case under the US Bankruptcy Code, where the position of senior secured lenders as secured creditors is protected by well-established rights and processes. Chapter 11 allows senior secured lenders to cram down “out of the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

money" junior secured or unsecured creditors and release their debt claims, guarantee claims and security pursuant to a Bankruptcy Court-approved plan of reorganisation.

A Chapter 11 restructuring is a uniform, typically group-wide, court-led process where the aim is to obtain the greatest return by delivering the restructured business out of bankruptcy as a going concern. Bankruptcy petitions filed under Chapter 11 invoke an automatic stay prohibiting any creditor (importantly this includes trade creditors) from taking enforcement action which in terms of its practical effect has global application, because any person violating the automatic stay may be held in contempt of court by the applicable US Bankruptcy Court. The automatic stay protects the reorganisation process by preventing any creditor from taking enforcement action that could lead to a diminution in the value of the business. It is important to note that a Chapter 11 case binds all creditors of the given debtor (or group of debtors). Senior secured lenders retain control through this process as a result of their status as senior secured creditors holding senior secured claims on all (or substantially all) of the assets of a US borrower group.

By contrast, in Europe and Asia, it is more usual for a restructuring in a leveraged finance transaction to be accomplished through an out-of-court process;[2] this is typically achieved through enforcement of share pledge security to effect a transfer of equity interests of the top holding company of the borrower group and a sale of the business as a going concern, although in some situations restructurings can be achieved through a consensual out-of-court restructuring process without enforcing transaction security.

The reason for this is that placing a company into local insolvency proceedings in many European and Asian jurisdictions is often viewed very negatively as the option of last resort. Suppliers and customers typically view it as a precursor to the corporate collapse of the business and often there is no Chapter 11 equivalent restructuring process available in the applicable European or Asian jurisdiction(s). The result is that entering into local insolvency proceedings is usually value-destructive (in particular because of the lack of an automatic stay that binds trade creditors and, in some cases, because of a lack of clear procedures for cramming down junior creditors).

In order for senior secured lenders to retain control of a restructuring process in Europe or Asia, they traditionally rely on contractual tools contained in an intercreditor agreement (principally standstill and release provisions).

A standstill, which typically applies to junior creditors that are party to the intercreditor agreement, operates to limit or prohibit such junior creditors from enforcing their own security interests or forcing borrower groups into local insolvency proceedings. It allows senior secured lenders to control the reorganisation of the borrower group's obligations by being able to prevent junior creditors from obtaining leverage through threatening to force a borrower group into a value-destroying local insolvency proceeding and allows them time to implement a controlled disposal of the borrower group through enforcement of security.

Release provisions applicable upon a "distressed" disposal of the borrower group, i.e. upon a trigger event such as the occurrence of a continuing Event of Default or following an acceleration event, operate to allow senior secured lenders to sell a borrower group free of the claims of material junior creditors that are party to the intercreditor agreement outside of formal insolvency proceedings.

Either or both of these intercreditor provisions are designed to enable a borrower group to be sold as a going concern and, in connection with this, for the guarantee and security claims (and in some cases, the primary debt claims) of junior creditors against the borrower group entities that are sold to be released once the proceeds from such sale have been applied pursuant to the waterfall provisions of the intercreditor agreement. This practice has developed because, unlike the US Chapter 11 framework, there is no equivalent single insolvency regime that may be implemented across European or Asian jurisdictions. While the EC Regulation on Insolvency Proceedings provides a set of laws that promote the orderly administration of a European debtor with assets and operations in multiple EU jurisdictions, such laws do not include a concept of a "group" insolvency filing (and there is no equivalent law in Asia) and most European and Asian insolvency regimes (with limited exceptions) do not provide for an automatic stay on enforcement applicable to all creditors.

The important distinction to note is that while a Chapter 11 proceeding binds all of a borrower group's creditors, the provisions of the intercreditor agreement will only be binding on the creditors that are a party to it. Typically, these would be the primary creditors to the group (such as the providers of senior secured credit facilities, mezzanine or second lien facilities lenders and, in some instances, high-yield bondholders), but would not include trade and other non-finance creditors, nor would it include (unless execution of an intercreditor agreement is required as a condition to such debt being permitted) third party creditors of permitted debt (e.g. incremental equivalent debt or ratio debt). In view of that, consideration should be given to requiring the third party creditors of such debt to become bound by appropriate intercreditor arrangements for the benefit of senior secured lenders as a condition of incurrence.

Documentation

Historically, deals syndicated in the US leveraged loan market were those where the business or assets of the borrower's group were mainly in the US, albeit that some of the group may have been located in Europe, Asia or elsewhere, and these deals traditionally adopted the US approach to structuring: the loan documentation was typically New York law governed and assumed any restructuring would be effected in the US through Chapter 11 proceedings.

By contrast, historically, deals syndicated in the European or Asian leveraged loan market were those where the business or assets of the group were mainly in Europe or Asia, respectively, and these deals traditionally adopted a European or Asian approach to structuring: the loan documentation was typically English law governed, based on the LMA or APLMA form of senior facilities agreement, and provided contractual tools for an out-of-court restructuring in an intercreditor agreement (typically based on an LMA form).

US Term Loan B institutional investors are most familiar with, and typically expect, New York law and US market-style documentation. Therefore, most Yankee Loans are done using New York law documentation, which includes provisions in contemplation of a US Bankruptcy in the event of a reorganisation (including, for example, an automatic acceleration of loans and cancellation of commitments upon a US Bankruptcy filing due to the automatic stay applicable upon a US Bankruptcy filing).

However, while a European or Asian borrower group may be able to elect to reorganise itself pursuant to a US Bankruptcy proceeding (which would require only a minimum nexus with the US), most European and Asian borrower group restructurings have traditionally occurred outside of an insolvency process.

In light of this, to give senior secured lenders the ability to control the restructuring process in deals that involve European or Asian borrower groups, and protect their recoveries against competing creditors, a Yankee Loan done under New York law documentation should include the contractual "restructuring tools" typically found in a European or Asian-style intercreditor agreement, most

© Published and reproduced with kind permission by Global Legal Group Ltd, London

notably a release or transfer of claims upon a "distressed" disposal. Depending on the jurisdiction of the primary borrowers and material guarantors, consideration should also be given to inclusion of a standstill on enforcement actions applicable to junior creditors (which in many ways can be seen as a parallel to the automatic stay under the US Bankruptcy Code) to protect against a European or Asian borrower group's junior creditors accelerating their debt and forcing the borrower group into local insolvency proceedings.

Location of borrower and guarantors

Legal/structuring considerations

In US leveraged loan transactions, the most common US state of organisation of the borrower is Delaware, but the borrower could be organised in any state in the US without giving rise to material concerns to senior secured lenders. In Europe or Asia, however, there are a number of considerations which are of material importance to senior secured lenders when evaluating in which European or Asian jurisdiction a borrower should be organised and the credit support that can be provided by guarantors.

Borrower considerations

First, many European and Asian jurisdictions impose regulatory licensing requirements for lenders providing loans to borrowers organised in that jurisdiction. Second, withholding tax may be payable in respect of payments made by borrowers organised in many European or Asian jurisdictions to lenders located outside of the same jurisdiction (in particular, many "offshore" US Term Loan B investors are unable to lend directly to a borrowers located in certain European and Asian jurisdictions without triggering withholding tax or interest deductibility issues). Finally, some European and Asian jurisdictions may impose limits on the number of creditors of a particular nature that a borrower organised in that jurisdiction may have.

Comparing guarantees and collateral

<u>US</u>: The value of collateral and guarantees from borrowers and guarantors located in the US in leveraged loan transactions is generally not a source of material concern for senior secured lenders. The UCC provides for a relatively simple and inexpensive means of taking security over substantially all of the non-real property assets of a US entity and taking security over real estate assets is, generally, relatively straightforward and inexpensive. Furthermore, save for well understood fraudulent conveyance risks, upstream, cross-stream and downstream guarantees from US entities do not give rise to material concerns for senior secured lenders.

<u>Europe and Asia</u>: In contrast, there are very few European and Asian jurisdictions in which fully perfected security interests can be taken over substantially all of a company's non-real property assets with the ease or relative lack of expense afforded by the UCC and taking security over real estate assets is generally less straightforward and can often be very expensive. Furthermore, the value of upstream and cross-stream guarantees given by companies in many European and Asian jurisdictions is frequently limited as a matter of law (and in some cases, may be prohibited altogether). This can often mean that lenders do not get the benefit of a guarantee for either the full amount of their debt or the full value of the assets of the relevant guarantor. Some other factors which do not apply to US borrowers or guarantors also need to be taken into account for European and Asian borrowers and guarantors. Examples include: (1) in many jurisdictions, it is not practically possible to take security over certain types of assets, especially in favour of a syndicate of lenders which may change from time to time (if not from day to day); (2) in some jurisdictions, it is not possible to take both first-ranking and second-ranking security over the same asset (an issue in second lien financings); and (3) the US concept of excluding certain assets from the collateral package is not workable for certain types of "floating" security available in some European and Asian jurisdictions; instead, customary guaranty and security principles should operate in those jurisdictions to reflect local market requirements.

As a result, when structuring a Yankee Loan, significant consideration should be given to the jurisdiction of borrowers and guarantors to assess the quality and value of credit support and security that will be available.

In addition, to ensure that a European or Asian borrower group restructuring may be accomplished through the use of the relevant intercreditor provisions, it is important to determine an appropriate "single enforcement point" (SPE) in the group structure where a share pledge could be enforced quickly and efficiently, without interference by other creditors and stakeholders, in order to effect a sale of the whole group or business as a going concern. In this regard, the governing law of the share pledge and the jurisdiction of the relevant entity whose shares are to be sold should be considered to ensure that the distressed disposal provisions in a European or Asian intercreditor agreement may be fully taken advantage of (if needed). Particular attention should be paid to provisions which ensure that a senior secured lender can obtain financial information needed at the time of enforcement to produce any required market valuations.

Investor considerations

Many institutional investors in the US leveraged loan market (CLOs in particular) have investment criteria which govern what type of loans that they may participate in. These criteria usually include the jurisdiction of the borrower of the relevant loans, with larger availability or "baskets" for US borrower loans, and smaller "baskets" for non-US borrower loans. As a result, many recent Yankee Loans have included US co-borrowers in an effort to ensure that a maximum number of US Term Loan B institutional investors could participate in the financing. In deals where the US co-borrower will actually incur all or a portion of the relevant loans, careful consideration needs to be given to limitations that may affect joint and several liabilities between US co-borrowers and non-US co-borrowers. For example, the non US co-borrower may not legally be able to be fully liable for its US co-borrower's obligations due to cross-stream guarantee or upstream guarantee limitations. In addition, a US co-borrower may raise a number of tax structuring considerations, including a potential impact on the deductibility of interest, which should be carefully considered.

"Lost in Translation" – a Comparison of Key Terms

In addition to the well-known (if not always fully understood or appreciated) difference in drafting styles between New York leveraged loan credit agreements and European and Asian LMA and APLMA facility agreements, the substantive terms of loan documentation in the US and European and Asian markets have traditionally differed as well, with certain concepts moving across the Atlantic in either direction over time.

Since 2010, Yankee Loan deals have been responsible for a lot of increased flexibility for borrowers in a variety of forms moving (initially slowly; since 2015, much more rapidly) from the US market to the European market (and to a lesser extent the Asian market). These new, more flexible terms are now starting to gain far more widespread acceptance in European deals due to a number of factors, including "cross-pollination" (based on European sponsors now having more experience in raising financing in US markets and US sponsors continuing to import terms "across the pond") and the continued expansion of the European Term Loan B market.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

US covenant-lite *v.* European covenant-lite

Covenant-lite (US and Europe): Since 2010, the US leveraged loan market has seen the re-emergence of "covenant-lite" facilities and these facilities have, since the beginning of 2015, also become much more commonplace in the European leveraged loan market, with the development of European Term Loan B facilities.

Covenant-lite facilities accounted for 29%[3] market share of US leveraged loan issuance in 2015 (a significant drop from 2014) and 45%[4] market share of European leveraged loan issuance in 2015 (a significant increase from 2014).

In covenant-lite deals, term loans do not benefit from any maintenance financial covenant. Only the revolving facility benefits from a single maintenance financial covenant, normally a leverage-based ratio (and this only applies on a "springing" basis, i.e. at the end of a fiscal quarter, on a rolling LTM-basis, if utilisation exceeds a certain trigger percentage; at the time of writing, typically ranging between 25–35%).

More importantly, the negative covenant package for "covenant-lite" facilities is either fully or partially incurrence-based in nature, similar to what would commonly be found in a high-yield unsecured bond covenant package, reflecting the growing convergence between the Term Loan B and high-yield bond markets in both the US and Europe.

Incurrence-based covenants typically provide permissions (for example, to incur additional debt) subject to compliance with a specific financial ratio which is tested at the time of the specific event, rather than a maintenance financial covenant which would require continual compliance at all times, which traditionally has been required in secured senior bank loans by testing compliance against a projected business plan or base case financial model.

European covenant-loose: Traditionally, European leveraged loans were structured as full maintenance financial covenant deals (i.e. with the benefit of four maintenance financial covenants (leverage, interest cover, cashflow cover and capex) but the market in Europe has now evolved to the point where nearly every deal is being done on a "covenant-loose" basis with a reduced maintenance financial covenant package for the benefit of both terms loans and revolving facilities (either one or two covenants (always leverage, and sometimes interest cover) instead of the usual four).

Both "covenant-loose" deals and traditional deals are now increasingly following the approach in US and European covenant-lite deals with respect to increased negative covenant flexibility, although they typically do not include full US-style covenant-lite incurred-based flexibility.

Outlook

There are differences between the US and European and Asian loan markets that mean that for at least some deals, loan terms may never fully converge. The key reasons for this are (1) banks remain an important source of liquidity in several European jurisdictions and banks generally have not been willing to buy significant amounts of covenant-lite debt on a take and hold basis, and (2) some European jurisdictions have withholding tax or regulatory barriers that make it more difficult for debt to be syndicated to institutional investors (particularly institutional investors structured on the assumption that they will lend to US borrowers). While deals can often be structured to mitigate the second issue, we expect that the former issue will mean that some European borrowers agree to include maintenance financial covenants in transactions that would, if marketed in the US, be much more likely to be done on a covenant-lite basis.

In spite of this, over time there will continue to be more convergence between the US and European markets, because borrower groups will continue to seek to maximise terms flexibility through adoption of "best in class" on both sides of the Atlantic, and cross-pollination (i.e. the same underwriting banks and borrowers, and sometimes the same investors will already be familiar with concepts from US or European deals) will make it easier to import new terms into the respective leveraged loan markets. It will take longer for convergence to occur to the same degree with Asian markets (because of the smaller volume of Yankee Loan deal flow).

Issues to watch out for

When agreeing to increased flexibility in negative covenant packages in the case of a Yankee Loan provided to a European or Asian borrower group, senior secured lenders need to consider very carefully the impact of this when compared to similar flexibility in negative covenant packages provided in the case of a loan provided to a US borrower group because the result may be very different in a restructuring scenario for European or Asian borrower groups.

In particular, the following issues are worth noting:

Debt incurrence (including incremental or accordion baskets and ratio debt baskets)

In US leveraged loan deals, there is usually no hard cap on debt incurrence, i.e. an unlimited amount of additional debt can be raised subject to compliance with one or more different incurrence ratio tests.

Such debt may be equal ranking secured debt incurred pursuant to the credit agreement (as incremental debt), typically by the existing borrower(s) only.

It may also be incremental "equivalent" debt (relying on incremental basket capacity), "ratio" debt or, in some deals, acquisition debt, and such debt may be either senior secured debt (which can be in the form of senior secured notes or in some cases in the form of sidecar loans (the latter is typically subject to the same "MFN" protection as incremental debt, although certain "strong" borrowers negotiate for exceptions to this)) or junior secured, subordinated or unsecured debt. In each case, such debt is incurred outside of the credit agreement, which usually can be incurred by any "restricted" group member subject to a non-guarantor cap. More recently, some deals in the US market have added a further restriction that senior secured debt incurred in the form of senior notes must not be on terms that are functionally the equivalent of a Term Loan B bank loan, to avoid backdoor circumvention of MFN protection.

Debt incurrence flexibility works well in deals that only involve US borrowers/guarantors, because there is generally no material concern about being able to deal with junior secured creditors or unsecured creditors in a restructuring or bankruptcy context.

However, in deals that involve non-US borrowers/guarantors, if comparable debt incurrence flexibility is allowed, issues can arise due to the fact that guarantees provided by non-US entities may be subject to material legal limitations and/or prohibitions and because the collateral provided by non-US entities may be subject to material legal and/or practical limitations resulting in security over much less than "all assets" of the relevant non-US entity, leading to some unexpected results for senior secured lenders in a Yankee Loan deal.

Specifically, the claims of the creditors of such incremental, incremental equivalent or ratio debt, even if junior secured or unsecured, may rank equally, or in some cases even effectively senior, to the guarantee claims of the senior secured lenders who provided the main senior secured credit facilities.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

This may be because incremental, incremental equivalent or ratio debt is subject to less stringent guarantee limitations or prohibitions than the guarantee limitations or prohibitions applicable to the senior secured acquisition finance facilities incurred to pay for the acquisition of the applicable European or Asian borrower group or it may be because the transaction security provided by the applicable European or Asian borrower group is not fully comprehensive, resulting in a larger pool of unsecured assets, the value of which gets shared equally between senior secured creditors, junior secured creditors and unsecured creditors with equal ranking debt claims.

Additionally, for reasons detailed in the Structuring Considerations section above, in the event of a restructuring accomplished by means of a distressed disposal and release of claims, providers of incremental, incremental equivalent or ratio debt may not be subject to the contractual standstills or release provisions provided under a European or Asian intercreditor agreement.

This had led to an increasing number of European covenant-lite and covenant-loose transactions including provisions capping the amount of additional debt (especially unsecured debt) that can be incurred without the new creditors in respect of such additional debt entering into an intercreditor agreement with the agent for the senior secured lenders. Typically, borrowers will seek to agree the terms of such intercreditor agreement at the outset of the deal in order to avoid having to negotiate or obtain consent from senior secured lenders in order to incur junior secured debt or unsecured debt in the future. To an extent, this is continuation of a trend in the European market for transactions to include flexibility for several categories of potential future indebtedness in intercreditor agreements. The reason for doing this is to avoid senior secured lenders having a *de facto* consent right over future debt incurrence (if terms have not been agreed in advance, it is likely that obtaining such consent may be difficult in practice because of the detailed intercreditor provisions that are normally required in European loan transactions and the scope for resulting disagreement between different classes of creditors). In 2015, a small number of Yankee Loans started to follow the same approach. Given the general push back by US loan investors since the start of 2016 on more aggressive loan documentation terms, this may be one area where Yankee Loans start to follow the approach in European loan transactions more closely.

"Grower" baskets

It is now common to include "grower" baskets in both US and European deals (including Yankee Loans) set by reference to the greater of a fixed amount and either a percentage of Consolidated Total Assets (historically more common) or a percentage of Consolidated EBITDA (now becoming much more common in both US and European deals). These have tended to be more generous in US deals and are of particular relevance for intercompany transaction baskets – typically in US deals, unlimited intercompany transactions (investments and asset transfers) are permitted between borrowers/guarantors, but depending on the location of certain borrowers/guarantors (especially where either guarantee or security coverage may be weak), this may give rise to credit support value leakage concerns in Yankee Loan deals for European or Asian borrower groups.

The lack of any intercompany basket protection may also be of concern in Yankee Loan deals specifically in relation to "unrestricted" subsidiaries (a concept imported originally from high-yield bond deals and now routinely included in Term Loan B deals). The ability to designate "unrestricted" subsidiaries allows a borrower group to operate a portion of its business outside of the credit-support "ring-fence". The result is that such entities are not subject to any of the covenants or other provisions of the loan documentation and, correspondingly, their net income is not factored into any of the financial covenants or incurrence-condition testing of the "restricted" borrower group. This is problematic because third party creditors who lend money to such entities could potentially disrupt an out-of-court restructuring by senior secured creditors through security enforcement, by blocking a distressed disposal of the borrower group as a going concern through foreclosure or share pledge enforcement.

Finally, it is worth noting that historically, a "grower" did not apply to the "fixed" or "free and clear" components for Incremental debt baskets or Available Amount baskets but "strong" borrowers have successfully negotiated for this in some deals in both the US and Europe.

Investments and acquisitions

US deals now usually do not include a fixed cap (although some deals retain requirement for *pro forma* compliance with a financial ratio condition). However, it is still typical to include a non-guarantor cap (or in some deals a guarantor coverage test requirement, more similar to European or Asian deals, or a combination of the two concepts). In Yankee Loan deals with little or no US credit support, and weak guarantee/security credit support packages in non-US locations, this normally is the subject of far more detailed negotiation between lenders and borrowers, with tighter baskets and sometimes fixed caps in place of incurrence ratio conditions.

To enable borrower groups to undertake additional acquisitions on a "Sungard" or "certain funds" conditionality basis, while keeping in place their existing capital structure, the market is now seeing:

- Limited Conditionality Acquisitions (i.e. acquisitions that are not conditioned on obtaining financing) – satisfaction of conditions to acquisitions and other events occurring now tested at time of acquisition (including *pro forma* debt incurrence) – what happens in relation to additional *pro forma* incurrence testing with respect to other transactions in the time between the Limited Conditionality Acquisition test (if tested at signing) and the consummation of that acquisition remains subject to negotiation.
- Limits on requirements with respect to Event of Default blocker conditions or bring down of representation conditions.

This flexibility is now increasingly also being included in European and Asian deals.

"Available Amount" (or "Builder") basket for investments and acquisitions, restricted payments and restricted junior debt repayments

This basket builds with Consolidated Net Income (typically 50% CNI minus 100% losses) or a percentage of Retained Excess Cash Flow, plus certain equity contributions and returns on investments made using the Available Amount basket – this basket may be applied subject to certain Event of Default blocker conditions and subject to *pro forma* compliance with a leverage-based incurrence ratio condition (although leverage-based incurrence ratio condition protection may be limited, or even excluded, in some deals). Use of the basket is typically subject to an incurrence ratio condition for restricted payments (in some deals, restricted debt payments and investments benefit from the same condition) while the extent of Event of Default blocker conditions varies. However, market conditions in the US tightened significantly in Q1, 2016, with investors calling for more stringent restrictions and controls on

© Published and reproduced with kind permission by Global Legal Group Ltd, London

restricted payments to equity (prior to meaningful reduction of debt leverage). Historically, Available Amount/builder baskets were not common in European deals but they are now being included more frequently in European Term Loan B deals, with smaller fixed baskets and tighter financial ratio conditions.

Additional unlimited baskets for permitted investments and acquisitions, restricted payments and restricted debt repayments

These baskets allow for the application of unlimited amounts towards permitted acquisitions and investments, restricted payments and restricted debt payments subject to (in some cases) an Event of Default blocker condition and (in some cases) *pro forma* compliance with an incurrence ratio condition (the level typically varies in range from at least 0.5x inside to at least 2.0x inside closing date total net leverage, depending on the intended application/usage) rather than a fixed cap amount. These baskets have become fairly common in US covenant-lite deals (including Yankee Loan deals) but have yet to be seen with any frequency in European covenant-lite or covenant-loose deals or Asian syndicated deals.

Asset disposals

In US deals (including Yankee Loan deals), this is now commonly an unlimited basket, subject to no Event of Default blocker condition (although even this protection is excluded in some deals), and provided that 75% of consideration is cash (or designated non-cash consideration), sale is for fair market value and net sale proceeds are applied and/or reinvested in accordance with mandatory prepayment asset sale sweep provisions. By contrast, it is still more common in European and Asian deals to include some form of fixed cap, although European and Asian deals do tend to include more extensive basket carve-outs for certain identified assets (such as the sale of “non-core” assets following the acquisition of new businesses).

Conditionality

Documentation Principles v. Interim Facilities and “Full Docs”

In acquisition financing, the risk that the purchaser in a leveraged buyout will not reach agreement with its lenders prior to the closing of the acquisition (sometimes referred to as “documentation risk”) is generally not a material concern (or at least is a well understood and seen to be manageable concern) of sellers in private US transactions. Under New York law, there is a general duty to negotiate the terms of definitive documentation in good faith and US leveraged finance commitment documents also typically provide that the documents from an identified precedent transaction will be used as the basis for documenting the definitive credit documentation, with changes specified in the agreed term sheet, together with other specified parameters. These agreed criteria are generally referred to as “documentation principles” and give additional comfort to sellers in US transactions that the documentation risk is minimal.

In European and Asian deals, documentation risk is generally a much greater concern for sellers. This can be explained in part by the fact that there is no similar duty imposed to negotiate in good faith under English law, the typical governing law for European and Asian leveraged financings (and under English law, an agreement to agree is unenforceable). Therefore, to address seller concerns about documentation risk in European and Asian deals, lenders typically agree with purchasers to enter into fully negotiated definitive credit documentation prior to the submission of bids, or to execute a short-form interim facility agreement under which funding is guaranteed to take place in the event that the lenders and the borrower are unable to agree on definitive credit documentation in time for closing, with the form of the interim facility pre-agreed and attached as an appendix to the commitment documents (or in some more recent cases, actually executed at the time of bid submission).

Over time, it will be interesting to see if European sellers (and their advisors) become more comfortable with addressing documentation risk by relying on documentation principles, and follow the US practice for commitment documentation, given that the governing law of the finance documents, not the jurisdiction of the seller, is the key factor in evaluating documentation risk. However, until this point becomes more settled, consideration will need to be given to the appropriate form of financing documentation and the potential timing and cost implications that may arise as a result.

SunGard v. Certain Funds

Certainty of funding for leveraged acquisitions is a familiar topic in the US, Europe and Asia. It is customary for financing of private companies in Europe and Asia to be provided on a private “certain funds” basis, which limits the conditions to funding or “draw stops” that lenders may benefit from as conditions to the initial funding for an acquisition. Bidders and sellers alike want to ensure that, aside from documentation risk, there are minimal (and manageable) conditions precedent to funding at closing (with varying degrees of focus by the bidder or seller dependent on whether the acquisition agreement provides a “financing out” for the bidder – an ability to terminate the acquisition if the financing is not provided to the bidder).

Similar concerns exist in the US market, which has developed a comparable, although slightly different approach to “certain funds”. In the US market, these provisions are frequently referred to as “SunGard” provisions, named after the deal in which they first appeared.

In both cases, the guiding principle is that the conditions to the initial funding should be limited to those which are in the control of the bidder/borrower, but as expected, there are some familiar differences which are relevant to consider in the context of a Yankee Loan.

The first key difference is that in the US market, lenders typically benefit from a condition that no material adverse effect with respect to the target group has occurred. However, the test for whether a material adverse effect has occurred must match exactly that which is contained in the acquisition agreement. With this construct, the lenders’ condition is the same as that of the buyer; however, if the buyer did want to waive a breach of this condition, the lenders would typically need to consent to this. In European and Asian private “certain funds” deals, it is more customary for the lenders not to have material adverse effect condition protection (in contrast to US deals which still typically have such protection). However, lenders usually benefit from a consent right to any material changes or waivers with respect to the acquisition agreement, so if a European or Asian buyer wished to waive a material adverse effect condition that it had the benefit of in an acquisition agreement, it is likely that this would be an action that lenders would need to consent to.

The second key difference is that in the US market, lenders typically benefit from a condition that certain key “acquisition agreement representations” and certain key “specified representations”, in each case made with respect to the target, must be true and correct (usually in all material respects), although in the case of such “acquisition agreement representations” these must be consistent with the representations made by the target in the acquisition agreement and this condition is only violated if a breach of such “acquisition agreement representations” would give the buyer the ability to walk

© Published and reproduced with kind permission by Global Legal Group Ltd, London

away from the transaction. By contrast, in the European and Asian markets, no representations with respect to the target group generally need to be true and correct as a condition to the lenders' initial funding. The only representations which may provide a draw stop to the initial funding are typically core representations with respect to the bidder. Similar to the material adverse effect condition, while these appear different on their surface, in most European and Asian transactions if a representation made with respect to the target group in the acquisition agreement was not correct, and as a result the buyer had the ability to walk away from, or not complete, the transaction, waiver of this condition would likely require the consent of the lenders under a European or Asian "certain funds" deal.

Much like the comparison between documentation principles *v.* full documents (or an interim facility), a comparison between SunGard *v.* European "certain funds" reveals that despite technical differences, the substantive outcomes are similar. Yankee Loans continue to approach these issues on a case-by-case basis, with a roughly even split between the US and European approaches.

Diligence – reliance or non-reliance

Lenders in US leveraged finance transactions normally expect to perform their own commercial diligence with respect to a target group and expect their counsel to perform legal diligence with respect to the target group, based on a combination of a review of primary review of information available in a data room or a data site and, sometimes, a review of diligence reports prepared by the bidder's advisors and/or the seller's advisors, which are provided on a non-reliance basis only.

Lenders in European or Asian leveraged finance transactions normally expect to perform their own commercial diligence with respect to a target group but also typically perform their own legal diligence as well (sometimes, but less frequently, with the assistance of their counsel), and such review is normally limited to a review of diligence reports prepared by advisors to the bidder and/or the seller (with no separate review of data room or data site materials). However, European and Asian lenders typically do benefit from express reliance on these reports, which is also extended to lenders which become party to the financing in syndication. Borrowers familiar with the US market will often seek to provide reports on a non-reliance basis only, particularly in covenant-lite transactions. This is something that lenders need to consider carefully, because the underlying practice of lenders and their counsel undertaking detailed diligence rather than simply relying on reports is typically not duplicated outside the US.

In the context of a Yankee Loan, while the advisors to the bidder and/or seller may be willing to provide reliance on their reports for lenders, consideration will need to be given as to whether this is needed and/or desired. Lenders' expectations may also diverge in the context of a Yankee Loan which includes a revolving credit facility to be provided by European or Asian banks (likely relationship banks to the borrower or target group) as opposed to the US banks that initially arrange and underwrite the term loan facilities.

Conclusion

Ultimately, Yankee Loans can be viewed simply as US Term Loan B facilities provided by institutional investors to European or Asian borrower groups (as opposed to US borrower groups). However, because of the fundamental differences between the manner in which restructuring of a US borrower group and restructuring of a European or Asian borrower group would occur in a default situation and because of the "lost in translation" issues that have arisen and will continue to arise in the future (caused by differing market practices and the use of different terminology in New York law and English law transactions), greater care must be taken when structuring a Yankee Loan.

Endnotes

1. Source: Thompson Reuters Loan Connector, 2016.
2. While it is possible in certain European and Asian jurisdictions to restructure through court-controlled processes that achieve a result similar to a Chapter 11 case, this will depend entirely on the jurisdiction of the borrower(s) and material guarantors.
3. Source: Thompson Reuters Loan Connector, 2016.
4. Source: S&P Capital IQ, 2016.

Acknowledgment

The authors would like to thank Samantha Richardson, White & Case London, and Han Rhee and Christopher Cameron, White & Case New York, who helped with the research for this chapter.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Alan Rockwell
White & Case LLP
1155 Avenue of the Americas
New York, NY 10036-2787
USA

Tel: +1 212 819 7888
Email: arockwell@whitecase.com
URL: www.whitecase.com

Alan Rockwell is a partner in White & Case's Bank Finance practice, based in New York, having previously been based in London, and he is recognised as a leading practitioner in the Banking and Finance field by Chambers USA 2014. He is dual-qualified to advise on New York law and English law and has extensive experience in advising on cross-border Yankee Loan transactions syndicated in the New York, European and Asian leveraged loan markets, with a particular focus on representing and advising leading investment and commercial bank arrangers and underwriters.

His experience includes advising on secured lending and restructuring/workout transactions involving borrowers and guarantors in the US, Europe (including Luxembourg, Netherlands, France, Germany, Spain and the UK), Asia-Pacific (including Labuan, Hong Kong and Singapore) and Latin America, and he has acted on Yankee Loan deals for borrowers located in France, Germany, Labuan, Luxembourg, Norway, Spain and the UK.

Alan also has experience advising lenders, borrowers and financial sponsors in a wide range of other financing transactions, including investment grade and leveraged acquisition finance, bridge finance, refinancings, repricings, maturity extensions, debt buybacks, secured lending and restructuring/workout transactions under both New York law and English law.

Martin Forbes
White & Case LLP
5 Old Broad Street
London EC2N 1DW
United Kingdom

Tel: +44 20 7532 1229
Email: mforbes@whitecase.com
URL: www.whitecase.com

Martin Forbes is a partner in White & Case's Bank Finance practice, based in London. His practice focuses primarily on advising private equity sponsors, their portfolio companies and other borrowers. He also advises banks and alternative capital providers.

Educated in the UK and the United States, clients benefit from Martin's contribution to the Firm's leading US/European leveraged finance product platform. This combines sophisticated finance support with the English, US and local law capability already provided by the Firm in all the major jurisdictions in which investment and commercial banks conduct business and private equity firms invest or raise finance.

He has experience in advising both borrowers and lenders in relation to all major leveraged finance loan products, including bank and bond financings as well as leveraged loans. Martin has acted on transactions in every major European jurisdiction as well as in Asia and the United States.

WHITE & CASE

White & Case LLP is a leading global law firm with lawyers in 39 offices across 26 countries. Among the first US-based law firms to establish a truly global presence, we provide counsel and representation in virtually every area of law that affects cross-border business. Our clients value both the breadth of our global network and the depth of our US, English and local law capabilities in each of our regions and rely on us for their complex cross-border transactions, as well as their representation in arbitration and litigation proceedings.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Commercial Lending in the Developing Global Regulatory Environment: 2016 and Beyond

Bill Satchell

Elizabeth Leckie

Allen & Overy LLP

Concern about the slow pace of growth and the changing role of regulation with respect to the financial services sector is a continuing global theme and is likely to remain so for several years to come. Since the 2008 global financial crisis, global regulators have adopted a far more prescriptive approach to supervision and oversight, especially with respect to the largest organisations, including the adoption of a wide range of rules intended to mitigate systemic risk and end what some perceive as a "too big to fail" problem.

Banking regulators have made substantial progress in completing measures with respect to banking organisations, some of which, as they mature, are increasingly likely to impact overall lending activities in a negative manner. The increased role of asset managers in lending has not escaped notice by the Financial Stability Board or other regulators, although there is not a robust analytical framework for assessing or legal framework for addressing such risks. In a recent report, the International Monetary Fund observed:

> The IMF's tests found that the [U.S.] banking system is resilient to severe shocks, similar in magnitude to the 2008 crisis.
>
> The IMF staff's analysis also suggests that insurance companies, hedge funds, and other managed funds contribute to overall financial risks in an amount larger than suggested by their size, and therefore deserve greater attention.
>
> [O]fficials need to enhance stress tests of nonbanks, such as insurance companies, mutual funds, and pension funds. Improvements include undertaking both solvency and liquidity stress tests not only for banks but also for nonbanks; and examining spillover risks between nonbanks and banks.

While insurance companies, hedge funds and other management funds have historically been more effective than banks in resisting regulatory change, they face growing scrutiny from regulators and other policymakers persuaded of their own ability to better manage systemic risk through prescriptive technocratic measures, even if some of such measures may materially slow credit transmission or significantly amplify risk as a result of growing correlation of institutional behaviour in response to regulatory prescriptions.

In addition, in recent years the anti-bank sentiment which has inhibited the banking sectors response to regulatory pressures has gained momentum. Not only did popular antipathy towards the banking sector prompt what some perceived as the harsh measures in Dodd-Frank and the G-20 initiative to regulate banks more strictly, but it insulated U.S. bank regulators from criticism when they adopted measures more restrictive than those developed in coordination with their international brethren. Moreover, as was illustrated in the U.S. when Congress, looking for revenue to fund the Highway Trust Fund other than by spreading the cost to highway users by increasing the gas tax, filled the gap by raiding the dividends paid by Federal Reserve Banks to their largest bank members. There is a popular view that banks are deep pockets available to fund a variety of social objectives.

Even during the depths of the crisis, many failed to recognise the important part played by banks in transmitting credit to the larger economy, characterising as a bank bail-out measures designed to mitigate the liquidity crisis prompted by yet another collapse of the residential mortgage market that had a crippling effect on global credit markets. Even now, few seem to appreciate the critical role of banks and their securities affiliates in facilitating the flow of credit to retail and commercial markets and ensuring the funding of credit by suitable market participants, including those who lack the infrastructure to participate in credit origination.

While the data concerning the possible impact of regulatory and related initiatives on credit creation is insufficient to support definitive conclusions, even a superficial review of measures adopted globally in recent years is sufficient to raise questions about the possibility that regulators are at least contributing to the headwinds that have retarded or stalled post-crisis growth.

It is not as though credit markets are robust. Although the U.S. Treasury Department has resolutely disputed the contention that the Dodd-Frank Act has adversely affected securities market liquidity, earlier this year, the Treasury Department sought public views on market structure in response to the Joint Staff Report, The U.S. Treasury Market on October 15, 2014. This report studied sudden price swings that occurred on October 15, 2014, when yields fluctuated dramatically in a way that had only happened rarely before. The Treasury Department is seeking feedback that may help it to understand the evolution of the U.S. Treasury market and undoubted challenges resulting from market structure and liquidity pressures.

The Federal Reserve's January 2016 Senior Loan Officer Opinion Survey on Bank Lending Practices, which received responses from 73 U.S. domestic banks and 24 U.S. branches and agencies of foreign banks, suggested that, on balance, banks had tightened their standards on commercial and industrial (**C&I**) and commercial real estate (**CRE**) loans in the fourth quarter of 2015. Overall, banks indicated that they expected standards on all those loans to tighten over 2016 and loan performance of commercial and industrial loans to deteriorate over that same period.

Outstanding commercial paper, an important source of short-term funding to many of the most creditworthy businesses, is still less than two-thirds the level outstanding in 2001, and is even more significantly below immediate pre-crisis levels.

Moreover, bank lending has responded anaemically to the robust quantitative easing (**QE**) policies pursued by central banks. While QE injected liquidity into the financial system, a significant portion

© Published and reproduced with kind permission by Global Legal Group Ltd, London

of that additional liquidity actually returned to central banks' balance sheets in the form of excess reserves; in fact, money growth declined by some measures during the post-crisis period. There has been only limited lift to aggregate demand or investment rates in many developed countries. Between January 2000 and August 2008, the excess reserves of banks on the Federal Reserve's balance sheet averaged $1.8 billion. The total volume of excess reserves in the Federal Reserve reached $1 trillion by November 2009. As of October 2015, the Federal Reserve was holding excess reserves of $2.6 trillion, nearly 75 per cent of total assets purchased by the Federal Reerve since the onset of the financial crisis. This reflects that U.S. banks are keeping much of their cash with the Federal Reserve instead of devoting it to increased lending. This appears to be consistent with the conclusions drawn in other markets in which QE is perceived to have had little impact on bank lending, signifying a marked weakening in the role of banks in transmitting credit into broader markets.

Securitisation activity is also very weak. By transforming illiquid credit exposures into liquid traded securities, securitisation reduces banks' liquidity risk, expands opportunities for bank portfolio diversification, and facilitates the shift from depositors to the broader capital markets. By enhancing the ability of banks to originate such credit exposures, securitisation reduces borrowing costs and provides improved credit access to borrowers. By 2005, the U.S. market for asset-backed securities had grown to almost $2 trillion. In the U.S., private mortgage securitisation activity in the U.S. still has not recovered and, accordingly, Fannie Mae, Freddie Mac and Ginnie Mae dominate residential mortgage securitisation – and the future of both Fannie Mae and Freddie Mac remains uncertain. New issuances of U.S. CLOs, an important vehicle for spreading risk with respect to commercial loans, have halved from 2014 levels. In Europe, total securitisation issuance declined to a 10-year low in 2013, more than 40 percent below the post-1999 average. At the same time that the Europe's banking system has faced considerable pressure to deleverage, tight credit conditions have hampered the recovery of the European economy, particularly affecting small and medium enterprises. Much of the issuance in Europe since the crisis has been retained by issuing banks for the primary purpose of using it as collateral with central banks. Pronounced declines have been recorded in residential and commercial mortgage-backed securities, and collateralised debt obligations. Although European asset-backed securities volumes have recovered back to or above long-term averages, these product types have historically accounted for only a comparatively small part of the European securitisation market.

Global growth remained moderate in 2015, decidedly more so than projected at the beginning of the year. Although country-specific shocks and developments play a role, the modest pace of recovery in advanced economies and persistent growth declines in emerging markets suggest that structural forces are in play. These include low productivity growth, high public and private debt, financial sector weakness, low investment, demographic transitions in many economies, a major realignment in China – with important cross-border repercussions – and a downturn in commodity prices triggered by weaker demand as well as higher production capacity.

Viewed from the beginning of 2016, the economic prospects are modest at best. Such prospects are deeply shadowed by growing political uncertainty and the emergence of radical populism in many of the developed and developing economies, as well as growing political and religious violence; these mark, by some lights, the vanguard of even more pronounced global instability.

Challenges for Lending Advocacy

The Wall Street stigma has proved an ongoing challenge to those who are advocates of the importance of the credit transmission role played by banks, securities firms and securitisation. Efforts to bring light to the debates over such initiatives as FATCA, the Interagency Leveraged Lending Guidance, the Volcker Rule, the risk retention rule and other regulatory measures affecting lending have garnered a less profound response than the gravity of the issues or the complexity of the merits warranted. Instead, too much deference has been accorded to what may well prove quixotic – or at least misguided – efforts to eliminate the risk of financial crises or end "too big to fail". As is evident from the most recent global financial challenges and alternative narratives concerning the sources of the 2008 financial crisis, market failures often derive, at least in part, from failures of governance that demonstrate the folly of over-reliance on regulation as proof against future failures.

Regulatory Change

While the links between reduced credit intermediation and regulatory change are difficult to validate, the change in the regulatory sphere has been prodigious, and its main themes echo around the world, as the brief summary below demonstrates.

Basel III

Capital

In December 2010, the Basel Committee on Banking Supervision released Basel III, which set higher levels for capital requirements and introduced a new global liquidity framework. Subject to transitional and phase-in arrangements, it was contemplated that it would be implemented from January 2013. Significant elements included a capital conservation buffer, a countercyclical buffer, a standardised approach to measuring counterparty credit risk exposures, and a securitisation approach to strengthen the capital standards for securitisation exposures held by banks.

Liquidity and Leverage Ratios

In January 2013, the Basel Committee issued a revised liquidity coverage ratio, which required banking organisations to hold specified levels of high-quality liquid assets (**HQLA**) against liquidity exposures, a measure that potentially curbed the liquidity transformation role of banking organisations and potentially put more pressure on covered banks to categorise facilities and price them according to the bucket in which they fall. In some transactions, the purpose clause in loan documents is likely to become much more important, for example in showing that a revolving facility is not intended to be used as a liquidity facility

In January 2014, the BCBS issued the Basel III leverage ratio framework, which requires institutions to comply with an overall requirement on the ratio of assets (as well as certain off-balance sheet exposures) to capital. In contrast to core capital ratios, which focus on the risk weighting of assets, the leverage ratio makes no distinction based on credit quality and, accordingly, can make high-quality assets comparatively a constraint on overall leverage.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Net Stable Funding Ratio

In October 2014, the Basel Committee issued the final standard for the Net Stable Funding Ratio (**NSFR**). This measure will require that assets that cannot be liquidated in less than a year must be backed by stable funding, requiring banks to become more disciplined in matched funding. This is likely to affect the ability of banks to offer long-term facilities.

Implementation

While regulatorily prescribed requirements will undoubtedly enhance the safety of the sector, the impact of such changes on the ability of the banking sector to perform its traditional roles of risk and maturity intermediation is less certain. Rather than proceeding incrementally on a basis consistent with the principle of countercyclicality, regulators have elected for a full implementation of such new requirements, even as their respective economies struggle to achieve robust employment and earnings growth.

Risk-Weighted Assets

Although the framework for determining required capital has changed little from Basel II framework, the underlying constituents have been tightened. The requirements for qualifying capital have become more challenging, risk weightings have increased and the required composite ratios have increased. The resulting increase in the amount of capital is intended to serve as a shock absorber allowing banks to better weather economic downturns. A bank with insufficient capital is a bank that cannot lend. A bank with more capital will have relatively lower returns on equity and face greater challenges in raising additional capital.

The amended capital requirements across the G20 countries have required affected institutions to increase substantially the quality and quantity of their existing capital reserves. The rules also force affected institutions to assess counterparty credit and the character of exposures with much greater caution, with nearly inevitable consequences for lending activities.

Supplementary Leverage Ratio

Beginning January 1, 2018, banks in the U.S. and Europe must maintain a minimum ratio of Bank tier 1 capital to total leverage exposure (such supplementary leverage ratio is referred to as the **SLR**) of 3%. The principal distinction between the capital ratio and the SLR is that no risk weighting is applied to assets in the case of the SLR. Moreover, off-balance sheet exposures, such as commitments, guarantees and commitments will be treated similarly to direct exposures.

In the case of the most significant U.S. banks, the U.S. regulators have adopted an "enhanced" SLR for any U.S. top-tier bank holding company with more than $700 billion in total consolidated assets or more than $10 trillion in assets under custody and its insured depository institution subsidiaries. There are currently eight U.S. bank holding companies – all systemically important financial institutions – covered by the requirement. Under the enhanced SLR, a covered bank holding company must have an enhanced SLR exceeding 5% – comprised of the 3% minimum SLR applicable to all advanced approaches banking organisations and an additional 2% leverage buffer – to avoid limitations on capital distributions and discretionary bonuses. The enhancement addresses the concerns of U.S. regulators that the 3% minimum SLR for global institutions under the international Basel III accord is not adequate.

As was noted by commenters at the time of its proposal by U.S. regulators, the SLR to some extent intersects with requirements under the liquidity coverage ratios discussed below and other initiatives, observing that the inclusion of high-quality liquid assets in total leverage exposure put pressure on these other requirements. Commenters also pointed out that the measure potentially penalised core aspects of the custody bank business model, including the intermediation of high-volume, low-risk, low-return financial activities and broad reliance on essentially riskless assets, notably central bank deposits.

The response of the U.S. regulators answering these concerns, while marginally harsher than that of other global requlators, is illustrative of the shared global approach. They answered most of these concerns by noting that there are actions a banking organisation could take to address a shortfall in high-quality liquid assets, such as reducing short-term funding sources or off-balance sheet requirements that would not necessarily increase a firm's capital requirement under the SLR. The regulators also dismissed arguments to exclude certain low-risk assets, such as cash, central bank deposits, or sovereign securities from total leverage exposure, stating their belief that such exclusions would be inconsistent with the broad goal of limiting leverage. The SLR would also include cash collateral received in derivative transactions, even if required to be segregated or not available to be netted against derivative exposures. This response specifically acknowledges that the purpose of the rules is to reduce the role of banks in risk or term intermediation.

Liquidity

The liquidity coverage ratio rule (**LCR Rule**) requires covered institutions to maintain a minimum ratio of specified "high-quality liquid assets" (**HQLA**) (*e.g.*, high-quality deposits, government securities) to the institution's "total net cash outflows" over a 30-calendar day period designed to be available during a periods of extreme financial stress. HQLA buffers must be maintained at all times, with the result that exposures associated with relatively high cash outflow rates become comparatively expensive.

The rationale for the LCR Rule is relatively simple, although the consequences may be complex. U.S. federal banking agencies view certain types of funding as particularly prone to being withdrawn or withheld in the event of significant financial distress. Consequently, the "outflow rate" under the LCR Rule for certain such funding sources is as high as 100% for a given calculation date. This means that a covered entity is required to assume that the entire amount of the funding in question will be drawn or withdrawn over the course of 30 calendar days, and the organisation must have assets that it can reliably liquidate to fund the draw or withdrawal and its other requirements for cash without suffering material financial distress (such as refusing to roll over or make new extensions of credit or by disposing of assets in a "fire sale"). The higher the assumed outflow rate for a class of obligations, and the higher the amount of such obligations held by a covered entity during a given calculation period, the higher the denominator will be for the ratio above, and the larger the stock of HQLA that the covered entity must hold against the class of obligations to comply with the rule. Ergo, commercial lending, which is not a category of HQLA, may be significantly impacted by implementation of the LCR Rule.

The agencies are also concerned that counterparties that are "financial sector entities" and their consolidated subsidiaries may entail greater risk. A "financial sector entity" includes an investment adviser, investment company, pension fund, non-regulated fund, regulated financial company, or identified company. Of particular note are "non-regulated funds" and "regulated financial companies".

© Published and reproduced with kind permission by Global Legal Group Ltd, London

"Non-regulated funds" means any hedge fund or private equity fund whose investment adviser is required to file SEC Form PF (Reporting Form for Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors), other than an SBIC. The agencies specifically altered this definition from what was set forth in the proposed regulation to eliminate "consolidated subsidiaries" of private funds, which would have captured portfolio companies of private equity that are not independently engaged in financial activities. While the cash outflow rate provisions specifically include consolidated subsidiaries of all financial sector entities, these provisions are probably best construed to exclude non-financial consolidated subsidiaries of non-regulated funds.

Based on these distinctions, the agencies adopted the "cash outflow rates" which vary between 10% and 100% with respect to liquidity and credit facilities. For this purpose, the undrawn amount of a committed credit facility or committed liquidity facility is the entire unused amount of the facility that could be drawn upon within 30 calendar days of the calculation date under the governing agreement, less the amount of certain highly liquid assets.

The LCR requirements will have a significant impact on bank lenders in respect of committed undrawn facilities, since these will be required to be backed with liquid assets. Under historic rules, banks were only required to hold sufficient assets to fund likely outflows as assessed by the bank in the circumstances.

Because liquid assets tend to be low-yielding, the maintenance of HQLA is likely to increase costs. Moreover, because loans are not eligible for inclusion as HQLA, but certain corporate bonds may (albeit subject to haircuts), with the effect that corporate bonds become a relatively more attractive income source than corporate loans.

Volcker Rule

The Volcker Rule has no international counterpart, but applies, in addition to U.S. bank holding companies, to both domestic and international (albeit to a limited extent) activities of foreign banks that have branches, agencies, commercial lending subsidiaries or bank subsidiaries in the U.S. The Volcker Rule sharply limits most kinds of proprietary trading and affiliation with private funds by U.S. banking organisations. The Volcker Rule was intended to, and has, caused bank to retreat from or reduce many dealing activities in many securities markets. Indeed, the undoubted complexity of compliance has likely caused a retrenchment even in some markets that are still technically permitted. Despite assertions to the contrary by senior governmental officials, some have argued that resulting declines in liquidity and greater perceived regulatory uncertainty will confront market participants with higher costs of capital and resulting reductions in aggregate investment.

Although the Volcker Rule permits banks to continue to invest in CLOs that only invest in loans, the Volcker Rule – together with the other rules described above and below – have sharply limited the ability of banks to organise or invest in vehicle designed to hold and spread credit risk.

Risk Retention

The credit risk retention rule requires originators or sponsors of asset-backed securities (**ABS**) to retain risk with respect to securitisations. The rule recognises the moral hazard associated with originating assets and securitising them, and seeks to align the interests of sponsors or originators and investors. Sponsors or originators are required to retain risk as either an eligible horizontal retained interest (i.e., retaining the most subordinate 5% of the securitisation vehicle), an eligible vertical interest (i.e., retaining a 5% slice of each tranche), or a composite vertical/horizontal interest. Retained interests – particularly horizontal interests (such as an equity tranche) – would be particularly costly in capital terms for banks as a result of provisions that (particularly under U.S. rules) penalise the holding of equity.

The objective of the credit risk retention rule is to ensure appropriate alignment of the interests of originators with respect to assets underlying securitisations.

Qualified Residential Mortgages (**QRM**) securitisations (tied to the definition of QRM to the Consumer Finance Protection Bureau's definition of Qualified Mortgage (**QM**)) and Fannie Mae, Freddie Mac or Ginnie Mae securitisations are exempt. CLOs are covered, even when the sponsor had no role in originating the underlying credits and instead selects them in the open market, a measure that is thought to be adversely impacting new CLO offerings.

Conclusion

The year 2015 was characterised by emerging global uncertainties in Asia, Europe and among the less developed economies, low oil and commodities prices, and stuttering U.S. growth. Despite these challenges and the danger of reinforcing cyclical weaknesses, the resolve of the financial institution regulators to complete their implementation of the G20 and Dodd-Frank agendas remains undimmed. Indeed, many remain ambitious to implement a strategy designed to curb the shadow banking sector notwithstanding substantial political challenges and uncertainty as to what tools might be most suited to that purpose.

At the same time, it seems likely that during 2016 many banking organisations will be focused on fine-tuning their infrastructure for compliance with the new regulatory framework, as well as continuing to reinforce capital reserves to meet enhanced requirements. Many will also be distracted by growing supervisory and business concerns with cybersecurity and the necessity of complying with resolution-related rules. It seems unlikely given these multiple challenges that it would be reasonable to look for robust growth in loan volumes or improving performance of outstanding credits. At best, the year seems likely to mark a period during which market participants will respond defensively to these regulatory constraints and market pressures.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Bill Satchell
Allen & Overy LLP
1101 New York Avenue, NW
Washington, DC, 20005
United States

Tel: +1 202 683 3860
Email: bill.satchell@allenovery.com
URL: www.allenovery.com

Bill is a member of the global Financial Services Regulatory practice and has nearly 30 years of experience representing financial services organisations – particularly banks – across a wide range of regulatory issues. These have included advising banking organisations on structure and powers issues under the National Bank Act, the Bank Holding Company Act, the Federal Reserve Act and the International Banking Act. He has also worked in the bank mergers and acquisition area, representing banking organisations in the acquisition of, or investment in, banking and nonbank organisations. He advises domestic and foreign banking organisations in connection with compliance and enforcement issues related to many kinds of activities, including lending, fiduciary, securities processing, custody and mortgage servicing businesses.

Elizabeth Leckie
Allen & Overy LLP
1221 Avenue of the Americas
New York, NY 10020
United States

Tel: +1 212 610 6317
Email: elizabeth.leckie@allenovery.com
URL: www.allenovery.com

Elizabeth specialises in U.S. finance and restructuring with over 25 years of experience on a broad range of finance transactions for financial institutions and corporations through all phases from origination through workout, restructuring and bankruptcy. Her experience covers syndicated secured and unsecured lending, asset-based lending, acquisition finance, subordinated debt, structured finance, letters of credit and other bank finance transactions. She has experience with a number of industries and specialises in cross-border issues.

Elizabeth is a frequent speaker on cross-border financings and the U.S. loan market at industry events, and she was recently elected as a Fellow of the American College of Commercial Finance Lawyers (ACCFL).

ALLEN & OVERY

With over 1,000 specialist lawyers worldwide, Allen & Overy has one of the largest and most international teams of banking and finance lawyers of any global law firm. Few practices can match our top-tier position across the full range of financial products. With such a deep team and global reach, international and industry-leading 'first-of-a-kind' transactions are our hallmark. We have been instrumental in nearly all the major developments in the modern financial markets. Renowned for our intellectual rigour, our banking and finance lawyers draw on deep product expertise and regularly work alongside our regulatory, litigation, restructuring and other specialists – particularly important in light of recent market conditions – to develop innovative solutions for our clients, often incorporating complex financing techniques that lead the industry. That is why over 800 corporate and financial institution participants in the financial markets entrust us with the full range of their domestic and cross-border transactions.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Acquisition Financing in the United States: Will the Boom Continue?

Geoffrey R. Peck

Morrison & Foerster LLP

Mark S. Wojciechowski

Global M&A hit a new high in 2015 with roughly $5 trillion of M&A deals struck. Deal volumes in North America surged, with strong growth in the Asia-Pacific and Middle East regions. Europe saw moderate growth, with Latin America being the only area with less deal volume than 2014.

Mega deals drove aggregate deal volumes, including Pfizer's announced $160 billion merger with Allergan, AB InBev's $107 billion acquisition of SAB Miller, and Kraft Food's $55 billion merger with Heinz. While in 2015 deals were seen across all industries, consumer, energy, TMT and healthcare were particularly active. Cross-border deal flow continued to be strong.

For deals with debt financing, banks were the dominant providers of loans. Yet non-banks were strong in middle market M&A financings, where many deals were structured as unitranche.

Indicators suggest that the boom should continue in 2016. Private equity firms and corporations continue to have large amounts of cash on hand. Many industries, such as a healthcare and energy, continue to be ripe for consolidation. Mega deals should continue to be struck, including tax inversion deals.

Yet there are factors that warrant caution including: choppy economic markets; China's economy; falling oil prices; continued talk of Britain leaving the European Union; and the uncertainties of a volatile U.S. presidential election.

Regardless of 2016 M&A volume, the need for acquisition financing will continue to be strong. It is important to review the fundamentals of U.S. acquisition financing using secured loans and monitor trends in this regularly changing area of financing.

The Commitment Letter is Key

The commitment letter for a financing sets forth the material terms of the lenders' obligations to fund the loans and the conditions precedent to such obligations. Obtaining a suitable commitment letter from one or more lenders is of particular importance to acquisition financing and can be the deciding factor as to whether a seller will sign an acquisition agreement with a particular buyer where the buyer cannot otherwise prove itself able to fund the acquisition from its own funds. As in all committed financings, the borrower wants an enforceable commitment from its lenders which obligates the lenders to extend the loans, subject to certain conditions that have been mutually agreed upon. In acquisition financing, where the proceeds of the loans will be used by the borrower to pay the purchase price for the target company, in whole or in part, the seller will also be concerned whether the buyer has strong funding commitments from its lenders. If the buyer's lenders do not fund the loans, a failed acquisition could result.

In a typical timeline of an acquisition, especially one involving public companies, the buyer and seller execute the definitive agreement for the acquisition weeks, if not months, in advance of the acquisition. Following execution, the buyer and seller work to obtain regulatory approvals and other third-party consents that may be needed to consummate the acquisition, execute a tender offer if required, complete remaining due diligence, finalise the financing documentation and take other required actions. Signing an acquisition agreement often results in the seller not pursuing other potential buyers for a period of time while the parties work to complete the items noted in the prior sentence. For example, acquisition agreements routinely contain covenants forbidding the seller from soliciting or otherwise facilitating other bids and requiring the parties to work diligently towards closing. Further, many acquisition agreements either do not give the buyer a right to terminate the agreement if its financing falls through (known as a "financing-out" provision), or require a substantial penalty payment to be made by the buyer if the transaction fails to proceed, including as a result of the financing falling through (known as a "reverse break-up fee"). Accordingly, at the signing of the acquisition agreement, and as consideration for the buyer's efforts and costs to close the acquisition, the buyer will want the lenders to have strong contractual obligations to fund the loans needed to close the acquisition.

Who Drafts the Commitment Letter?

Private equity funds (also known as sponsors) are some of the most active participants in M&A transactions and related financings. With their sizeable volumes of business that can be offered to banks, sponsors often have greater leverage in negotiations with lenders than non-sponsor-owned companies. Sponsors and their advisors monitor acquisition financings in the market and insist that their deals have the same, if not better, terms. As economic tides shift, the ability of sponsors to leverage their large books of banking business grows and wanes, and the favourability for sponsors of acquisition financing terms shift as well.

Who drafts the commitment papers is one area where sponsors are often treated more favourably than other borrowers. While lenders in most cases expect to draft commitment papers, the larger sponsors are now regularly preparing their own forms of commitment papers and requiring the lenders to use them. From the sponsors' perspective, controlling the drafts can result in standardised commitment letters across deals, and a more efficient and quick process to finalise commitment letters. To get the best terms, the sponsors often simultaneously negotiate with a number of potential lenders and then award the lead role in an acquisition financing to the lender willing to accept the most sponsor-favourable terms.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Conditionality

The buyer's need for certainty of funds to pay the purchase price puts sharp focus on the conditions that must be met before the lenders are contractually obligated to fund the loans. As a result, a buyer has a strong preference to limit the number of conditions precedent in a commitment letter, and to make sure that the commitment letter is explicit as to the included conditions, in order to enhance funding certainty. The buyer and seller want to avoid a scenario where the conditions precedent to the buyer's obligation to close the acquisition have been met but the lenders' obligation to fund the loans have not. Particularly in the scenario where no financing-out clause is included in the acquisition agreement, if the acquisition financing falls through because the buyer cannot satisfy the conditions in the commitment letter, the buyer may not be able to close the acquisition and could be required to pay the seller sizeable contractual break-up fees and be subject to lawsuits from the seller. Certain conditions discussed below are commonly subject to heavy negotiation in an acquisition financing.

Conditions Precedent, Covenants and Defaults

Commitment letters for general financings often contain vague and partial lists of documents and conditions that the lenders will require before funding the loans. Phrases like "customary conditions precedent" are often seen. In contrast, a commitment letter for an acquisition financing typically has an explicit, detailed and often lengthy list of conditions.

If the lenders are permitted to require satisfaction of conditions precedent to funding that are not expressly set forth in the signed commitment letter (whether customary conditions or not), this increases the risk to the borrower that these additional conditions cannot be met. It is common in an acquisition financing to see an express statement from the lenders that the list of conditions precedent in the commitment letter are the only conditions that will be required for funding. In some cases, the list of conditions precedent in commitment letters for acquisition finance are so detailed that they are copied directly into the final forms of loan agreements.

Similarly, vague references to "customary covenants" and "customary events of default" in a commitment letter present similar risks, particularly the proposed inclusion of unreasonable provisions which could not be met by the borrower. To limit this risk, commitment letters for acquisition financings often include fully negotiated covenant and default packages (which may include pages of detailed definitions to be used in calculation of any financial covenants).

Form of Loan Documents

Some sponsors even require that the form of the loan agreement be consistent with "sponsor precedent", meaning that the loan documentation from the sponsor's prior acquisition financing will be used as a model for the new financing. Agreeing to use or be guided by "sponsor precedent" limits the risk to the sponsor that the financing will be delayed or not close because the lender and its counsel produce a draft loan agreement with unexpected terms and provisions.

Many acquisition financings, particularly in the middle market, involve multiple classes of loans with complex intercreditor arrangements. These financings include 1st/2nd lien, split-collateral, *pari passu* collateral, subordinated, holdco and unitranche financings. In complex and technical intercreditor agreements, lenders agree on many issues relating to their respective classes of loans, including priority of liens, priority of debt, control of remedies and certain technical bankruptcy issues. Negotiation of these agreements among different classes of creditors can be lengthy and frustrate closing time frames. As middle market M&A continues to grow, and more deals have complex intercreditor arrangements, some sponsors are also requiring lenders to use a specified form of intercreditor agreement.

Representations and Warranties

Loan agreements typically require that the included representations and warranties be accurate as a condition to funding. Lenders financing the acquisition also want the representations with respect to the target in the acquisition agreement to be accurate. This is reasonable because after consummation of the acquisition, the target is likely to be obligated on the loans (either as the borrower or a guarantor) and thus part of the credit against which the lenders are funding.

"SunGard" (named for an acquisition financing that included these terms) or "certain funds" provisions are now common in commitment letters for acquisition financings. These clauses are relevant to several provisions in a typical commitment letter. With respect to representations and warranties, these clauses provide that on the closing date of the loan, as a condition to the lenders' funding obligations, only certain representations need to be accurate. Strong sponsors even negotiate the precise meaning of the term "accurate". The representations required to be accurate as a condition to the lenders' funding obligation in a typical SunGard clause include the following:

- The only representations and warranties relating to the target are those that, were they untrue, would be material to the lenders and for which the buyer has a right under the acquisition agreement to decline to close the acquisition. While providing certainty of funding, this standard avoids a scenario where the loan agreement has different representations with respect to the target than the acquisition agreement.
- Only certain representations with respect to the borrower set forth in the loan agreement must be accurate (the "specified representations"). These can include those with respect to corporate existence, power and authority to enter into the financing, enforceability of the loan documents, margin regulations, no conflicts with law or other contracts, solvency, status of liens (see below regarding this topic) and certain anti-terrorism and money laundering laws. A financial covenant could also be included as a specified representation in some deals. What are included as specified representations change with changing economic conditions and relative bargaining strength of companies and sponsors. As financial markets have improved and the leverage of sponsors has increased, the typical list of specified representations has shrunk and may well continue to weaken, benefitting sponsors.

These are the only representations applicable as conditions precedent to the initial funding of the loans. Even if the other representations in the loan agreement could not be truthfully made at the time of the initial funding, the lenders nonetheless are contractually obligated to fund the loans.

Company MAC

Company material adverse change (MAC), sometimes referred to as a "company MAC" or a "business MAC", is a type of representation included in some acquisition agreements and loan agreements. This is a representation that no material adverse change in the business of the target has occurred. Inability to make the representations in the acquisition agreement typically permits the buyer to terminate the acquisition agreement and in the loan agreement it excuses the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

lenders from their funding obligations. A customary MAC definition in an acquisition agreement differs from that in a loan agreement. Acquisition agreement MAC clauses are often more limited in scope and time frame covered, and have more exceptions (including for general market and economic conditions impacting the target). Like other representations, buyers and sellers often require that the MAC definition in loan agreements mirror the definition in acquisition agreements, but solely for purposes of the initial funding of the acquisition loans (and not for ongoing draws under a working capital revolver or a delayed draw term loan, for instance).

Market MAC and Flex

"Market MAC" is another type of MAC representation in some commitment letters. Seen more in economic down-cycles, these clauses allow the lenders to terminate their commitments if there has been a material adverse change in the loan and syndication markets generally. Strong borrowers and sponsors have had success with excluding these clauses in their commitment letters over the last several years as the economy has continued to improve.

As discussed above, the time between signing the commitment letter, on one hand, and closing the acquisition and funding the loans on the other, is often a lengthy period. Lenders whose commitment letters do not have a market MAC, especially those lenders who fully underwrite the commitments, are subject to deteriorating financial markets during the syndication of the commitments and the risk that they will not be able to sell down the commitments to other lenders. "Flex" provisions limit this risk and allow for amendments to the terms of the financing without certain agreed-upon borrower's consent when necessary to allow the lenders arranging the loan to sell down their commitments.

If, during syndication, there is no market for the loans at the price or terms provided in the commitment letter and term sheet, a flex provision will allow the committed lenders to "flex" the pricing terms (by increasing the interest rate, fees or both) within pre-agreed limits or make other pre-agreed changes to the structure of the loans (such as call protections, shorter maturities, etc.). While these changes provide some comfort to committed lenders in gradually deteriorating financial markets, they may not be as helpful in a dramatic downturn where there is little to no market for loans on any terms.

Just after the financial crisis, not surprisingly, flex clauses often became broader in scope and gave lenders greater flexibility to change key terms of a financing. The types of provisions that can be subject to flex include interest rate margins, negative covenant baskets, financial covenant ratios, the allocation of credit between first lien, second lien and high yield bonds and the amount and type of fees. As markets continue to improve, sponsors are using their leverage to limit the breadth of flex provisions, and to require greater limits on the scope of the changes that can be made without their consent.

Some sponsors have even turned the tables on their lenders and required "reverse flex" arrangements. These provisions require the lenders to amend the financing terms under the commitment letters to be more favourable to the borrower if syndication of the loans is "oversubscribed", meaning that there is more demand from potential lenders than available loans.

Perfection of Liens

As in all secured financings, lenders in an acquisition financing need evidence that their liens on the borrower's assets are perfected and enforceable, preferably as a condition precedent to the initial funding under the loan agreement. However, ensuring perfection of the liens is often highly technical and can be a time-consuming process depending on the nature and location of the borrower's assets and the specific legal requirements for perfection. The technical nature of lien perfection raises the risk (to the borrower and the seller) that lenders will delay or withhold funding for the loans because insufficient steps were taken to perfect the liens, and in an acquisition financing timing and certainty are at a premium.

Typical SunGard provisions limit this risk by requiring delivery at funding of only (i) Uniform Commercial Code financing statements which perfect a security interest in personal property that can be perfected by filing, and (ii) original stock certificates for any pledged shares. Perfecting a security interest in other asset classes is required on a post-funding basis by a covenant detailing what perfection steps are required. The sorts of collateral perfected on a post-closing basis can include real estate, deposit and securities accounts, intellectual property, foreign assets and other more esoteric collateral requiring more complicated efforts.

As financial markets continue to improve, sponsors are likely to continue pushing lenders to increase the time frames to complete post-closing collateral deliverables, give the administrative agent greater flexibility to extend these time frames without lender consent and limit efforts by lenders to increase the collateral deliverables required at closing.

The Acquisition Agreement Matters

Delivery of the executed acquisition agreement is a condition precedent to the lenders' obligation to fund the loans. As discussed in more detail below, as a fallback, lenders sometimes accept a near final draft of the acquisition agreement, coupled with a covenant from the buyer that there will be no material changes. The terms of the acquisition agreement are important to lenders in a number of respects, beyond understanding the structure and business of the borrower after consummation of the acquisition. Lenders also regularly require inclusion of certain provisions in acquisition agreements.

Structure of the Acquisition

The structure of the acquisition is important to the lenders as it will dictate a number of issues for the financing, including collateral perfection, identity of the guarantors and borrowers and timing of the acquisition (*i.e.*, how long the lenders need to have their commitments outstanding). There are a number of common acquisition structures. While the specifics of those structures are beyond the scope of this article, these include stock purchases (with or without a tender offer), mergers (including forward, forward triangular and reverse triangular mergers) and asset purchases. Each has its own unique structuring issues for the lenders.

Representations and Company MAC

As described above, the lenders often rely on the representations and warranties in the acquisition agreement, including the definition of material adverse change, and incorporate those terms into the loan agreement.

Obligation to Continue Operating

Lenders often review whether the seller is contractually obligated in the acquisition agreement to continue operating the business in the ordinary course and not to make material changes to the business. Again, the target is a part of the lenders' credit and the lenders do not want to discover after consummation of the acquisition that the target has been restructured in a way that results in its business being different than the lenders' understanding.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Indemnity

Lenders also typically consider the indemnities provided by the seller in the acquisition agreement. If, after the acquisition is consummated, it is discovered that the seller made a misrepresentation or, worse, committed fraud or other wrongdoing as part of the acquisition, those indemnities could affect the buyer's ability to recover against the seller. If the misrepresentation or wrongdoing results in the lenders foreclosing on the assets of the borrower, the indemnities could be inherited by the lenders if the rights of the borrower under the acquisition agreement are part of the collateral. Acquisition agreements typically contain anti-assignment and transfer provisions. It is important that those provisions expressly permit the lenders to take a lien on the acquisition agreement.

Purchase Price Adjustments and Earn-Outs

Any payments to be made to the seller by the buyer after consummation of the acquisition are important to the lenders. Many loan agreements define these payments, whether based on performance of the target or other factors, as debt and their payment needs to be specifically permitted by the loan agreement. Beyond technically drafting the loan agreement to permit payment of these amounts, the proceeds to be used to make these payments should be viewed as assets of the buyer that are not available to the lenders to repay the loans and this may impact the credit review of the loan facility.

Xerox Provisions

When a proposed acquisition terminates, the commitment letters for the acquisition financing typically state that the lenders' commitments also terminate. That is not always the end of the lenders' concerns. Many terminated acquisitions result in accusations of breach of contract, wrongdoing or bad faith by the parties. Litigation is not uncommon. Lenders want to make sure that any litigation brought by the seller does not look to the lenders for damages.

Xerox provisions (named for a financing with Xerox where these clauses were first seen) give lenders this protection in the form of an acknowledgment by the seller in the acquisition agreement that the seller's sole remedy against the buyer and its lenders for termination of the acquisition is the break-up fee specified in the acquisition agreement. If the acquisition terminates because the lenders fail to fund their commitments, the lenders may be subject to a breach of contract suit brought by the buyer. But the lenders in any termination scenario often seek to restrict suits brought against them by the seller. Conversely, sellers' focus on certainty of the financing have caused some sellers to push back on inclusion of these provisions. Some sellers with strong leverage even negotiate for the right to enforce remedies (or cause the buyer to enforce remedies) against the lenders under a commitment letter.

Since the lenders are not party to the acquisition agreement, applicable law creates hurdles for the lenders to enforce the Xerox provisions. To address these hurdles, lenders seek to be expressly named as third-party beneficiaries of the Xerox provisions. In the event that the lenders have claims against the seller for breach of the Xerox provisions, lenders will have customary concerns about the venue and forum of any claims brought by the lenders under the acquisition agreement. Like in loan agreements, lenders often seek to have New York as the exclusive location for these suits and seek jury trial waivers in the acquisition agreement.

Efforts to Obtain the Financing

Lenders will consider provisions in the acquisition agreement regarding the buyer's obligations to obtain financing. Typically, buyers agree to use "reasonable best efforts" or "commercially reasonable efforts" to obtain the financing in the commitment letter. These provisions may include a requirement to maintain the commitment letter, not to permit any modification to the terms of commitment letter without the seller's consent (with some exceptions), to give notice to the seller upon the occurrence of certain events under the commitment letter, and obtain alternative financing, if necessary. As noted above, acquisition agreements may also contain provisions obligating the buyer to enforce its rights against the lender under the commitment letter, or even pursue litigation against the lender. Buyers with strong leverage will want to limit provisions in the acquisition agreement requiring specific actions against the lenders.

Cooperation with the Financing

As discussed above, the lenders have an interest in understanding the acquisition and the nature of the target's business. Further, the conditions precedent will require deliverables from the target and the lenders' regulatory, credit and legal requirements demand that they receive certain diligence information about the target and its business. None of this can be accomplished if the seller does not agree to assist the buyer and its lenders. Lenders often require that the acquisition agreement include a clause that the seller will cooperate with the lenders' diligence and other requirements relating to the acquisition financing.

Amendments to the Acquisition Agreement

Lenders usually have the opportunity to review the acquisition agreement, or at least a near final version, prior to executing their commitment letters. The buyer and seller will want the lenders to acknowledge that the final agreement or draft is acceptable. The lenders, on the other hand, will want to receive notice of any amendments to the acquisition agreement and ensure they do not adversely impact the financing. To avoid the lenders' refusal to fund the loans because of an amendment to the acquisition agreement, buyers and sellers are often careful to ensure that no amendments to the acquisition agreement will be required. Some amendments are unavoidable and commitment letters often contain express provisions as to the nature of those amendments that need lender approval. If lender approval is not needed, then the lenders cannot use the amendment as a reason to refuse funding.

Negotiations of the "no-amendment" condition focus on the materiality of the amendments and whether the change has to be adverse or materially adverse, with some lenders negotiating consent rights for any material change in the acquisition agreement. Lenders often seek to negotiate express provisions that would be deemed material or adverse, including some of the above clauses that were included in the acquisition agreement at the requirement of the lenders. Some lenders with strong negotiating leverage even negotiate for a clause in the acquisition agreement that any amendments will require the lenders' consent.

Conclusion

Leveraged acquisitions in the United States raise unique structuring issues and techniques, only some of which are discussed here. As global financial markets continue to improve, expect to see greater volumes of acquisition financings and sponsors exercising greater leverage over their lenders to loosen acquisition financing terms.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Geoffrey R. Peck
Morrison & Foerster LLP
250 West 55th Street
New York, NY 10019-5201
USA

Tel: +1 212 336 4183
Fax: +1 212 468 7900
Email: gpeck@mofo.com
URL: www.mofo.com

Geoffrey Peck is a Partner in Morrison & Foerster's New York office. Mr. Peck specialises in financial transactions and restructurings, representing banks, funds, issuers and borrowers in a broad spectrum of financings, including syndicated and asset-based loans, acquisition, subscription-backed, debtor-in possession, mezzanine, structured commodity and project financings, and secondary market trading. His practice is both domestic and cross-border. Mr. Peck received his B.A. and B.S. from Boston University and his J.D. from the University of Pennsylvania.

Mark S. Wojciechowski
Morrison & Foerster LLP
250 West 55th Street
New York, NY 10019-5201
USA

Tel: +1 212 468 8079
Fax: +1 212 468 7900
Email: mwojciechowski@mofo.com
URL: www.mofo.com

Mark Wojciechowski is a Partner at Morrison & Foerster LLP. Mr. Wojciechowski focuses on leveraged and acquisition finance, mergers and acquisitions and hybrid transactions involving structured debt and equity investments. His clients include major foreign and domestic commercial banks and investment banks, as well as public and private corporations and investment funds. Mr. Wojciechowski routinely advises these clients on both transactional and regulatory matters. Mr. Wojciechowski is recognised as a leading lawyer by *Chambers USA* 2013 for excellence in the field of M&A/Corporate work.

MORRISON
FOERSTER

Morrison & Foerster is a global firm of exceptional credentials and clients, including some of the most successful financial institutions, asset managers, investment funds and companies. With over 1,000 lawyers in 17 offices in the world's key financial and business centres, MoFo handles some of the world's largest and most complex domestic and cross-border financial, restructuring, acquisition and corporate transactions. MoFo is committed to provide the best customer service to our clients, while providing innovative and business-minded results. *Chambers Global* named MoFo its 2013 USA Law Firm of the Year. Visit us at www.mofo.com.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

A Comparative Overview of Transatlantic Intercreditor Agreements

Milbank, Tweed, Hadley & McCloy LLP

Lauren Hanrahan

Suhrud Mehta

Introduction

The intercreditor frameworks applicable to a given financing structure in a particular market are often fairly settled, but where cultures collide, for example in a U.S. syndicated bank loan financing for European borrowers, or other financings involving practitioners and business people in different parts of the world, deal parties may have very different expectations as to the key intercreditor terms that ought to apply.

In this article, we will compare and contrast the key terms in U.S. second lien and European second lien intercreditors and discuss the blended approach taken in some recent intercreditor agreements for financings of European companies in the U.S. syndicated bank loan markets. Similar dynamics may be involved when documenting intercreditor agreements involving other non-U.S. jurisdictions as well, but for ease of reference, we will refer to these intercreditor agreements as "Transatlantic Intercreditor Agreements".

Assumptions

U.S. second lien intercreditors are predicated on two key assumptions: *first*, that the business will be reorganised pursuant to Chapter 11 of the United States Bankruptcy Code (Chapter 11); and *second*, that the first lien lenders will receive the benefits of a comprehensive guarantee and collateral package (including shares, cash, receivables and tangible assets) pursuant to secured transactions laws that effectively provide creditors with the ability to take a security interest in "all assets" of the borrower and guarantors. European second lien intercreditors, in contrast, (i) assume that it is unlikely that the borrower and guarantors will be reorganised in an orderly court-approved process and indeed more likely that, since there is no pan-European insolvency regime (and thus no pan-European automatic stay on enforcement of claims), the intercreditor terms will have to function in the context of potentially multiple and disparate insolvency proceedings (ideally outside of insolvency proceedings altogether), and (ii) contemplate that not all assets of the borrower and guarantors will be subject to the liens of the first lien and second lien secured parties. As a result, one of the key goals that European second lien intercreditors seek to facilitate is a swift out-of-court, out-of-bankruptcy, enforcement sale (or "pre-pack") resulting in a financial restructuring where the business is sold as a going concern on a "debt free basis", with "out of the money" junior creditors' claims being released and so removed from the financing structure.

Overview

The first lien/second lien relationship in the U.S. closely resembles the senior/second lien relationship in Europe; however, for the reasons stated above, the key terms of U.S. second lien and European second lien intercreditors have been constructed on the basis of very different assumptions, which therefore results in significant differences.

European second lien intercreditor agreements typically combine claim subordination, payment blockages, lien subordination, broad enforcement standstill provisions restricting the junior lien creditors' ability to take enforcement action (not only with respect to collateral but also with respect to debt and guarantee claims) and extensive release mechanics. U.S. second lien intercreditors establish lien subordination, which regulates the rights of the U.S. second lien creditors with respect to collateral only, and include an enforcement standstill with respect to actions against collateral only. U.S. second lien intercreditors do not generally include payment or claim subordination and they rely heavily on waivers of the junior lien creditors' rights as secured creditors under Chapter 11.

European second lien intercreditors are often, and increasingly, based on the Loan Market Association's form (the "LMA"), but are negotiated on a deal-by-deal basis. By contrast, there is no market standard first lien/second lien intercreditor agreement in the U.S. (The Commercial Finance Committee of the American Bar Association did publish a model form of intercreditor agreement in 2010, but it is not widely used.) As discussed below, recent intercreditors for financings of European companies in the U.S. syndicated bank loan markets vary even more significantly, but common themes are emerging.

Key Terms of U.S. Second Lien Intercreditor Agreements and European Second Lien Intercreditor Agreements

1. Parties to the Intercreditor Agreement

U.S. second lien intercreditors are generally executed by the first lien agent and the second lien agent and executed or acknowledged by the borrower and, sometimes, the guarantors. Depending on the flexibility negotiated by the borrower in the first lien credit agreement and second lien credit agreement, the intercreditor agreement may also allow for other future classes of first lien and

© Published and reproduced with kind permission by Global Legal Group Ltd, London

second lien debt permitted by the credit agreements to accede to the intercreditor agreement. U.S. second lien intercreditors also typically allow for refinancings of the first lien and second lien debt.

By contrast, the parties to European second lien intercreditors generally include a longer list of signatories. In addition to the first lien agent and lenders, the second lien agent and lenders and the obligors, the obligors' hedge providers, ancillary facility lenders, the lenders of intra-group loans, the lenders of shareholder loans and the security agent will execute a European-style intercreditor agreement. The longer list of parties to European second lien intercreditors is largely driven by the senior creditors' need to ensure that, after giving effect to the senior lenders' enforcement, the borrower group is free and clear of all claims (both secured and unsecured) against the borrower and guarantors coupled with a desire to ensure that any enforcement action by creditors is choreographed in a manner which maximises recoveries for the senior secured creditors (and thus indirectly for all creditors). With an increased number of incurrence-based TLB deals having been executed in the past year or so, it has become fairly common for refinancing and incremental debt (e.g., under an incurrence ratio or starter basket) to be permitted in European deals. European intercreditors would require such debt to be subject to the intercreditor agreement even if (above a certain threshold amount and subject to negotiation) it is unsecured.

Hedge obligations are generally included as first lien obligations (and sometimes also as second lien obligations) under U.S. second lien intercreditors, but hedge counterparties are not directly party to U.S. second lien intercreditors. By accepting the benefits of the first priority lien of the first lien agent, the hedge counterparties receive the benefits of the first priority lien granted to the first lien agent on behalf of all first lien secured parties (including the hedge counterparties) and the hedge counterparties are deemed to agree that the first lien security interests are regulated by the intercreditor agreement and other loan documents. The hedge counterparties under U.S. second lien intercreditors in syndicated bank financings generally have neither the ability to direct enforcement actions nor the right to vote their outstanding claims (including any votes in respect of enforcement decisions).

Cash management obligations (e.g., treasury, depository, overdraft, credit or debit card, electronic funds transfer and other cash management arrangements) are often included as first lien obligations under U.S. second lien intercreditors on terms similar to the terms relating to the hedge obligations. By contrast, European second lien intercreditors typically do not expressly contemplate cash management obligations. In European financings, the cash management providers would typically provide the cash management services through ancillary facilities – bilateral facilities provided by a lender in place of all or part of that lender's unutilised revolving facility commitment. Ancillary facilities are not a common feature of U.S. credit facilities. The providers of ancillary facilities would be direct signatories of a European second lien intercreditor.

2. Enforcement

a. Enforcement Instructions

The first lien agent under a U.S. second lien intercreditor takes instructions from the lenders holding a majority of the loans and unfunded commitments under the first lien credit agreement, which follows the standard formulation of required lenders in U.S. first lien credit agreements. (Note, however, that the vote required to confirm a plan of reorganisation in a Chapter 11 proceeding is a higher threshold – at least two-thirds in amount and more than one-half in number of the claims actually voting on the plan.)

The security agent under European second lien intercreditors, however, takes instructions from creditors holding 66 2/3% of the sum of (i) the drawn and undrawn amounts under the senior credit agreement, and (ii) any actual outstanding liabilities (plus any mark to market value if the senior credit agreement has been discharged) under any hedging arrangements.

b. Enforcement Standstill Periods

U.S. second lien financings involve lien subordination as opposed to payment (also referred to as debt or claim) subordination. The result of lien subordination is that only the proceeds of shared collateral subject to the liens for the benefit of both the first lien secured parties and second lien secured parties are applied to repayment in full of the first lien obligations before the second lien secured parties are entitled to receive any distribution of the proceeds of the shared collateral, but the second lien secured parties may receive other payments (such as payments of principal and interest and payments from other sources, e.g., unencumbered property) prior to the first lien obligations being paid in full. In the context of U.S. obligors, it is unlikely, in practice, that there would be substantial property that is unencumbered since the security granted would likely pick up substantially all assets – in contrast to a number of European obligors whose unencumbered assets may be significant due to local law limitations.

Payment subordination requires the junior lien creditors to turnover to the first lien secured parties all proceeds of enforcement received from any source (including the proceeds of any unencumbered property) until the first lien obligations are paid in full. In consequence, the difference in recoveries between lien subordination and payment subordination could be significant in a financing where material assets are left unencumbered, as is likely in a financing in which much of the credit support is outside the U.S.

U.S. second lien intercreditors prohibit the second lien agent from exercising any of its rights or remedies with respect to the shared collateral until expiration of the period ending 90 to 180 days after notice delivered by the second lien agent to the first lien agent after a second lien event of default or, in some cases, if earlier, second lien acceleration. The standstill period becomes permanent to the extent the first lien agent is diligently pursuing in good faith an enforcement action against a material portion of the shared collateral. An exercise of collateral remedies generally includes any action (including commencing legal proceedings) to foreclose on the second lien agent's lien in any shared collateral, to take possession of or sell any shared collateral or to exercise any right of set-off with respect to any shared collateral, but the acceleration of credit facility obligations is generally not an exercise of collateral remedies.

European second lien intercreditors typically contain a much broader enforcement standstill provision than U.S. second lien intercreditors. The scope of the restricted enforcement actions typically prohibits any acceleration of the second lien debt, any enforcement of payment of, or action to collect, the second lien debt, and any commencement or joining in with others to commence any insolvency proceeding, any commencement by the second lien agent or second lien creditors of any judicial enforcement of any of the rights and remedies under the second lien documents or applicable law, whether as a secured or an unsecured creditor. The enforcement standstill period typically runs for (i) a period of 90 days (in most cases) following notice of payment default under the senior credit agreement, (ii) a period of 120 days (in most cases) following notice of financial covenant default under the senior credit agreement, and (iii) a period of 150 days (in most cases) following notice of any other event of default under the senior credit agreement, plus (in some cases) 120 days if the security agent is taking enforcement action. In European second lien intercreditors, the senior creditors firmly control enforcement. In addition, the senior agent is entitled to override the junior agent's instructions to the security agent, leaving the second lien lenders only able to influence the timing of enforcement action after the standstill period.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Because the enforcement standstill in U.S. second lien intercreditors is limited to enforcement against shared collateral, U.S. second lien lenders, unlike their European counterparts, retain the right to accelerate their second lien loans and to demand payment from the borrower and guarantors during the standstill period. However, in the event any second lien agent or any other second lien creditor becomes a judgment lien creditor in respect of the shared collateral as a result of enforcement of its rights as an unsecured creditor (such as the ability to sue for payment), the judgment lien would typically be subordinated to the liens securing the first lien obligations on the same basis as the other liens securing the second lien obligations under the U.S. second lien intercreditor agreement. This judgment lien provision effectively limits the effectiveness of the junior lien creditors' efforts to sue for payment, since the junior lien creditors ultimately will not be able to enforce against shared collateral, although the junior lien creditors could still precipitate a bankruptcy filing and/or obtain rights against any previously unencumbered assets of the borrower and guarantors.

3. Payment Blockages

U.S. second lien intercreditors do not generally subordinate the junior lien obligations in right of payment to the first lien obligations.

European second lien intercreditors do subordinate the junior lien obligations in right of payment to the senior lien obligations and include a payment blockage period that is typically co-extensive with a payment default under the senior credit agreement and of a duration of 120 days during each year whilst certain other material events of default under the senior credit agreement are continuing. The second lien creditors may negotiate for exceptions to the payment blockage periods, e.g., payment of a pre-agreed amount of expenses related to the restructuring or a valuation of the borrower group (other than expenses related to disputing any aspect of a distressed disposal or sale of liabilities). In addition, separate payment blockage rules typically apply to hedge obligations, shareholder loan obligations and intragroup liabilities in European second lien intercreditors.

4. Releases of Collateral and Guarantees

In order to ensure that the junior lien creditors are unable to interfere with a sale of the shared collateral, both U.S. second lien intercreditors and European second lien intercreditors contain release provisions whereby the junior lenders agree that their lien on any shared collateral is automatically released if the first lien creditors release their lien in connection with a disposition permitted under both the first lien credit agreement and the second lien credit agreement and, more importantly, in connection with enforcement by the first lien creditors.

While important in U.S. second lien intercreditors, the release provisions are arguably the most important provision of European second lien intercreditors. Under European intercreditor agreements, in connection with enforcement by the senior creditors (or a "distressed disposal"), the junior security and debt and guarantee claims can be released (or disposed of) subject to negotiated conditions. Market practice continues to evolve, but fair sale provisions are increasingly common, i.e., public auction/sale process or independent fair value opinion. The LMA intercreditor agreement requires the security agent to take reasonable care to obtain a fair market price/value and permits the sale of group entities and release of debt and guarantee claims, and, in addition, the sale of second lien debt claims. European intercreditor agreements typically provide that the security agent's duties will be discharged when (although this list is not exhaustive): (i) the sale is made under the direction/control of an insolvency officer; (ii) the sale is made pursuant to an auction/competitive sales process (which does not exclude second lien creditors from participating unless adverse to the sales process); (iii) the sale is made as part of a court supervised/approved process; or (iv) a "fairness opinion" has been obtained. Any additional parameters/conditions to the above will be hotly negotiated, particularly in deals where specialist second lien funds are anchoring the second lien facility. Typical points for discussion will be: (i) the circumstances in which/whether the senior creditors are entitled to instruct a sale in reliance on a fair sale opinion rather than a public auction; (ii) terms of any public auction (i.e. how conducted, on whose advice, who can participate, who can credit bid); (iii) any requirement for cash consideration; and (iv) any information/consultation rights.

In addition to the release provisions, European second lien intercreditors typically allow (subject to the fair sale provisions discussed above) the security agent to transfer the junior lien debt, intragroup liabilities and/or shareholder loans to the purchasers of the assets in an enforcement situation. The disposal of liabilities option could be more tax efficient than cancelling the subordinated debt in connection with enforcement.

Many of these conditions with respect to sales of collateral are absent in U.S. second lien intercreditors because meaningful protections are afforded by the Uniform Commercial Code requirement for a sale of collateral to be made in a commercially reasonable manner and, in the case of a 363 sale process, by a court-approved sale in Chapter 11, as discussed more fully below.

In addition, the release provisions in U.S. second lien intercreditors are also premised on the first lien and second lien security interests being separately held by the first lien collateral agent and the second lien collateral agent and documented in separate, but substantially similar, documents that are meant to cover identical pools of collateral. In European second lien intercreditors, the release provisions assume that one set of security interests are held by one security agent on behalf of all of the creditors (senior and second lien).

5. Limitation on First Lien Obligations

U.S. second lien financings include a "first lien debt cap" to limit the amount of first lien obligations that will be senior to the second lien obligations. The analogous provision in European second lien intercreditors is referred to as "senior headroom". Amounts that exceed the first lien debt cap or senior headroom will not benefit from the lien priority provisions in the intercreditor agreement. The "cushion" under the first lien debt cap or senior headroom is meant to allow for additional cash needs of the borrower group, whether as part of a loan workout or otherwise.

The first lien debt cap in U.S. second lien financings is typically 110% to 120% of the principal amount of the loans and commitments under the first lien facilities on the closing date plus 100% to 120% of the principal amount of any incremental facilities (or equivalent) permitted under the first lien credit agreement on the closing date. The first lien debt cap is sometimes reduced by the amounts of certain reductions to the first lien commitments and funded loans (other than refinancings), e.g., mandatory prepayments. The first lien debt cap does not apply to hedging obligations and cash management obligations, which are generally included as first lien priority obligations without limitation (although the amounts are regulated by the covenants in the credit agreements). In addition, interest, fees, expenses, premiums and other amounts related to the principal amount of the first lien obligations permitted by the first lien debt cap are first lien priority obligations, but are generally not

© Published and reproduced with kind permission by Global Legal Group Ltd, London

limited by the cap itself. The trend in U.S. second lien financings is to allow for larger first lien debt caps; some borrower-friendly U.S. second lien financings even allow for unlimited first lien obligations (subject of course to any covenants restricting debt in the applicable credit agreements and other debt documents, including the second lien credit agreement). Additional capacity is often also permitted in the case of DIP financings in the U.S. (as discussed below).

Senior headroom is typically set at 110% of senior term debt plus revolving commitments in European second lien intercreditors, although the headroom concept has not been extended to cover incremental and other additional senior debt. Ancillary facilities that would be provided in European deals in lieu of external cash management arrangements would be naturally limited by the amount of the revolving commitments since they are made available by revolving credit facility lenders in place of their revolving commitments. Hedging obligations are typically unlimited but naturally constrained to a degree by the fact that most credit agreements will restrict the borrower group from doing speculative trades.

6. Amendment Restrictions

In both U.S. second lien intercreditors and European second lien intercreditors, first lien lenders and second lien lenders typically specify the extent to which certain terms of the first lien credit agreement and the second lien credit agreement may not be amended without the consent of the holder of the other lien. Amendment restrictions are negotiated on a deal-by-deal basis and may include limitations on increasing pricing and limitations on modifications of maturity date and the introduction of additional events of default and covenants. The trend in U.S. second lien intercreditors, in particular in financings of borrowers owned by private equity sponsors, is for few (or no) amendment restrictions; the inclusion of amendment restrictions in European second lien intercreditors is reasonably well-settled at this point – and is typically limited to the day-one senior debt terms only.

7. Purchase Options

Both U.S. second lien intercreditors and European second lien intercreditors contain similar provisions whereby the second lien creditors are granted the right to purchase the first lien obligations in full at par, plus accrued interest, unpaid fees, expenses and other amounts owing to the first lien lenders at the time of the purchase. This purchase option gives the second lien creditors a viable alternative to sitting aside during an enforcement action controlled by the first lien creditors by allowing them to purchase the first lien claims in full and thereby acquire the ability to control the enforcement proceedings themselves.

The European version of the purchase option is similar but also includes a buyout of the hedging obligations, which may or may not be included in U.S. second lien intercreditors.

The triggering events for the purchase option in U.S. intercreditors vary. They generally include acceleration of the first lien obligations in accordance with the first lien credit agreement and the commencement of an insolvency proceeding. Other potential trigger events include any payment default under the first lien credit agreement that remains uncured and unwaived for a period of time and a release of liens in connection with enforcement on shared collateral. The triggering event for the European version of the purchase option also varies and may include acceleration/enforcement by the senior creditors, the imposition of a standstill period on second lien enforcement action or the imposition of a payment block.

8. Common U.S. Bankruptcy Waivers

First lien secured parties in the U.S. try to ensure that the first lien secured parties control the course of the Chapter 11 proceeding to the maximum extent possible by seeking advanced waivers from the second lien secured parties of their bankruptcy rights as secured creditors (and, in some cases, as unsecured creditors) that effectively render the second lien secured parties "silent seconds". These waivers can be highly negotiated. However, U.S. second lien intercreditors routinely contain waivers from the second lien secured parties of rights to object during the course of a Chapter 11 proceeding to a debtor-in-possession facility (or "DIP facility"), a sale by the debtor of its assets free of liens and liabilities outside of the ordinary course of business during Chapter 11 proceedings, with the approval of the bankruptcy court (a section 363 sale) and relief from the automatic stay. (The automatic stay stops substantially all acts and proceedings against the debtor and its property immediately upon filing of the bankruptcy petition.)

The enforceability of the non-subordination-related provisions in U.S. second lien intercreditors is uncertain because there is conflicting case law in this area. However, garden-variety subordination-related provisions are regularly enforced by U.S. bankruptcy courts to the same extent that they are enforceable under applicable non-bankruptcy law pursuant to Section 510(a) of the Bankruptcy Code.

The second lien creditors in U.S. second lien intercreditors provide their advanced consent to DIP facilities by agreeing that, subject to certain conditions (including a monetary limit), they will not object to the borrower or any other obligor obtaining financing (including on a priming basis) after the commencement of a Chapter 11 process, whether from the first lien creditors or any other third party financing source, if the first lien agent desires to permit such financing (or to permit the use of cash collateral on which the first lien agent or any other creditor of the borrower or any other obligor has a lien).

In the U.S., second lien claimholders often expressly reserve the right to exercise rights and remedies as unsecured creditors against any borrower or guarantor in accordance with the terms of the second lien credit documents and applicable law, except as would otherwise be in contravention of, or inconsistent with, the express terms of the intercreditor agreement. This type of provision, for the reasons articulated above, does not have a counterpart in and would be inconsistent with the underlying rationale of European second lien intercreditors.

9. Non-cash Consideration/Credit Bidding

The LMA intercreditor agreement includes explicit provisions dealing with application of non-cash consideration (including "credit bidding") during the enforcement of security. Credit bidding facilitates debt-for-equity exchanges by allowing the security agent, at the instruction of the senior creditors, to distribute equity to senior creditors as payment of the senior debt or to consummate a pre-pack where the senior debt is rolled into a newco vehicle.

In the U.S., the term "credit bidding" refers to the right of a secured creditor to offset, or bid, its secured allowed claim against the purchase price in a sale of its collateral under section 363(k) of the Bankruptcy Code, thereby allowing the secured creditor to acquire the assets that are subject to its lien in exchange for a full or partial cancellation of the debt. In U.S. second lien intercreditors, the second lien creditors consent to a sale or other disposition of

© Published and reproduced with kind permission by Global Legal Group Ltd, London

any shared collateral free and clear of their liens or other claims under section 363 of the Bankruptcy Code if the first lien creditors have consented to the sale or disposition. However, the second lien creditors often also expressly retain the ability to credit bid their second lien debt for the assets of the borrower and guarantors so long as the first lien obligations are paid in full in cash. In European intercreditor agreements, the second lien creditors would not typically have an explicit right to credit bid their second lien debt.

10. The Holders of Shareholder Obligations and Intragroup Obligations

In addition to direct equity contributions, shareholder loans are often used in European capital structures. Shareholder loans are less common in U.S. capital structures and, if present in the capital structure, would likely be subordinated to the credit agreement obligations under a separately documented subordination agreement (i.e., not included as part of the typical U.S. second lien intercreditor agreement). Similarly, holders of intragroup liabilities would also not be included in U.S. second lien intercreditor agreements. The treatment of intragroup liabilities is often negotiated by the borrower and arrangers in U.S. syndicated credit agreements and, although results differ, the intragroup liabilities are often required to be documented by an intercompany note and made subject to an intercompany subordination agreement. The intercompany subordination agreement would subordinate the intragroup liabilities to be paid by the loan parties to their credit facility obligations and would generally include a payment blockage in relation to intragroup liabilities payable by borrowers and guarantors under the credit facilities during the continuation of an "acceleration event".

Blended Approach Taken in Recent Transatlantic Intercreditor Agreements

Recent intercreditor agreements for financings involving primarily non-U.S. companies in U.S. syndicated bank loan financings, and using NY-law governed loan documents, have taken different approaches to the intercreditor terms, which seem to be determined on a deal-by-deal basis depending on several considerations: (1) the portion of the borrower group's business located in the U.S.; (2) the jurisdiction of organisation of the borrower; (3) the likelihood of the borrower group filing for U.S. bankruptcy protection; and (4) the relative negotiating strength of the junior lien creditors and the borrower, who will be inclined to favour future flexibility and lower upfront legal costs. For these and other reasons, seemingly similar financings have taken very different approaches. Some intercreditor agreements ignore the complexities of restructuring outside of the U.S. and simply use a U.S.-style intercreditor agreement; other similar financings have been documented using the opposite approach – by using a form of intercreditor agreement based on the LMA intercreditor agreement; and still other similar financings have sought to blend the two approaches or to adopt an intercreditor agreement in the alternative by providing for different terms (in particular different release provisions) depending on whether a U.S. or non-U.S. restructuring is to be pursued. Given all of these various considerations, Transatlantic Intercreditor Agreements are often quite *à la carte*. We have highlighted below some of the more interesting points:

- the parties typically have included the holders of intra-group liabilities and shareholder loans, following the European approach, and have embedded restrictions on payment of the intra-group liabilities and shareholder loans under certain circumstances;
- the enforcement instructions are typically required to come from a majority of the first lien loans and unfunded commitments in the U.S.-style while the actual exposures of hedge counterparties (plus mark to market positions post-credit agreement discharge) are taken into account in calculating that majority in the European-style;
- the European-style release provisions discussed above generally have been included either as the primary method of release or as an alternative method in the event that a U.S. bankruptcy process is not pursued;
- in certain deals, enforcement standstill and turnover provisions have been extended to cover all enforcement actions and recoveries (broadly defined), rather than just relating to collateral enforcement actions;
- payment subordination of the second lien facility has typically ***not*** been included;
- the full suite of U.S. bankruptcy waivers from the second lien creditors generally have been included; and
- it is increasingly the case, based on the underlying rationale of European intercreditors, that secured or (above an agreed threshold amount) unsecured incremental and refinancing debt (whether *pari passu* or subordinated) is required to be subject to the intercreditor agreement.

In addition, other provisions appear in Transatlantic Intercreditor Agreements that will not be familiar to those accustomed to the typical U.S. second lien intercreditors, such as parallel debt provisions (a construct necessary in certain non-U.S. jurisdictions in which a security interest cannot be easily granted to a fluctuating group of lenders), expanded agency provisions for the benefit of the security agent and special provisions necessitated by specific local laws to be encountered (or avoided) during the enforcement process (e.g., French *sauvegarde* provisions and compliance with U.S. FATCA regulations).

Conclusion

As the number of financings that touch both sides of the Atlantic continues to rise and the complexity of such financings increases, the intercreditor arrangements for multi-jurisdictional financings will continue to be important and interesting. Whilst there is not a standard or uniform approach to documenting such intercreditor terms, there is now a fairly broad understanding on both sides of the Atlantic in relation to the different provisions and their underlying rationale. Accordingly, most transactions are implemented on a blended basis, combining many of the above-mentioned European or US elements into a US or European intercreditor, respectively. Having said this, as was the case with European second lien intercreditor agreements, a uniform approach is unlikely to emerge until the new forms of Transatlantic Intercreditor Agreement are stress tested in cross-border restructurings.

For further information, please contact Lauren Hanrahan by email at lhanrahan@milbank.com or by telephone at +1 212 530 5339 or Suhrud Mehta by email at smehta@milbank.com or by telephone at +44 20 8960 7680. The authors' views are their own.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Summary of Key Terms of U.S. Second Lien Intercreditor Agreements and European Second Lien Intercreditor Agreements			
Key Terms	**Traditional U.S. Second Lien Approach**	**Traditional European Second Lien Approach**	**Hybrid/Transatlantic Approach**
Parties to the Intercreditor Agreement	The first lien agent and the second lien agent and executed or acknowledged by the obligors.	The first lien agent and lenders, the second lien agent and lenders and the obligors, the obligors' hedge providers, ancillary facility lenders, the lenders of intra-group loans, the lenders of shareholder loans and the security agent.	Generally follows the European approach, except with respect to each lender executing the intercreditor agreement.
Enforcement Instructions	First lien agent takes instructions from lenders holding 50% of the loans and unfunded commitments under the first lien credit agreement.	Security agent takes instructions from creditors holding 66 2/3% of the sum of (i) amounts under the senior credit agreement, and (ii) any actual exposure under hedging agreements.	Generally follows the U.S. approach, but may include hedge counterparties.
Scope of Enforcement Standstill Provisions	Only applies to enforcement against shared collateral (i.e., lien subordination).	Fulsome enforcement standstill including payment default and acceleration (i.e., payment subordination).	Generally follows the European approach, but depends on negotiation.
Length of Enforcement Standstill Provisions	Typically 180 days but could be from 90 to 180 days depending on negotiation.	Typically (i) 90 days (in most cases) following notice of payment default under the senior credit agreement, (ii) 120 days (in most cases) following notice of financial covenant default under the senior credit agreement, and (iii) 150 days (in most cases) following notice of any other event of default under the senior credit agreement, plus (in some cases) 120 days if the security agent is taking enforcement action.	Generally follows the U.S. approach, but depends on negotiation.
Payment Blockages	None.	Included.	Generally not included.
Releases of Collateral and Guarantees	Releases of collateral included.	Releases of claims included.	Generally follows the European approach.
Limitation on First Lien Obligations	Typically 110% to 120% of the principal amount of the loans and commitments under the first lien facilities on the closing date plus 100% to 120% of the principal amount of any incremental facilities (or equivalent) permitted under the first lien credit agreement on the closing date plus secured hedging and other secured obligations.	Typically 110% of day-one senior term debt and revolving commitments plus secured hedging plus 100% of incremental (or equivalent) debt permitted under the second lien credit agreement.	Included, but formulation is subject to negotiation.
Amendment Restrictions	May be included depending on negotiation.	Typically included but limited to day-one senior credit agreement.	Generally follows the U.S. approach.
Second Lien Purchase Options (to purchase the First Lien Obligations)	Included.	Included.	Included.
Common U.S. Bankruptcy Waivers	Included.	Not included.	Included.
Non-Cash Consideration/Credit Bidding by First Lien Lenders	Included.	Included.	Included.
Shareholder Obligations	Not included.	Included.	Often included.
Intragroup Obligations	Not included. Often covered by a separate subordination agreement.	Included.	Often included.
Unsecured Ratio Debt	Not included.	Included (above a threshold).	Often included (above a threshold).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Lauren Hanrahan

Milbank, Tweed, Hadley & McCloy LLP
28 Liberty Street
New York, NY 10005-1413
USA

Tel: +1 212 530 5339
Fax: +1 212 822 5339
Email: lhanrahan@milbank.com
URL: www.milbank.com

Lauren Hanrahan is a partner in the New York office of Milbank, Tweed, Hadley & McCloy and a member of the firm's Leveraged Finance Group. A partner since 2010, Ms. Hanrahan's practice focuses on representing banks and other financial institutions in senior lending transactions. She has significant experience in representing lenders in acquisition financings, including leveraged buyouts, tender offers and other going private transactions, recapitalisations, bridge and mezzanine financings, debtor-in-possession and exit facilities and special situation financings. She has a broad range of financing experience in both US and international transactions. She also devotes a portion of her practice to acting as agent's counsel or lead investor's counsel in connection with amending and restructuring troubled loans and negotiating workouts. Recognised as a leading lawyer for bank lending and finance in *The Legal 500* & *IFLR*, Ms. Hanrahan has handled major transactions for financial institutions such as Goldman Sachs, Credit Suisse, UBS AG, The Royal Bank of Scotland plc, Canadian Imperial Bank of Commerce and various hedge funds.

Suhrud Mehta

Milbank, Tweed, Hadley & McCloy LLP
10 Gresham Street
London EC2V 7JD
United Kingdom

Tel: +44 20 7615 3046
Fax: +44 20 7615 3100
Email: smehta@milbank.com
URL: www.milbank.com

Suhrud Mehta is a partner in the London office, leads the firm's European Leveraged Finance Group and is also a member of the Financial Restructuring Group. Suhrud focuses mainly on leveraged finance and restructuring transactions. He has advised on some of the most significant cross-border, public to private, leveraged, infrastructure and investment grade financings in the London/European market. His leveraged and restructuring expertise focuses on multi-tiered capital structures: bank and bond and bank and mezzanine, in particular. Suhrud has been recognised as a leader in his field by a number of journals, among them: *Chambers UK* (which designated him among the 1st tier of banking lawyers in London), *Chambers Global*, *The Legal 500*, *Who's Who Legal*, *Super Lawyers* and *Legal Business* (where he was named as one of the leading finance lawyers/rainmakers in London). He is the author of a number of articles published in *International Financial Law Review* and regularly speaks at conferences.

Milbank

Milbank, Tweed, Hadley & McCloy LLP is a leading international law firm providing innovative legal solutions to clients throughout the world for more than 140 years. Milbank is headquartered in New York and has offices in Beijing, Frankfurt, Hong Kong, London, Los Angeles, Munich, São Paulo, Singapore, Tokyo and Washington, D.C.

With one of the largest and most experienced teams in this field, Milbank's Banking and Leveraged Finance group assists clients on some of the most advanced and complicated leveraged finance transactions in the world. They represent underwriters, lenders, private equity sponsors, strategic investors, issuers and borrowers on a broad array of financings, including:

- First and second lien loans, bridge loans, secured and unsecured high-yield bonds and mezzanine financing.
- Leveraged buyouts, other acquisition financings, leveraged recapitalisations and going-private transactions.
- Working capital and letter of credit facilities.
- Financings for investment-grade and sub-investment-grade borrowers.
- Debtor-in-possession financings and exit financings.
- Restructurings.
- Vendor financings.
- Structured financings.
- Asset-based lending and securitisation.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

A Comparison of Key Provisions in U.S. and European Leveraged Loan Agreements

Sarah M. Ward

Skadden, Arps, Slate, Meagher & Flom LLP

Mark L. Darley

While there are many broad similarities in the approach taken in European and U.S. leveraged loan transactions and an increasing convergence of terms (and, indeed, convergence with high-yield bond terms for larger leveraged transactions), there are also still a number of significant differences in commercial terms and overall market practice. The importance of practitioners and loan market participants having a general understanding of the similarities and differences of both markets has been highlighted in recent years as European and U.S. borrowers increasingly broaden their horizons and seek to access whichever market may provide greater liquidity (and potentially more favourable pricing and terms) at any given time.

This chapter will focus only on a number of the more significant key differences between practice in the United States and Europe that may be encountered in a typical leveraged loan transaction, and is intended to serve as an overview and a primer for practitioners. References throughout this article to "U.S. loan agreements" and "European loan agreements" should be taken to mean New York-law governed and English law governed leveraged loan agreements, respectively.

Divided into four parts, Part A will focus on differences in documentation and facility types; Part B will focus on various provisions, including covenants and undertakings; Part C will consider differences in syndicate management; and Part D will focus on recent legal and regulatory developments in the European and U.S. markets.

Part A – Documentation and Facility Types

Form Documentation

In both the European and U.S. leveraged loan markets, the standard forms used as a starting point for negotiation and documentation greatly influence the final terms. In Europe, both lenders and borrowers, through conduct adopted over a number of years, expect the starting point to be one of the very comprehensive "recommended forms" published by the LMA unless there are very exceptional circumstances. However, in the United States, such practice has not emerged and the form on which the loan documentation will be based (as well as who "holds the pen" for drafting the documentation) – which may greatly influence the final outcome – will be the subject of negotiation at an early stage.

The LMA (or, to give it its formal title, the Loan Market Association) has achieved widespread acceptance of its recommended forms as a result of the breadth of its membership and the spread of constituencies represented at the "board" level, being comprised of more than 500 member organisations, including commercial and investment banks, institutional investors, law firms, service providers and rating agencies. While the LMA originated with the objective of standardising secondary loan trading documentation, it now plays a "senior statesman" advisory role in the European loan market by producing, updating and giving guidance on key provisions in its recommended forms for, amongst other things, investment grade loan transactions, leveraged acquisition finance transactions, real estate finance transactions and most recently, the growing European private placement market. The LMA plays an active role in monitoring developments in the financial markets, responding to regulatory consultation requests and giving guidance on appropriate approaches in documentation in response to market and regulatory developments: its influence is significant.

The widespread use of the LMA standard forms has resulted in good familiarity by the European investor market which, in turn, has added to the efficiency of review and comprehension not just by those negotiating the documents but also by those who may be considering participating in the loan. The LMA recommended forms are only a starting point, however, and whilst typically, the "back-end" LMA recommended language for boilerplate and other non-contentious provisions of the loan agreement will be only lightly negotiated (if at all), the provisions that have more commercial effect on the parties (such as mandatory prepayments, business undertakings, representations and warranties, conditions to drawdown, etc.) remain as bespoke to the specific transaction as ever.

Similar to the LMA in Europe, the Loan Syndications and Trading Association (the "LSTA") in the United States (an organisation of banks, funds, law firms and other financial institutions) was formed to develop standard procedures and practices in the trading market for corporate loans. One of the main practical differences from the LMA, however, is that although the LSTA has developed recommended standard documentation for loan agreements, those forms are rarely used as a starting draft for negotiation. Instead, U.S. documentation practice has historically been based on the form of the lead bank or agent, although many banks' forms incorporate LSTA recommended language. In relation to market and regulatory developments that could affect both loan markets as a whole, the LSTA and LMA often cooperate and coordinate their approach in issuing guidance and recommended language. Most recently, for example, the LSTA and LMA worked closely in preparing and publishing the recommended form provisions to address the recent "EU contractual recognition of bail-in" directive (considered in further detail below).

Whilst traditionally, the lender side has "held the pen" on documentation, there is a growing trend, both in the United States and Europe, for the larger sponsor borrowers to insist on taking control of, and responsibility for, producing the key documents which, inevitably, leads to a more borrower-friendly starting point.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Facility Types

The basic facility types in both U.S. and European leveraged loan transactions are very similar. Each may typically provide for one or more term loans (ranking equally but with different maturity dates, amortisation profiles (if amortising) and interest rates) and a *pari passu* ranking revolving credit facility. Of course, depending on the nature of the borrower's business and objectives, there could be other specific, standalone facilities, such as facilities for acquisitions, capital expenditure and letters of credit.

In the United States, as in Europe, typically all lenders in a given facility share the same security package, the same ability to enforce such security and the same priority in relation to payments and the proceeds from the enforcement of security. In the U.S., as in Europe, however, an alternative to the typical structure is the first lien/second lien structure, in which the "first lien" and "second lien" loans are secured by the same collateral but the liens of the second lien lenders are subordinated to those of the first lien lenders (i.e., no collateral proceeds may be applied to any second lien obligations until all first lien obligations are repaid). First lien/second lien structures were traditionally treated as essentially two separate loans, with two sets of loan documents and two agents, with the relationship between the lenders set out and governed under an intercreditor agreement. In the U.S., however, and in small to mid-market financings in Europe, over recent years a market trend has developed for certain transactions (typically the smaller deals) to instead effect a "first lien/second lien" structure through a unitranche facility: a single loan with two tranches, a first out tranche and a last out tranche, governed by only one set of loan documents, one agent, one interest rate and one set of lenders. A separate agreement among lenders ("AAL") provides the rights and obligations of the first out and last out lenders and also the division of the interest receipts between the lenders (the borrower pays a blended rate and the lenders decide how much of that is paid to the first out lenders and how much to the last out, depending on the market appetite for the different levels of risk). One unknown with respect to unitranche facilities was whether a court presiding over a borrower's bankruptcy could construe and enforce an AAL even though borrowers are not party to AALs. The *In re RadioShack Corp.* bankruptcy litigation largely resolved this question by implying that courts do have the authority to interpret and enforce an AAL.

Term Loan Types

The terms of a financing are influenced not just by the size and nature of the transaction but also to a large extent by the composition of the lending group. Term A loans are syndicated to traditional banking institutions, who typically require the amortisation and tighter covenants characteristic of Term A loans. Term B loans, which comprise a large percentage of the more sizeable leveraged loans (especially in the United States), are typically held by high-yield bond investors who are generally comfortable with no financial maintenance covenants and greater overall covenant flexibility. Term B loans have a higher margin and other economic protections (such as "no-call" periods) not commonly seen in Term A loans.

In the European market, for certain sponsors and borrowers unable to negotiate sufficiently flexible or desirable loan terms with their usual relationship banks, U.S. Term B loans and the U.S. high yield bond market have provided an attractive alternative means of achieving such flexibility given the institutional investor base such instruments attract. For larger transactions, the developing English law "European TLB" is also becoming an increasingly attractive funding option for borrowers, albeit that market terms are not yet as flexible as those seen in the U.S. Term B loan market – for example, European TLB instruments will typically contain guarantor coverage tests, higher consent thresholds, more expansive events of default, and mandatory prepayment provisions and smaller permitted baskets compared to their U.S. counterparts.

Certainty of Funds

In the United Kingdom, when financing an acquisition of a UK incorporated public company involving a cash element, the City Code on Takeovers and Mergers requires purchasers to have "certain funds" prior to the public announcement of any bid. The bidder's financial advisor is required to confirm the availability of the funds and, if it does not diligence this appropriately, may be liable to provide the funds itself should the bidder's funding not be forthcoming. Understandably, both the bidder and its financial advisor need to ensure the highest certainty of funding. In practice, this requires the full negotiation and execution of loan documentation and completion of conditions precedent (other than those conditions that are also conditions to the bid itself) at the point of announcement of the public bid.

Whilst not a regulatory requirement, the concept of "certain funds" has also permeated the private buyout market in Europe, so that sponsors are required to demonstrate the same level of funding commitment as if they were making a public bid.

In the United States, there is no regulatory certain fund requirement as in the United Kingdom and, typically, only commitment papers, rather than full loan documents, are executed at the time when the bid becomes binding on the bidder (that is, upon execution of a purchase agreement). In the U.S., though, it has become more common for parties to agree on terms while negotiating the commitment letter that traditionally were not settled until negotiation of the definitive loan documentation, such as the definition of EBITDA and related terms, baskets and specified levels for negative covenants and incurrence tests for debt, restricted payments and investments. Ordinarily, when commitment papers are conditioned on the negotiation of definitive loan documentation, they contain "*SunGard*" clauses that limit the representations and warranties made by the borrower and the delivery of certain types of collateral required by the lenders on the closing date of the loan. In practice, given the level of commitment implicit in NY law commitment papers, there is probably little difference between "certain funds" and SunGard commitment papers, though it is still most unlikely that SunGard would be acceptable in a City Code bid.

Part B – Loan Documentation Provisions

Covenants and Undertakings

Whilst a theme of recent years has been the increasing European adoption from the U.S. of more flexible, borrower-friendly loan provisions – or "convergence" as it is commonly referred to – there remain many traditional differences between U.S. and European loan agreements in the treatment and documentation of covenants (as such provisions are termed in U.S. loan agreements) and undertakings (as such provisions are termed in European loan agreements). This Part B explores some of those differences.

Both U.S. and European loan agreements use a broadly similar credit "ring fencing" concept, which underpins the construction of their respective covenants/undertakings. In U.S. loan agreements, borrowers and guarantors are known as "loan parties", while their European equivalents are known as "obligors". In each case, loan

© Published and reproduced with kind permission by Global Legal Group Ltd, London

parties/obligors are generally free to deal between themselves as they are all within the same credit group and bound under the terms of the loan agreement. However, to minimise the risk of credit leakage, loan agreements will invariably restrict dealings between loan parties/obligors and other members of the borrower group that are not loan parties/obligors, as well as third parties generally. In U.S. loan agreements there is usually an ability to designate members of the borrower's group as "unrestricted subsidiaries" so that they are not restricted under the loan agreement. However, the loan agreement will then limit dealings between members of the restricted and unrestricted group and the value attributed to the unrestricted group might not be taken into account in calculating financial covenants.

Restrictions on Indebtedness

U.S. and European loan agreements include an "indebtedness covenant" (in U.S. loan agreements) or a "restriction on financial indebtedness" undertaking (in European loan agreements) which prohibits the borrower (and usually, its restricted subsidiaries) from incurring indebtedness unless explicitly permitted. Typically, "indebtedness" will be broadly defined in the loan agreement to include borrowed money and other obligations such as notes, letters of credit, contingent and lease obligations, hedging liabilities (on a mark-to-market basis), guaranties and guaranties of indebtedness.

In U.S. loan agreements, the indebtedness covenant prohibits all indebtedness, then allows for certain customary exceptions (such as the incurrence of intercompany debt, certain acquisition debt, certain types of indebtedness incurred in the ordinary course of business or purchase money debt), as well as a specific list of exceptions tailored to the business of the borrower. The indebtedness covenant will also typically include an exception for a general "basket" of debt, which can take the form of a fixed amount or a formula based on a ratio or a combination, such as the greater of a fixed amount and a ratio formula. Reclassification provisions (allowing the borrower to utilise one type of permitted debt exception and then reclassify the incurred permitted debt under another exception) are also becoming more common in the United States.

The loan agreements of large cap and middle market U.S. borrowers also typically provide for an incremental facility allowing the borrower to incur additional debt (on top of any commitments the credit agreement originally provided for) under the credit agreement, or in certain cases additional *pari passu* or subordinated secured or unsecured incremental debt outside the credit agreement under a separate facility (known as "sidecar facility" provisions). Traditionally the incremental facilities were limited to a fixed dollar amount, referred to as "free-and-clear" tranches, but now many borrowers can incur an unlimited amount of incremental loans so long as a *pro forma* leverage ratio is met. The recent trend is toward increasingly borrower-friendly incremental provisions. It is becoming more common for borrowers to have both a free-and-clear incremental basket and unlimited incremental capacity subject to a leverage test. Some such borrowers have negotiated the ability to refresh a free-and-clear basket by redesignating debt originally incurred under the free-and-clear basket as debt incurred under the leverage-based incremental capacity. Another new development is permitting borrowers to simultaneously use the free and clear basket and the leveraged-based incremental basket without the former counting as leverage for purposes of the ratio test. Most incremental facilities have a most favoured nations clause that provides that, if the margin of the incremental facility is higher than the margin of the original loan, the original loan's margin will be increased to within a specific number of basis points (usually 50 bps) of the incremental facility's margin. Sponsor-friendly loan agreements often include limitations with respect to most favoured nation clauses, usually a "sunset" restricting its application to a certain timeframe, typically 12 to 18 months following closing.

The restriction on financial indebtedness undertaking typically found in European loan agreements is broadly similar to its U.S. covenant counterpart and usually follows the same construct of a general prohibition on all indebtedness, followed by certain "permitted debt" exceptions (both customary ordinary course type exceptions as well as specifically tailored exceptions requested by the borrower). Historically, ratio debt exceptions and reclassification provisions were not commonly seen in European leveraged loan agreements, as lenders in the European market have traditionally focused on borrowers deleveraging over the term of the loan. However, European deal activity in 2015 has confirmed an increasing trend towards U.S. style permissions, such as "permitted debt" exceptions based on a leverage and/or secured leverage (and sometimes interest coverage) ratio test combined with a general fixed permitted basket (where such additional debt may be incurred within the loan agreement by way of an accordion facility, or outside the loan agreement by way of a separate side-car facility).

Restrictions on Granting Security/Liens

U.S. loan agreements will also invariably restrict the ability of the borrower (and usually, its subsidiaries) to incur liens. A typical U.S. loan agreement will define "lien" broadly to include any charge, pledge, claim, mortgage, hypothecation or otherwise any arrangement to provide a priority or preference on a claim to the borrower's property. This lien covenant prohibits the incurrence of all liens but provides for certain typical exceptions, such as liens securing permitted refinancing indebtedness, purchase money liens, statutory liens and other liens that arise in the ordinary course of business, as well as a general basket based on a fixed dollar amount or a percentage of consolidated total assets to secure a specified amount of permitted indebtedness. In some large cap deals, both in the U.S. and in Europe, borrowers are able to secure permitted indebtedness based on a total leverage ratio or senior secured leverage ratio.

The European equivalent, known as a "negative pledge", broadly covers the same elements as the U.S. restriction on liens (with the same business driven exceptions, but typically goes further and restricts "quasi-security" where the arrangement or transaction is entered into primarily to raise financial indebtedness or to finance the acquisition of an asset). "Quasi-security" includes transactions such as sale and leaseback, retention of title and certain set-off arrangements.

Restriction on Investments

A restriction on the borrower's ability to make investments is commonly found in U.S. loan agreements. "Investments" include loans, advances, equity purchases and other asset acquisitions. Historically, investments by loan parties in non-loan parties have been capped at modest amounts. In some recent large cap deals, however, loan parties have been permitted to invest uncapped amounts in any of their restricted subsidiaries, including foreign subsidiaries who are not guarantors under the loan documents. Other generally permitted investments include short term securities or other low-risk liquid investments, loans to employees and subsidiaries, and investment in other assets which may be useful to the borrower's business. In addition to the specific list of exceptions, U.S. loan agreements also include a general basket, sometimes in a fixed amount, but increasingly based a flexible "builder basket" growth concept.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

The "builder basket" concept, typically defined as a "Cumulative Credit" or an "Available Amount", represents an amount the borrower can utilise for investments, restricted payments (as discussed below), debt prepayments or other purposes. Traditionally, the builder basket begins with a fixed-dollar amount and "builds" as retained excess cash flow (or in some agreements, consolidated net income) accumulates. Some loan agreements may require a borrower to meet a *pro forma* financial test to use the builder basket. If the loan agreement also contains a financial maintenance covenant (such as a leverage test), the borrower may also be required to satisfy a tighter leverage ratio to utilise the builder basket for an investment or restricted payment. Some sponsors have also negotiated loan documents that allow the borrower to switch between different builder basket formulations for added flexibility. In another example of convergence with high-yield bond indentures, recently builder baskets that use 50% of consolidated net income (including the proceeds of equity issuances and equity contributions) rather than retained excess cash flow, and an interest coverage ratio rather than a leverage ratio, have become more common. This approach gives borrowers more flexibility, because a basket using consolidated net income is usually larger, and an interest coverage ratio is usually easier to comply with, than a leverage ratio.

European loan agreements will typically contain stand-alone undertakings restricting the making of loans, acquisitions, joint ventures and other investment activity by the borrower (and other obligors) and commonly restricted such activity by way of fixed cap baskets and other additional conditions. While the use of builder baskets is still not the norm in European loan agreements, often acquisitions will be permitted if funded from certain sources, such as retained excess cash flow. Whilst (historically) reference to ratio tests alone were not commonly seen in European loan agreements, recent transactions over the course of the last year have revealed an increasing trend towards borrowers being permitted to make acquisitions subject to satisfying a leverage ratio test (with fewer additional conditions on acquisitions generally).

Restricted Payments

U.S. loan agreements will typically restrict borrowers from making payments on equity, including repurchases of equity, payments of dividends and other distributions, as well as payments on subordinated debt. As with the covenants outlined above, there are typical exceptions for restricted payments not materially adverse to the lenders, such as payments on equity solely in shares of stock, or payments of the borrower's share of taxes paid by a parent entity of a consolidated group.

In European loan agreements, such payments are typically restricted under separate specific undertakings relating to dividends and share redemptions or the making of certain types of payments to non-obligor shareholders, such as management and advisory fees, or the repayment of certain types of subordinated debt. As usual, borrowers will be able to negotiate specific carve-outs (usually hard capped amounts) for particular "permitted payments" or "permitted distributions" as required (for example, to permit certain advisory and other payments to the sponsor), in addition to the customary ordinary course exceptions.

In U.S. loan agreements, a borrower may use its "builder basket" or "Available Amount" (increasingly based on consolidated net income rather than retained excess cash flow as discussed above) for restricted payments, investments and prepayments of debt, subject to annual baskets based on either a fixed-dollar amount or compliance with a certain financial ratio test. In some recent large cap and sponsored middle market deals in the United States, borrowers have been permitted to make restricted payments subject only to being in *pro forma* compliance with a specific leverage ratio, rather than meeting an annual cap or basket test.

European loan agreements typically have not provided this broad flexibility. However, some strong sponsors have been able to negotiate provisions permitting payments or distributions from retained excess cash flow, subject (typically) to satisfying a certain leverage ratio and, illustrating further convergence of terms, some transactions have adopted the U.S. approach outlined above.

Call Protection

In both European and U.S. loan agreements, borrowers are commonly permitted to voluntarily prepay loans in whole or in part at any time. However, some U.S. loan agreements do include call protection for lenders, requiring the borrower to pay a premium if loans are repaid within a certain period of time (the "call period"). While "hard call" premiums (where term loan lenders receive the premium in the call period for any prepayment, regardless of the source of funds or other circumstances) are rare, "soft call" premiums (typically 1%) on prepayments made within a certain period (typically six months to a year after closing, although 18 months has been becoming more common[1]) and funded from a refinancing or re-pricing of loans are common in the U.S. loan market. In some recent large cap deals, though, lenders waived call protection premiums in connection with a refinancing to consummate a material acquisition.

While call protection is relatively rare in the European market for senior debt (other than Term B Loans), soft call protections have been introduced in certain European loans which have been structured to be sold or syndicated in the U.S. market. Hard call protection provisions are more commonly seen in the second lien tranche of European loans and mezzanine facilities (typically containing a gradual step down in the prepayment premium from 2% in the first year, 1% in the second year, and no call protection thereafter).

Voluntary Prepayments and Debt Buybacks

During the financial crisis, many U.S. borrowers amended existing loan agreements to allow for non-*pro rata* discounted voluntary prepayments of loans that traded below par on the secondary market. Although debt buybacks have been less frequent in the current market, the provisions allowing for such prepayments are still in U.S. loan agreements.

U.S. loan agreements typically require the borrower to offer to repurchase loans ratably from all lenders, in the form of a reverse "Dutch auction" or similar procedure. Participating lenders are repaid at the price specified in the offer and the buyback is documented as a prepayment or an assignment. Loan buybacks may also take the form of a purchase by a sponsor or an affiliate through non-*pro rata* open market purchases. These purchases are negotiated directly with individual lenders and executed through a form of assignment. Unlike loans repurchased by the borrower and then cancelled, loans assigned to sponsors or affiliates may remain outstanding. Lenders often cap the amount that sponsors and affiliates may hold and also restrict the right of such sponsors or affiliates in voting the loans repurchased.

Similarly, in European loan agreements, "Debt Purchase Transaction" provisions have been included in LMA recommended form documentation since late 2008. The LMA standard forms contain two alternative debt purchase transaction provisions – one that prohibits debt buybacks by a borrower (and its subsidiaries),

© Published and reproduced with kind permission by Global Legal Group Ltd, London

and a second alternative that permits such debt buybacks, but only in certain specific conditions (for example, no default continuing, the purchase is only in relation to a term loan tranche and the purchase is made for consideration of less than par).

Where the loan agreement permits the borrower to make a debt purchase transaction, to ensure that all members of the lending syndicate have an opportunity to participate in the sale, it must do so either by a "solicitation process" (where the parent of the borrower or a financial institution on its behalf approaches each term loan lender to enable that lender to offer to sell to the borrower an amount of its participation), or an "open order process" (where the parent of the borrower or financial institution on its behalf places an open order to purchase participations in the term loan up to a set aggregate amount at a set price by notifying all lenders at the same time).

Both LMA alternatives permit debt purchase transactions by the sponsor (and its affiliates), but only subject to the disenfranchisement of the sponsor (or its affiliate) in respect of the purchased portion of the loan.

Mandatory Prepayments and Change of Control

U.S. borrowers are typically required to prepay loans incurred under their loan agreements using the net proceeds of certain asset sales, incurrences of new *pari passu* debt and issuances of equity. Recently, though, mandatory prepayment provisions relating to asset sales have provided greater flexibility for borrowers by carving out more types of dispositions from the definition of asset sale, expanding the duration and scope of reinvestment rights, increasing the threshold amount under which the borrower need not use the proceeds to prepay, adding step-downs permitting borrowers to apply increasingly lower percentages of the net proceeds to prepayment as increasingly tighter leverage ratios are met, and allowing the borrower to use asset sale proceeds to ratably repay *pari passu* debt.

While the mandatory prepayment triggers are broadly similar in European loan agreements, a notable trend in Europe has been the rise of "portability" provisions, which allows a change of control to occur, without the usual mandatory prepayment obligation found in European loan agreements. While portability is not a universal feature in European loans, stronger European sponsors have been increasingly able to achieve this flexibility subject to certain restrictions (typically, a one-time use limit and a requirement that the buyer be on an approved white list of "acceptable buyers"). Perhaps more common in European loan agreements, and also common in U.S. loan agreements, is the right of individual lenders to waive the prepayment requirement. A handful of deals in the United States have included "precapitalised" or "precap" provisions that permit the sale of a borrower to a qualified purchaser without causing a change-of-control event of default, but the concept has not taken off and "precap" provisions remain rare.

In U.S. loan agreements a change of control triggers an event of default rather than a mandatory prepayment as is commonly seen in European loan agreements. Recent Delaware Court of Chancery cases have applied increasing scrutiny to the continuing director, change of control provisions. The issues raised in the cases include whether a change of control provision may restrict the ability of the existing board of directors to approve a dissident slate; whether a director breaches his fiduciary duty by failing to approve a dissident slate where such failure causes a change of control event of default under an existing credit agreement or indenture; and whether the administrative agent of a company's credit facility aids and abets a breach of fiduciary duty by such company's board due to adoption of a credit agreement containing a change of control provision restricting the ability of existing directors to approve a dissident slate.[2]

Financial Covenants

Historically, U.S. and European leveraged loan agreements contained at least two maintenance financial covenants: total leverage; and interest coverage, typically tested at the end of each quarter.

In the United States, "covenant-lite" loan agreements containing no maintenance or ongoing financial covenants comprised more than 60% of outstanding S&P/LSTA loans, and have found their way into many middle market deals (although the volume of covenant-lite middle market deals receded substantially in the fourth quarter of 2014 and remained depressed in 2015 as compared to 2013 and the first half of 2014). In certain transactions, the loan agreement might be "quasi-covenant-lite" meaning that it contains only one financial maintenance covenant (usually a leverage covenant) which is applicable only to the revolver and only when a certain percentage of revolving loans are outstanding at the testing date (15–25% is fairly typical, but has been as high as 37.5%). Covenant-lite (or quasi-covenant-lite) loan agreements may nonetheless contain financial ratio incurrence tests – such tests are used merely as a condition to incurring debt, making restricted payments or entering into other specified transactions. Unlike maintenance covenants, incurrence-based covenants are not tested regularly and a failure to maintain the specified levels would not, in itself, trigger a default under the loan agreement.

European loan agreements traditionally included a full suite of on-going financial maintenance covenants, with a quarterly leverage ratio test being the most common. However, deal activity in 2014 and 2015 revealed that the European market has become more accepting of the covenant-lite and covenant-loose deal structures more typically seen in deals in the U.S. market, especially where it is intended that the loan will be syndicated in the U.S. market in addition to the European market – indeed, European deal activity in 2015 revealed that even in European loan financings where maintenance covenants were included, the majority of such transactions only included a leverage ratio (whereas in 2014, both leverage and interest cover ratios were included in the majority of such transactions). Whilst structures containing no term-loan maintenance covenant and a single springing leverage covenant applicable only to the revolving facility have become more common in the European market, it is fair to say they are still not as prevalent as in the United States.

In the United States, the leverage covenant historically measured consolidated debt of all subsidiaries of the borrower. Today, leverage covenants in U.S. loan agreements frequently apply only to the debt of restricted subsidiaries. Moreover, leverage covenants sometimes only test a portion of consolidated debt – sometimes only senior debt or only secured debt (and in large cap deals of top tier sponsors, sometimes only first lien debt). Lenders are understandably concerned about this approach as the covenant may not accurately reflect overall debt service costs. Rather, it may permit the borrower to incur unsecured senior or subordinated debt and still remain in compliance with the leverage covenant. This is not a trend that has yet found its way over to Europe.

In the event a U.S. loan agreement contains a leverage covenant, it invariably uses a "net debt" test by reducing the total indebtedness (or portion of debt tested) by the borrower's unrestricted cash and cash equivalents. Lenders sometimes cap the amount of cash a borrower may net out to discourage both over-leveraging and hoarding cash. The trends with regard to netting illustrated borrowers' rapidly increasing success in pushing for greater flexibility prior to the market downturn that began in late 2014. The LSTA[3] reported that, in the third quarter of 2013, a sample of leveraged loan agreements

© Published and reproduced with kind permission by Global Legal Group Ltd, London

revealed that nearly half had a fixed cap and the rest had unlimited netting – only a year later, in the third quarter of 2014, loan agreements with an unlimited cap had increased to three quarters of the sample. In 2015, however, experts noted that lenders were more resistant to uncapped netting.[4]

In Europe, the total net debt test is tested on a consolidated group basis, with the total net debt calculation usually including the debt of all subsidiaries (but obviously excluding intra-group debt). Unlike the cap on netted cash and cash equivalents in some U.S. loan agreements, European borrowers net out all cash in calculating compliance with the covenant.

With strong sponsor backing, borrowers have increasingly eased the restriction of financial covenants by increasing the amount of add-backs included in the borrower's EBITDA calculation. Both U.S. and European loan documents now include broader and more numerous add-backs including transaction costs and expenses, restructuring charges, payments to sponsors and certain extraordinary events. Recently, many borrowers have negotiated add-backs (generally to the extent reasonably identifiable and factually supportable) for projected and as-yet unrealised cost savings and synergies. The Leveraged Lending Guidance and the federal regulatory agencies enforcing it (discussed further in Part D), though, suggest that regulators may apply heightened scrutiny to definitions of EBITDA that provide for add-backs without "reasonable support". This regulatory scrutiny has led to greater negotiation of EBITDA add-backs for projected improvements in operating results, resulting in more frequent use of limits on the timing for the realisation of anticipated synergies, administrative agent approval of add-backs, and caps on savings and synergies add-backs (either a fixed amount or a certain percentage of EBITDA (15% in the United States, 5–20% in Europe)).

Equity Cures of Financial Covenants

For a majority of sponsor deals in the United States, loan agreements that contain a financial maintenance covenant also contain the ability for the sponsor to provide an "equity cure" for non-compliance. The proceeds of such equity infusion are usually limited to the amount necessary to cure the applicable default, and are added as a capital contribution (and deemed added to EBITDA or other applicable financial definition) for this this purpose. Because financial covenants are meant to regularly test the financial strength of a borrower independent of its sponsor, U.S. loan agreements increasingly place restrictions on the frequency (usually no more than two fiscal quarters out of four) and absolute number (usually no more than five times over the term of the credit facility) of equity cures.

In Europe, equity cure rights have been extremely common over the last few years. As in the United States, the key issues for negotiation relate to the treatment of the additional equity; for example, whether it should be applied to increase cash flow or earnings, or otherwise reduce indebtedness. While, historically it was restricted to the latter (as adding to earnings would make it much easier to cure the default), recent European deal activity has revealed a continued trend towards cure amounts being permitted to increase earnings rather than to reduce debt. Similar restrictions apply to equity cure rights in European loan documents as they do in the United States in respect of the frequency and absolute number of times an equity cure right may be utilised – however, in Europe the frequency is typically lower (and usually, an equity cure cannot be used in consecutive periods) and is subject to a lower overall cap (usually, no more than two or three times over the term of the facility). From a documentation perspective, it is also important to note that there is no LMA recommended equity cure language.

Sanctions, Anti-Money Laundering and Anti-Bribery Provisions

A recent trend in both European and U.S. loan agreements is the increasing expansiveness of (and lender focus on) the representations, warranties and covenants relating to anti-bribery, anti-money laundering and sanctions laws locally and abroad (the "Anti-Corruption/Sanctions Laws") coupled with lenders' increasing rigidity and resistance to negotiation with regard to these expansive Anti-Corruption/Sanctions Laws provisions. In the U.S. market context, additional evidence of this trend is that *SunGard* provisions (discussed in Part A) increasingly identify representations with respect to Anti-Corruption/Sanctions Laws as specified representations. Similarly in the European market, lenders invariably insist on such representations being characterised as "major representations" for certain funds purposes. Negotiation of these provisions may focus on whether it is appropriate to limit these provisions by materiality and/or by knowledge. Both European and U.S. borrowers often are concerned about their ability to fully comply with broadly drafted provisions without some form of knowledge, scope and/or materiality qualifiers.

Part C – Syndicate Management

Voting Thresholds

In U.S. loan agreements, for matters requiring a vote of syndicate lenders holding loans or commitments, most votes of "required lenders" require only a simple majority of lenders (that is, more than 50% of lenders by commitment size) for all non-unanimous issues. In European loan agreements, most votes require 66.67% or more affirmative vote of lenders by commitment size. In some, but not all, European loan agreements, certain votes that would otherwise require unanimity may instead require only a "super-majority" vote, ranging between 85–90% of lenders by commitment size. Such super majority matters typically relate to releases of transaction security or guarantees, or an increase in the facilities (though not an increase that might result in an obligation to fund on the part of the non-consenting lender).

"Unanimous" decisions in U.S. loan agreements are limited to fundamental matters and require the consent only of affected lenders (and are not, therefore, truly unanimous), while in European loan agreements (except where they may be designated as a super majority matter), decisions covering extensions to commitment periods, payment dates and reductions in amounts payable (even certain mandatory prepayment circumstances), changes to currencies and commitments, transfer provisions and rights between lenders all require the unanimous consent of lenders (not just those affected by the proposed changes). Because of its adherence to requiring 100% lender consent to extend, the European market would not be amenable to the amend and extend provisions that permit borrowers to extend their loan's maturity without 100% lender consent (and sometimes with only the consent of the extending lenders), which have become popular in the U.S. for borrowers confronting refinancing difficulties. Instead, European borrowers have turned to the forward start facility, which is structured as a new loan agreement that sits beside the existing loan agreement but is not drawn until the existing facility matures. The forward start facility is used solely to refinance the indebtedness outstanding under the existing loan agreement.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Yank-a-Bank

U.S. loan agreements often contain provisions allowing the borrower to remove one or more lenders from the syndicate in certain circumstances. A borrower may, for example remove a lender where such lender refuses to agree to an amendment or waiver requiring the unanimous consent of lenders, if the "required lenders" (typically more than 50% of lenders by commitment) have consented. Other reasons a borrower may exercise "yank-a-bank" provisions are when a lender has a loss of creditworthiness, has defaulted on its obligations to fund a borrowing or has demanded certain increased cost or tax payments. In such circumstances, the borrower may facilitate the sale of the lender's commitment to another lender or other eligible assignee. In most European loan agreements, yank-a-bank provisions are also routinely included and are similar in mechanism. However, the threshold vote for "required lenders" is typically defined as at least 66.67% of lenders by commitment.

Snooze-You-Lose

In addition to provisions governing the required votes of lenders, most European loan agreements will also contain "snooze-you-lose" provisions, which favour the borrower when lenders fail to respond to a request for an amendment, consent or waiver. Where a lender does not respond within a specific time frame, such lender's vote or applicable percentage is discounted from the total when calculating whether the requisite vote percentage have approved the requested modification. Similar provisions are rare in U.S. loan agreements.

Transfers and Assignments

In European loan agreements, lenders may assign their rights or otherwise transfer by novation their rights and obligations under the loan agreement to another lender. Typically, lenders will seek to rely on the transfer mechanism, utilising the standard forms of transfer certificates which are typically scheduled to the loan agreement. However, in some cases, an assignment may be necessary to avoid issues in some European jurisdictions which would be caused by a novation under the transfer mechanic (particularly in the context of a secured deal utilising an English-law security trust, which may not be recognised in some European jurisdictions).

Generally, most sub-investment grade European deals will provide that lenders are free to assign or transfer their commitments to other existing lenders (or an affiliate of such a lender) without consulting the borrower, or free to assign or transfer their commitments to a pre-approved list of lenders (a white list), or not to a predetermined list of lenders (a blacklist). For stronger borrowers in both Europe and the United States, the lenders must usually obtain the consent of the borrower prior to any transfer or assignment to a lender that is not an existing lender (or affiliate).

In the United States, the LSTA has recommended "deemed consent" of a borrower where a borrower does not object to proposed assignments within five business days, which is the same position taken in the European market. Similar to stronger European borrowers and sponsors who are able to negotiate a "blacklist", stronger borrowers in the United States, or borrowers with strong sponsors, often negotiate a "DQ List" of excluded (disqualified) assignees. Recently in the United States, large cap borrowers have pushed for expansive DQ lists and the ability to update the list post-closing (a development not seen in European loan agreements). In both the European and US contexts, the DQ List or blacklist helps the borrower avoid assignments to lenders with difficult reputations.

In the U.S. market, exclusion of competitors and their affiliates is also negotiated in the DQ List. In European loan agreements, the LMA recommended form assignment and transfer language provides that existing lenders may assign or transfer their participations to other banks or financial institutions, or to trusts, funds or other entities that are "regularly engaged in or established for the purpose of making, purchasing or investing in loans, securities or other financial assets". This language has the practical effect of limiting the potential range of investors in the loan, including (usually) competitors of the borrower.

Part D – New Regulatory and Legal Developments in the Loan Market

Leveraged Lending Guidance

U.S. federal bank regulators indicated during the third quarter of 2014 that they would more carefully scrutinise leveraged lending issuances following their determination that a third of leveraged loans they reviewed did not comply with the Leveraged Lending Guidance (the "Guidance") issued in March 2013 by the Federal Reserve, the OCC and the FDIC. The Guidance provides, among other things, that a leverage level in excess of 6x total debt over EBITDA will raise regulatory concerns for most industries and may result in the loan being criticised (as discussed further in in Part B). In addition, the Guidance provides that a borrower should be able to amortise its senior secured debt or repay half its total debt with five to seven years of base cash flows.

Regulators have identified some specific ways the Guidance may affect credit agreement provisions or features. For example, regulators have said they will be critical of credit agreement terms that allow for the material dilution, sale, or exchange of collateral or cash flow-producing assets without lender approval. Sidecar loan agreements or accordion features that allow borrowers to incur more debt without protecting the existing lenders may attract regulatory scrutiny. EBITDA adjustments must be supported by third-party due diligence and a "large-percentage" adjustment will attract regulators' suspicion. Regulators have said that because refinancings or modifications count as originations to which the Guidance applies, any refinancings or modifications of non-pass loans must show meaningful improvements to structure or controls to avoid being criticised. Such improvements might be new or tightened covenants, additional collateral or restrictions on acquisitions.

Supplementary regulatory commentary provides that failure to adhere to these requirements is not a bright line bar to an issuance if there are other mitigating factors. The lack of a bright line rule may permit some loan issuances that do not achieve complete compliance, but it also introduces significant uncertainty into the process of underwriting a loan issuance for sponsors, borrowers and lenders alike. Experts predicted that the Guidance could result in more borrowers electing to use non-regulated institutions as agents and lenders and, as predicted, in 2015, non-regulated financing sources have been more active with respect to loans that might have been criticised. This trend is not without problems. Sponsors are wary of trusting the execution of large deals to non-regulated financing sources, and borrowers are hesitant to rely on revolving commitments from them. Also, overreliance on non-regulated financing sources could create liquidity problems in a few years when borrowers seek to refinance (regulators have indicated that the Guidance may be applied to a refinancing). Regulators are considering regulations to address the non-regulated financing sources loophole.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Restrictive Auditor Selection Clauses in Europe

Both U.S. and European loan agreements traditionally contain provisions restricting the accountancy firm that may be engaged by the borrower for the purposes of examining and auditing its financial statements to a "big four" firm (that is, E&Y, KPMG, PwC or Deloitte). However, the Council of the European Union have recently passed an audit market reform package that, amongst other things, seeks to prohibit such restrictive auditor choice clauses in any contract, including loan agreements. The legislative package consists of a regulation and a directive, the provisions of which European Union Member States are required to incorporate into their respective national law by 2016. The prohibition on "big four" auditor clauses will apply to both existing and future loan agreements and will come into effect in June 2017. Significantly, the regulation also requires borrowers that are public-interest entities (for example, listed companies and insurance entities) to inform authorities of any attempt by any third party, such as a lender, to impose such a contractual clause or to otherwise "improperly influence" the decision of the general meeting of shareholders or members on the selection of a statutory auditor or an audit firm. Restrictive auditor clauses are still permitted in the United States. The Public Company Accounting Oversight Board, implemented by the Sarbanes-Oxley Act of 2002, considered a mandatory auditor rotation requirement to promote independence but abandoned the proposal after pressure from legislators.

Changes in LIBOR Administration

In response to the LIBOR-rigging scandal that was exposed in 2012, extensive LIBOR reforms were adopted, including discontinuation of certain rates and the addition of confidentiality restrictions on each bank's LIBOR submission. One documentation issue the reforms have raised is determining LIBOR for interest periods that have been discontinued. Some U.S. loan agreements have taken the approach of approximating LIBOR for an interest period for which it is not available by interpolating on a linear basis the rates for the next longest and next shortest interest period for which LIBOR is available. Others have taken the approach of using an alternative benchmark in the event that a particular LIBOR rate is unavailable. Some use a hybrid of the two approaches – if the requisite LIBOR rate is unavailable, then an alternative benchmark is to be used and, if that is not available, an interpolated rate is to be used. The LMA's suggested provision uses linear interpolation. Banks have also questioned whether the new confidentiality rules could affect reference banks or restrict the provision of internal rates. The opinion of the LMA is that this is not an issue, but some banks remain concerned about liability for quoting their internal rates or acting as a reference bank.

European Contractual Recognition of Bail-In

As part of a series of recently implemented European banking reforms, the EU Bank Recovery and Resolution Directive (or "**BRRD**") has empowered European bank regulators to facilitate the rescue of a failing financial institution incorporated in the European Economic Area (or "**EEA**") – these include powers to write-down and/or convert into equity certain unsecured liabilities of a failing EEA financial institution.

As a result of the BRRD, where an EEA financial institution has entered into a contract governed by the law of a non-EEA country (for example, a New York law credit agreement), the EEA financial institution is required to include a "recognition of bail-in" clause through which the counterparties to that contract (for example, borrowers in a loan transaction) are required to expressly acknowledge that the EEA financial institution's obligations under that document are subject to the write-down and conversion powers provided for under the BRRD. Where an EEA financial institution has entered into a contract governed by the law of an EEA country (such as an English law credit agreement), no such "recognition of bail-in" clause is required as any bail-in powers under the BRRD will be effective as a matter of law, regardless of the terms of the document.

Both the LMA and the LSTA have published recommended form language to be included in loan agreements governed by non-EEA law, which can be used to the extent a transaction involves an EEA financial institution.

Conclusion

As highlighted in this article, it is important for practitioners and loan market participants to be aware of the key differences in the commercial terms and market practice in European and U.S. leveraged loan transactions. While there are many broad similarities between the jurisdictions, borrowers and lenders that enter into either market for the first time may be surprised by the differences, some of which may appear very subtle but which are of significance. As more and more borrowers are prepared to look beyond their domestic market and willing to seek access to whichever debt market (whether U.S. or European) offers greater liquidity and more favourable pricing and terms at any given time, the importance of having a general understanding of the differences is now even more critical.

For further information in relation to any aspect of this chapter, please contact Sarah Ward in New York by email at sarah.ward@skadden.com or by telephone at +1 212 735 2126 or Mark Darley in London by email at mark.darley@skadden.com or by telephone at +44 20 7519 7160.

Endnotes

1. *What's Market: 2015 Year-End Trends in Large Cap and Middle Market Loan Terms*, Practical Law Company, Jan. 28, 2016.
2. *Kallick v. SandRidge Energy, Inc.*, C.A. No. 8182-CS, slip op. at 12 (Del. Ch. Mar. 8, 2013); *Pontiac Gen. Emps. Ret. System v. Healthways, Inc.*, C.A. No. 9789-VCL (Del. Ch. Oct. 14, 2014).
3. *Credit: Just the Stats (Well, Maybe a Little Commentary*), Loan Syndications and Trading Association Week in Review, Nov. 7, 2014, available at http://www.lsta.org/news-and-resources/lsta-newsletter (accessed Feb. 26, 2015).
4. *Trends in Acquisition Finance*, ABA Business Law Section – Syndications & Lender Relations Subcommittee, Sep. 18, 2015, available at http://www.lsta.org/uploads/ArticleModel/218/attach/paul-weiss_trends-in-acqusition-finance.pdf (accessed Jan. 22, 2016); *Debt Financing From a Borrower's Perspective: From Healthy LBO to Distressed Debtor*, ABA Business Law Group – West Coast, Apr. 17, 2015, available at http://apps.americanbar.org/dch/thedl.cfm?filename=/CL190035/relatedresources/2015spring_debtfinancing_041715.pdf (accessed Jan. 22, 2016).

Acknowledgment

The authors would like to acknowledge the assistance of their colleagues Emily Stork, Alyssa McAnney and Amin Doulai for their invaluable assistance in the preparation of this chapter.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Sarah M. Ward

Skadden, Arps, Slate, Meagher & Flom LLP
4 Times Square
New York, NY 10036
USA

Tel: *+1 212 735 2126*
Fax: *+1 917 777 2126*
Email: *sarah.ward@skadden.com*
URL: *www.skadden.com*

Sarah M. Ward serves as co-chair of Skadden's Legal Opinion Oversight Committee. She served as co-head of Skadden's Banking Group from 2009 to 2014 and is a former member of Skadden's Policy Committee, the firm's governing body. Ms. Ward focuses primarily on the representation of borrowers and lenders in acquisitions and other leveraged financings, as well as corporate restructurings and workouts. She has extensive experience representing financial institutions such as Barclays, Citigroup and Goldman Sachs, and companies such as Travelport, CIT and Exide.

In 2015, Ms. Ward won the "Banking and Finance Award" at the Americas Euromoney Women in Business Law Awards. Ms. Ward is recognised as a leading attorney in *Chambers Global: The World's Leading Lawyers for Business* and *Chambers USA: America's Leading Lawyers for Business* and has been singled out for her extensive experience in leveraged financing work. She also has been included in *Best Lawyers in America in 2016*, *IFLR1000* (2013–15), *The Legal 500 U.S.* (2013 and 2014) and *The International Who's Who of Banking Lawyers* (2014 and 2015). Ms. Ward has authored numerous articles related to her practice, and has lectured extensively on banking-related topics.

Mark L. Darley

Skadden, Arps, Slate, Meagher & Flom LLP
40 Bank Street, Canary Wharf
London, E14 5DS
United Kingdom

Tel: *+44 20 7519 7160*
Fax: *+44 20 7072 7160*
Email: *mark.darley@skadden.com*
URL: *www.skadden.com*

Mark L. Darley has led Skadden's European law banking practice since joining the firm in April 2002 and was appointed global co-head of Skadden's Banking Group in 2009. Throughout his career, Mr. Darley has focused particularly on leveraged finance, restructuring and project finance transactions. His practice embraces advising both lenders and borrowers, including international financial institutions, private equity houses, hedge and other funds, and investment grade corporates. His clients have included Citibank, RBS, SG, SEB, Credit Suisse, UCB SA, Joh. A. Benckiser, Ares Life Sciences, Pfizer Inc., News Corporation, Vue Cinemas, Doughty Hanson and Oaktree, among others.

Mr. Darley has been selected for inclusion in *Chambers Global: The World's Leading Lawyers for Business*, *Chambers UK* and *Who's Who Legal – Banking*, and named "Leveraged Finance Lawyer of the Year in England 2014" by *Global Law Experts*.

Skadden

Skadden, Arps, Slate, Meagher & Flom LLP
and Affiliates

Serving clients in every major international financial centre, Skadden, Arps is one of the leading law firms in the world, with 23 offices and approximately 1,700 attorneys. Our diversified practice enables us to offer solutions to the most challenging legal issues in virtually every area of corporate law, providing the specific legal advice clients need to compete most effectively in a global business environment. We represent approximately 50% of the Fortune 250 industrial and service corporations, as well as financial and governmental entities; small, entrepreneurial companies; and cultural, educational and charitable institutions, advising on high-profile transactions, regulatory matters, and litigation and controversy issues.

Our Banking Group represents lenders and borrowers in complicated financing transactions. Our clients include some of the world's largest commercial and investment banks, insurance companies, finance companies, institutional lenders and investors, as well as LBO sponsors, private equity funds, hedge funds, strategic buyers, borrowers and issuers of securities.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

The Global Subscription Credit Facility and Fund Finance Markets – Key Trends and Forecasting 2016

Michael C. Mascia

Wesley A. Misson

Cadwalader, Wickersham & Taft LLP

Introduction

Despite numerous headwinds, the Subscription Credit Facility (each, a "Facility") and related Fund Finance markets continued their outpaced growth in 2015, building upon and continuing a market trend in place since at least 2010. Similarly, Facility credit performance remained pristine, and no loan losses or write-downs from last year have become public. This chapter summarizes the key trends in the Facility and Fund Finance markets in 2015 and forecasts developments for the coming year.

Credit Performance

To our knowledge, there were no payment events of default in the Facility or related Fund Finance markets in 2015. None of the Lenders from the 50+ banking institutions in attendance at the 6th Annual Global Fund Finance Symposium hosted by the Fund Finance Association on March 2, 2016 in New York (the "2016 Global Conference") reported a loss or payment event of default last year. Similar to 2014, we were not consulted on any funding delinquencies by limited partners ("Investors") on their capital calls ("Capital Calls"), other than a few by high net worth and family office Investors ("HNW Investors") that were subsequently remedied. While this positive credit performance has to a large extent become a baseline expectation in the Facility market, it does bear noting that this perfect credit performance extended to our hybrid and asset-level facilities last year, which are underwritten at significantly higher risk profiles. Interestingly, however, we have seen a significant rise in technical defaults caused by covenant breaches, predominantly around borrower reporting obligations. While we think this trend is simply a function of portfolio growth and the increase of newer private equity funds (each, a "Fund") borrowing their first Facility, it bears watching. Several active Lenders in the market are adding post-closing Fund training sessions with the aim to reduce these occurrences.

Resilient Growth

The year 2015 included a number of macro challenges to the Facility Market: drastic reductions in oil and commodity prices; significant disruptions and volatility in the public equity markets; a reported 24% drop in the total number of Funds closed in 2015 compared to 2014; and a growing Investor preference for separately managed accounts ("SMAs"), which are more challenging to lend to than traditional commingled fund vehicles.[1] Yet, despite these challenges, the Facility market marched onward, with many of the major lending participants ("Lenders") reporting portfolio growth in the 10% to 30% range for 2015. This growth was driven by the same factors that have been driving the market for some time. There are still Funds being introduced to the Facility product, and market penetration has been and remains a primary growth driver, especially in the middle market buyout space. Further, many Lenders have been upwardly adjusting their maximum hold positions, leading to larger availability for the larger Funds currently being formed. Similarly, Lenders have developed concepts to lend against the uncalled capital commitments of Investors that have historically been excluded from Facility borrowing bases ("Borrowing Bases"). These structural evolutions have extended Borrowing Base availability later into Fund life cycles, further extending the market. Finally, asset-based lending to fund-of-funds and secondary Funds secured only or primarily by their underlying fund interest investments has increased considerably. The fund-of-funds and secondaries sub-market is rapidly maturing to near consistent structures. This growth, combined with the huge fundraising success of secondary Funds in 2014, created extensive leverage financing activity in 2015 as well.

Structural Evolution

Partnership Agreements. Facility structural evolution was more muted in 2015 compared to prior years. The increasing concentration of Funds with the top-tier Fund formation law firms has been a significant positive for the Facility market, as these firms are intimately familiar with lending requirements and tend to produce bankable Fund limited partnership agreements from the outset. This positive trend on the collateral side of Facility structure has somewhat reduced the prevalence of asset-level mitigants, such as net asset value covenants, periodic clean downs and covenants to call capital.

Hurdle Requirements. One structural evolution that appears to be gaining traction across the market is "Hurdle Requirements" for including certain Investors in a Borrowing Base. Despite potential enforcement issues for certain sovereign wealth Fund, Texas and other historically challenging Investors, Lenders are more frequently gaining comfort including such Investors with solid credit profiles where the Fund is managed by a top-tier sponsor and the Investor pool is diverse.[2] The concept, often referring to such Investors as "Hurdle Investors", generally requires the Investor to have net funded at least 50% of its capital commitment before being eligible for inclusion in the Borrowing Base. Although this approach does not solve potential legal enforcement issues, Lenders gain comfort via the funded Capital Calls that the Investor's substantial skin in the game strongly incentivizes its further Capital Call funding.

Shadow Borrowing Bases. Another interesting trend is that of "Shadow Borrowing Bases". Many of the regional banks in the United

© Published and reproduced with kind permission by Global Legal Group Ltd, London

States have done an exceptional job of lending to smaller Funds over the years, but the sponsor's new Funds require Facilities larger than the regional bank wishes to deliver bilaterally. The Fund sponsor, valuing the relationship and frequently the perceived simplicity of a coverage ratio-style Borrowing Base afforded by these regional banks, awards them the mandate, tasking them with syndicating material Lender loan commitments. The traditional "subscription" Facility style Lenders, in order to participate, underwrite the Investor pool according to their more traditional included Investor/designated Investor/concentration limit formula, but do it on a shadow basis not conscripted in the credit documentation. In a static pool, this would of course be simplistic. But it does create interesting issues and approval standards with respect to new Investor closings and Investor transfers.

HNW Investor Facilities. During the past two years, we have experienced a notable uptick in the establishment of Facilities for Funds comprised mostly or exclusively of HNW Investors. This trend has emerged not only for middle-market sponsors but also for some of the largest sponsors in the market today. While traditionally challenging for Lenders to include HNW Investors in a Borrowing Base, certain Lenders are now viewing the diversity and granularity of the Investor pool in many cases to be a credit positive. For Funds where the HNW Investors invest indirectly through managed platforms of brand name wealth management institutions, comfort with the managed platform and some level of negotiated look-through rights or bespoke exclusion events related to the platform are often present. Many such Facilities remain bilateral and are generally smaller ($150 million or less) in size. However, we have recently seen some relative "giants" in terms of Facility size, where two or more Lenders have been required to participate. While we expect the overall impact of HNW Facilities to remain small in 2016, we forecast this as an area of continued growth.

Fund Performance

Fund performance in 2015 continued to be a factor driving overall Facility growth. Happy Investors are certainly expected to fund Capital Calls and seek to invest additional capital into new Funds. The most telling trend is that Investors are reaping the benefit of hefty distributions at record rates. The year 2015 marked the fifth consecutive year that Investors received more from Fund distributions than they funded via Capital Calls.[3] The net cash flows to Investors over that five-year period have exceeded $300 billion – equal to more than one-and-a-half years' worth of fund raising during that same period.[4] In fact, according to data presented by Preqin at the 2016 Global Conference, 94% of all Investors today have a positive view of Fund investment.

Legal Updates

Case Law Update. Other than the infrequent dust up that has occurred between an Investor and a general partner,[5] we are not aware of any substantial new case law relevant to Facilities in 2015. In fact, the often-cited *In re LJM2 Co-Investment, L.P.* and *Iridium* cases remain good law in Delaware and stand for the proposition that capital commitment funding obligations are enforceable for debt repayment in spite of a Fund bankruptcy or bad faith modification of Investor funding obligations.[6]

Making Bail-In. In January of 2016, new European "bail-in" rules became law and the ripple effect is making its way into Facility documentation, both in the U.S. and in Europe. Affected financial institutions, including European banks, under the new rules are subject to "bail-in" where certain of their unsecured liabilities could be subject to cancellation, write-downs, or conversion into equity in order to recapitalize the affected institution. Credit agreement language will require other Lenders and the borrowers to acknowledge and accept the potential application of the bail-in legislation.[7] Since banks are infrequent Investors in Fund borrowers today given the current regulatory regime, including the Volcker Rule,[8] we do not anticipate that the new "bail-in" rules will have a significant impact on collateral or the credit outlook for Facilities.

2016 Market Forecast

While we do expect the rate of Facility growth to slow in 2016 as compared to the previous three or four years, we continue to forecast growth in Lender portfolios in the 10% range year-over-year. There are simply too many factors supporting continued growth that outweigh a more pessimistic view. The number of Funds in the market is at an all-time high at 2,651.[9] The record levels of cash distributions made to Investors since 2013 will require them to re-up with Funds at meaningful levels to come close to maintaining their asset allocations, and as a result we are hard pressed to forecast a meaningful decline in 2016 Fund formation. If these Funds come anywhere close to their projected aggregate target for 2016 fundraising of $946 billion,[10] then 2016 could prove to be very solid from a fundraising perspective. But even assuming the recent macro level economic uncertainties materially slow fundraising, we think the Facility market will still show somewhat uncorrelated growth. There is a reported $1.34 trillion in dry powder available at the start of 2016, which is up from the $1.2 trillion level last year and marks the third consecutive annual increase since 2012.[11] Assuming a Facility market size of $300 billion in Lender commitments (our reasoned but unsubstantiated estimate), this still only yields a global advance rate of approximately 23%. Most Lenders have an average blended advance rate of closer to 30% across their portfolios, which suggests there is still ample room for Facility growth via penetration into new Funds. When you combine this likelihood of market expansion with Lenders getting increasingly comfortable lending to SMAs, lending to all HNW Investor Funds, extending Borrowing Bases and lending against Fund net asset value or investment assets, we think 2016 will continue its growth trend. Thus, market growth, while materially more modest than the eye-popping numbers sustained the last few years, should approach double digits once again in 2016.

Conclusion

Despite uncertainties in the macro landscape, the Facility market appears poised for another solid year in terms of portfolio growth in 2016. While Facility structures have been trending moderately in favor of Fund borrowers, we continue to believe that the credit profile of market-structured Facility transactions forecasts well for Facility performance in the coming year and we do not forecast any systematic or widespread default or loss occurrences.

Endnotes

1. *See*, 2016 Preqin Global Private Equity & Venture Capital Report ("2016 Preqin Report"), p. 19. Note: Preqin cautions that data as of the 2016 Preqin Report publish date was preliminary and this percentage is likely to decrease when final reporting has been completed.
2. We note that Texas state Investors are the most common subject of this trend as local law may not provide a complete waiver of contractual immunity.
3. $475 billion was returned to Investors in 2015 alone according to data presented by Preqin at the 2016 Global Conference.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

4. *See*, 2016 Preqin Report, p. 43.
5. *See*, *Wibbert Investment Co. v. New Silk Route PE Asia Fund LP et al.*, case number 650437/2013, in the Supreme Court of the State of New York, County of New York. Wibbert sought to avoid making a Capital Call seven times alleging fraud on the part of New Silk, but, according to the last publicly available reports, ultimately funded its capital commitment in order to preserve its status as a limited partner in the Fund.
6. *See*, *In re LJM2 Co.-Investment, L.P.*, 866A. 2d 762 (Del. Super. Ct. 2004) and *Chase Manhattan Bank v. Iridium*, 307 F.Supp 2d 608, 612-13 (D. Del. 2004); local counsel should be consulted for non-Delaware jurisdictions, which often have similar case law: *see Advantage Capital v. Adair* [02 Jun 2010] (QBD) Claim no. HQ10X01837 (Order for breach of contract granted in favor of private equity fund that sued a limited partner for repudiation under English law).
7. Each of the LSTA and LMA have published form language for syndicated credit agreements regarding European "bail-in" acknowledgment.
8. The aggregate level of bank Investor commitments has reduced by an aggregate of nearly 56% since 2011 according to numbers presented by Preqin at the 2016 Global Conference.
9. *See*, Preqin 2015 Fundraising Update ("Preqin 2015 Update"), p. 2.
10. *See*, Preqin 2015 Update, p. 2.
11. *See*, 2016 Preqin Report, p. 13.

Michael C. Mascia
Cadwalader, Wickersham & Taft LLP
227 West Trade Street
Charlotte, NC 28202
USA

Tel: +1 704 348 5160
Email: michael.mascia@cwt.com
URL: www.cadwalader.com

Mike Mascia is a partner in Cadwalader, Wickersham & Taft's Capital Markets Group. He has extensive experience representing a variety of lenders across a range of secured lending transactions, with particular emphasis on the financing of investment funds and financial institutions. He has a globally recognised practice in the subscription credit facility space, having represented both balance sheet and commercial paper conduit lenders in facilities to real estate and private equity funds sponsored by many of the world's preeminent fund sponsors.

Mike has represented the lead arrangers in many of the largest subscription credit facilities ever consummated. He has been lead counsel on numerous hybrid facilities, and is one of the few attorneys in the United States with experience in both subscription credit facilities and CLOs. Mike represents lenders on leverage facilities to secondary funds and other credits looking primarily to fund assets for repayment. Many of his transactions are cross-border in nature, and he is well-versed in the nuances of multi-jurisdictional transactions.

Mike is the founder of the annual Subscription Credit Facility and Fund Finance Symposium and is a founding member and the Secretary of the Fund Finance Association. Mike is recognized as a Leading Lawyer in the area of Banking and Finance in the *International Financial Law Review*'s IFLR1000 Legal Directory in 2015.

Wesley A. Misson
Cadwalader, Wickersham & Taft LLP
227 West Trade Street
Charlotte, NC 28202
USA

Tel: +1 704 348 5355
Email: wesley.misson@cwt.com
URL: www.cadwalader.com

Wes Misson is a partner in Cadwalader, Wickersham & Taft's Capital Markets Group. Wes's practice focuses on fund finance and he has represented financial institutions as lenders and lead agents in hundreds of subscription credit facilities and other fund financings, with his experience encompassing both subscription and hybrid facilities. Wes also works with fund-related borrowers on the negotiation of third-party investor documents with institutional, high net worth and sovereign wealth investors.

Wes has served as lead counsel on many of the largest and most sophisticated fund financings ever consummated, notably having assisted more than 35 banks as lead or syndicate lender during the past two years with transaction values totalling in excess of $25 billion. Many of the transactions he advises on are precedent setting, carrying unique structures and complex international components – whether that be foreign limited partners or funds, multi-currency advances or foreign asset investment.

Wes has been recognized as a "Rising Star" in the US in the area of Banking and Finance in the *International Financial Law Review*'s IFLR1000 Legal Directory, and is also a frequent speaker and an accomplished author in the area of fund finance. He has worked extensively with financial institutions to develop form agreements for fund finance transactions, many of which are the dominant forms used in the market today, and to educate bankers, internal legal counsel and credit officers on hot issues and trends affecting the fund finance market.

Cadwalader, Wickersham & Taft LLP, founded in downtown New York in 1792, is proud of more than 200 years of service to many of the world's most prestigious financial institutions and corporations. With more than 450 attorneys practicing in New York, London, Charlotte, Washington, Houston, Beijing, Hong Kong and Brussels, we offer clients innovative solutions to legal and financial issues in a wide range of areas. As a longstanding leader in the securitization and structured finance markets, the Cadwalader team features lawyers with a broad range of experience in corporate, securities, tax, ERISA, bankruptcy, real estate and contract law. Consistently recognized by independent commentators and in the league table rankings, our attorneys provide clients unparalleled insight regarding fund finance, asset-backed and mortgage-backed securitization, derivatives, securitized and structured products, collateralized loan obligations, synthetic securities, swap and repo receivables, redundant insurance reserves, and other financial assets.

For more information please visit www.cadwalader.com.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Recent Trends and Developments in U.S. Term Loan B

David Almroth

Denise Ryan

Freshfields Bruckhaus Deringer LLP

Introduction

The year 2015 represented a challenge for the U.S. loan market. The effects of the global slump in oil and gas prices, a decline in collateralised loan obligation (***CLO***) activity and the increasing regulatory focus on leveraged lending all contributed to a noticeable slow-down, especially in the second half of the year.

Overall syndicated loan issuance was down 6% on 2014, falling to $1.99 trillion, and the decline was more noticeable in the leveraged loan market with leveraged loan issuance falling to $783.34 billion, down 17% on 2014 and representing a four-year low.

Against that backdrop, it is interesting to note that the trend towards increased documentation flexibility for borrowers of Term Loan B (***TLB***), which has been a consistent theme of the last few years, continued in 2015. This article examines some of those trends, including areas where the terms of TLB continue to converge with those of high yield bonds.

Shifting Attitudes

Investment banks in today's TLB market operate an originate-to-distribute model, arranging the financing package before distributing all or a significant portion of the TLB to investors (although they will usually retain a portion of the revolving or other liquidity facility, which is still the domain of traditional banks). The ultimate holders of TLB are more likely to be non-bank lenders, i.e. institutional investors such as hedge funds and CLOs.

Institutional investors take a different approach to their participation in a loan syndicate from their traditional bank counterparts, viewing them as liquid, tradable and impersonal investments, rather than part of a broader institutional banking relationship with that borrower. They buy and sell loans opportunistically instead of holding them to maturity, meaning that they are less reliant on the protection that a more traditional TLB covenant package affords. They invest as part of an overall portfolio in which they will invest in high yield bonds as well as loans and, accordingly, have familiarity with high yield incurrence-based covenants. Opportunistic sponsors and borrowers have been able to use the shift in composition of the lender base to their advantage in order to push for greater flexibility in terms, in the knowledge that investors will continue to tolerate 'cov-lite' structures as long as the debt is sufficiently liquid. The increase in secondary market activity, absence of a close relationship between a borrower and its lenders and increasing syndicate sizes mean that covenant flexibility becomes even more important for a borrower, as larger and more impersonal syndicates mean that amendments to loan documentation can no longer be easily or cheaply obtained.

Regulatory Headwinds

As already noted above, while much of the resilience of the loan market over the last few years has been credited to the additional liquidity provided by CLOs, additional US and European capital requirements and risk retention regulations have put a strain on profitability, thus having an impact on new CLO issuance, which fell to $98.5 billion for 2015, down 17% on 2014.

In addition to this, the Leveraged Lending Guidance (the ***Guidance***) issued in 2013 by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System and Federal Deposit Insurance Corporation (collectively, the ***Agencies***) is having an increasingly noticeable effect on the leveraged lending industry.

Banks are required to report all leveraged loans to the Agencies for post-hoc review, and the Agencies have the power to find that banks under their supervision are engaged in unsafe and unsound banking practices. For U.S. banking organisations, the Guidance applies on an enterprise-wide basis. For foreign institutions with U.S. charters, the Guidance applies to all leveraged loans that are both originated and distributed in the U.S. The Guidance maintains that additional scrutiny will apply to transactions where leverage levels exceed 6.0x and the Agencies will focus on, among other things, the ability of the borrower to repay all senior debt or at least half of total debt within five to seven years. The Guidance provides general guidance for banks to follow, which the Agencies have further clarified in public statements and Q&A sessions, but does not provide a bright-line test for leveraged loans that could place a bank in danger of sanction by the Agencies.

The Guidance is now having a visible impact on the TLB market, not only in terms of deal flow but also on the leverage multiples and other specific documentation terms of leveraged transactions, including the flexibility to incur incremental debt and to make restricted payments. Regulated investment and commercial banks have become more cautious when underwriting highly leveraged transactions, regardless of market appetite. Leverage levels in syndicated financings fell in 2015 after an upward trend during the previous five years and leverage multiples on leveraged buyout (LBO) financings, in particular, fell to 6.0x, down from 6.5x times in 2014. In keeping with this, the average equity contribution in sponsored M&A deals increased to 39% in 2015 from 35% in 2014.

This reluctance on the part of the regulated investment and commercial banks has presented an opportunity for unregulated, non-bank (or at least non-deposit-taking bank) lenders to originate highly leveraged loans that may otherwise have attracted regulator criticism. The most prominent example being Jefferies, who have risen to second in the league tables (from ninth in 2014) as

© Published and reproduced with kind permission by Global Legal Group Ltd, London

an arranger of U.S. LBO loans by volume. Various large direct lending funds were also successfully closed in 2015, with a view to exploring the opportunities presented by the withdrawal of the traditional banks from the highly-leveraged loan arena.

Recent Developments in Documentation

EU Bail-in provisions

In December 2015, the LSTA (alongside the LMA in Europe) published recommended language for inclusion in New York law loan documentation to accommodate the EU bail-in rules, implementing Article 55 of the EU Bank Recovery and Resolution Directive (2014/59/EU) (***BRRD***). Article 55 of the BRRD provides broad powers to the European regulatory authorities to rescue EU financial institutions without undergoing a formal insolvency process and, importantly, without the application of public funds. Such rescues may be implemented by way of writing-down or converting into equity the claims of unsecured creditors (unless expressly excluded) and cancelling or diluting shareholder interests.

The LSTA's suggested contractual recognition provision complies with the BRRD requirement to notify, and obtain acknowledgment from, contractual counterparties that unsecured liabilities arising under agreements with the creditor may be compromised through any potential bail-in.

Dead hand proxy puts

Proxy put provisions in change of control definitions returned to the spotlight in 2015, following on from the 2014 decision in *Pontiac General Employees Retirement System v. Ballantine (Healthways)*, in which the Delaware Court of Chancery did not dismiss a claim of breach of fiduciary duty against a board or a claim against the company's lenders of aiding and abetting that breach. The decision in question concerned the specific dead hand proxy put provision in the company's credit agreement which defined "continuing directors" (for the purposes of assessing whether a change of control had taken place) in a way which excluded any director nominated in connection with, or as a result of, a dissident-proxy challenge, whether or not the current directors had approved their appointment.

Both borrowers and their lenders are again weighing up the merits, and the risks, of including dead hand proxy put provisions in their credit agreements. In certain circumstances, lenders may be amenable to amending credit agreements in order to mitigate their risk of potential aiding and abetting liability.

Economic Terms

Pricing

Attitudes towards TLB pricing have changed over recent years and parties now consider a wider range of factors rather than just margin. LIBOR, typically set at 1%, and other base rate 'floors' are common features of TLB. While TLB facilities are traditionally floating-rate instruments, the historically low interest rates of recent years have resulted in TLB effectively becoming fixed-rate with a rate of interest equal to the floor plus the applicable margin. This remains the case despite the increase in interest rates by the Federal Reserve in December – the first in nearly a decade.

The increasing importance of LIBOR floors and OID (the discount from par value at the time that the loan is issued) in both syndicating and trading TLB has led to a broader approach when calculating or considering pricing of TLB. Loan agreements will typically refer to the more encompassing concept of 'all-in yield' (particularly in connection with 'soft call' repricing protection and the 'most-favoured-nation' pricing restriction governing the incurrence of incremental facilities) which takes each of these factors into account.

Call protection

Investors still generally accept that TLB is a prepayable instrument. However, the depth and liquidity of the TLB investor base continue to drive pricing as much as the credit fundamentals of a particular borrower. This has allowed borrowers to take advantage of high demand in the market to reprice (either by way of an amendment to a loan agreement or a refinancing of outstanding loans) even within a few months of initial issuance. As a result, investors often demand that some limited pricing protection be included in TLB facilities from the outset.

This protection usually takes the form of a 'soft call' – a prepayment premium of typically 1% payable in connection with repricings of TLB occurring within 6 to 12 months (and more recently, 18 months) from the original issuance of the loan. Borrowers will push for carve-outs and exceptions to this regime in circumstances where prepayments are made in connection with a change of control, with IPO proceeds and, increasingly, if loans are repriced in connection with a permitted acquisition or major acquisition or if the repricing of the loans is not the 'primary purpose' of any relevant refinancing.

Non-call periods (subject to 'make-whole' calls) and 'hard-calls' (i.e. prepayment premiums of typically 1% to 3% within one to three years following the closing date) are rarely included in TLB (although they are more customary in second lien or other junior financings). However, in the limited deals where we have seen TLB with hard call protection and non-call periods, the borrowers have had high yield bonds outstanding and including bond-like call protection was necessary in order to attract investors to the TLB.

Mandatory prepayments

In keeping with the move away from a delevering model, mandatory prepayment requirements have become less onerous. Many TLB facilities no longer contain a requirement to prepay debt with the proceeds of equity offerings. More recently, we have begun to see the elimination of the excess cash flow (***ECF***) sweep.

The requirement to prepay TLB with the net proceeds of dispositions is subject to many carve-outs, including per-transaction and aggregate materiality thresholds (below which the prepayment requirement does not apply) and permissive reinvestment rights during 12- to 18-month periods following the receipt of the relevant net proceeds. In addition, where TLB facilities permit a borrower to incur additional *pari passu* senior secured indebtedness, asset sale prepayment covenants now often permit the borrower to share asset sale proceeds ratably with such other *pari passu* secured creditors, if required under the terms of the relevant documentation. More recently, the asset sale prepayment requirement has been further eroded through leverage hurdles, which if met, require a declining percentage of net proceeds to be applied in prepayment.

Collateral package

Generally speaking, TLB will be secured on a senior basis by substantially all the assets of the borrowers and guarantors. A list of 'excluded collateral' has become fairly commonplace, excluding both categories of collateral, including leasehold interests, immaterial real

© Published and reproduced with kind permission by Global Legal Group Ltd, London

property and immaterial commercial tort claims, and subsidiaries, such as controlled foreign corporations (where pledges of shares are limited to 65% of first tier foreign subsidiaries) and pledges of shares of unrestricted subsidiaries and immaterial subsidiaries. The location and type of assets and geographic spread may result a collateral package that may be significantly more limited than expected.

Restrictive Covenants

The overall framework governing the covenants in TLB facilities has remained roughly stable, despite the significant loosening of terms. For the most part, TLB facilities have not adopted the form of high yield covenants. However, the substance of the covenants in 'cov-lite' and even in facilities with maintenance covenants provides much more flexibility, akin to high yield bond incurrence covenants, where many corporate actions are permitted subject to the meeting of certain ratios. For example, most TLB facilities keep payments to shareholders (or restricted payments), investments and prepayments of subordinated debt as separate covenants but have builder baskets and general baskets that net across the three covenants. This bond-like flexibility allows borrowers to enter into strategic transactions and incur or refinance debt without seeking the consent of their lender syndicate and without incurring the associated costs of doing so.

As in high yield bond indentures, TLB facilities now typically include the concept of restricted and unrestricted subsidiaries, where the borrower may designate certain subsidiaries as unrestricted subsidiaries. Unrestricted subsidiaries are not subject to guarantee and security requirements, compliance with covenants and events of default and are excluded from the calculation of financial definitions and ratios.

Grower baskets (i.e. where a basket is sized at the greater of a fixed dollar amount or a set percentage of the borrower's total assets or EBITDA) are now a generally accepted concept in TLB. While there is an increasing trend towards EBITDA rather than total assets, occasionally, if more appropriate for the relevant business, other metrics such as net revenues or net tangible assets may be referenced instead. Grower baskets may have started life as a feature of debt and investment covenants (the rationale being that as a result of organic growth or bolt-on acquisitions, a fixed basket based on the size of the business at the closing date may be too restrictive for the larger business) but have spread to various other covenants, including restricted payments baskets.

Financial maintenance covenants

On larger deals, the prevailing trend for 'cov-lite' TLB remains for maintenance covenants to be limited to a springing maintenance covenant applicable only to, and controlled by, the revolving or asset-based lenders, or no covenants at all. These springing covenants are tested only when the relevant revolving or asset-based lending facility is drawn above a certain threshold.

Despite this, the current difficult market conditions have resulted in an increase in the inclusion of maintenance financial covenants, particularly on mid-market or smaller deals or those involving borrowers with an element of cyclicality to their cash-flows.

Debt incurrence

TLB facilities continue to allow broad flexibility to incur additional debt, whether on a first-lien, junior-lien or unsecured basis, inside or outside the credit facility and/or in the form of loans or bonds. Broadly, there is a distinction between refinancing or replacement loans, which may be incurred within certain parameters (relating to maturity, identity of the borrower and guarantors, etc.) and additional debt, which are subject to similar parameters but also to *pro forma* compliance with a financial ratio.

In practice, there have been a wide – and sometimes inconsistent – variety of approaches to documenting such flexibility, with debt being categorised in a number of different and often overlapping ways. Additional debt capable of being incurred within the framework of a particular credit agreement is generally referred to an incremental facility. Other types of permitted additional debt include incremental equivalent debt, acquisition-related debt, permitted ratio debt, replacement loans, amend-and-extend provisions and others. Similarly, there is not a consistent approach as to what type of financial ratio should govern the incurrence of a specific category of debt: first lien leverage; total secured leverage; total leverage; or a fixed charge cover ratio (***FCCR***).

Credit agreements will often include a "Most Favored Nation" provision or "**MFN**", which is designed to prevent a borrower from incurring incremental facilities or additional *pari passu* term loans with substantially higher pricing than the pricing applicable to the original TLB facility (a headroom of 1% is customary). The MFN is often drafted so that it only applies for an agreed period (known as the "sunset" period) of time, ranging from 6 to 18 months. In underwritten financings, the MFN sunset is increasingly the focus of flex provisions, allowing the lead arrangers to extend the sunset period or remove the concept entirely, with the effect that the MFN provisions will apply for the life of the facilities. We have also seen the MFN apply to refinancing debt in circumstances where only a portion of the original TLB is refinanced.

To facilitate using incremental facilities to finance acquisitions, it is increasingly common to allow the testing of the conditions to drawing an incremental facility (including projected compliance with any ratios and whether a default or event of default has occurred, other than specified major defaults) to be tested only at the time of signing the related acquisition agreement, in order to provide the borrower with more certainty around the availability of their financing to close the acquisition.

A number of TLB facilities now permit the incurrence of unlimited unsecured debt subject to satisfaction of a minimum FCCR (in many cases set at 2.0x) instead of a maximum total leverage ratio, aligning the standard to incur unsecured debt with high yield bonds. Even where a FCCR test for debt incurrence applies, in TLB facilities, additional secured debt is only permitted subject to satisfaction of a maximum leverage ratio (either first lien or total leverage). TLB facilities typically still include more stringent parameters around the terms of secured debt, including limitations on borrowing entity, final maturity, weighted average life, prepayments and, sometimes, more restrictive terms (for example, to require an 'MFN' with respect to the inclusion of any/more stringent financial covenant in any *pari passu* debt).

There is an increased focus on the levels at which the incurrence of incremental 'ratio' debt is permitted (regardless of whether such additional debt is incurred as part of the facilities or outside, in the form of bonds or loans). In some instances, these levels are becoming more conservative as a result of the Leveraged Guidance. Many borrower-friendly TLB facilities allow incremental borrowings in an unlimited amount subject to a ratio – frequently set at closing date leverage plus an additional dollar-capped basket (which itself may sometimes be increased dollar-for-dollar by the amount of loans voluntarily prepaid). This level of permissiveness, where the facilities build in the ability to leverage up beyond closing date leverage has become an area of increasing concern, given the Leveraged Guidance which, significantly, includes untapped baskets in calculating total leverage.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

An increasing number of TLB facilities are importing from high yield the ability of a borrower to reclassify debt from one basket or exception to another, including from fixed dollar baskets to ratio-based exceptions. Any such reclassification has the effect of 'replenishing' the fixed dollar basket, which can then be used in the future at a time at which the borrower can no longer meet the incurrence ratio.

Another common feature of high yield bonds which is now frequently seen in TLB facilities is the contribution debt exception. This exception allows the borrower to incur debt in the same amount as any equity contributed to the borrower since the closing date, the theory being that the recapitalisation of the business should allow a certain amount of relevering without any significant deterioration of credit. The formulation has in some cases been tighter than found in high yield bonds, with time limits placed between the timing of the equity contribution and any related incurrence of debt. However there are no constraints on the use of proceeds of the initial equity contribution, other than excluding it from counting towards the available amount or other purposes which would lead to double-counting.

Builder baskets and additional ratio-based permissions

Flexibility to make restricted payments, investments and to prepay subordinated debt has come in the form of an 'available amount' or 'cumulative credit' builder basket. When first introduced, this basket was almost always built from a basis of retained ECF and could only be used subject to satisfying a certain leverage level. While retained ECF remains the basis in the majority of deals, an increasing number of TLB facilities calculate the available amount based on 50% of consolidated net income (or in a small number of deals, other formulations, such as the greater of retained ECF and 50% of consolidated net income) and, if the test for incurring unsecured debt is a FCCR condition and not a leverage test, replacing the leverage ratio condition with a FCCR condition.

Typically, the use of the builder basket is subject to meeting a leverage ratio condition and the absence of any continuing defaults. In some TLB facilities, these conditions now only apply to the making of restricted payments, not to investments. In addition, the builder basket may also benefit from a 'starter' basket: a fixed amount which is available from the closing date and can be used without satisfying any of the other conditions to the use of the builder basket, effectively increasing the true size of the fixed-dollar general basket capacity for restricted payments and investments.

In addition to the flexibility to use the available amount, many recent deals have also included a separate carve-out giving unlimited ability to make restricted payments and investments and to prepay junior secured debt, subject only to compliance with a maximum leverage ratio and typically a requirement that no event of default is continuing at the relevant time. The leverage ratio is generally set at a lower level than required for use of the available amount or the incurrence of ratio debt, but this additional flexibility is now a feature of many top-tier sponsor deals.

Permitted acquisitions and investments in non-loan parties

The conditions to making acquisitions continue to loosen, with the only conditions frequently being the absence of any continuing event of default and a cap on the acquisition of entities that do not become loan parties. However, in some instances, particularly where a borrower has significant non-U.S. operations or a non-U.S. growth strategy, permitted acquisitions of entities that do not become loan parties as well as investments by loan parties in non-loan parties are uncapped. The borrower remains subject to the overriding requirement that any restricted subsidiary which becomes a material subsidiary must become a guarantor and grant security.

However, the requirement to provide a guarantee and grant security does not apply to excluded subsidiaries, often defined to include all controlled foreign corporations or in some cases, all foreign subsidiaries. For borrowers with a more international presence or growth strategy, an alternative to the blanket exclusion of all foreign subsidiaries from the guarantee and collateral requirement is a requirement for non-US subsidiaries to grant guarantees and security in favour of the obligations of any existing or future non-US borrowers. This may mitigate any lender concerns around value leakage to non-loan parties while avoiding the adverse tax consequences that can result from controlled foreign corporations granting guarantees and security in favour of obligations of US borrowers.

Financial definitions

The flexibility afforded by TLB covenant structures is enhanced further by the generous terms of the financial definitions that govern the ratios and baskets. In particular, the definition of EBITDA includes broad add-backs for items including any extraordinary, unusual or non-recurring items, the latter two of which are not defined under US GAAP and which have no fixed definition, and for actual restructurings and business optimisation expenses. The definition will also include an add-back for projected cost savings and synergies (including those relating to initiatives with respect to which actions are only expected to be taken within 12 to 24 months) which are sometimes capped at a percentage of actual EBITDA of the group for the relevant period. It is standard for these projected cost savings to be reasonably identifiable and factually supportable as determined by the borrower with no requirement for independent verification. In addition, many leverage covenants and tests are calculated on a net basis – reducing the debt by the amount of unrestricted cash of the borrower (often without any cap). Once again the Guidance has put pressure on the ability of borrowers to achieve as flexible terms as in the past when it comes to financial calculations and addbacks.

Assignments and Consents

Assignments

Despite the active trading market in TLB and investor focus on liquidity, some constraints on assignments remain customary. In general, a borrower's consent to assignments (not to be unreasonably withheld) is required. However, the consent requirement falls away while certain events of default (typically limited to payment and bankruptcy) are continuing. Consent will also be deemed to be given if the borrower fails to respond within a specified period. The length of such period has been a recent point of negotiation, with borrowers resisting the LSTA recommended position of five business days. Assignments to disqualified institutions (i.e. competitors and other identified institutions) are also prohibited. The list of disqualified institutions is typically frozen at the start of primary syndication (other than as to competitors, which can be updated over the life of the TLB) and must be disclosed to all potential and existing lenders.

Consents

The thresholds for amendments have historically been set at a simple majority of lenders, when most fundamental rights (including economic rights and release of substantially all guarantees and security) requiring consent of all lenders. These thresholds have evolved in order to accommodate increased flexibility for the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

borrower to partially refinance TLB and to incur additional debt. Matters that used to require unanimous consent commonly now require consent only from 'each affected lender'. This would, for example, allow a borrower to extend the maturity of a loan with only the consent of the lenders who agree to extend, while lenders who do not agree to be extended do not have any blocking right. While the standard is frequently expressed to be 'each affected lender', in practice some amendments (e.g. the release of collateral) will still require unanimous consent.

Separately, TLB facilities now include provisions to make it possible in practice for borrowers to take advantage of the more permissive debt covenant. No lender consent is required for consequential amendments that are necessary in order to allow the incurrence of permitted debt; for example, amendments to the TLB facilities to include incremental or replacement loans or amendments to an intercreditor agreement to provide for a new class of creditors.

Conclusion

The TLB covenant package continues to evolve away from the traditional bank model of covenants that require delevering and engagement with lenders for significant transactions and this theme continued in 2015. However, the volatility in the loan markets has had a noticeable effect already and there appears to have been a loss in momentum as the year drew to a close. Regulatory pressures in the form of the Leveraged Guidance and Basel III have further dampened activity, especially in the leveraged loan market, and renewed investor focus on quality credit is driving the types of deals that can get done and financing structures available to implement them.

As we enter 2016, borrowers may find themselves needing to find increasingly creative solutions, and may be required to approach a wider number of banks and non-bank lenders, in order to secure financing. It is possible we will see less opportunistic financings (i.e. with the aim of reducing rates or improving other terms), with borrowers waiting out soft market conditions unless strategic or other reasons compel them to enter unpredictable markets.

Acknowledgment

The authors would like to acknowledge the assistance of finance associate Leon Daoud in the preparation of this chapter.

David Almroth

Freshfields Bruckhaus Deringer LLP
601 Lexington Avenue, 31st Floor
New York, NY 10022
USA

Tel: *+1 212 277 4070*
Email: *david.almroth@freshfields.com*
URL: *www.freshfields.com*

Dave has represented corporations, equity sponsors and strategic investors, as borrowers, and investment banks, commercial banks, hedge funds and other institutions, as agents and lenders, in a wide range of financing transactions. These transactions have included secured and unsecured financings, asset-based loans, bridge loans, first lien/second lien financings, corporate recapitalisations, acquisition financings, and other types of complex and traditional transactions. He has also represented both borrowers and lenders in connection with in-court and out-of-court restructurings and workouts, including debtor-in-possession financings and bankruptcy "exit" financings. Prior to joining Freshfields, Dave was a member of the banking group at Skadden, Arps, Slate, Meagher & Flom. He earned his JD from Seton Hall University School of Law and his BA from Wheaton College.

Denise Ryan

Freshfields Bruckhaus Deringer LLP
65 Fleet Street
London EC4Y 1HT
United Kingdom

Tel: *+44 20 7785 2767*
Email: *denise.ryan@freshfields.com*
URL: *www.freshfields.com*

Denise concentrates on cross-border corporate finance transactions, with a particular focus on acquisition and leveraged finance, advising on both bank financings and high-yield bond offerings, acting for sponsors, borrowers and lenders. Her facility with both capital markets and banking products, as well as with both U.S. and European acquisition finance market practice, allows her to advise clients across a broad range of products and jurisdictions. Denise is noted by *The Legal 500* for her "top-class response times and brilliant industry experience". She received a JD from New York University.

Freshfields Bruckhaus Deringer

This material is provided by the U.S. law firm Freshfields Bruckhaus Deringer US LLP and the international law firm Freshfields Bruckhaus Deringer LLP (a limited liability partnership organised under the law of England and Wales) (the UK LLP) and by the offices and associated entities of the UK LLP practising under the Freshfields Bruckhaus Deringer name in a number of jurisdictions, together referred to in the material as "Freshfields". For regulatory information please refer to www.freshfields.com/support/legalnotice.

Freshfields Bruckhaus Deringer US LLP has offices in New York City and Washington, D.C. The UK LLP has offices or associated entities in Austria, Bahrain, Belgium, China, England, France, Germany, Hong Kong, Italy, Japan, the Netherlands, Russia, Singapore, Spain, the United Arab Emirates and Vietnam.

This material is for general information only and is not intended to provide legal advice. Prior results do not guarantee a similar outcome.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

The Continued Migration of US Covenant-Lite Structures into the European Leveraged Loan Market

Latham & Watkins LLP

Jane Summers

James Chesterman

At the start of 2016, global sponsors and their advisers are continuing to apply their experiences from financing transactions in the US leveraged loan and global bond markets to the European leveraged loan market. Healthy investor appetite over the last several years means attractive terms can be selected from the US loan market, which has been more sponsor-friendly for longer than the European market, owing primarily to the depth of its investor base. The continued adoption of US covenant-lite terms into European loans itself generates a source of European "cov-lite" precedents, thus in turn strengthening the precedential case for cov-lite, in the absence of a market correction. Loan markets are currently somewhat volatile, however, so further erosion of covenant terms may be unlikely for as long as this volatility continues. This convergence brings a number of new documentation issues to consider.

Covenant-Lite Loans

The US model of covenant-lite is increasingly being adopted in Europe. In a covenant-lite loan, either there is no financial maintenance covenant or there is a single financial covenant solely for the benefit of the lenders under the revolving credit facility with no financial maintenance covenant for the term lenders. Moreover, the covenant benefiting the revolving lenders typically is a "springing" covenant, i.e., tested when the revolver is drawn and such usage exceeds a certain percentage of the revolving credit commitments, often 25–35%, with the applicable levels set with significant EBITDA "cushion" or "headroom" of around 30% or more and no or very few step downs. It is worth noting that associated provisions customary in US covenant-lite structures have not necessarily been adopted wholesale in Europe. For example, the US-style equity cure, with amounts being added to EBITBA and no requirement for debt pay-down, is still resisted by some lenders in Europe (although perhaps increasingly less successfully). The European market generally permits over-cures, whereas the US market does not.

Documentary Flux

The characteristics of European covenant-lite loans other than with respect to financial covenants themselves have to date been less uniform. This was in part due to a 'battle of the forms' in relation to documenting European covenant-lite loans. The first covenant-lite loans to emerge in the Europe market in the post-credit crunch cycle appeared in 2013, and which were documented under New York law, were used to acquire European assets and were either partly or wholly syndicated in Europe. The next generation were governed by LMA-based credit agreements, stripped of most financial covenants and otherwise modified in certain respects to reflect 'looser' US practice on terms. The third generation, in the market in 2015 and set to become the norm, are hybrid LMA-based loan agreements that in addition to the absence of financial covenants for the term loan adopt more wholesale changes based on US market practice, primarily in that they introduce leverage- or coverage-based incurrence style ratio baskets rather than traditional loan market baskets fixed at a capped amount. A number of the other features of current covenant-lite European leveraged loans are considered below.

Increased Debt Baskets

Limitations on borrowings are developing US-style characteristics, so rather than a traditional debt basket with a fixed capped amount, we now see permitted debt limited solely by a net leverage or secured leverage test with a separate fixed capped ("freebie") basket alongside. This debt can be raised through an incremental "accordion" feature and sometimes separate "sidecar" financings. This style of covenant leads to far greater flexibility for a borrower to raise additional debt as *pari passu* secured, unsecured or subordinated loans or bonds. In some financings, reclassification is permitted so that the "freebie" basket can be used if the ratio basket is unavailable, and then subsequently moved into the ratio basket once the ratio is met, thus freeing up the "freebie" basket.

Builder Baskets

Another trend from the US covenant-lite loan market (which is also a feature of the high-yield bond market) that is being adopted in European loan deals is a "restricted payments builder basket", where the borrower is given "credit" as certain items "build up" to create dividend capacity, starting with the borrower's retained portion of excess cashflow ("ECF"), IPO and other equity proceeds, and unswept asset sale proceeds, usually subject to a net leverage ratio governor as a condition to usage. There is a trend towards an even more aggressive variant based more closely on the high-yield bond formulation, which credits a percentage of consolidated net income ("CNI") (usually 50%) rather than retained excess cashflow, with the disadvantage for lenders in that CNI is not reduced by the deductions used to calculate ECF and because the build-up may begin for years prior to the onset of the ECF sweep.

US-style Events of Default

US-style events of default continue to be resisted by European loan syndicates, but we have seen isolated loan financings that

© Published and reproduced with kind permission by Global Legal Group Ltd, London

include defaults more akin to the US loan approach, e.g., removal of material adverse change default; no audit qualification default or even the high-yield bond approach (more limited defaults with longer remedy periods).

Other Provisions

There are a few other provisions we are seeing migrate from the US covenant-lite (or high yield) market to Europe, such as:

- Permitted acquisitions controlled by a leverage test rather than by imposing absolute limits – and otherwise fewer controls on acquisitions.
- Permitted disposals similarly trending towards a high yield formulation that does not impose a cap and has varying requirements for reinvestment/prepayment and cash consideration.
- Change of control mandatory prepayment being adjusted to allow individual lenders to waive repayment (becoming effectively a put right).
- Increased use of general "baskets" (as distinct from and in addition to ratio-based incurrence tests) with a soft dollar cap that increases as total assets or EBITDA grows.
- Provisions that state that if FX rates result in a basket being exceeded, this will not, in and of itself, constitute a breach of the debt covenant (or other limitation).

Economic Adjustments

Economic adjustments such as a 101% soft call for six months, a EURIBOR floor, and nominal (0.25%) quarterly amortisation are also being introduced to make loans more familiar to US loan market participants.

Structural Consequences – the Intercreditor Agreement Revisited

Adopting products from other jurisdictions brings with it the risk of unintended consequences. US terms and market practice have developed over decades against a background of the US bankruptcy rules and US principles of commercial law. The wholesale adoption of US terms without adjustment to fit Europe's multiple jurisdictions can lead to a number of unintended consequences.

A good example of this relates to European intercreditor agreements, which have over time developed to include standstills on debt claims and release provisions. At heart is the continuing concern that insolvency processes in Europe still, potentially, destroy value. Although significant steps have been taken in many jurisdictions to introduce more restructuring friendly and rescue-driven laws, it remains the case that in Europe there is a far greater sensitivity to the ability creditors may have in times of financial difficulty to force an insolvency filing by virtue of putting pressure on boards of directors through the threat of directors' liability under local laws. A significant feature of the restructuring market in Europe for many years has been the use of related techniques that creditors, particularly distressed buyers, adopt to get a seat at the table by threatening to accelerate their debt claims. Standstill provisions evolved to prevent creditors from using this type of action to disrupt a restructuring without having to resort to a bankruptcy proceeding to provide a stay and thereby obtain increased recoveries.

Another intercreditor provision of great focus over the years has been the release provision, which provides that in the case of distressed asset sales following default and acceleration, the lenders' debt and guarantee claims against, and security from, the companies sold are released. In some deals from the last decade, these protective provisions had not been included, with the result that junior creditors could gain significant negotiating leverage because their approval was needed for the release of their claims and security, without which it is not possible to maximise value in the sale of a business as a going concern.

The potentially significant debt baskets referred to above become relevant in this context. In the US, where this flexibility originated, debt baskets do not legislate as to where in the group debt can be raised – structural subordination does not often play a significant role in a US bankruptcy because typically the entire group would go into Chapter 11. In Europe, structural subordination can have a dramatic effect on recoveries (as suffered by the first wave of European high yield bonds in the 1990s, which were structurally subordinated). Even if those subsidiaries have granted upstream guarantees, the value of the claims under such guarantees are often of limited value.

Until very recently, most provisions allowing the incurrence of third party debt did not require the debt providers to sign up to the intercreditor agreement unless they were sharing in the security package. With this new flexibility it is very possible that an unsecured creditor under a debt basket can have a very strong negotiating position if the senior secured creditors are trying to sell the business in an enforcement scenario, given the lack of standstill and release provisions. We are therefore seeing a continuing trend that third party debt over a materiality threshold is required to become subject to the main intercreditor agreement. It is of note that while this is becoming a trend in loan transactions, it has yet to become a focus in European bond transactions.

What Does This Mean for the Rest of 2016?

It seems likely that ultra-low interest rates, likely to prevail in the Eurozone for some time, and the depth of the investor base looking for yield will continue to permit significant flexibility in covenant and documentation issues when the loan markets are open for business. Whilst volatility in 2016 has meant that further erosion of terms has not occurred, we do not see an end to the continued migration of covenant-lite in the European market at this time.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Acknowledgment

The authors would like to thank Daniel Seale and Sam Hamilton for their invaluable assistance in the preparation of this chapter.

Daniel Seale is a partner in the New York office of Latham & Watkins and is a Co-chair of the firm's global Banking Practice. Mr. Seale is a member of the Finance Department and the Banking, Capital Markets and Private Equity practices, and is a member of the firm's Strategic Client Committee. He is a former Vice Chair of the firm's Associates Committee and former local chair for the Finance Department in the New York office. Mr. Seale's practice focuses primarily on the representation of financial institutions, borrowers and issuers in leveraged finance transactions with a particular focus on acquisition financings. Mr. Seale has also represented buyers and sellers in both public and private mergers and acquisitions transactions. He is recognised as a leading lawyer in his field by *Chambers USA 2015*. Tel: +1 212 906 1341 / Email: daniel.seale@lw.com.

Sam Hamilton is a finance partner in the London office and is Chair of the firm's Finance Department in London, which includes the practice areas of acquisition finance, banking, project finance, restructuring and structured finance. Mr. Hamilton has experience working at all levels of finance capital structures, including senior debt, mezzanine debt, unitranche debt, first/second lien financings, PIK debt, vendor loans, dividend recapitalisations, asset-backed loans, bridge facilities, high-yield bonds and restructurings. Mr. Hamilton is recognised as a leading lawyer in his field by *Chambers UK 2016*. Tel: +44 20 7710 1124 / Email: sam.hamilton@lw.com.

Jane Summers
Latham & Watkins LLP
885 Third Avenue
New York, NY 10022-4834
USA

Tel: +1 212 906 1838
Email: jane.summers@lw.com
URL: www.lw.com

Jane Summers is a partner in the New York office of Latham & Watkins and is a member of the Finance Department and Banking Practice. She focuses on the representation of financial institutions in leveraged finance transactions, including acquisition, cross-border, and exit financings and other senior secured lending transactions. Ms. Summers also advises loan market participants on strategic initiatives designed to address structural issues in the syndicated lending and loan trading markets.

Ms. Summers has been active in the syndicated lending market since its infancy in the mid-1980s, having spent the first decade of her career at another global law firm, then serving as Deputy General Counsel for Barclays in the Americas, and from 2000 to 2005 acting as the LSTA's first General Counsel where she led the efforts to develop the organisation's legal, documentation and regulatory strategies for key industry issues that established standard market practices and procedures.

James Chesterman
Latham & Watkins LLP
99 Bishopsgate
London EC2M 3XF
United Kingdom

Tel: +44 20 7710 1004
Email: james.chesterman@lw.com
URL: www.lw.com

James Chesterman is a partner in the London office of Latham & Watkins and has more than 25 years' experience in finance matters across Europe, including investment grade lending, asset-based lending, leveraged and acquisition finance and workouts and restructurings. His clients include many of the world's top investment and commercial banks and he has also acted for a range of private equity funds and corporates in the negotiation of their loan facilities. More recently, his client base has extended to include various non-bank lenders, including credit funds and hedge funds. Mr. Chesterman is recognised as a leading lawyer in his field by *Chambers UK 2016*.

LATHAM&WATKINS

Latham & Watkins is a global law firm of more than 2,200 lawyers located in the world's major financial, business and regulatory centres dedicated to working with clients to help them achieve their business goals and to find innovative solutions to complex legal issues.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Unitranche Financing: UK vs. US Models

Stuart Brinkworth

Fried, Frank, Harris, Shriver & Jacobson LLP

Julian S.H. Chung

I Introduction

What does "unitranche" mean? Most can agree that unitranche financings refer to debt financings that are typically provided by non-bank lenders for acquisition financings and refinancings in the middle-market – credit facilities of less than $450 million, which combine a senior tranche and a junior tranche in a single financing, providing borrowers with several key advantages over traditional first-lien/second-lien financings.[1]

It is also generally agreed that unitranche facilities permit one-stop shopping for borrowers; instead of needing to arrange senior and junior financing from different credit sources and negotiating multiple sets of credit documents, borrowers are able to negotiate a single loan agreement and single set of covenants. Additionally, unitranche lenders offer "bought" deals where the pricing and terms are set at the commitment letter stage (by which time the lending club has been arranged), with no risk to borrowers that pricing will be flexed upward at or after closing. In return, the pricing is generally higher than what might be expected in a more typical, syndicated bank financing but less than that of first-lien/second-lien financings on a blended basis if the syndicated bank market is not available to a borrower.

These structural advantages exist because these types of financings are typically provided by smaller groups of lenders who intend to hold their loans through maturity, instead of trading their investments like a Term Loan B. While more expensive than a single senior financing, these tighter lending relationships give borrowers more execution certainty over traditional financings with a potentially faster closing process, allowing the borrower to negotiate with a known group of lenders for amendments or in times of trouble.

But while unitranche financings have the same general attributes and similar origins in the US and the UK, they have a very different structure in each market. This article will explore and compare unitranche facilities, their history and related documentation in the UK and the US markets.

II Unitranche Loan Financing – the London Market

a) Background to the development of direct lending in Europe

Direct lending by non-bank lenders (also referred to as "direct lenders") in Europe has seen growth over the last two to three years. 2014 saw 195 deals completed, compared to 136 in 2013 (with less than 100 in 2012). During the three quarters ending September 2015, there were 173 direct lending deals recorded across Europe, the bulk of which were closed in the United Kingdom and France (source: Deloitte Alternative Lender Deal Tracker). The European middle-market leveraged finance market is undergoing a transformation from a bank-driven model to a fund or institutional investor-driven model. There are a number of factors influencing this shift:

- The onset of the Basel III system of bank regulation has required banks to hold more capital against leveraged loans. Consequently, leveraged loans have become an expensive and unattractive asset class for many European banks, especially the traditional "lend and hold" players in the middle-market.
- The low interest rate environment of the last few years has made it a rich fund-raising environment for credit funds that have been able to market favourable returns to investors seeking yield. For example, in December 2015, BlueBay Asset Management announced the closing of a €2 billion direct lending fund.
- Financial sponsors have been attracted to Term Loan B ("TLB")-style non-amortising structures offered by non-bank lenders and the more attractive terms that they have been able to offer compared with traditional bank debt. While banks have been trying to hold the line on covenants and amortisation, non-bank lenders in the unitranche market can often offer looser terms, including increased covenant headroom, fewer financial maintenance covenants ("cov-less"), portability (ability for acquirors of the borrower to keep the financing in place), permitted investor payments, looser acquisition/capital expenditure controls, greater use of retained cash and grower/builder baskets, among other terms. Sponsors have been willing to pay a premium over the cost of bank financing for those structures, especially given the additional liquidity and flexibility.
- As familiarity with the asset class has grown and the product has become more popular, the number of sponsors willing to borrow from direct lenders has increased rapidly.
- The growth in popularity of these types of structures has been amplified by the amount of liquidity in the middle-market created by the number of direct lending entrants and participants and the intense competition for mandates that such liquidity brings, creating competitive pressures to provide better terms to borrowers.
- Direct lenders are also often able to offer financing solutions across the entire capital structure, including minority equity/preferred equity investments and equity bridges, as well as payment in kind and other forms of subordinated debt (including second lien and mezzanine), thereby offering a greater range of options than traditional senior debt and enabling funds to structure returns in a more creative way.
- Direct lenders generally will offer larger deal holds than traditional banks (generally between €30 million and €200 million) and offer smaller teams and more efficient processes

© Published and reproduced with kind permission by Global Legal Group Ltd, London

to aid deal execution. Direct lenders will also provide direct access to deal-makers who will then follow the deal through its life rather than seeing it shipped off to a portfolio or even a restructuring team, where the relationship with the sponsor is of secondary interest.

While there can be no doubt that this transformation is taking place, the multi-jurisdictional nature of the European market means these changes are progressing at a different pace across the continent. This in itself poses challenges for investors that need to diversify their risk pool on a geographic basis but local banking regulations that vary by jurisdiction make it difficult to do so. And even with this transformation taking place, traditional banks will continue to participate in middle-market leveraged deals. Direct lenders cannot offer much needed ancillary facilities for sponsor-owned businesses and not many funds can offer (or are willing to administer) cash revolving credit facilities and hedging and other treasury management products, meaning there is still a role for traditional banks to play. Indeed, banks have responded to the rise in direct lending by themselves offering European TLB-style structures and one of the features of growth in the direct lending market has been the number of banks and funds that have entered into formal or informal arrangements to work together on transactions.

b) Overview of standard unitranche facilities

In a typical English law financing, the borrower will enter into a credit agreement that looks very much like a standard leveraged loan credit facility with a revolver and a term loan. The parties to the agreement will often be the final parties to the agreement and any margin allocation, voting rights, assignment restrictions and similar terms will be contained in the credit agreement, whilst enforcement rights, standstill protections, purchase and buy-out rights, rights to make protective advances, etc. will be set out in a separate intercreditor agreement. The borrower and lenders are party to both these agreements and there is no other agreement behind the scenes that alters any of the rights of the parties. In these facilities, the revolver will be the "super-senior" piece and the term loan will be the "junior" or "subordinated" tranche and will be generally larger in size than the super-senior tranche; both the revolver and term loan are secured by all assets, but the super-senior revolver piece will be paid before the junior term loan piece from the proceeds of collateral following an enforcement.

European deals utilise a 66⅔% majority lender concept (the "Majority Lenders"), and in almost all direct lending unitranche deals, the direct lenders providing the subordinated tranche constitute the Majority Lenders – thereby giving them sole control of day-to-day voting matters (other than those provisions that typically require unanimous consent), including control of the financial covenants and enforcement rights. As a result, the super-senior lenders (who do not typically have a blocking vote on Majority Lender decisions) are granted the right to exercise remedies (subject to standstill) without the consent of the Majority Lenders upon the occurrence of certain "Material Events of Default". The super-senior lenders also generally benefit from a stand-alone financial covenant (either super-senior drawn leverage or minimum EBITDA) which remains within their sole control.

Typical Material Events of Default in European deals are:

- Breach of the super-senior financial covenant.
- Event of default as a result of a breach of the financial information undertakings.
- Payment default.
- Insolvency – this is sometimes limited just to a Revolving Facility Borrower or a "Significant Company".
- Repudiation and rescission of the Finance Documents.
- Breach of the negative pledge.

In addition, the super-senior lenders are given certain entrenched voting rights to protect them against Majority Lender decisions that may prejudice their position. These entrenched voting rights typically include:

- Amendments to the Material Events of Default.
- Sales/disposals which are "Significant" and amendments to such definitions.
- Amendments to the financial information undertakings.
- Amendments to certain general undertakings such as the negative pledge.
- Amendments to the super-senior financial covenant.
- Amendments to the conditions of utilisation of the super-senior facilities and repayment/prepayment terms related to the super-senior facilities.

Although the super-senior lenders have the right to exercise enforcement remedies following the occurrence of the Material Events of Default, this right can only be exercised at the end of the applicable standstill period, provided that the relevant Material Event of Default is still continuing and also provided that the Majority Lenders have not exercised an option to purchase super-senior liabilities, which is usually provided for in the documentation. The standstill periods can vary on a deal-by-deal basis but common periods are:

- 90 days for a non-payment Material Event of Default.
- 120–150 days for any other Material Event of Default.

In addition, where the Majority Lenders have commenced enforcement, the documentation usually provides that the super-senior lenders must be paid out in full (and in cash) within a specific time period and, failing that, the super-senior lenders may have their own independent right to enforce. Where the enforcement process is then driven by the super-senior lenders, the Majority Lenders take protection in the documentation by stipulating that their liabilities and security may only be released if such process is either a court-approved process, a competitive sales process or where a financial adviser has provided a fairness opinion on the proceeds realised from such enforcement.

c) First-out, last-out (FOLO) unitranche structures in Europe

One of the key features of the UK direct lending market has been that banks and direct lending funds have sought to enter into arrangements to enable them to offer a combined term loan product to sponsors. These arrangements have seen a block of unitranche debt carrying a blended unitranche margin offered to sponsors at term sheet stage (alongside a super-senior revolving credit facility), with the right to tranche that debt into two pieces and re-allocate the interest among those lenders as the bank and direct lender see fit prior to documents being entered into. This tranching creates a first-out loan (which ranks as part of the super-senior debt) and a last-out loan, which is more akin to the traditional subordinated tranche and enables the direct lender to enhance its return on the last-out loan by skimming some of the interest on the first-out loan as additional compensation for the increased risk.

The key item to note here is that the tranching and re-allocation of interest typically happen upfront at the time documentation is entered into and therefore the commitments, margin and ranking of debt is contained in the main credit agreement and intercreditor agreement. These structures are similar to the standard unitranche structure whereby the super-senior debt (which includes the revolving facility and the first-out loan of the unitranche debt) still constitutes no more than a third of the senior debt structure. They are therefore "junior led" in that the majority direct lenders still retain overall control

© Published and reproduced with kind permission by Global Legal Group Ltd, London

of the deal and the super-senior lenders retain similar individual rights in regards to voting and enforcement as with the standard unitranche structure as described above (although some may seek to enhance those rights by including more items in the "super-senior consent" provisions or by negotiating shorter standstill periods for super-senior enforcement as a result of holding a larger portion of the senior debt structure than in a standard unitranche facility).

One of the principal reasons why the European style FOLO structure has struggled to gain momentum in the European market has been the excess pool of liquidity available to middle-market sponsors coupled with the method of procuring that debt by the use of debt advisors. Debt advisors play a key role in the European middle-market as many sponsors do not have internal debt teams and therefore outsource the debt procurement process to industry specialists. These debt advisors will play the pool of liquidity to its maximum, often running multiple lenders individually against each other for as long as possible through a procurement process. Because lenders are often selected by the independent debt advisors based on a competitive process, they are not afforded the opportunity to come together as a lending group until right at the end of this process – meaning there is little room for lenders and funds who have formal or informal arrangements between them to offer this product directly to sponsors.

III Unitranche Loan Financing – the US Model

The principal difference between the UK and US style of unitranche FOLO financing is that the tranching and re-allocation of interest between the first-out and last-out lenders is not contained in the credit agreement or any other document to which the borrower is generally a party. Agreements Among Lenders or "AALs" are usually negotiated *inter se* between the senior and junior lenders participating in a given unitranche facility, though recently borrowers are increasingly requested to acknowledge or become parties to the AALs. In addition, because these deals are generally private and proprietary to the arranging lender, there is no standardised form of AAL that is followed in the US market, and as a result, AALs are highly negotiated for each transaction without a general standard template of terms. In the US, some direct lenders specialising in unitranche financings have relationships with other non-bank lenders that are often willing to provide the senior or junior tranche utilising a form of AAL from prior common deals.

Also, in the US, some of the key features that sponsors have negotiated in the mid-cap and large-cap financing markets can be tighter (or even absent) in unitranche financings such as tighter baskets, caps on incremental facilities and tighter limits on restricted payments.

a) Background to the development of direct lending in the US

A variety of factors similar to those in Europe have contributed to the increased presence of unitranche financings in the US middle-market over the last 10 years, including, significantly:

- Bank regulation in the US, including increased capital requirements and lower leveraged thresholds under the Leveraged Lending Guidelines, have restricted the liquidity available from traditional banks to middle-market borrowers which typically require higher leverage.
- Increased liquidity, combined with growth in the number of direct lending funds competing for deals and declining yields since 2009–2010.
- Sponsor familiarity with unitranche financings in capital structures.
- Increasing willingness of direct lenders (that are not currently subject to the same regulations as banks) to provide more significant amounts of financings above the typical middle-market levels at higher leverage levels.

In November 2015, Leveraged Commentary & Data estimated the outstanding US unitranche market based on five direct lenders alone was approximately $10 billion. Of the five lenders polled by LDC, the Senior Secured Loan Program (a joint venture between Ares Capital and GE Capital) has approximately $8.8 billion of outstanding unitranche loans alone.[2]

b) Agreements among lenders compared to intercreditor agreements

In a US unitranche financing, the AAL operates in place of the intercreditor agreement. Except for the splitting of the single interest rate, the AAL generally follows the allocation of rights between first lien and second lien intercreditor models. The following table briefly highlights some of the differences between an AAL and an intercreditor agreement.

Provision	Unitranche Agreement Among Lenders	First Lien/Second Lien Intercreditor Agreement
Waterfall	Applies to proceeds from enforcement actions; ensures that first-out lenders get repaid (up to a cap) before the last-out lenders.	Applies to proceeds from enforcement actions; ensures that first lien lenders get repaid (up to a cap) before the second lien lenders.
Interest Rates	First-out lenders could be required to pay the last-out lenders a specified portion of the interest payments.	Silent; no sharing of interest payments between first lien lenders and second lien lenders.
Voting Rights	Includes voting rights for (i) all amendments of credit agreement, (ii) enforcement actions, and (iii) bankruptcy proceedings.	Includes voting rights for (i) enforcement actions, and (ii) bankruptcy proceedings.
Right of First Offer	Includes ROFO/ROFR to other tranche upon proposed sale of loans.	None.
Buyout Option	Allows last-out lenders to buy out first-out lenders upon certain triggering events, such as payment default, bankruptcy filing, exercise of remedies, failure under financial covenants and failure of first-out lenders to approve certain amendments approved by last-out lenders.	Allows second lien lenders to buy out first lien lenders upon certain triggering events such as payment default, bankruptcy filing, exercise of remedies and release of liens on common collateral.
Exercise of Remedies	Permits first-out lenders to exercise remedies with very short standstill periods for the last-out lenders in some cases.	Permits first-lien lenders to exercise remedies with standstill periods typically of 60 to 180 days for the second lien lenders.
Bankruptcy Provisions	Addresses rights under bankruptcy, including rights to propose DIP financing and Section 363 asset sales.	Same as Agreement Among Lenders.

c) Typical terms of agreements among lenders

The following are some of the typical terms seen in AALs:

1) **Payment Allocation or Waterfall**: In a US unitranche facility, interest payments, and sometimes principal payments, made by the borrower are applied to the obligations in the ordinary course. However, upon occurrence of certain trigger events, payments (including payments received by lenders in violation of the terms of the AAL) will typically be apportioned among the different tranches of lenders.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Generally, the last-out lenders will not be paid the proceeds of the common collateral and exercise of remedies until the first-out lenders are paid in full. The list of events triggering the application of the waterfall can include the occurrence of any event of default and typically includes:

- Payment default.
- Bankruptcy/insolvency.
- Failure of leverage ratio tests.
- Exercise of remedies.
- Acceleration of the loans.
- Insufficient available cash.

2) **Interest Rates**: The unitranche facility has a single interest rate derived on a blended basis. However, the first-out lenders assume less risk than the last-out lenders in a unitranche loan. The borrower pays a single blended-interest rate to the lenders, but to compensate the last-out lenders for their increased risk, the AAL sometimes requires the first-out lenders to pay to the last-out lenders a specified portion of the interest received from the borrower.

3) **Voting Rights**: Generally amendments to the credit documents or the exercise of the remedies will require the consent of a majority of the lenders in the credit agreement but the AAL may allocate the voting power differently between the first-out and last-out lenders giving the last-out lenders the general right to control voting (subject to certain exceptions), or providing that a majority of each tranche consent to any amendment. The voting provisions and required percentages in the AAL may change based upon the amount of the outstanding loans that are held by first-out lenders as compared to last-out lenders.

4) **Exercise of Remedies**: Upon the occurrence of an event of default under the credit agreement, some AALs offer the first-out lenders a short period of time (i.e., five business days) after a receipt of a request to exercise remedies from the last-out lenders to request an exercise of remedies on behalf of the first-out lenders. This may create a situation where each of the first-out lenders and last-out lenders are racing against each other to put in a request for exercise of remedies in a timely fashion. In contrast, similar to a first-lien second-lien intercreditor agreement, other AALs require a more substantive standstill period so that the first-out lenders can consider and exercise most remedies without the last-out lenders independently exercising their own remedies.

5) **ROFO/ROFR**: Because unitranche financings are generally less liquid and are held by lenders who do not intend to sell their investments, the transfer provisions in the AAL can be restrictive. The lenders from different tranches may agree to transfer or sell their interest to the existing members within the unitranche deal before offering it to a third party, by building in a right of first refusal or right of first offer in the AAL.

6) **Buyout Options**: Sometimes, the AAL provides the last-out lenders with the right to purchase the obligations owed to the first-out lenders upon the occurrence of certain trigger events (e.g., leverage ratio test, payment default, bankruptcy filing, exercise of remedies, failure to approve amendments approved by last-out lenders). This right can be limited to last-out lenders holding a minimum percentage of the outstanding principal balance of the loans subject to payment at par plus accrued interest.

7) **Bankruptcy Provisions**: Similar to intercreditor agreements, AALs may also determine the actions of the first-out lenders and last-out lenders during bankruptcy proceedings, including (i) voting for Section 363 asset sales and DIP financings offered by the other group of lenders so long as such terms comply with the requirements set forth in the AAL (e.g., first-out lenders must support a qualifying last-out lenders DIP financing if no first out lenders offered DIP financing), and (ii) agreements that the first-out lenders and last-out lenders will be separately classified during insolvency proceedings and voting agreements in the event that that the first-out lenders and last-out lenders are classified together.

IV Comparative Analysis

While sharing the same name and some common characteristics, the majority of unitranche financings in the UK and the US currently differ in a number of ways, as described below:

Term	UK	US
Revolving Credit Facility	Provided on a super-senior basis by a bank.	Either provided on a super-senior basis by a bank or in a separate asset-backed lending credit facility.
Term Loans	Most deals are unitary – all term lenders have the same rights.	Most deals are bifurcated with a first-out and last-out provision.
Documentation	Borrower is party to all documentation.	Borrower may not be a party to the AAL.
Financial Covenants	Generally included though some term loan unitranche is cov-lite (with a financial covenant for the super-senior revolver).	Generally included though some term loan unitranche is cov-lite (with a springing financial covenant for the super-senior revolver).

In the UK, the most common unitranche financings are cross-lien structures with a super-senior revolving facility, while in the US, unitranche financings are structured as tranched term loans with a separate AAL. The UK market has begun to see FOLO unitranche structures that are closer to the US model because of the increasing size of transactions, which often requires a larger number of participating lenders and is better suited to a tranched term loan structure. However, due in part to the significant role of debt advisors in arranging UK financings which impedes lenders from independently forming arrangements to offer FOLO unitranche structures directly to borrowers, the growth of FOLO unitranche structures in the UK may not be as rapid as expected.

From a lender perspective, the substance of the lender relations in the transaction documents between the UK and US FOLO models do not differ significantly. Notably, neither the UK nor the US unitranche FOLO structure has been fully tested in bankruptcy. To date, bankruptcies involving US unitranche facilities have not involved disputes between tranches of lenders arising under an AAL. In addition to uncertainty whether a US bankruptcy court would have jurisdiction to adjudicate any dispute based on an AAL if the borrower is not a party, lenders are also concerned about whether a bankruptcy court would view the first-out and last-out lenders as a separate class for voting and secured claims purposes, and whether the AAL is a "subordination agreement" under the US bankruptcy laws. In the UK, the low default rate in unitranche financings has not required a court to opine on similar matters. As a result, it is difficult to say in either jurisdiction how a court would view these arrangements.

V Conclusion

So long as banks are facing regulatory pressure and there remains a demand for liquidity among borrowers, we expect non-bank lenders to increase their participation in the lending market. While these markets are still evolving, we see a convergence of the FOLO markets in the UK and the US. We expect this trend to continue, though not without some risks due to uncertainty of treatment in bankruptcy courts in both the UK and the US.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Endnotes

1. These types of middle-market transactions can be contrasted with mid- and large-cap financings generally led by banks.
2. The Senior Secured Loan Program is currently being wound down since it was not acquired by the Canada Pension Plan Investment Board with the other GE Capital assets in 2015, though Ares reportedly is currently investigating alternatives to maintain the platform.

Acknowledgment

The authors would like to thank Stewart Kagan (stewart.kagan@friedfrank.com), Paul Tannenbaum (paul.tannenbaum@friedfrank.com) and Ariel Zell (ariel.zell@friedfrank.com) for their invaluable contribution to this chapter.

Stuart Brinkworth
Fried, Frank, Harris, Shriver & Jacobson LLP
99 City Road
London EC1Y 1AX
United Kingdom

Tel: +44 207 972 9248
Fax: +44 207 972 9602
Email: stuart.brinkworth@friedfrank.com
URL: www.friedfrank.com

Stuart Brinkworth heads the London office's Finance Practice. He specialises in acting for UK and international lenders (including credit and debt funds), sponsors and bidding consortia on a variety of UK domestic and cross-border leveraged finance transactions. His practice focuses on private equity-backed leveraged buy-outs, management buy-outs/buy-ins, public bids, corporate M&A and recapitalisations. Mr. Brinkworth also has experience across all elements of the debt capital structure. In addition, he has been at the forefront of the development of unitranche as a funding source in the European leveraged finance market. His sector experience includes healthcare, media, sports, real estate, financial services, business services, retail and leisure.

Mr. Brinkworth is recognised for his involvement in highly leveraged deals and complex financings. *Chambers UK* 2016 describes him as "a highly active player in the London finance space". He was also recommended for acquisition & leveraged finance by *The Legal 500*.

Julian S.H. Chung
Fried, Frank, Harris, Shriver & Jacobson LLP
One New York Plaza
New York, NY 10004
USA

Tel: +1 212 859 8957
Fax: +1 212 859 4000
Email: julian.chung@friedfrank.com
URL: www.friedfrank.com

Julian S.H. Chung focuses her practice on the representation of large financial institutions and borrowers in commercial lending transactions, with an emphasis on senior secured finance for leveraged acquisitions. She also represents financial institutions and debtors in connection with restructurings and refinancing existing credit facilities.

Ms. Chung is recognised as a leading practitioner in bank lending by *The Legal 500* and *The American Lawyer* has named her one of the top lawyers under the age of 45.

Ms. Chung is a member of the Women's Forum Planning Committee, a representative group directing Fried Frank's Firmwide women's affinity group.

Fried, Frank, Harris, Shriver & Jacobson LLP is a leading international law firm with approximately 450 lawyers who advise the world's leading corporations and financial institutions on their most critical legal needs and business opportunities. The Firm has offices in New York; Washington, DC; London; Paris; Frankfurt; Hong Kong; and Shanghai. More information can be found at www.friedfrank.com.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Recent Developments in Islamic Finance

Andrew Metcalf

Leroy Levy

King & Spalding LLP

Introduction

Islamic finance refers to practices used by those who wish to invest and arrange their finances in compliance with *Shari'ah*, or Islamic, law. Probably the most well-known feature of Islamic finance is its prohibition on paying or receiving interest. This feature derives from the prohibition of *riba*, a term which can be understood generally as unearned excess, or profit gained without exchange of value. Islamic finance also bans speculation (*maisir*) and excessive uncertainty (*gharar*). Islamic finance parties may still take commercial risks, but cannot engage in transactions that depend upon pure chance or that amount to gambling. Some *Shari'ah* scholars assert that *maisir* and *gharar* prohibit life insurance contracts and derivative contracts. Islamic investors also may not invest in activities considered harmful or un-Islamic, such as gambling, and the production of alcohol, ammunition, pornography and pork products.

Islamic finance encourages fair and productive economic activity, and also promotes the sharing of profits and losses. Equity investments are favoured over financing, as are transactions based on the use or development of assets. However, Islamic finance practices vary considerably. This is due primarily to differences among the four main schools of Sunni Islam and regional variations in application. In practice, the rules followed by any particular Islamic finance participant are shaped by its *Shari'ah* advisors, who review investments and structures for compliance. *Shari'ah* advisors can take divergent positions regarding which practices and structures are permissible. Differences are most pronounced between Islamic finance based in Gulf Cooperation Council countries and that practised in Southeast Asia, with the former being considered more conservative than the latter.

Industry participants have attempted to make *Shari'ah* rules more broadly consistent to reduce uncertainty and transaction costs. This effort has produced organisations such as the Accounting and Auditing Organization for Islamic Financial Institutions, which was formed in 1990 by market participants, and which develops and issues *Shari'ah* standards. Other influential standard-setting bodies include the *Fiqh* Academy of the Organization of the Islamic Conference, the *Shari'ah* Supervisory Board of the Islamic Development Bank, and the Islamic Financial Services Board based in Kuala Lumpur.

Most commentators date the origin of the modern Islamic finance industry back to the 1990s. Since that time, a number of basic structures have been adopted by the industry. These include:

1. *ijara* – a lease structure, which can be used for real estate leases, equipment leases, and in some jurisdictions for corporate acquisitions;
2. *murabaha* – essentially a cost-plus financing, involving the purchase and the immediate resale of an asset to a third party for the original purchase price plus an agreed profit;
3. *istisna'a* – a sale contract for an item that has not yet been produced, and that can be used to finance the item's production;
4. *mudaraba* – a quasi-partnership, in which one party furnishes capital and the other provides expertise or management;
5. *mushaka* – a partnership arrangement, regarded by many as the purest form of Islamic finance, in which all partners contribute capital in the form of cash and/or property; and
6. *sukuk* – participation certificates representing ownership in underlying assets that provide certificate-holders with a share in the profits produced by those assets. *Sukuk* are often referred to as Islamic bonds, although *sukuk* are expressly based on, and sometimes backed by, the performance of their underlying assets.

In addition to this, the Islamic finance industry has developed *takaful*, a *Shari'ah*-compliant insurance product based on the Islamic principles of mutual assistance. Under *takaful*, participants contribute money to a common pool of funds managed by a *takaful* manager, which funds are then used to pay for participants' claims. Surplus amounts are invested in *Shari'ah*-compliant instruments for the benefit of *takaful* participants, who are considered owners of the *takaful* funds.

The basic structures outlined above have proven flexible enough to use in a variety of contexts. Islamic banks have grown in countries with significant Muslim populations, and offer retail services to their customers, such as deposit accounts, home financing and auto financing. In addition, major investments have been made throughout the world on a *Shari'ah*-compliant basis in real estate, private equity, project finance and other asset classes. A great deal of these investments are cross-border. Investors in this space include Islamic financial institutions, investment funds and family offices.

The Islamic finance industry has grown rapidly in recent years, including at an estimated 17.3% compound annual growth rate between 2009 and 2014. Although quoted statistics vary, the Islamic finance industry is believed to have approximately $2 trillion in assets. It is estimated that Islamic banking assets represent over $1.2 trillion of these assets, followed by approximately $290 billion in outstanding *sukuk*, over $50 billion in Islamic funds and approximately $30 billion in *takaful*. Nonetheless, Islamic finance assets constitute only approximately 1% of global financial assets.

The great promise and ambition of Islamic finance has been to create an Islamic economy in which all of the financial needs of its participants can be met. This is a mammoth project that will by necessity take years to realise. However, the industry continues to move steadily toward its goal by expanding into new financial sectors and national markets. Recent developments in the field demonstrate not only the growth of the industry generally, but also the manner in which Islamic finance techniques may be adapted to financial market needs.

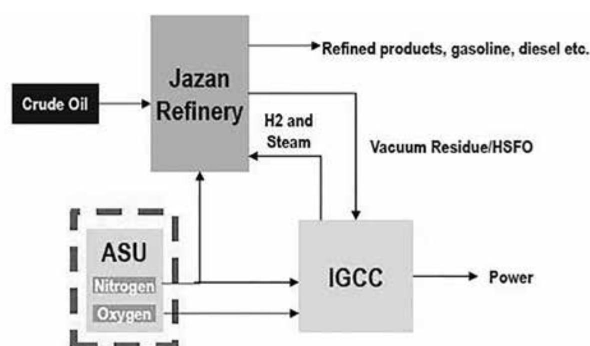
© Published and reproduced with kind permission by Global Legal Group Ltd, London

Project Finance

One of the most significant Islamic finance accomplishments over the past year occurred in the project finance space. In July 2015, Air Products of the U.S. and ACWA Holding of Saudi Arabia achieved financial close of the largest project financing of an air separation unit ("***ASU***") project in the world. The $2 billion Jazan ASU project was one of the most important project financings of 2015, being awarded industrial deal of the year for 2015 by Project Finance International. The project broke ground in a number of areas, including as the first ASU to be financed exclusively on an Islamic finance basis. The project was supported by a $1.7 billion financing package provided by a bank syndicate that included both Saudi Arabian institutions and international banks Mizuho, Bank of Tokyo Mitsubishi, Societe Generale, Sumitomo Mitsui Banking Corporation and First Gulf Bank. The involvement of these international banks demonstrates both the significance and increasingly global reach of Islamic finance. In addition, the Jazan ASU project illustrates that conventional lenders have become more familiar with and accepting of Islamic finance techniques, and that these methods can be employed to finance extremely complicated project finance transactions.

The significance of the Jazan ASU project also stems from its role in fostering development. The Jazan ASU project supports the vital petrochemical industry while also increasing Saudi Arabia's technical capabilities. The Jazan ASU project is a captive industrial gases plant providing feedstock to Saudi Aramco's 400,000 barrel-a-day oil refinery and a 4,000 MW integrated gasification combined cycle power plant ("***IGCC***"). This is a highly complex project, with 70,000 people expected to work on the 16 square km refinery and IGCC site, and with a budget of several billion dollars. Moreover, the Jazan ASU project is located in Jazan Economic City ("***JEC***"), a 100 square km site northwest of Jazan city on the Red Sea coast. JEC represents one of a number of economic cities that Saudi Arabia is employing to attract domestic and international investment in order to increase employment and diversify its economy. Accordingly, the Jazan ASU project may be understood as helping both to strengthen and transform the Saudi Arabian economy.

A high-level configuration of the complex is depicted in the following diagram.



Asian Investment

As noted above, a number of Japanese banks participated in the *Shari'ah*-compliant financing package provided for the Jazan ASU facility. Japanese participation may be seen as part of a larger Islamic finance strategy, which has seen Japanese institutions take numerous measures in recent years to increase Japan's Islamic finance participation. In 2010, Japan's Financial Services Agency announced that it would promote the development of an environment for the issuance of *sukuk* in Japan, and in 2011, Japan's Asset Securitization Act was amended to extend the favourable tax treatment to foreign investment in Japanese *sukuk*. There have been corporate issuances of *sukuk*, including by: Aeon Credit Services in Malaysia (2007); Toyota Capital Malaysia Sdn (2008); Nomura Investment Company (2010); and Bank of Tokyo-Mitsubishi UFJ ("***MUFG***") (2014), through its Malaysian subsidiary, Bank of Tokyo-Mitsubishi UFJ (Malaysia) Bhd. Toyota's Malaysian subsidiary has announced plans to issue additional *sukuk*, with MUFJ acting as a joint principal adviser and lead arranger. The Japan Bank for International Cooperation ("***JBIC***") is also said to be considering a *sukuk* issuance.

In addition to the above, the Japan International Cooperation Agency ("***JICA***") and the Islamic Development Bank are co-developing *Shari'ah*-compliant products. JICA announced that their first project would be to assist Jordan in its plans to issue *sukuk*. Sumitomo Mitsui Banking Corp. ("***SMBC***") has created an in-house *Shari'ah* board to assist with Islamic finance offerings through its Malaysian subsidiary, and is reported to be working with the Islamic Development Bank to discuss financing infrastructure deals. MUFJ has also obtained approval from the Dubai Financial Services Authority to operate an Islamic window, which will allow the bank to conduct Islamic finance.

The World Islamic Economic Forum Roundtable, held in Tokyo in May, 2015, further highlights Japan's efforts in Islamic finance. Malaysia's Prime Minister Najib Razak spoke during a session entitled "Islamic Banking and Finance in Japan: Prospects for Growth", and addressed the untapped potential for Islamic finance in countries such as Indonesia, the Philippines, Thailand and Cambodia. He also rode on Japan's high-speed rail in a demonstration of Japan's Shinkansen bullet train technology. Japan has pushed this technology for the planned Singapore-Kuala Lumpur high-speed rail project, which may potentially be supported by Islamic financing. However, Japan faces competition for the Singapore-Kuala Lumpur project from China, France, Germany and South Korea, all of which have also expressed interest in the same.

Japan's initiatives are mirrored by similar efforts by China. As with Japan, only a small percentage of China's population is Muslim. However, China has announced a "One Belt, One Road" strategy to resurrect Silk Road trading ties with Asia and Europe. This trade corridor would pass through both the Middle East and Southeast Asia, which has encouraged both state-owned and private Chinese companies to become more interested in Islamic finance. HNA Group, a mainland China firm, is reported to be considering Islamic financing in connection with an $150 million acquisition of ships, as well as the issuance of *sukuk*. *Sukuk* is also being weighed as an option to finance a high-speed rail project for the eastern Chinese province of Shandong. The Islamic Corporation for the Development of the Private Sector, the private sector branch of the Islamic Development Bank Group, is working with Chinese entities considering Islamic finance opportunities, including ICBC Financial Leasing, the leasing arm of the Industrial and Commercial Bank of China.

The efforts of both Japan and China demonstrate how Islamic finance may function not only as a source of financing, but also as a tool of commercial diplomacy for countries seeking to advance their interests in the Middle East and Southeast Asia. This dynamic also enables Islamic finance to grow by engaging participants outside of its traditional geographic markets.

Sukuk

Sukuk has long been a kind of standard bearer and bellwether for the Islamic finance industry. This is due in part to high-profile issuances made over the past few years. These include GE Capital's issuance

© Published and reproduced with kind permission by Global Legal Group Ltd, London

of a $500 million *sukuk* in 2009, and the UK government's 2014 issuance of the first sovereign *sukuk* offered by a nation outside the Islamic world. Similar offerings by Hong Kong, South Africa and Luxembourg have followed. The past year also saw significant issuances, including the March 2015 $913 million *sukuk* offering by Dubai-based airline Emirates to finance the acquisition of four new Airbus A380-800 aircraft. Notably, the Emirates offering was guaranteed by the United Kingdom's Export Credit Guarantees Department, which represents the first time it has guaranteed *sukuk*.

However, 2015 also witnessed a downturn in the volume of *sukuk* issuances. Global *sukuk* issuances for 2015 were an estimated $63.5 billion, as compared with $116.4 billion in 2014. Lower oil prices and possible rate increases by the U.S. Federal Reserve may also put pressure on issuances for 2016, although these effects may be counteracted by quantitative easing by the European Central Bank, the lifting of sanctions against Iran and new issuers from new emerging economies entering the market. It should be noted that the drop in 2015 is not as dramatic in substance as it first appears. Much of the drop was due to the fact that Bank Negara Malaysia, Malaysia's central bank, stopped issuing *sukuk* at the beginning of 2015. Bank Negara began issuing *sukuk* in an attempt to provide liquidity for the Islamic finance market, and the bank became the largest global *sukuk* issuer. However, Bank Negara realised that its popular *sukuk* issuances were contributing little to liquidity, but were instead attracting investors who purchased the *sukuk* to hold them. Thus, most of the drop in 2015 *sukuk* issuances was because those issuances were too popular, not due to lack of demand.

It also appears that there is a gradual trend toward standardisation in the *sukuk* market. One of the criticisms of *sukuk* has been that their structuring may take additional time and money when compared to conventional bonds. This is mostly due to the fact that the bond market is a long-established industry, while *sukuk* are relatively new. However, increased experience and standardisation should continue to reduce both the time and costs needed for *sukuk* issuances, and make *sukuk* more attractive for issuers. Thus, despite 2015's drop, the *sukuk* market should resume its long-term growth in the near future.

United States

Islamic finance has flourished in countries such as Malaysia because of governmental support of the industry. However, Islamic finance may also be conducted in countries that do not explicitly promote it. An Islamic finance transaction executed in a jurisdiction without specific enabling legislation must satisfy a number of potentially conflicting *Shari'ah* and domestic legal requirements, which may present challenges in structuring investments. Experience in countries such as the U.S. shows that this is nonetheless possible. In the U.S., although there is a paucity of enabling legislation and judicial decisions, structures have been developed to finance investment on a *Shari'ah*-compliant basis. This has required a careful consideration and balancing of Islamic finance concepts with U.S. legal issues, including ownership liability, taxation, transfer tax treatment, bankruptcy, and proper recordation of ownership rights.

Although firm statistics are not available, it is believed that 2015 witnessed an increase in U.S. investment conducted on a *Shari'ah*-compliant basis, primarily focused on real estate. Most of this investment originated from the Middle East. Real estate has long been a preferred asset class for Islamic finance investors. Such investment has traditionally taken the form of tax-efficient equity investment, often as part of a joint venture with a U.S.-based real estate operator. However, there has been growing interest in mezzanine financing, which offers a type of quasi-ownership interest in real estate, but with the possibility of current returns. Mezzanine investments of this type are most typically structured as *murabaha* arrangements, although a structure such as *mudaraba* could conceivably be adapted for this purpose as well. Mezzanine financing may be thought of as quasi-ownership because the financing is secured by a pledge of the equity ownership in the real estate title holder. Upon an event of default, the mezzanine finance provider has the ability to enforce its pledge and take control of the title holder.

However, mezzanine financing also presents inherent difficulties. Mezzanine financing is usually subordinate to one or more other loans or financings that have security interests that are superior to the mezzanine financing security. If those superior security interests are enforced, the mezzanine financing provider will often be left without security. In addition, in order to realise upon its security, a mezzanine financing provider must be prepared to take control over its financed real estate asset and either (1) find a qualified owner for the asset, or (2) indirectly own the asset itself. Depending upon the asset, ownership may prove problematic. Financing for construction projects presents a particular challenge, because they may require the new owner to finish construction that has stalled prior to completion.

The non-recourse – or "bad boy" – guaranty can present further complications. Under this guaranty, an indirect equity owner of real estate may become directly and personally liable for some or all of the financing provided for that real estate. This can happen upon the occurrence of specified events that are assumed to be under the equity owner's ultimate control, such as a bankruptcy filing involving the real estate asset. If a mezzanine financing provider enforced its equity pledge, it may thereby become the indirect equity owner for purposes of this guaranty. Monetary considerations aside, if the senior mortgage financing placed on the real estate is a conventional loan, then the mezzanine finance provider would face the prospect of giving a guaranty of a conventional loan. Since most *Shari'ah*-compliant institutions would likely conclude that they could not execute such a guaranty, an alternative arrangement would have to be found. This could require a capital-intensive *Shari'ah*-compliant refinancing of the asset in order to prevent foreclosure by the senior mortgage lender. Although the ability to put such a refinancing in place could be included in an intercreditor agreement among the finance providers for the transaction, such a provision would be atypical for U.S. real estate transactions. Despite these and other issues with U.S. real estate financing transactions, it is expected that interest in the sector will continue to grow as a result of demand for safe-haven real estate.

Challenges and Potential

As noted, the long-term goal of the Islamic finance industry is to develop a full spectrum of products for economic investment and financial needs. This effort is being undertaken simultaneously by multiple participants in a variety of industries and countries, each country with its own legal regime. Some nations and regions have actively promoted Islamic finance, while others have essentially ignored it. In those countries where no explicit Islamic finance framework has been provided, participants have had to carefully analyse and create structures that will satisfy both *Shari'ah* and relevant legal rules.

As a result of these factors and the industry's relative youth, at this point in its development the modern Islamic finance industry is somewhat fragmented. There are a number of small, but growing, business lines centered in relatively few countries. Islamic finance practitioners are simultaneously forced to innovate in order to expand into new markets, while trying to standardise documentation

© Published and reproduced with kind permission by Global Legal Group Ltd, London

to increase market participation. Some of the issues faced by the industry are intertwined and involve economies of scale. As the experience of Bank Negara demonstrates, there is strong demand for Islamic finance investments, but constrained supply. A scarcity of liquid Islamic finance instruments also impedes the economic competitiveness of Islamic banks and *takaful* companies. In some jurisdictions, a lack of legal precedent creates a degree of uncertainty and can increase transaction and product costs. In addition, more human resources are needed to grow the industry.

All of the above represent obstacles to success, but not complete barriers. In the face of these challenges, Islamic finance continues to grow. One often hears the word "potential" in discussions of Islamic finance. This arises from four basic facts. First, as noted earlier, the industry has grown rapidly in recent years. Second, despite this growth, the industry comprises only approximately 1% of the overall world financial market. Third, the Islamic finance industry's accomplishments to date demonstrate its willingness and ability to fulfil complex economic objectives. Fourth and finally, a large percentage of Islamic finance's target market has not yet fully engaged with the industry.

Indonesia serves as an example of this latter point. Indonesia is home to the largest Muslim population in the world, but its Islamic finance industry lags behind much smaller Malaysia. To address this, Indonesia's capital markets regulator published a five-year Islamic finance strategy last year. The plan calls for Islamic banks to hold 15% of Indonesia's banking assets by 2023, up from the current 5%. A number of countries in which Islamic finance is prevalent or growing in influence are also undeveloped. Unsurprisingly, Islamic finance is viewed by many, including increasingly in sub-Saharan Africa, as a way to encourage development in these nations. Islamic finance's focus on ethical investment, profit-and-loss sharing and productive investment lends itself to the increase in financial inclusion and resources that these nations need.

Andrew Metcalf
King & Spalding LLP
1185 Avenue of the Americas
New York, NY 10036
USA

Tel: +1 212 556 2111
Email: ametcalf@kslaw.com
URL: www.kslaw.com

Andrew Metcalf is a partner in the Middle East & Islamic Finance Practice Group in King & Spalding's New York office. A graduate of the University of Virginia School of Law, Mr. Metcalf joined King & Spalding after being in corporate practice in Cairo, Egypt, for 2½ years. Over the past 17 years, he has represented a number of clients in *Shari'ah*-compliant finance and investment transactions, including private equity acquisitions, real estate transactions, working capital financing, structured and subordinated financings, and letter of credit/guaranty facilities. He has also represented financial institutions and their customers in connection with domestic and international finance transactions, including secured and unsecured credit facilities, asset-based loan facilities, structured financings, project financings, bridge financings, acquisition credits, participations, syndications, subordinated debt facilities, letter of credit facilities and other credit-related transactions.

Leroy Levy
King & Spalding LLP
Al Fattan Currency House
Tower 2, Level 24
Dubai International Financial Centre
Dubai
United Arab Emirates

Tel: +971 4 377 9910
Email: llevy@kslaw.com
URL: www.kslaw.com

Leroy Levy is a partner in King & Spalding's Dubai office and a member of the firm's Middle East and Islamic Finance Group. Mr. Levy is an infrastructure lawyer and has some 16 years of experience representing clients in the Middle East and particularly the Kingdom of Saudi Arabia. He has worked on a number of innovative and groundbreaking deals. Many of these transactions have won international deal awards. They include the Mobily 2nd GSM License and the Shuaibah IWPP. As the Shuaibah IWPP was the first IWPP in the Kingdom, Mr. Levy has played a major role in shaping the power and water sector in Saudi Arabia and is considered to be a market leader in the utilities sector. Mr. Levy has also worked on a number of substantial petrochemical projects, including the Sadara petrochemical complex, the world's largest petrochemical complex.

KING & SPALDING

Celebrating more than 130 years of service, King & Spalding is an international law firm that represents a broad array of clients, including half of the Fortune Global 100. King & Spalding's lawyers are consistently recognised for the results they obtain, their uncompromising commitment to quality, and their dedication to understanding the business and culture of the firm's clients.

King & Spalding's global finance practice brings together more than 100 finance lawyers located across the United States, Europe, the Middle East and Asia to represent lenders, arrangers, investors, funds, borrowers, issuers, underwriters and financial sponsors across a full range of debt and equity financings. The firm provides clients worldwide with expertise in Islamic finance, project finance, leveraged finance, capital markets, structured finance, financial restructuring, and tax and regulatory matters – areas for which the firm and firm attorneys are rated among the best in the world. Among the firm's accolades are Tier 1 rankings in *U.S. News & World Report*'s 2015 "Best Law Firms" (in the Banking & Finance and International Trade & Finance categories). In addition, King & Spalding's Islamic finance practice is consistently ranked among the top four in the world by *Chambers Global*.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Translating High Yield to Leveraged Loans: Avoiding Covenant Convergence Confusion

Jeff Norton

Linklaters LLP

Danelle Le Cren

1 Introduction

Throughout 2015, High Yield (HY) covenant concepts and related terms continued to shape US leveraged loan documentation. While the impact is strongest at the Term Loan B (TLB) covenant light upper tier of the markets, these concepts are increasingly influencing leveraged loan documentation generally for a variety of credits and transactions. The impact is by no means confined to the US as many of the leveraged acquisition deals originating in Europe and Asia are broadly importing these concepts (and, in some cases, doing so more broadly than in the US), changing the leveraged loan landscape globally.

The motivation for financial sponsors to continue this trend is understandable. Merging HY covenant flexibility with the borrower-friendly mechanics of bank lending, such as limited call protection, a relatively easy amendment process, investor group control and no public reporting (in direct contrast to the HY position on these issues), creates an extremely flexible and refinanceable credit package. There is a great deal of investor overlap between HY and TLB facilitating the convergence of terms between the two, but the TLB syndication market is generally not as receptive to many of the points that are customary in the HY market. As 2015 ended and we entered the new year, there was more investor resistance on envelope pushing and more terms were being flexed. Many of these concepts, however, have become part of the standard TLB landscape over the last several years and it is expected that convergence will continue when markets rebound.

The convergence requires a fundamental change in drafting perspective. Simply importing HY covenants, which are drafted from an unsecured and subordinated perspective, into a senior secured bank credit is not a "plug and play" exercise and can be problematic – particularly in cross-border transactions where structural subordination, leakage and intercreditor issues become even more complex. Discussed below are the key elements of the HY covenant approach that have become prevalent in the upper tier of bank lending for sponsor-based acquisition financing, along with drafting notes on incorporating these concepts into leveraged loan structures.

2 Covenant Flexibility: Incurrence *plus* Baskets *plus* Categories *plus* Reclassification

Incurrence Tests. At the core of the HY covenant scheme is the incurrence-based covenant approach which only tests financial performance at the time when an action is taken or committed to. If the test cannot be met it does not trigger a default and the only downside is that the exception is not available. Most of the covenants are drafted with both an incurrence limb and then a series of basket and category exceptions to the general covenant restriction. This is seen most often in the covenants for debt, liens, investments and restricted payments. The incurrence limb provides additional headroom for the covenant as long as the financial test can be met at the relevant time.

For instance, a HY debt covenant will typically provide first for unlimited debt incurrence within the agreed financial ratio and then follow with a series of permitted baskets and categories for additional debt which can be incurred independently from the ratio test. The most common incurrence test is a *pro forma* maximum leverage ratio, often with a senior leverage ratio sub-limit. Many transactions replace the junior leverage ratio with a *pro forma* interest or fixed charge coverage test. Generally, under the HY approach, the focus for unsecured or junior debt is on debt service, while for senior debt the focus is on leverage. In loan documents, the same approach is taken for the debt covenant and is also used for setting the parameters for incremental facilities. There is usually a set "starter" basket for an incremental amount and then additional room from an incurrence ratio and other baskets depending on whether the incremental is *pari passu* or junior to the rest of the bank debt.

Other than with respect to a springing leverage ratio for revolving loan tranches (which only has a real impact if the business is consuming cash and the revolver remains drawn above expected levels), financial maintenance tests have largely disappeared from the upper TLB market and have been replaced by the HY incurrence plus baskets approach.

Grower and Builder Baskets. The baskets that supplement the incurrence test are drafted to be flexible through the use of both grower and builder baskets. Tying baskets to the greater of a fixed dollar amount or a percentage of total assets or EBITDA, acts as a grower mechanism for the basket going forward. As total assets or EBITDA grow through acquisitions or performance, the basket effectively increases. The fixed dollar portion of the basket acts as a floor for the permitted exception if total assets or EBITDA decline, and in some transactions baskets are permanently increased by the same percentage increase of *pro forma* EBITDA due to an acquisition. Using the balance sheet test of total assets as the basis for the basket calculation is generally a more conservative approach, but the trend has been to use a percentage of EBITDA.

In addition to the grower mechanism, HY also includes a common builder basket (usually defined as the Available Amount or Cumulative Credit). The builder basket is based on a cumulative calculation from the issuance date (or an agreed earlier date if the desire is to keep the basket consistent with other outstanding

© Published and reproduced with kind permission by Global Legal Group Ltd, London

debt) based on 50% of consolidated net income (CNI) plus equity contributions, return on investments, asset sale proceeds and other event proceeds not required to prepay debt, as well as other negotiated items. This builder basket acts as a shared "piggy bank" that can provide additional flexibility under a number of covenants; customarily those focused on credit leakage including dividends and other restricted distributions and investments. It has also become common to include a starter basket (which itself can be a fixed dollar amount or a grower basket) in the builder basket concept so that there is availability from the closing date prior to the basket growing through the ongoing calculation.

Categories. In addition to the baskets there are also set category exceptions to most covenants, such as refinancing debt and liens for permitted debt. Categories are usually tied to defined terms that set the parameters of the permitted exception. For instance, refinancing debt is usually permitted as long as the maturity of the new debt is no earlier than the refinanced debt, its average life to maturity is equal to or exceeds that of the refinanced debt, and the principal amount and guarantor and collateral coverage of the new debt is not greater than the refinanced debt. It is also common to require that the terms of the new debt not be more restrictive or be on prevailing market terms or a similar construct. The refinancing debt mechanism effectively allows debt to be continued to be rolled forward as it matures, making the risk of any cross-default less likely. Similar approaches are used to define other category exceptions to multiple covenants.

Reclassification. The combination of incurrence tests, baskets and category exceptions to covenants provides a lot of flexibility and it is common for a particular transaction to fit within more than one exception. As a result, another HY feature that has become prevalent in the TLB market is the ability of the borrower to reclassify these transactions across the relevant covenant exceptions to provide more flexibility.

Customarily, designation must be fixed on an annual basis as part of the year-end compliance audit reporting, but until that time the transaction may be redesignated with the result that the original designated basket or exception is then refreshed and available for use again. For instance, debt issued under a basket at a time the incurrence covenant is not available can later be shifted to the incurrence limb if performance improves. The usual approach of issuers to reclassification is to use incurrence tests first and to keep the baskets and other defined exceptions to the covenants as "dry powder" for when financial performance might otherwise limit the incurrence mechanism.

Drafting Notes:

- *The combination of incurrence limbs with baskets and categories may lead to more leverage and credit leakage than may first be apparent. An interesting exercise is to take the maximum amount of debt (secured, unsecured, senior and subordinated) that is permitted on day one under the leverage ratio (or fixed charge or interest coverage ratio if applicable) and add to that all of the baskets and categories of debt (including any incremental amounts not netted to the debt covenant). This will give an estimate of how much leverage can be put on the business and is a better indicator of total debt than looking at the ratio test alone.*
- *Much like the exercise above, amounts available under the incurrence and basket tests for restricted payments and investments are added together (including declaration of restricted subsidiaries) to estimate total potential leakage from the credit. Combining the leakage and leverage amounts provides a rough calculation of total credit dilution.*
- *Approaching the covenant scheme in this manner highlights the need for careful drafting of these concepts. All of the elements need to be tied together to avoid duplicative points of leakage or dilution. In particular, the use of starter baskets and the level set for the incurrence limb should take into account how much day one leverage or leakage can occur before the business has established a post-closing EBITDA run rate. For example, lenders may want to limit use of starter baskets for dividends (as opposed to investments) for a period of time (or have additional tests on their use. In respect of incremental and additional debt incurrence, lenders may want to consider whether reloading to closing leverage is permitted or if the level should require deleveraging before the incurrence limb is available.*
- *US HY is drafted from a subordinated and unsecured perspective and there is usually a large combination of baskets, defined categories and incurrence tests setting the parameters for senior and secured debt. Moving these concepts to a leveraged loan structure that is usually drafted as the only senior secured debt on the balance sheet (or senior first secured) requires precise drafting. The senior and secured concepts have to be worked into the provisions related to incremental tranches and permitted pari passu debt outside of the credit facility with appropriate cross-referencing and netting. The reworking of these concepts has ripple effects throughout the debt and lien covenants and the key defined terms (including refinancing debt and replacement liens) that support them. Changes to intercreditor provisions are also necessary to properly reflect the intended priority of the various levels of permitted debt and liens. None of these issues are apparent from reviewing US HY precedent as it is at a balance sheet level below the senior pari battlefield and therefore does not need the precision in this space that must be taken at top end of the leverage spectrum.*
- *Parties should consider whether all baskets and incurrence limbs should be available throughout the credit structure particularly in cross-border deals where collateral and guarantor coverage may be more limited. Otherwise permitted junior debt could be unintentionally structurally senior through non-obligor issuance or guarantees. For deals with material credit concentration outside of the US, consider whether accession to the intercreditor agreement should be a requirement for some debt limbs – for example, unsecured debt (above a threshold).*
- *If the builder basket is based on CNI as opposed to retained excess cash, the methodology used for determining the amount of the cash sweep in favour of the lenders and the builder basket in favor of the borrower should be consistent. Further, if the commitment papers allow the borrower to choose between CNI and retained excess cash as the core element of the basket, the choice should be made prior to primary syndication so the basket can be calculated with more certainty in credit models. Finally, parties should consider what payments should reduce the builder basket, such as payments made pursuant to the general restricted payment basket.*
- *Rolling forward outstanding debt without requalifying under a covenant exception through the permitted refinancing debt provision should typically be limited to debt incurred under specified baskets and categories of permitted debt. If the debt was incurred and remains outstanding under a ratio test, then parties should consider whether the ratio should likewise apply to its refinancing.*
- *Parties should consider whether debt that would not otherwise qualify initially, can later be reclassified into a senior, secured or pari passu position. One approach is to exclude senior baskets and any other category that could impact collateral and intercreditor arrangements from the reclassification provision so that only dedicated baskets or specific tests can be used for relevant debt and liens. For the same reason, the amount of incremental facilities and additional debt permitted under the covenant should be netted properly. Otherwise, the incremental can be refreshed by reclassifying under another basket or limb for permitted debt.*

© Published and reproduced with kind permission by Global Legal Group Ltd, London

- *HY covenants group concepts differently from traditional leveraged loan documentation. For instance, the restricted payment covenant covers dividends and investments, and the investments portion in turn covers minority acquisitions and does not address majority acquisitions as those are generally permitted investments. When bringing the concepts over to a leveraged loan, all of the exceptions and cross-references must be carefully tracked to ensure that they work collectively as intended and without duplication. Otherwise, unintentional gaps in covenant coverage may undermine the intended scheme.*

3 The Credit Group

HY deals have traditionally allowed a safe harbour from the covenants and defaults through the use of the unrestricted subsidiary concept. This enables issuers to declare certain subsidiaries as outside the reach of the covenants (hence unrestricted) usually by tying the value of the subsidiary so declared to the availability that could otherwise be used for dividends or investments. Once declared unrestricted, the subsidiary is free from compliance with the indenture and is excluded from EBITDA and all financial calculations (other than to the extent of actual distributions received by the credit group). Once declared unrestricted, a subsidiary remains as such, even if its value increases, until affirmatively redesignated as restricted by the issuer.

Drafting Notes:

- *The unrestricted subsidiary concept developed in the US market where comprehensive guarantor and collateral coverage is normal for most acquisition financing structures. Typically there is ring fencing around the restricted group to prevent leakage to the unrestricted group other than to the extent permitted by the relevant covenant exceptions. The issue is more problematic in jurisdictions where collateral and guarantor coverage is more limited and the category of non-obligors and non-collateral assets in the structure can be material. For these situations, the ring fencing has to be interwoven into the corresponding non-obligor ring fencing and leakage covenants. However, taking a strict ring fencing approach where the non-obligors are material or are operating entities interacting regularly with the credit group is impractical. While the concepts may be similar in that there are groups within and without the credit, the concentric ring fencing approach is not a simple overlay – it has to be adapted to balance the needs of the business and acceptable levels of value leakage for the investors.*

4 Expanded EBITDA

In both HY and TLB financings, the definition of EBITDA is critical. A number of common add-backs have developed over the traditional items of interest, taxes, depreciation and amortisation, including add-backs for cost savings, operating expense reductions and synergies related to acquisitions, combinations, divestitures and restructurings.

Financial information reporting for HY is subject to Regulation S-X, which also includes standards for adjusting EBITDA on a *pro forma* basis so as to reflect how financial statements would have been rendered had the subject transaction occurred on the first day of the fiscal period being reported. Generally speaking, Regulation S-X provides that EBITDA be adjusted to give effect to any event that is directly attributable to the subject transaction, is expected to have a continuing impact on the credit group and is factually supportable. While originally focused on acquisitions and dispositions, the *pro forma* concept has been expanded to incorporate a myriad of transactions including debt issuance, dividends and internal business reorganisations. In the HY context, the use of caps on these add-backs is not common. Generally, the approach is from an accounting perspective that the add-backs either do or do not qualify under the S-X criteria.

The TLB approach has been converging with HY precedent but the use of caps on the broader line-item add-backs is still common. Many deals incorporate certain S-X criteria into the EBITDA definition itself but then have the overriding protection of a cap (individually or collectively on the group of adjustments), usually through a maximum percentage of unadjusted EBITDA. Whether a particular add-back qualifies under the criteria of the EBITDA definition is usually made in the good faith reasonable determination of the borrower. This is consistent with the HY approach of not having subjective or qualitative determinations made by the trustees (which do not want this responsibility) or the noteholders (where it would be impractical to exercise). There is a general trend in upper-tier TLB deals to follow the HY formulation of having subjective items vested with the borrower.

Further, these *pro forma* add-backs are also commonly permitted under the HY approach to be included in the current period if they are projected by the issuer, acting in good faith, to result from actions that have been taken (or, in some deals, are reasonably expected to be taken) within a certain period of time (usually 18 to 24 or, in some deals, 36 months) after the end of the applicable calculation period. This effectively brings forward expected add-backs to EBITDA for the current period, thus increasing debt capacity and covenant headroom.

Drafting Notes:

- *EBITDA calculations in bank transactions are typically syndication points and, while the TLB market has been incorporating HY concepts, the EBITDA definitions are still tighter on average than their HY counterparts. HY uses EBITDA only for exceptions to the covenants while bank transactions also use it for excess cash flow sweeps, pricing grid determinations, springing financial covenants and other purposes. Accordingly, relevant TLB precedents are more influential in this area than comparable HY deals.*
- *Consider whether sublimits on limb calculations in the EBITDA definition should be tied to a percentage of unadjusted EBITDA or flat dollar amounts to avoid inflationary accounting.*
- *The period of time over which the impact of expected add-backs can be brought forward is a syndication issue in the TLB market with 12–24 months common but longer periods less so (and all may be subject to flex).*
- *HY bonds do not have an equity cure concept, so additional drafting to common definitions and covenants may be needed to limit the application of cure amounts solely to the springing financial covenant compliance and not for use in counting toward increasing EBITDA for any other purpose including increasing baskets, incurring contribution debt or incurrence covenant tests. For example, cure amounts may be 'round-tripped' as dividends unless they are excluded from restricted payment exceptions.*
- *Regulators may concentrate more on EBITDA calculations given the impact on flexibility and overall leverage levels for the whole transaction. The recommended limits on leverage presume a standard EBITDA underpinning for effectiveness. As a general rule, each limb of the EBITDA definition should be tied to the diligenced credit model for support.*
- *For subjective and qualitative determinations for EBITDA and other items, parties should consider whether the borrower reasonable good faith standard is sufficient, particularly in transactions that are not widely syndicated and the agent has a hold position making the keeping of agent discretion for key credit issues a more substantive issue.*

© Published and reproduced with kind permission by Global Legal Group Ltd, London

5 Other Issues to Consider: Flex and the Leveraged Lending Guidelines

Many of the issues identified in this article are often preserved as flex items as each can be syndication issues to varying degrees depending on the quality of the underlying credit and market conditions. Going into 2016, starter baskets, incremental sizing, MFNs, soft call sunsets, EBITDA caps and bring forwards, have all been common flex items, among others.

In the US, the typical approach is to allow flex of items regardless of whether required for a successful syndication. This is different from the European approach which still typically requires a syndication nexus for the flex.

A number of the issues and trends identified in this article also run counter to the policy considerations underlying the US leveraged lending guidance. In addition to stressing discipline in underwriting standards and credit models, the guidance is critical of transactions with high leverage, lack of maintenance covenants, inability to amortise free cash flow, excessive covenant headroom and loose EBITDA discipline. While the guidance is not law, *per se*, as prudent lending practice from the Federal Reserve, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, it influences the impact of the overall regulatory framework of regulated banks and their relationship with the agencies that govern them.

6 Conclusion

Our expectation is that leveraged loan documentation will continue to shift away from the traditional credit model of maximising principal repayment and governing financial performance to the HY approach of maximising yield income to maturity, default avoidance and minimal impact of financial tests on the conduct of business. That said, there remain a number of areas where HY bonds fundamentally differ from bank loan documents, such as the treatment of permitted acquisitions (where any majority acquisition is permitted), the consequences of a change of control (which triggers an offer to purchase and not a default) and events of default (which are more limited and have longer grace periods). The degree to which additional terms join the convergence depends on the markets and the quality of the credit driving the precedent. At the start of 2016, there has been a chilling effect on some of the terms already in play, making it less likely for new terms to enter quickly. In any event, absent a significant and sustained downturn in markets or change in the regulatory landscape on leveraged lending in the US and other markets, the onward global march of TLB/HY convergence will likely continue. While the terms may converge, TLB and HY still occupy different markets and positions on the balance sheet and credit food chain. Accordingly, the incorporation of HY terms into leveraged loans requires thoughtful drafting to ensure all the various elements combine correctly and properly balance the needs of the business and the protection of investors.

Acknowledgment

The authors thank Eamon Nolan, Senior Associate, Linklaters, for his invaluable assistance in preparing this article.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Jeff Norton
Linklaters LLP
1345 Avenue of the Americas
New York, NY 10105
USA

Tel: +1 212 903 9115
Email: jeff.norton@linklaters.com
URL: www.linklaters.com

Jeff Norton, Head of the U.S. Banking Practice, has over 30 years of experience leading complex domestic and cross-border financing transactions. Jeff's practice focuses primarily on acquisition finance, including syndicated senior and junior debt and bridge loan financings and high yield issuances in the U.S., Europe and Asia, including numerous U.S. and European TLB loan transactions. He also advises clients on restructurings, liability management transactions and general finance matters. Jeff acts regularly for many of the firm's leading financial institution, financial sponsor and corporate clients.

Jeff has been consistently ranked for domestic and cross-border banking and finance matters in *Chambers* and other leading practice guides.

Danelle Le Cren
Linklaters LLP
One Silk Street
London EC2Y 8HQ
United Kingdom

Tel: +44 207 456 2395
Email: danelle.le_cren@linklaters.com
URL: www.linklaters.com

Danelle Le Cren is a Partner in Linklaters' Banking Group and has extensive experience in advising a range of clients in complex domestic and cross-border finance transactions, including acquisition and leveraged finance transactions, with particular focus on New York and European Term Loan B transactions involving financial sponsors, general corporate financings, infrastructure financings and project finance transactions, structured and tax-based financings, and debt restructurings and work-outs. She has considerable product knowledge and regularly works on transactions with material involvement in many of the global financial markets.

Danelle was named an "Up and Coming" attorney in Banking & Finance in the 2013 edition of *Chambers USA* and a "Rising Star" in Banking and Finance in the 2016 edition of *IFLR1000*. Danelle recently relocated to London from Linklaters' New York office where she was based for 15 years.

Linklaters

Linklaters is a leading global law firm, supporting clients in achieving their strategies wherever they do business. We use our experience and resources to help clients pursue opportunities and manage risk across emerging and developed markets around the world.

We build lasting relationships to support clients as they adjust to changes in their markets and the regulatory landscape. Discipline, teamwork and agility enable us to help clients navigate important business challenges successfully.

Our focus is on consistently delivering integrated, global solutions, built on our strong local capability. Although we are organised across three divisions, advising our clients invariably involves more than one division and jurisdiction. This is why we take a team-driven, collaborative approach to all that we do for our clients.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Albania

Neritan Kallfa

Tonucci & Partners

Blerina Nikolla

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Lending activity in Albania is a regulated activity and performed by local banks, non-bank financial institutions, savings and loan associations and other microfinance institutions.

However, lending activity can also be seen in cross-border lending transactions made by international financial institutions, foreign commercial banks and other finance companies which lend directly to local companies and/or operations of other international companies in Albania.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The significant lending transactions in recent years have been between international financial institutions and local banks/non-bank financial institutions. The local banks and non-bank financial institutions have borrowed money from international financial institutions in order to boost their domestic lending activity.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

An individual managing a single member company may not enter into a contract with another company concerning loans and guarantees.

Otherwise there are no explicit restrictions that a company can guarantee the borrowings of one or more other members of its corporate group.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Regardless of the extent of a benefit, if it is deemed unjustified by law, company members and shareholders including managing directors and members of the Board of Directors who act, or fail to perform required actions, shall be jointly and severally liable for company commitments (including company guarantees) to the extent of their total assets:

1. If they abuse the company form (i.e. limited liability) for illegal purposes.
2. If they treat company assets as if they were their own assets.
3. If they fail, with respect to the type of activities, to ensure that the company has sufficient capital at a time when they know or must have known that the company will not be able to meet its commitments toward third parties.

2.3 Is lack of corporate power an issue?

If the company will incur contingent debt from the guarantee amounting to more than 5% of the company's annual turnover of the last business year, the legal representative (i.e. managing director) would normally seek an approval from the Board of Directors of the company.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

There are no requirements in respect of governmental or other consent or filings. The shareholders' approval is required if it is provided specifically or generally in the Articles of Association of the company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no net worth, solvency or similar limitations imposed on the amount of a guarantee.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There is no exchange control or similar obstacles to enforcement of a guarantee provided between resident companies.

In principle, the same applies for cross-border guarantees provided from a resident company to the benefit of the other members of its corporate group abroad, but cross-border transfers due from such guarantee must be in accordance with the rules of foreign exchange transfer imposed by the central bank.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The collaterals available for secured lending obligations are immovable properties, tangible and intangible personal properties including property rights (i.e. usufruct rights), account receivables, financial instruments, etc.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is not possible to give a general security agreement.

It is advisable to provide either an agreement in relation to a specific asset or to a group of assets similar to their nature as provided under Albanian law (i.e. mortgage over immovable property 1, immovable property 2, etc.).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

According to Albanian legislation, security can be taken either over real (immovable) property (land) or over movable property (i.e. machinery and equipment).

Mortgage (security taken over immovable assets, usufruct or emphyteusis rights) can be taken/given not only over present or future immovable assets as well as present and/or future fixtures related thereto, but also easement rights over immovable property. It is created upon an agreement made in writing before a Notary Public, which in turn is perfected by registering it with the immovable properties registry kept by the local Real Estate Registration Office.

The Law on Securing Charges provides as an instrument of security a non-possessory pledge which is an alternative to the possessory pledge provided by the Albanian Civil Code. Therefore, a non-possessory security securing charge is given/taken only over present or future movable, tangible assets (i.e. machineries and equipment), for securing either a present or a future debt. In order to create a securing charge a written agreement is needed. The securing charge is then perfected through registration with the securing charges registry.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

The collateral security can be taken over receivables. Collateral security over receivables can be created by a written agreement. The collateral security over receivables is then perfected through registration with the securing charges registry (when securing charge is applicable) and provided to a local bank for 'possession' of the receivables (when financial collateral is applicable) while there is a collateral security.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Collateral security can be taken over bank accounts. As in question 3.4 above, collateral security over bank accounts can be created by a written agreement. The collateral security over receivables is then perfected through registration with the securing charges registry (when securing charge is applicable) and provided to a local bank for 'possession' of the receivables (when financial collateral is applicable) while there is a collateral security.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Collateral security can be taken over shares in companies incorporated in Albania. Collateral security over shares in companies incorporated in Albania can be created by a written agreement as a pledge under the Albanian Civil Code and financial collateral under a specific law.

In case of a pledge under the Albanian Civil Code, collateral security over shares in companies incorporated in Albania is perfected through registration in the company's own share ledger and with the Company Registration Centre.

In case of financial collateral provided to a local bank acting as a custodian while taking 'possession' of the shares in companies incorporated in Albania.

Such security cannot be validly granted under a New York or English law governed document.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

The Law on Securing Charges provides as an instrument of security a non-possessory pledge which is an alternative to the possessory pledge provided by the Albanian Civil Code.

Therefore, a non-possessory security securing charge is given/taken only over present or future movable, tangible assets (i.e. inventory), for securing either a present or a future debt. In order to create a securing charge a written agreement is needed.

The securing charge is then perfected through registration with the securing charges registry.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

The company can grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

It is not mandatory that the securing charge agreement be made in writing in the form of a notary deed; however in practice the document is drawn up by a Notary Public and the notarisation fee may vary from ALL 1,500 (approx. EUR 11) to ALL 4,000 (approx. EUR 29), depending on the guaranteed amount to be repaid by means of the securing charge agreement.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

It is mandatory that the mortgage agreement be made in writing in the form of a notary deed. For a mortgage agreement it may vary from ALL 2,000 (approx. EUR 14) to ALL 15,000 (approx. EUR 107).

The registration fee with the securing charges registry is ALL 1,400 (approx. EUR 10). Additional fees will be charged depending on the pages of the extract and how many additional collaterals, chargees/chargors, etc. shall be registered under the same registration number.

The fees applicable for registration with the Real Estate Registration Office of mortgage agreements depend on the amount of the loan.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The filing, notification or registration requirements in relation to security over different types of assets involve a reasonable amount of time or expense.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No, there are not.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

No, there are not.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Albanian company law does not provide rules on financial aids. Despite that, a joint stock company must not subscribe for its own shares, unless specifically provided under the law.

(b) Shares of any company which directly or indirectly owns shares in the company

Albanian company law prohibits a joint stock company from purchasing shares of its parent company.

(c) Shares in a sister subsidiary

There are no specific rules in Albanian company law regarding this issue.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

No. Albanian law does not recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

There is no alternative mechanism available.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Pursuant to the Albanian legislation (the Civil Code), the lender may transfer the loan to another lender even without the prior debtor's consent, except for the cases provided by the Albanian Civil Code.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

According to Albanian tax legislation, the interest payable on loans is subject to a withholding tax of 15%. In cases of a Double Taxation Treaty between the Republic of Albania and a foreign country, the provisions of the treaty are to be applied.

There are no specific rules in Albanian tax legislation regarding this issue.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no specific rules regarding tax incentives or other incentives and taxes applied to foreign lenders.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

No, because pursuant to Albanian tax legislation, only incomes which have their source in Albania can be taxable in Albania.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Foreign lenders may bear the notarial fees, the cost for the apostille seal and translation costs which are to be determined *mutatis mutandis*.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no adverse consequences to a borrower in cases where some or all of the lenders are organised under the laws of a jurisdiction other than the Albanian jurisdiction.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The law "On International Private Law" defines rules for the law that applies in civil legal relations, which have foreign elements, jurisdiction and procedural rules of Albanian courts.

The Albanian courts may enforce contracts with foreign elements according to the rules provided in the Civil Code.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

As a general principle, foreign judgments are recognisable and applicable in the Republic of Albania in accordance with the rules provided by the Code of Civil Procedure. The foreign judgment is enforceable after its recognition by a decision of the Appeal Court. These decisions shall not enter into force only when they do not comply with the rules provided by the Code of Civil Procedure.

In cases of recognition and enforcement of foreign courts the Court of Appeal does not judge on the merits of the case. It only examines whether or not the court decision contains provisions that are contrary to the aforementioned.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

If the loan/guarantee agreement regulated under foreign law is considered an enforceable title, the lender can initiate the enforcement procedure by immediately obtaining an enforcement order by the court. Then, the enforcement order can be forwarded to the Bailiff's Office for the execution.

If the loan/guarantee agreement regulated under foreign law is not considered an enforceable title, the lender must file a suit against the company in a court in Albania, obtain a final and binding judgment, and enforce the judgment against the assets of the company. This procedure may last approximately two years.

Enforcing a foreign judgment in a court in Albania against the assets of the company may take approximately two to three months.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

The procedure is enforced by the Bailiff's Office as according to specific steps and criteria listed in the Albanian Civil Procedure.

Before the enforcement is initiated, the Bailiff Officer shall invite the debtor to settle the obligations to the creditor within ten (10) days.

In case a debtor does not pay the debt sum, the bailiff initiates the enforcement procedure by seizing the collateral. The property is appraised by the bailiff according to that value specified in the Real Estate Registry, and if not registered, the property is then appraised by an appraiser.

During this process the collateral is generally kept in custody by the debtor, and if it is found that the debtor is not taking care of its condition (thus affecting its value) then the bailiff appoints a third party to keep it until the auction takes place.

Following the 10 (ten)-day grace period which the debtor is given to repay any outstanding amount to the creditor, the property is put forward for sale by auction. In the case when that there are no bidders in the first auction or if the proposed prices have not exceeded the minimum price set out in the first auction, a second auction will be held in conformity with the rules of the first one. This second auction can only be held after three months of the termination of the first one.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

There are no specific restrictions applicable to foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The collateral security and securing charge should not be considered under the bankruptcy estate.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

With reference to foreign arbitral awards, with Albania being a contracting state to the 1958 New York Convention on the Recognition and Enforcement of Arbitral Awards, foreign arbitral awards are recognised and may be enforced in Albania. The Court of Appeal does not judge on the merits of the case in cases of recognition and enforcement of foreign courts judgments.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The lenders that have a collateral security are entitled to enforce their rights through the execution of the collateral out of bankruptcy proceedings, but subject to the following exceptions: Chargees or Lessors may not raise claims related to rent or financial lease payments to a period of 12 months prior to the opening of the bankruptcy proceedings, or any other claims on damages relief, as a consequence of the termination of the lease.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The bankruptcy administrator may treat as invalid transactions that "disadvantage bankruptcy creditors" occurring within specified periods prior to opening the bankruptcy proceedings or after a request to open a bankruptcy proceeding. A transaction may be treated as invalid if it has occurred within three months prior to the request to open the proceeding or after the opening of the proceeding when, at the time of transaction the other party to the transaction was aware or as a result of gross negligence was unaware of the illiquidity of the debtor or the request to open the proceeding. Moreover, a transaction may be treated as invalid when the debtor has entered into a transaction with the intention to disadvantage his/her creditors occurring within 10 years before the date of the request to open the proceeding if the other party was aware of this intention, the debtor's illiquidity or the effect of the transaction on creditors.

With regards to the preferential creditors' rights, the Albanian Civil Code sets out the following order of preference, with some exemptions including cases otherwise provided for by the Albanian Civil Code and other specific laws.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes. The following entities are excluded from bankruptcy proceedings:

a) the State and its bodies;

b) the strategic sectors; and

c) local government and its bodies.

The bankruptcy proceedings applicable to banks and other financing institutions are not governed by the Bankruptcy Law but by specific laws.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

There are no processes other than out-of-court proceedings available for the creditor to seize assets subject to enforcement.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

There are specific matters where the Albanian courts have exclusive jurisdiction, i.e. ownership rights and/or real rights over immovable properties if the immovable property is within the territory of the Republic of Albania.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

With regard to this issue, Albanian legislation does not provide for the waiver of sovereign immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Lending activity in Albania is regulated. The resident lender must be licensed and supervised by the central bank.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Please refer to the answers above.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Neritan Kallfa

Tonucci & Partners
Torre Drin, Rruga Abdi Toptani, kati II
Tirana
Albania

Tel: +355 4225 0711
Fax: +355 4225 0713
Email: nkallfa@tonucci.com
URL: www.tonucci.com

Neritan Kallfa is one of the Partners of Tonucci & Partners Albania. He graduated from the University of Tirana – Law Faculty. He completed the Academy of American and International Law in Dallas Texas, USA and an LL.M. in International, Commercial & European Law at the University of Sheffield, United Kingdom. He is specialised in Corporate Finance; Project Finance; Banking and Finance Law, Commercial Mediation and Arbitration. Neritan has led the legal advisors team of Tonucci & Partners Albania for several financing projects in Albania.

Blerina Nikolla

Tonucci & Partners
Torre Drin, Rruga Abdi Toptani, kati II
Tirana
Albania

Tel: +355 4225 0711
Fax: +355 4225 0713
Email: bnikolla@tonucci.com
URL: www.tonucci.com

Blerina Nikolla is one of the attorneys of Tonucci & Partners Albania. She graduated from the University of Tirana – Law Faculty and continued her postgraduate Master's studies in the area of Tax Law at Università Cattolica del Sacro Cuore in Milan (Italy). She specialises in Tax Law, Corporate and Commercial Law.

Tonucci & Partners

Tonucci & Partners is a leading law firm and has operated in Albania since 1995. The firm also has offices in Italy (Rome, Milan, Padua, Prato, Florence) and in Romania (Bucharest).

Its Tirana office includes a team of Albanian and expatriate lawyers that combine the firm's leading international experience with local expertise, language skills and knowledge of local market practices.

Our clients in Albania are small, medium and large companies, associations, financial institutions, banks, Governmental agencies and other state-owned organisations which turn to Tonucci & Partners – Albania for advice on legal issues concerning their Albanian activities or international transactions.

The firm assists its clients in every aspects of their business in Albania, providing a full range of legal services in the area of: corporate and commercial law; banking and finance; contracts; energy; power and utilities law; natural resources; real estate and construction law; administrative law with particular regard to public procurements and concessions (EU IPA funds); telecommunication; antitrust; multimedia and IT; environment; IP, employment and immigration; tax and customs; international law; foreign investments; and litigation and arbitration.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Andorra

Audrey Montel Rossell

Montel&Manciet Advocats

Liliana Ranaldi González

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Andorra is still a rather conservative jurisdiction in terms of secured lending structures. However, the recent opening up of the Andorran economy to foreign investment by the implementation of the Foreign Investment Act of 2012 will probably stimulate the lending markets in the future.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

In recent years, there have been several significant transactions involving both domestic and foreign lenders. The collateral securities structures have involved pledges over shares and receivables and mortgages over real estate properties in Andorra as well as personal guarantees granted by the borrowing party. The details of such transactions are confidential.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, without prejudice to the restrictions mentioned in the section regarding financial assistance and the considerations contained in question 2.2 below.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

According to the Andorran Companies Act, the directors have a duty of diligence towards the company. Furthermore, a resolution passed by the general meeting might be challenged if it is considered that it prejudices the company's interests for the benefit of one or more shareholders or of a third party. In such events, the resolution might be annulled.

2.3 Is lack of corporate power an issue?

Yes, in Andorra the representative of a party to a contract must be duly empowered to act on its behalf.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In general terms, there are not specific requirements concerning governmental authorisations or consents. For transactions outside the ordinary course of business of a company, the authorisation of the general meeting is customarily obtained.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, without prejudice to the restrictions mentioned in the section regarding financial assistance and the considerations in the answer to question 8.2 concerning guarantees granted by an insolvent company or person.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, there are not.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The most common types of collateral to secure lending obligations are classified into: (i) personal guarantees, such as bails granted by a third party that acts as guarantor or guarantees on first demand, on which there is not express regulation but that have been admitted by the Andorran courts; and (ii) *in rem* security interest, the most common being mortgages over real estate property and pledges over movable assets with transfer of possession.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Under Andorran law, it is not possible to give asset security by means of a general security agreement. In order to create security over specific assets, it is necessary to constitute mortgages or pledges in accordance with the nature of the asset that will be granted as security. With respect to mortgages, it is required to constitute them by means of a public deed. With respect to pledges, even if their constitution is not required to be done by means of a public deed, it is highly advisable to do so in order to ensure their efficacy in front of third parties. Furthermore, pledges normally require the transfer of possession over the collateral.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

In Andorra, mortgages cover the land and the buildings built on it. According to the doctrine, and by virtue of the principle of freedom of contract, a mortgage can be extended to other properties physically bound with the main mortgaged asset.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Andorran doctrine and practice recognise the possibility of taking a security over receivables. Furthermore, there is a judicial precedent in which this type of security has been implicitly recognised.

A security over receivables could be taken by means of a pledge, constituted through the granting of a public deed in front of an Andorran notary.

In accordance with the Andorran practice, notification to the debtor is required in order for the pledge to be perfected.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, this type of collateral security can be taken by means of a pledge over a bank account, which, as in the case of security over receivables, must be constituted by means of a public deed granted in front of an Andorran notary. In this case, it is also necessary to notify the depositary bank about the existence of the pledge.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, a collateral security can be taken over shares of Andorran companies. Such collateral must also be constituted by means of a public deed granted by an Andorran notary.

In accordance with article 15 of the Companies Act, the shares can be documented by means of nominative titles.

This type of security must be granted under Andorran law-governed documents.

Besides the above-referred notarisation, the pledge must be registered in the relevant public deeds of acquisition of the shares affected by the pledge and in the Registry Book of Shareholders.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

To our knowledge this type of security is not used in Andorra considering the nature of securities available and the lack of transfer of possession.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, without prejudice to the restrictions mentioned in the section regarding financial assistance and the considerations in the answer to question 2.2.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notarisation fees are fixed by the Andorran Government. The current notarisation fees were fixed in the year 2000 and are established proportionally to the amount of the document to be notarised. In the case of securities, the fees are generally calculated over the amount of the secured liability.

The scale contemplates a percentage that varies progressively from 3% (applicable to relatively small amounts) to 0.1%. The Andorran equivalent of value added tax is applicable to notarisation fees.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

In general terms, the amount of time required in order to notarise a security is not significant. The related expenses depend on the amount of the secured liability, as mentioned in the answer to question 3.9 above.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No, in general terms there are not.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Please see the answer to question 3.2. Power of attorney must also be notarised.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Andorran companies, excluding banking institutions and other entities that integrate the Andorran financial system and are allowed to enter into credit transactions with third parties, may grant financial assistance to acquire their own shares or to accept them as security within the limit of 10% of the share capital of the company and as long as: (i) the assistance is charged against distributable profits and unrestricted reserves; (ii) the general meeting authorises the transaction and the maximum amount of shares that can be acquired and their maximum price; and (iii) the company establishes a reserve in its balance sheet equivalent to the amount of its credits or to the value of the shares accepted as security.

(b) Shares of any company which directly or indirectly owns shares in the company

Even if the Companies Act does not provide for a specific prohibition for this type of financial assistance, the prohibition of establishing reciprocal participations at a percentage higher than 10% leads one to believe that the restrictions referred to in the (a) above can be equally applicable in this scenario.

(c) Shares in a sister subsidiary

Please see the answer to (b) above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

There are no precedents that may confirm whether such figures would be recognised by the Andorran courts under secured lending structures.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Even if there are no judicial precedents that confirm its validity under Andorran law, and following recent trends in neighbouring countries, a parallel debt clause under the loan – which should be subject to a governing law that recognises such figure – could be used to grant Andorran securities directly to the trustee acting on behalf of the lenders.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Given the ancillary nature of securities with respect to the secured obligation, the assignment of a loan will normally entitle the transfer of the securities attached to it. However, considering the formal requirements applicable to securities in Andorra, and in particular to mortgages and pledges, it would be necessary to formalise such assignment by means of a public deed in order to ensure its efficacy in front of third parties.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest payments made to foreign lenders may be made without deduction or withholding on account of the Andorran Non-Resident Income Tax, given that the relevant law establishes a general exemption over interests when the payer is a resident of Andorra or when the interest arises from capital used in Andorra. Concerning interest payments on loans made to domestic lenders, if the lender is: (i) a company, there are no applicable deduction or withholding tax requirements (although interests are taxable); or (ii) an individual, and the paying party (a company or an individual acting in the course of its business) resides in Andorra, there is a withholding requirement for personal income tax at a rate of 10%.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Please see the answer to question 6.1 above. There are no taxes for the purposes of effectiveness or registration.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

No, it will not.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please see the answer to question 3.9 above.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, considering that there is no specific prohibition which bans the contracting parties to submit disputes arising from a contract to a specific law (except when a law provides the specific designation of Andorran law such as disputes arising from rights *in rem* over immovable properties located in the Principality of Andorra, lease contracts over properties located in the Principality of Andorra, and labour disputes, among others).

The Andorran courts would enforce contracts subject to a foreign governing law as long as (i) they are not related to matters which are submitted to the Andorran law by a mandatory rule, (ii) the foreign law does not contradict Andorran public policy, and (iii) the claiming party proves during the trial the content and validity of the applicable foreign law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes, as long as it is not considered by the Andorran courts that there is a lack of reciprocity between the Principality of Andorra and New York or England.

In this sense, under the *Llei Qualificada de la Justícia*, dated 3rd September of 1993, the enforceability of foreign judgments in the Principality of Andorra is subject to a prior judicial proceeding of recognition (the *exequatur* proceeding) which falls into the domain of competence of the Andorran High Court of Justice – the highest level of authority in the Andorran judicial system – and which is based on the criterion of reciprocity.

In accordance with article 49 of the *Llei Transitòria de Procediments Judicials* dated 21st December of 1993, the Andorran court shall verify that the foreign judgment complies with each one of the following conditions: (i) the competence of the jurisdiction that has rendered the foreign judgment; (ii) the regularity of the trial procedure followed; (iii) the accordance of the foreign judgment to national and international public order laws; and (iv) the absence of any type of fraud in Andorran law.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) It will depend on the complexity of the matter. The enforcement of a security in Andorra is subject to the determination that a breach of the main obligation has occurred (an average of between 12 and 18 months is required in matters that do not present a special complexity) and to a second procedure of foreclosure over the secured assets which normally requires several public auctions.

(b) As mentioned in question 7.2., the enforcement of a foreign judgment is subject to the *exequatur* procedure. The average resolution of this type of procedure is between six and 12 months. Once recognition of the foreign judgment is obtained, it is necessary to initiate a foreclosure procedure which is as well subject to public auctions.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Under Andorran law, a creditor cannot appropriate a secured property without commencing enforcement proceedings, which, in general terms, imply the sale in a public auction of the secured assets. A specific foreclosure proceeding has been recently regulated by the Foreclosure Act, dated 18th December of 2014. On the same date an Act was passed regulating the figure of the bailiff with the aim of accelerating the enforcement of judicial resolutions.

The Foreclosure Act provides two public auctions, the starting price being determined by an appraisal (which in certain events of disagreement between the parties must be established by an independent appraisal) of 70% for the first auction and of 50% for the second auction. The direct award of the collateral is only contemplated in exceptional cases and in the event that the public auctions are declared deserted. If a foreign secured party is finally awarded with real estate property, a foreign investment authorisation might be required.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

There are no restrictions for foreign lenders to file a suit in Andorra against an Andorran company. In the event of foreclosure and direct awarding of real estate property, the Foreign Investment Act might be applied and a previous authorisation might be required.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Please see the answer to question 8.1 below.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The recognition of foreign arbitral awards is subject to the *exequatur* procedure on the same terms as described in the answer to question 7.2. Furthermore, the Andorran Arbitration Act, dated 18th December of 2014, establishes that the *exequatur* on arbitral awards is subject to the New York Convention of 1958, notwithstanding any more favourable international treaty on the matter.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In accordance with the Andorran Decree on Insolvency, dated 4th October of 1969, a declaration of bankruptcy or the establishment of a judicial agreement of a person would imply that: (i) its creditors would not be allowed to demand their credits individually; (ii) their credits would be part of the insolvency estate represented by the administrator appointed by the court and; (iii) all individual actions in process at the time would be suspended.

However, if the creditor's rights are secured by means of *in rem* securities, such as pledges and/or mortgages, their credits would receive the consideration of privileged securities, and any enforcement action initiated by them would not be suspended as a result of the declaration of bankruptcy. Furthermore, their credits would not be part of the insolvency estate, except in the event that the securities were not sufficient to cover the secured liability.

Under an insolvency procedure, the administrator appointed by the court may require the secured creditor to cancel any pledge it may hold on a previous payment of the amount secured.

Concerning mortgages, if no action has been initiated in order to execute them before the declaration of insolvency, the administrator, with the court's authorisation, is entitled to realise the sale of the mortgaged properties within three months after the declaration of insolvency. Notwithstanding, the secured creditor, within the two-month period after the relevant notification from the court, may initiate the relevant proceeding in order to enforce its security. All of such sales shall be realised under the public auction proceeding carried out by the competent authority.

In both cases, if the amount recovered is insufficient to cancel the amount of the debt secured, the creditor's credits will be part of the insolvency estate, for the outstanding amount of the debt as ordinary creditors.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Under the Andorran Insolvency Decree, creditors' rights are qualified as privileged or ordinary. The law contemplates a general privilege in favour of the employees of the debtor over its properties. However, the Andorran courts have determined on several occasions that employees' privilege does not affect the privilege granted by *in rem* securities.

The Andorran Decree on Insolvency also provides the unenforceability of certain acts carried out by the debtor after the date of the declaration of insolvency against the mass of creditors, and particularly: (i) gratuitous dispositions and all the contracts in which debtors' obligations notably exceed its counterpart's obligations; (ii) payments made concerning debts not falling due at the moment of declaration of insolvency; (iii) mortgages or securities granted after the date of the declaration of insolvency for previous debts; and (iv) debtor's acts challenged by the administrators or by the creditors on the basis of simulation. A court declaration of insolvency must determine the date from which the debtor is considered to be insolvent. Such date must not be earlier than 18 months before the court's declaration. As a result, the third party involved in the rescinded act would be obliged to restitute the goods or services, plus interests and fruits, if any.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

According to the Insolvency Act, bankruptcy proceedings are solely applicable to commercial companies and individuals that carry out commercial activities.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes, extrajudicial procedures are available to the parties as long as they are agreed upon by them. Such procedures are normally carried out by Andorran notaries and are subject to the performance of several auctions. It is highly advisable to determine the procedure to follow in the security document.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Andorran courts have exclusive jurisdiction over certain matters where a specific law so provides, for instance: in claims related to the Andorran nationality; in disputes arising from rights *in rem* over immovable properties located in the Principality of Andorra and lease contracts over properties located in the Principality of Andorra; and in disputes related to the validity, invalidity or dissolution of Andorran companies or their resolution, among several others. Therefore, if the matter in question is not affected by an exclusive jurisdiction clause, the submission to a foreign jurisdiction made by the parties to a contract would be enforceable under the laws of Andorra.

Under Andorran law, the competent jurisdiction to resolve a dispute is the jurisdiction in which the defendant is domiciled, whenever there does not exist a specific provision in the law that attributes the exclusive jurisdiction to the Andorran courts, or whenever the parties have not agreed to submit the claim to any other jurisdiction. Additionally, the doctrine considers that, as regards the resolution of disputes in contractual matters, the first rule on the attribution of jurisdiction is the autonomous will of the parties. In the absence of designation by the contracting parties, the jurisdictional competence corresponds to the jurisdiction in which the defendant is domiciled.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A part of the doctrine admits the possibility to waive the sovereign immunity. Regarding the immunity of execution, the restriction to waive is considered to be related to the nature of the assets, it being understood that for certain type of assets, immunity is absolute.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no restrictions in that sense. However, if an entity carries out financing activities on a regular basis in Andorra, it must be duly authorised and it will be subject to regulation for its financial activities.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The majority of the matters have been mentioned in the previous answers.

Audrey Montel Rossell
Montel&Manciet Advocats
Carrer Ciutat Consuegra, núm. 16
Edifici L'Illa. Bloc A. 3r. 1a.
AD500, Andorra la Vella
Andorra

Tel: *+376 809 809*
Fax: *+376 863 698*
Email: *amontel@mmadv.ad*
URL: *www.mmadv.ad*

Audrey Montel Rossell has been a partner of Montel&Manciet Advocats since 2015 and she is specialised in corporate and contractual matters. She has experience in both domestic and cross-border transactions requiring secured lending structures with respect to assets located in Andorra. She graduated from the *Université des Sciences Sociales* (Toulouse, France) and she holds a post-graduate degree from the same university in Contracts and Professional Liability, and a Master's Degree in Business Legal Practice from the I.E. Business School (Madrid, Spain). She joined the firm in 2009 and was admitted to the Andorran Bar Association in 2008. She speaks fluent English, Catalan, French and Spanish.

Liliana Ranaldi González
Montel&Manciet Advocats
Carrer Ciutat Consuegra, núm. 16
Edifici L'Illa. Bloc A. 3r. 1a.
AD500, Andorra la Vella
Andorra

Tel: *+376 809 809*
Fax: *+376 863 698*
Email: *lranaldi@mmadv.ad*
URL: *www.mmadv.ad*

Liliana Ranaldi González has been an associate of Montel&Manciet Advocats since 2010. Her practice focuses on corporate and tax matters. She graduated from the *Universidad Católica Andrés Bello* (Caracas, Venezuela) and holds a Master's Degree in the Banking Sector and of Financial Agent (Madrid, Spain) and a Master's Degree in Business Legal Practice from the I.E. Business School (Madrid, Spain). She is member of the Bar Associations of both Andorra and Madrid. She speaks fluent English, Catalan and Spanish.

Montel&Manciet Advocats

Montel&Manciet Advocats was founded in 1992 and since the beginning it has been dedicated to integral and multidisciplinary legal counselling for both individuals and enterprises, with wide experience in outstanding domestic and cross-border transactions.

In continuous adaptation to the market, Montel&Manciet Advocats has a strong commitment to its clients in the development of their activities in Andorra and abroad. Its highly qualified team has a diverse and complementary academic background and professional experience abroad, and is engaged in rendering an efficient and dynamic service to its clients.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Argentina

Juan M. Diehl Moreno

Marval, O'Farrell & Mairal

Diego A. Chighizola

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The main issues at hand are those triggered by three current forces that have proved to be disruptive in the local financial market:

(i) inflation;

(ii) foreign exchange restrictions limiting the ability of local residents and non-Argentine residents to acquire foreign currency, although since December 2015 some *de facto* rules and restrictions have been slightly eased; and

(iii) lack of long-term financing.

In a nutshell, current interest rates in connection with secured financing in Pesos (but also in U.S. Dollars) are priced at a rate that, at some points, is even lower than inflation. In other words, inflation has trumped interest rates in terms of percentage and, therefore, interest rates have sometimes even proven to be negative.

In light of this issue, the most significant trends have been those aimed at structuring transactions that could mitigate the adverse effects of these situations. As an example of these features, we can mention:

(i) dollar-linked transactions, i.e. financings which are denominated in foreign currency but for which disbursements and repayments are made in local currency. This feature has been included in most recently issued securities (by private entities but also by publicly owned companies) and in some syndicate and bilateral loans. In addition, there are specific regulations issued by the Central Bank of the Republic of Argentina (the "Central Bank") that could be construed as supporting this mechanism; and

(ii) transactions including terms which allow the lender to request payment of principal and interest in a foreign currency, local currency at a specific exchange rate, or payment in kind.

Finally, since the re-enactment of foreign exchange restrictions in 2001, most of the financings received by local companies are trade-related financings, the proceeds of which are used by local companies to either finance production of commodities or other exportable goods or finance the acquisition of equipment or other goods. This type of transaction is afforded preferential treatment from a foreign exchange perspective.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

- In 2015, Banco Hipotecario, BACS, ICBC and Citibank granted Petrolera Pampa S.A. a US$ 83.4 million loan.
- In 2015, BBVA Banco Francés, Banco Santander Río, HSBC, Citibank, Banco Macro, Banco Galicia, Banco Hipotecario, BACS, ICBC, Banco Patagonia and Banco de la Pampa granted Bayer S.A. a US$ 245 million loan.
- In 2014, the Parisian branch of Deutsche Bank and Credit Agricole granted Axion Energy Argentina a US$ 73 million loan agreement, its first international financing.
- The loan was backed by French credit insurer Compagnie Française d'Assurance pour le Commerce Extérieur.
- In 2014, Banco de Servicios Financieros ("BSF") issued notes worth US$ 150 million.
- In 2014, Corporación Andina de Fomento granted Aceitera General Deheza S.A. an A/B loan for the aggregate amount of US$ 100 million. Corporación Andina de Fomento participated in the Tranche A loan for the amount of US$ 50 million and Rabobank Nederland participated in the Tranche B loan for the amount of US$ 50 million. The loan is secured by a mortgage and a registered pledge.
- In 2014, Latin American development bank Corporación Andina de Fomento granted Argentine oil and gas producer Pan American Energy a US$ 238 million loan.
- During 2013 and 2014, the Provinces of Neuquén, Chubut, Mendoza, Buenos Aires, and Entre Ríos issued notes for US$ 330 million, US$ 264 million, US$ 219.9 million, US$ 200 million, and US$ 63.7 million, respectively. The City of Buenos Aires also issued notes for US$ 216 million.
- In 2013, Argentine downstream oil company, Axion Energy, secured two loans worth 800 million Argentine Pesos (US$ 150 million) in total.
- In 2013, Argentina's local wheat and oilseed milling company, Molino Cañuelas SA, obtained a 200 million Argentine Pesos (US$ 38 million) loan from a syndicate of banks.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, it is possible to secure the borrowings of other members of the corporate group. The company acting as a guarantor should receive proper (arm's-length) benefits or consideration in return. Otherwise, it may be considered that the granting of the guarantee derives no benefit for the securing company and, hence, other creditors could challenge such a transaction.

In addition, the by-laws of the securing company should include the prerogative to grant borrowings to third parties or, alternatively, the main activity of the company should be financing.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

These requirements should be strictly defined when the guarantee is upstream (a controlled entity acting as guarantor of an obligation of its direct or indirect parent company or an affiliate).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In case the securing company does not have any financial corporate purpose, nor receives a consideration or benefit, the guarantee may be deemed out of the scope of the securing company's corporate purpose (*ultra vires*) and, consequently, may be declared void.

Further, pursuant to Argentine law, directors must act loyally towards the company and its shareholders, which includes the director's responsibility to perform its duties with the diligence of a "good businessman" and in the interest of the company. Any failure to comply with these standards results in directors' unlimited liability for the damages arising therefrom.

To be released from any such liability, the director must timely file written objections to the company's resolution that caused the damages, and, if applicable, give notice thereof to the company's statutory auditors or file proceedings for challenging the decision.

Therefore, although it is not specifically provided, if a guarantee is deemed out of the scope of the securing company's purpose, it might be understood as a breach of the director's duties and, consequently, the director would be deemed responsible for negligence.

2.3 Is lack of corporate power an issue?

Yes. Corporate power is required to grant guarantees and any guarantee granted without sufficient corporate power could trigger director liability, as explained above.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental authorisation, consent or approval is required to grant a guarantee. However, it is advisable that the Board of Directors or the shareholders' meeting previously approves the transaction, particularly if the guarantee is for a significant amount considering the net worth of the guarantor and there is no specific provision in the by-laws of the guarantor. A unanimous approval through a shareholders' meeting is also advisable.

Also, if the security consists of a mortgage over real property located in a security zone (close to borders and other strategic zones), upon execution, transfer of land will require prior approval from the Security Zone Commission, unless the transferee is an Argentine individual.

In addition, third parties' consents may be required for the assignment of agreements to a trust. As a general rule, since contracts involve both rights and obligations, the transfer of the obligations is not allowed unless the express consent of the counterparty is obtained (see questions 3.1 and 3.4).

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

As long as the company operates within its corporate purpose, as explained in question 2.1, Argentine law does not provide limitations on the amount of a guarantee; however, deduction of interest may be limited under certain thin capitalisation rules. Please refer to question 6.5.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Assuming that the enforcement of a guarantee implies an international transaction (i.e. a payment from an Argentine resident to a non-Argentine resident), it will be subject to foreign exchange regulations.

Foreign exchange rules allow access to the Argentine Foreign Exchange Market (the "FX Market") to purchase foreign currency to make payments abroad under the items "Commercial guarantees for export of goods and services" and "Financial guarantees", subject to compliance with applicable requirements in each case. Argentine foreign exchange rules do not affect a foreign lender's ability to exercise its rights against a foreign guarantor.

If the guarantee is established over a local asset and its enforcement implies the collection of Argentine Pesos, the foreign lender is able to purchase foreign currency for repatriation purposes, subject to compliance with certain specific requirements.

Also, proceeds obtained from a bankruptcy proceeding can be transferred abroad through the FX Market, provided that the creditor accessing the FX Market is the same creditor that filed for recognition of the credit in the insolvency proceeding.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In general terms, Argentine law recognises two kinds of guarantees: the "personal" guarantees; and the "asset-backed" guarantees.

"Personal" guarantees are granted by a person or a legal entity committing its property to assure the performance of one or more obligations of the debtor. Upon the debtor's default, the creditor may eventually take legal action over the debtor's property and the guarantor's property. This guarantee, unlike asset-backed guarantees, does not create a lien or a privilege in favour of the creditor.

"Asset-backed" guarantees are granted over a specific property owned by the guarantor. In this kind of guarantee, either the debtor or a third party may be the guarantor. Unlike personal guarantees, asset-backed guarantees grant the creditor (i) the rights of "persecution" and "preference" over the asset in question, which means that the creditor has the right to pursue the guarantor's property, even if the guarantor sells or transfers the property, and (ii) the right to execute the guarantee and receive the corresponding payment with preference over other creditors, even in the event of insolvency or bankruptcy of the debtor or the guarantor.

The most common guarantees are the following:

a) Mortgage: The mortgage is the most frequently used security over immovable property. Also for certain movable property which has significant value the law specifically demands the constitution of a mortgage instead of a pledge (i.e. aeroplanes). For further details, please refer to question 3.3.

b) Pledge: A pledge may be constituted over movable property, including but not limited to: machinery; vehicles; patents; and trademarks. For further details please refer to question 3.3.

c) Trust in Guarantee: A trust may secure both movable and immovable property for a maximum term of 30 years. Goods held in trust form an estate separate from that of the trustee and the trustor. Trusts must be registered with the appropriate

© Published and reproduced with kind permission by Global Legal Group Ltd, London

public registry. Also, if the property given in trust is registered in a public registry, the relevant registry will record the property in the trustee's name. Therefore, they should not be affected by any individual or joint actions brought by the trustee's or trustor's creditors, except in the case of fraud. The beneficiary's creditors may exercise their rights over the proceeds of the goods held in trust and be subrogated to the beneficiary's rights.

Any individual or legal entity may be appointed as a trustee of an ordinary trust. Financial entities that solicit services to act as trustees must obtain prior authorisation to do so. Although there is no ruling on the issue, it is advisable that the trustee be a different person from the secured creditor (although there is no obstacle if the trustee is a controlled or controlling entity of the secured party).

d) Security Assignments: Assets may also be assigned as security. One of the differences with a trust is that, in the case of security assignments, assigned assets are typically limited to rights or credits including, without limitation, receivables.

The creditor may demand payment of the credit to either the assignor or the debtor of the assigned credit. If the assignor pays the amounts owed, then the assigned credit should be assigned back to the assignor.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Although it is not possible to execute a general security agreement, including different types of collateral securities, it is possible to execute a general agreement including more than one asset of the same type; for example, a pledge may include machinery and vehicles. In any case, the assets must be clearly identified in the security agreement.

In relation to the procedure, a security is executed by means of an agreement between parties, subject – in certain cases – to certain formalities. For example, mortgages must be made through public deeds.

Argentine law allows the pledge over an inventory of goods ("floating pledge"). Please refer to question 3.3.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral security can be taken over real property (mortgage) or over machinery and equipment (pledge).

a) Mortgage: A mortgage generally secures the principal amount, accrued interest, and other related expenses owed by the debtor. To be valid, the following conditions should be met:

(i) The mortgagor must own the property or properties to be mortgaged.

(ii) The mortgagor must have the capacity to transfer its assets.

(iii) In certain cases, prior consent of the spouse is required.

(iv) The mortgage must be granted over one or more specific properties and the maximum amount and the obligation secured must be certain and determined. Conditional, future or undetermined obligations are permitted to be secured, provided that a maximum amount of the guaranty is determined upon creation of the mortgage. Additionally, the mortgage over real property extends to: (i) all its accessories as long as they are attached to the principal property; (ii) the supervening improvements made to the property; and (iii) the asset's earned income (*frutos civiles y rentas*).

Mortgages must be executed in writing by means of a public deed, which must be registered with the Land Registry of the jurisdiction where the property is located to be valid *vis-à-vis* third parties.

A mortgage remains in full force and effect until all amounts secured have been paid or the mortgage is otherwise cancelled. The registration of a mortgage will automatically expire 20 years after the date upon which it was registered, unless renewed.

b) Pledges: The debts secured by a pledge can be conditional, future or undetermined, or otherwise uncertain in amount.

Pledges in Argentina are mainly governed by the Argentine Civil and Commercial Code, which came into force in August 1, 2015.

According to the provisions of the current legislation, there are two classes of pledges:

(i) "Unregistered Pledge": the pledged assets can be delivered to the creditor or placed in the custody of a third party. Upon default, the creditor may sell the pledged asset through a public auction. The distinction between Civil and Commercial Pledge adopted by both abrogated Civil and Commercial Codes was not embodied into the new Civil and Commercial Code. The New Code provides that parties may agree on the following: (i) that the creditor may obtain ownership of the asset for the estimated value of it, made at the time of maturity of the debt, as set by the expert appointed by the parties or designated by the judge at the request of the creditor; or (ii) by means of a special sales proceeding.

(ii) "Registered pledge": There are two types of registered pledges: the "fixed pledge", used for specified assets; and the "floating pledge", used for a certain inventory of goods, with no precise identification of the goods. A floating pledge allows for the replacement of the goods of the pledged inventory.

The registration of a fixed pledge involves the filing of the petition to the Pledge Registry of the jurisdiction in which the personal property is located.

The pledge agreement is legally binding between the parties from the date of execution. Upon registration, the agreement is effective *vis-à-vis* third parties. It shall be effective *vis-à-vis* third parties from the execution date if the petition to register the pledge is filed made before the corresponding registry within 24 hours of its execution.

The registration of a pledge expires five years after the date on which it was registered, unless renewed. Once perfected, a pledge remains in full force and effect until all amounts secured have been fully paid or the pledge is otherwise cancelled.

The floating pledge may be created through a notarised private document, using the form provided by the Pledges Registry for such purposes (a public deed is not required).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. Collateral security can be taken over receivables. In order to have effect *vis-à-vis* third parties, a private assignment agreement must be executed and the assigned debtor must be notified by a notary public.

Alternatively, a trust structure may be used. Please refer to question 3.1.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Argentine law recognises the validity of a pledge over cash. In this case, the pledge shall have full effects upon delivery of the amounts pledged to the pledgee. However, these guarantees are not usual.

As for the procedure, please refer to question 3.3.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes. To be valid, the shareholder must inform the company about the terms and conditions of the pledge and the Board of Directors must record the existence of the pledge (i) in the Registry of Shares Book, and (ii) with a notation at the back of the share certificate (unless the shares are not represented in titles – i.e. book-entry shares).

Pursuant to Argentine law, movable assets which are permanently situated in a place and are not intended to be moved to a different jurisdiction are governed by the rules of the place where they are located. Thus, a guarantee agreement over the shares of a local company shall be governed by the rules of Argentina.

Parties in a loan agreement may freely agree on the law applicable to the contract (see question 7.1), but Argentine law must rule the content, conditions and effects of a security over the shares of the company.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, under a "floating pledge". Please refer to question 3.3.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

(i) Yes, debtors may guarantee their own obligations. Please refer to questions 3.1 and 3.3 above.

(ii) Yes. It is a guarantee of a third party, different from the debtor. Please refer to questions 3.1 and 3.3 above.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notarisation, registration and other fees vary depending on the jurisdiction in which the agreement is executed.

The following chart details the main costs applicable to different securities:

Security	Fees
Real Property (Mortgage)	Notary Fees: 1% of the principal amount. Stamp Tax: 1% of the economic value of the agreement in the City of Buenos Aires. 1.2% in other jurisdictions such as the Province of Buenos Aires. Registration Fees: 0.2% to 0.3% of the guaranteed obligation.
Chattel Personal Property (Pledge)	Notary Fees: low depending on the characteristics of the pledge. Stamp Tax: 1% of the economic value of the agreement in the City of Buenos Aires; 1.2% in other jurisdictions such as the Province of Buenos Aires. Registration Fees: 0.2% of the guaranteed obligation.
Accounts Receivable/Debt Securities	Notary Fees: low, depending on the characteristics of the security. Stamp Tax: 1% of the economic value of the agreement in the City of Buenos Aires; 1.2% in other jurisdictions such as the Province of Buenos Aires. Registration Fees: 0.2% of the guaranteed obligation.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Registration before the applicable registry may take approximately between one and six months, depending on the type of assets involved.

As for expenses, please see the table in question 3.9.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

There are no explicit statutory restrictions on the ability of Argentine companies to create pledges on their assets to secure *their own* obligations. However, certain limitations to, or special requirements on, the ability of an Argentine company to create pledges in its assets may be included in the by-laws of the company.

In addition, the by-laws may require express approval for the creation of any pledge on the assets of a company by its Board of Directors, in which case a resolution of the Board would be needed. In the absence of such requirement, the pledge may be created by any representative acting pursuant to an adequate power of attorney or, in the case of a corporation, by the president of the company.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No special priorities are provided for revolving credit facilities. In this kind of loan, careful drafting should be taken into account. The guarantee granted at execution of the agreement may secure the subsequent renewals of the loan.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

For documentary requirements, please refer to question 3.3.

When a public deed is required, signing in counterparts, although not expressly prohibited, is not advisable since it could create certain issues in terms of proof.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

The limitations referred to above with respect to guarantees also apply here. In addition, there might be a tax impact related to a leverage buy-out operation.

It should be noted that Income Tax Law does not provide clear parameters to distinguish between "debt" and "capital". Guidelines can be found in the Income Tax Law and its Regulating Decree, when they require – for irrevocable contributions – that "in no case shall there accrue interest or any accessories for the contributor".

As explained in question 6.1, a borrower is able to deduct interest (for income tax purposes) as long as the expenses were incurred to generate taxable income.

The Argentine Tax Authority has challenged the deduction of interest in cases of a leverage buy-out to acquire shares of local companies. The National Tax Authority considered that such expense is not necessary to obtain taxable income or to keep or maintain its source. In certain cases, the resolution of the Tax Authority was confirmed by the Tax Court.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

In Argentina, the role of the agent or trustee is governed by the rules of contract. Therefore, the parties in a syndicated lending may freely determine the functions and powers of the agent; such powers might include calculating the due amount of principal and interest, calculating financial ratios, informing the compliance or defaults of the debtor's obligations under the agreement, and keeping and guarding the loan documentation.

The figure of the agent in a syndicated loan is different from the figure of a collateral agent. Since in Argentina the guarantees must be linked to the credits which are guaranteed, it is not possible to split the holder of the credit from the holder of the guarantee. Thus, if a collateral agent is appointed, it might act as representative of the creditors but not as the holder of the rights arising from the guarantee. All creditors should be incorporated in the relevant security agreement and registered as secured parties rather than registering the relevant security in the name of a trustee or security agent. Thus, a security agent may enforce guaranties on behalf of the lenders (as *apoderado*), provided that it is duly empowered to do so by a power-of-attorney and the guaranty provides for such possibility.

The classic US-like structure of collateral agent pursuant to which security interests are granted directly to the trustee for the benefit of the lenders may pose certain procedural issues and challenges in Argentina.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

- The credits and the guarantee might be transferred to a trustee, who will be committed to enforcing the security if the debtor fails to comply with the agreement and applying the proceeds from the security among the grantors-beneficiaries.
- A real property might be transferred to a trustee, who might constitute a guarantee trust over such property in favour of the creditors.
- The guarantee might be granted in favour of one creditor, who commits to act as a collateral agent based on an intercreditor agreement.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The assignment of credits must be documented in an agreement. A debtor's intervention in the agreement is not required.

The enforceability of the credits by the new lender is subject to two requirements: (i) the transfer of the credit; and (ii) the debt being payable.

Debtors should be given notarised notice of the assignment to be effective *vis-à-vis* third parties and the debtor itself, in case of a judicial claim. The notice could also be made through a private instrument with an unequivocal date (*fecha cierta*).

Upon assignment of the credit, the local debtor must inform the details of the new creditor to the Central Bank, pursuant to a certain foreign debt information regime.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Deduction is allowed only for expenses incurred to generate taxable income.

Interest is deductible for the borrower. Interest deduction is limited by thin capitalisation rules (see question 6.5), unless a Double Tax Treaty with a non-discrimination clause is applicable. In such a case, total deduction could be possible.

In addition, if the loan is made with a related party or with a party located in a low tax jurisdiction (regardless if it is related or not), interest is deductible only when paid and transfer-pricing rules apply. Decree No. 589/2013 of the Argentina Tax Authority establishes that "cooperative jurisdictions" will be those which signed an agreement for the exchange of information on tax matters or a convention to avoid double taxation with broadly interpreting information exchange clauses with Argentina. The Argentine Tax Authority draws up, publishes and keeps a list of countries,

© Published and reproduced with kind permission by Global Legal Group Ltd, London

domains, jurisdictions, territories, associated states, or special tax regimes considered as "cooperative jurisdictions" up to date. If the loan is made with a non-related party which is not located in a tax haven jurisdiction, interest is deductible on an accrual basis and no transfer pricing rules apply.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives for foreign lenders. Non-Argentine residents without a permanent establishment in Argentina are only subject to income tax on their Argentine-source income.

Foreign lenders will be taxed by income tax only on their profits from Argentina. When the lender is a bank or financial institution incorporated or located in a country deemed to be a cooperative jurisdiction or in a jurisdiction that has entered into agreements of exchange of information with Argentina and, also, is a jurisdiction where the relevant governmental authority has adopted the international standards approved by the Basel Committee on Banking Regulations and Supervisory Practices, the presumed net income in case of cross-border interest payments is 43% and, deriving from that, a 15.05% effective withholding rate. In all other cases of cross-border interest payments, the presumed net income is 100% and, therefore, the effective withholding rate is 35%. The Argentine debtor is responsible for the withholding and payment of the tax. Argentina has entered into treaties for the avoidance of double taxation with different countries. In certain cases, such treaties set forth ceilings to the effective withholding mentioned above.

Value Added Tax ("VAT") applies to the sale of goods, the provision of services and the importation of goods and services. Under certain circumstances, services rendered outside Argentina, which are effectively used or exploited in Argentina, are subject to VAT.

Interest arising from a loan granted by a foreign entity is subject to VAT and the Argentine debtor is responsible for the payment of the tax.

The tax is levied on the interests paid and the current general rate is 21%. However, interests arising from loans granted by foreign banks are subject to a 10.5% rate when the central banks of their countries of incorporation have adopted the regulations provided by the Basel Committee.

Argentine Provinces and the City of Buenos Aires apply the Turnover Tax (Tax on Gross Income), levied on gross income obtained from the exercise of onerous and habitual activity within each relevant jurisdiction. The tax rate varies in each jurisdiction.

For tax purposes, the activity of lending money is presumed to be carried out on a habitual basis, even if carried out once, and therefore is subject to Turnover Tax. The amount of returned capital is excluded from the taxable base. Thus, only the total amount of interest will be subject to Turnover Tax. Notwithstanding, it is not clear if interest collected by a foreign lender is subject to Turnover Tax.

Stamp tax is a local tax levied on public or private instruments executed in Argentina, or documents executed abroad with effect in one or more relevant jurisdictions within Argentina. In general, this tax is calculated on the economic value of the agreement. Each jurisdiction applies different tax rates to different types of agreements, but the most common rate is 1%, e.g. the City of Buenos Aires. Certain ways of entering into contracts do not trigger this tax.

Finally, a tax imposed on credits and debits in bank accounts (the "TDC") must be paid in the case of credits and debits in Argentine bank accounts at a rate of 0.6%. However, the credit of the borrower in an Argentine bank account arising from the disbursement of principal of the loan would not be subject to the TDC since the disbursement of principal under a "banking loan" is exempt from the TDC.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Non-Argentine residents without a permanent establishment in Argentina are only subject to Income Tax on their Argentine-source income. Only income from Argentine sources will be taxed by the Argentine Income Tax.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

For notarisation, registration and other fees, please refer to question 3.9. Also, the loan and the guarantees will generally be taxed by Stamp Tax. For the purposes of the Stamp Tax, the loan and the guarantees could be considered independently even if they were agreed in the same document. Then, the transaction might be doubly taxed in certain jurisdictions. However, in the City of Buenos Aires, for example, there is an exemption by which the guarantees may not be subject to stamp tax if the main agreement has already paid the tax.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

When the loan is granted by a related party, interest payments are subject to thin capitalisation rules. According to these rules, the percentage of the interest payments equal to the percentage of the debt exceeding two times the net worth will not be deductible for the borrower, and will be treated as a dividend. This limitation will not apply if the recipient of the interest payments is a non-related party.

If the lender is located in a non-cooperative jurisdiction (regardless of whether it is related or not), interest is deductible only at the moment it is paid and transfer pricing rules apply. If the loan is made with a non-related party which is not located in a tax haven, interest is deductible on an accrual basis and no transfer pricing rules apply.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes. Parties are able to choose the laws that will govern the agreement as long as some connection to the system of the chosen law exists. Further, foreign law will only be valid to the extent that it does not contravene Argentine international public policy (i.e. criminal, tax, labour and bankruptcy laws). Also, rights associated with real estate are governed exclusively by local laws.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes. In principle, the courts of Argentina will recognise as valid and will enforce judgments of foreign courts if they refer to monetary transactions, subject to the compliance with certain procedural conditions (*exequatur*).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In Argentina, the length of litigation disputes depends on the complexity of the case and on whether appeals to court rulings are admitted.

Assuming the lender's creditor is unsecured, it might take between three and six years to obtain and enforce a final judgment. The render of a final decision might be delayed if foreign legislation governs the relationship between the parties.

Argentine procedural rules provide a fast-track proceeding called "*exequatur*" for the recognition and enforcement of a foreign judgment, which might last between one and three years. *Exequatur* proceedings do not require a re-examination of the merits of the case.

Despite the estimation above, freezing injunctions might be granted by Argentine courts if procedural requirements are met.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

In principle, there are no restrictions in order to enforce collateral security. Nevertheless, if the guarantor does not comply with its obligations, the creditor would have to file a suit in court.

Please refer to questions 2.6 and 7.3.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

In order to file a suit against a company in Argentina, the foreign lender must prove, if it is a company, that it is duly incorporated under the laws of its country.

As foreign exchange restrictions may apply, please refer to question 2.6.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The Bankruptcy Law does not provide any kind of moratorium on enforcement of lender claims.

Please refer to question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Arbitral tribunals are competent in monetary disputes. The enforcement of the arbitral award will be as equal as the enforcement of a judgment.

Arbitral tribunals may not solve cases in which Argentine tribunals have exclusive jurisdiction, nor when there is an express prohibition against arbitration (e.g. certain provincial matters).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy and reorganisation ("*concurso preventivo*") proceedings in Argentina generally cause personal actions to mutate into credit verifications ("*verificación de créditos y privilegios*") within the proceeding. All creditors with credits with cause or title prior to the debtor's petition for reorganisation proceedings, or a court's declaration of bankruptcy, must file their credit verification requests with the bankruptcy/reorganisation proceeding court.

Although the creditor does not have to wait until the credit filing procedure is finished before requesting the liquidation of the asset, the court will perform a summary examination of the documentation evidencing the creditor's preference and request the opinion of the trustee before carrying out the liquidation of the asset. During the reorganisation proceeding, security interest claims with respect to real guaranties shall continue its procedure before the court where they were initiated, provided that the creditors first verify their credits with the reorganisation proceeding's court.

Also, in the case of reorganisations, the court may, in the event of evident urgency or need, order the suspension for 90 days of any auction of property subject to a mortgage or a pledge ordered by any other judge.

A credit with a special preference has priority over credits with general preferences and unsecured credits. However, the recognition of these credits must be verified and accepted by the court, as explained in question 7.6.

Credits with special preferences will have priority on a specific asset, such as mortgages and pledges. This kind of preference can be enforced exclusively on the relevant assets and up to the proceeds of the liquidation of such assets.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The court may determine a preference period of up to two years prior to the bankruptcy proceedings, depending on the date when insolvency was first evidenced.

Certain acts which occur during that preference period may be ineffective, such as: acts for which no consideration is given; debts paid prior to its maturity; and security interests obtained for a debt which is un-matured and which was originally unsecured.

There are two types of preferences:

(i) Special preferences, which are granted exclusively over certain specific assets of the debtor, e.g.: securities over the proceeds from the sale of the secured asset; expenses related to the assets that continue to be in debtor's possession; and salaries, etc.

(ii) General preferences, which are granted over all of the debtor's assets, e.g.: labour credits not subject to a special preference; social security debts; and certain personal expenses (as funeral or medical costs), etc.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes. Among others, insurance companies, cooperative associations and public entities, such as the Nation, Provinces and Municipalities, the Catholic Church and embassies.

Financial institutions are, with a few exceptions, subject to general bankruptcy law. However, the Central Bank's cancellation of their banking licence is required, and they may not voluntarily enter into a reorganisation or bankruptcy proceeding.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes. The debtor may enter into out-of-court agreements with all or part of the creditors. A certain majority of unsecured creditors is required.

These agreements imply a debt restructure and are enforceable against all the unsecured creditors who executed it, including those that did not approve its content or voted against it.

To be enforceable against all unsecured creditors, the out-of-court agreement must be endorsed or validated by a competent court. Companies that are regulated by special insolvency rules (e.g. banks and insurance companies) cannot enter into this kind of proceeding.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

In principle, Argentine law allows parties of an international contract to submit to a foreign jurisdiction in matters of an economic nature.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes. The waiver of sovereign immunity is valid under Argentine law (it should be expressly provided in the underlying agreement).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no eligibility requirements in Argentina for lenders, agents or security agents. A loan may be granted by, and the agent may be, an individual, a company, a bank, or any other entity.

In the case of loans granted by banks, the role of an agent is generally performed by a financial entity.

In principle, lenders do not need to be licensed or authorised to grant loans, provided that the financing activity is not performed on a regular basis. Otherwise, certain corporate and regulatory issues should be considered.

From a corporate standpoint, foreign companies are able to perform isolated acts in Argentina but if they want to perform their activities on a regular basis, a branch or a subsidiary must be established. For such a purpose, foreign companies must: (i) evidence before the Public Registry the existence of the company; (ii) establish a domicile in Argentina; and (iii) justify the decision of establishing such branch or subsidiary, and appoint a legal representative.

From a regulatory perspective, if the activities performed by the lender fall under "financial intermediation" (intermediation between the supply and demand of financial resources on a regular basis), prior authorisation of the Central Bank is required. An activity shall be deemed financial intermediation if it combines both raising local or foreign funds and granting financing to third parties with such funds.

The activity in Argentina of the subsidiaries or representation offices of foreign financial entities is subject to regulation by the Central Bank, who will grant the required authorisation subject to the analysis of the backgrounds and responsibility of the foreign entity and its local office.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are no other material considerations which should be taken into account.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Juan M. Diehl Moreno
Marval, O'Farrell & Mairal
Av. Leandro N. Alem 928, 7th floor
(C1001AAR) City of Buenos Aires
Argentina

Tel: +54 11 4310 0100
Fax: +54 11 4310 0200
Email: jd@marval.com
URL: www.marval.com

Juan M. Diehl Moreno has been a partner of Marval, O'Farrell & Mairal since 2006. He specialises in banking and finance, corporate and real estate structuring and financing, capital markets, and foreign exchange controls. Several guides of the legal profession have recognised Mr. Diehl Moreno for several years as one of the leading lawyers in his field of practice in the Argentine legal sector. From 2000 to 2001, he was a foreign associate at Sidley Austin (New York office). He graduated from the Universidad Católica Argentina in 1993, and he obtained a Master's degree in Business Law from Universidad Austral in 1996 and an LL.M., with honours, from Northwestern University School of Law in 2000. He has lectured in several conferences in Argentina and abroad and has published various articles on his field of expertise. He currently gives presentations at the University of CEMA.

Diego A. Chighizola
Marval, O'Farrell & Mairal
Av. Leandro N. Alem 928, 7th floor
(C1001AAR) City of Buenos Aires
Argentina

Tel: +54 11 4310 0100
Fax: +54 11 4310 0200
Email: dac@marval.com
URL: www.marval.com

Diego A. Chighizola specialises in banking and finance, real estate development and financing, capital markets, and M&A. He has drafted and negotiated domestic and cross-border agreements for structured financings, syndicated loans, derivatives, acquisitions and joint ventures. He joined Marval, O'Farrell & Mairal in 2001 and became a partner in 2012. He worked in New York as foreign associate at Cleary, Gottlieb, Steen & Hamilton during 2004–2005. He graduated in 2001 as a lawyer from the Universidad Católica Argentina, and obtained a Master's in Law from Columbia University School of Law, New York, in 2004 and a Master's in Finance from University of CEMA in 2007. He is admitted to the New York State Bar and is a member of the City of Buenos Aires Bar. He currently teaches Business Law at the University of San Andrés and gives presentations at the University of CEMA and Austral University.

Marval, O'Farrell & Mairal, founded in 1923, is the largest and one of the oldest law firms in Argentina. The firm has grown considerably in recent years and currently has over 300 professionals. The firm's law practice covers a wide range of legal services to financial institutions, commerce and industry and to diverse sectors of government. Although the firm practices Argentine law, its lawyers are well-attuned to business issues and the complexities of multi-jurisdictional transactions. The firm is in the general practice of law including: Banking and Finance; Capital Markets; Project Finance; Commercial and Competition Law; Corporate Law; Foreign Investments; Mergers and Acquisitions; Real Estate and Construction Law; Administrative Law; Entertainment and Media; Environmental Law; Insurance Law; Intellectual Property; Internet and Information Technology; Natural Resources; Utilities and Energy Law; Tax and Customs Law; and Telecommunications and Broadcasting. The firm is ranked at the top of major legal publications and has been regularly awarded with many of the most recognised international awards. *Chambers & Partners* has recently recognised Marval, O'Farrell & Mairal as "Latin America Law Firm of the Year 2013".

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Australia

Yuen-Yee Cho

Richard Hayes

King & Wood Mallesons

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The Australian loan markets are still experiencing a supply/demand imbalance – with an insufficient number of quality deals, and many banks wanting to lend. Borrowing conditions are therefore very good – with pricing, terms and structures favouring borrowers – with many taking the opportunity to complete refinancings and recapitalisations during this period. Given the lending appetite, club facilities/best efforts syndication are prevalent, with underwritten deals confined to bespoke/proprietary event-driven situations. With pricing widening in the capital markets, bank lending is once more the preferred financing option.

Innovations/new developments in the market have included:

- the increasing participation of non-bank lenders such as senior debt funds, particularly in leveraged buyouts and other highly geared acquisitions and recapitalisations (refer to question 1.2);
- syndicated fronted bank guarantee facilities, where the fronting bank is backed by global insurers (refer to question 1.2); and
- unitranche facilities – mostly in the mid-market.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

- Jumbo financings for privatisation and infrastructure transactions including the Transurban consortium's A$7bn acquisition of Queensland Motorways Group;
- the seven-year covenant-lite senior secured Term Loan B financing of a joint venture between Apollo Global Management and Leighton Holdings (now known as CIMIC) – the unique feature was a first ever A$-only tranche of A$359m, sold mainly to Australian debt funds; and
- a world-first syndicated fronted bank guarantee facility, arranged by Commonwealth Bank and National Australia Bank for leading retailer, Woolworths Ltd. Global insurers provided the back-to-back indemnities to the fronting banks, freeing up bank credit lines and gaining exposure to a blue chip corporate.

KWM acted on all the above transactions.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes. However, corporate benefit and other requirements need to be considered. These issues are outlined below.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

The directors of a company owe a duty to the company to act for the benefit of the company in its best interests, with due care and diligence, in good faith and for a proper purpose. Directors must also avoid any conflict between a director's duty to the company and that director's personal interest. Directors must comply with these duties when resolving to give a guarantee.

Company directors may consider both direct benefits and indirect benefits of granting security and giving guarantees. Indirect benefits include a requirement for the ongoing support of other members of the corporate group. While it is not sufficient that the guarantee benefits the corporate group as a whole, a director of a wholly owned subsidiary may take into account the best interests of its holding company as long as the constitution of the company permits it to do so and the company is solvent at all relevant times.

Failure to comply with duties may render a guarantee voidable because it does not commercially benefit the company or, in a liquidation, the guarantee could be deemed an uncommercial transaction or unfair preference. A breach of duties by directors can result in civil and criminal penalties and personal liability for directors.

2.3 Is lack of corporate power an issue?

An Australian company has all the powers of an individual. This includes the power to give a guarantee. However, those powers may be limited by the company's constitution.

Third parties dealing with a company are entitled to make certain statutory assumptions, including that the company's constitution has been complied with unless they know or suspect the assumption to be incorrect.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Shareholder approval is not strictly required except for public companies in connection with related party transactions, subject to certain exemptions, the most relevant being where the transaction is on arm's length terms or is for the benefit of 100% owned subsidiaries. For private companies, it remains good practice to get shareholders' approval.

If the provision of a guarantee constitutes financial assistance, such as a guarantee of a loan used to assist the acquisition of shares in the company, the financial assistance must either (a) not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors, (b) be approved by shareholders and relevant holding companies, or (c) fit within another exception.

Transactions which involve consumers and small business are subject to additional requirements under national consumer protection legislation.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no specific requirements of this nature that apply in addition to the corporate benefit requirements outlined above. However, guarantees given while a company is insolvent/nearly insolvent or which render a company insolvent can be set aside by a liquidator.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange controls that would prevent payment under a guarantee or restrict enforcement of a guarantee. However, Australian sanctions laws prohibit dealings with designated persons and entities in various countries. Reporting requirements under anti money laundering and related legislation may also apply.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Most assets are available to secure lending obligations, subject to applicable contractual restrictions and, in limited cases, statutory restrictions. The regimes which apply to taking security differ according to whether the collateral is "personal property", in which case the *Personal Property Securities Act 2009* (Cth) ("**PPSA**") applies, or whether the collateral is real property, in which case State and Territory based real property legislation applies.

The PPSA is modelled on the Canadian and New Zealand Acts and shares similarities with Art 9 of the Uniform Commercial Code. It takes a substance over form approach when considering what constitutes a "security interest" in collateral. Generally speaking, security interests are interests in personal property that secure payment or performance and include some "deemed security interests" (such as certain leases of personal property) which may not secure payment or performance.

Australia recognises fixed charges (or, using PPSA terminology, security interests over non-circulating property), floating charges (security interests over circulating assets) and mortgages.

In order to have a fixed charge over personal property the secured party must have "control". Whether a secured party has control over the underlying personal property is determined by a mixture of common law and statutory provisions contained in the PPSA.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Yes. A general security agreement ("**GSA**") granting general security over all or substantially all of the present and future assets of the grantor is routinely entered into. It is also possible to take security under a limited specific security agreement, for example where the only collateral secured are shares in a company. Otherwise it is not usual to provide for security over different collateral classes in separate documents.

A GSA will typically cover all real and personal property. However, if the collateral is land, separate security documents are required, namely mortgages which are registered on the appropriate real property register.

The PPSA provides for perfection of a security interest in personal property by one of three means:

- registration on the Personal Properties Securities Register ("**PPSR**") – this is the most common method of perfection;
- in the case of chattels and other physical collateral, possession by the secured party; or
- in the case of certain financial assets (including shares, bonds and certain accounts with Australian authorised deposit taking institutions), control by the secured party.

If security interests governed by the PPSA are not perfected, then:

- they vest in the grantor immediately upon the grantor entering voluntary administration, bankruptcy or liquidation;
- a competing secured party may have a higher priority interest; and/or
- third parties may buy or lease the collateral free of the secured party's interest.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes.

Collateral security over interests in land typically take the form of a registered mortgage. Separate State and Territory laws regulate interests in land including real property mortgages and set out the applicable registration procedure.

Plant, machinery and equipment (as long as it is not a fixture attached to land) is secured as personal property taken under a GSA or under a specific security agreement relating to those assets and would be registered on the PPSR.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes.

Security over receivables can be taken under a GSA or a specific security agreement.

Receivables are generally categorised as "circulating assets". This means that unless the secured party takes control of the receivables collateral the grantor of the security can deal freely with that

© Published and reproduced with kind permission by Global Legal Group Ltd, London

collateral. Control is generally achieved by the secured party controlling the bank account into which the receivables are required to be deposited or by transferring the secured receivables to the secured party. In many cases the grantor will also be required give notice of the security to its debtors in order to perfect an assignment of the receivable.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes.

As is the case with receivables, security over bank accounts can be taken under a GSA or a specific security agreement.

Cash in bank accounts (like receivables) are "circulating assets" unless a secured party exercises "control" over that bank account. Certain authorised banks and other deposit taking institutions ("**ADI**s") are automatically deemed to have control over accounts held with them. If the secured party is not an ADI, the secured party may require an account control agreement with the account bank.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes.

Security over shares can be taken under a GSA or a specific security agreement.

Shares in unlisted companies are generally certificated. It is market practice in Australia that security over certificated shares is perfected by control as well as by registration on the PPSR. Control is obtained by providing the secured party with share certificates and blank share transfer forms.

Shares in listed companies are uncertificated and are recorded on an electronic register. They are transferred in accordance with Australian Securities Exchange rules. If a secured party wishes to obtain control over uncertificated shares in a company listed on the Australian Securities Exchange then, in addition to registration on the PPSR, it will also need to enter into an agreement with the "controlling participant" in the clearing system through which the shares are traded.

Even though an English or New York law governed document can create valid security over shares in an Australian company, the preferred method in practice is always to have an Australian law governed security document where the collateral comprises Australian shares in Australia. This is because the PPSA conflicts of law rules will apply to the security and override any contrary provisions under the chosen governing law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes.

Security over inventory can be taken under a GSA or a specific security agreement.

Inventory is a "circulating asset" in the same way that receivables and cash are circulating assets. This means that if the secured party does not "control" the inventory the grantor of the security interest is free to deal with that inventory.

It is not usual market practice for a secured party to take control over inventory because the grantor will need the freedom to deal with it in the ordinary course of business. Perfection of the security interest usually is effected by registration on the PPSR.

However, it is possible for a secured party to obtain control after the occurrence of certain events, or to take control of material inventory above a monetary threshold (depending on the type of financing).

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes. This is subject to corporate benefit, financial assistance requirements and other issues mentioned in this chapter.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notarisation is not required under Australian law. The duty and fees associated with taking security in Australia are registration fees and mortgage duty.

The fees for registering a security interest on the PPSR are nominal. Such registration can be made for seven years, 25 years or no stated end time.

The fees for registering a real property mortgage vary between States and Territories, but are similarly nominal, other than in South Australia.

One of the Australian states, New South Wales ("**NSW**"), levies a mortgage duty on any security document (regardless of the governing law) which grants security over assets located in NSW. The amount of mortgage duty payable is currently 0.4% of the total debt secured, and is proportionately reduced by reference to the percentage of the value of NSW assets subject to the security as a percentage of the value of worldwide assets subject to the security.

Under the *Duties Act 1997* (NSW), it is the grantor who is liable to pay the mortgage duty. However, a security document is unenforceable if it has not been duly stamped and would be inadmissible as evidence in Australian courts until it is duly stamped.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No. There is no significant time or expense, and registrations on the PPSR are instantaneous.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Foreign lenders and foreign beneficiaries of security over Australian assets may need to consider the application of the Australian Government's Foreign Investment legislation, which is administered by the Foreign Investment Review Board ("**FIRB**"). Under some circumstances, notification and FIRB approval is required before taking or enforcing security.

In general terms, if security over Australian assets is held in the ordinary course of carrying on a business of lending money and <u>solely</u> as security for the purposes of a moneylending agreement then a moneylenders

© Published and reproduced with kind permission by Global Legal Group Ltd, London

exemption will usually apply. The moneylenders exemption also covers the acquisition of an interest by way of enforcement of a security held solely for the purposes of a moneylending agreement. Where the exemption applies, notification and FIRB approval is not required when taking or enforcing the security.

A 'moneylending agreement' is defined to mean:

(a) an agreement entered into in good faith, on ordinary commercial terms and in the ordinary course of carrying on a business (a moneylending business) of lending money or otherwise providing financial accommodation, except an agreement dealing with any matter unrelated to the carrying on of that business; and

(b) for a person carrying on a moneylending business, or a subsidiary or holding entity thereof, an agreement to acquire an interest arising from a moneylending agreement (within the meaning of paragraph (a)).

For foreign government investors, the moneylender exemption only operates if an interest acquired by way of enforcement of a security is disposed of (or a sale process is commenced) within six months of the acquisition (or 12 months for an ADI). A foreign government investor includes a body politic of a foreign country, foreign governments, their agencies or related entities from a single foreign country that have an aggregate interest (direct or indirect) of 20% or more in the entity (or 40% or more if from multiple foreign countries), or if the entity is otherwise controlled by foreign governments, their agencies or related entities, and any associates, or could be controlled by them including as part of a controlling group.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No. If the security taken is perfected (whether by registration or control) there are no specific priority concerns just because the security secures a revolving credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Australian documentary and execution requirements are not particularly onerous. Notarisation is not required.

In Australia a company will generally sign in accordance with s 127 of the *Corporations Act 2001* (Cth) ("**Corporations Act**") (by two directors or a director and secretary) because certain assumptions as to corporate authority can be relied upon by the counterparty. However, it is also common for Australian companies to sign under power of attorney.

The execution of deeds by some foreign companies can present some minor logistical issues to ensure that the execution is valid; however, these issues are generally broadly understood in the market.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

A company is prohibited from financially assisting the acquisition of its shares or shares in its holding company, other than as set out below. A breach of the financial assistance provisions will not affect the validity of the transaction but can lead to civil offences for persons involved in the contravention and may lead to criminal offences where the breach was dishonest.

(a) Shares of the company

A company can give financial assistance if it either: (a) does not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors; or (b) the financial assistance is approved by shareholders. There are some other rarely used exemptions. Approval by shareholders (and relevant holding companies) is referred to as a "whitewash" procedure and is routinely sought unless it is clear that there no material prejudice to the interests of the company, its shareholders or its ability to pay creditors. The procedure involves lodging the shareholder approval documents with the Australian Securities and Investment Commission ("**ASIC**"). A 14-day waiting period applies before the financial assistance can be given.

(b) Shares of any company which directly or indirectly owns shares in the company

The financial assistance provisions also apply in situations where the financial assistance relates to shares being acquired in a holding company of the company giving the financial assistance. A holding company is any company that holds more than 50% of the shares, possesses more than 50% of the voting rights or otherwise controls the company board.

(c) Shares in a sister subsidiary

The financial assistance prohibition does not apply to the acquisition of shares in sister subsidiaries.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The use of agents for lenders and security trustees in syndicated lending agreements is common market practice in Australia.

Lenders will typically appoint an agent to represent them (in a non-fiduciary capacity), to perform defined administrative duties, to liaise with the borrower and security providers and to coordinate the lender group.

In most cases security for a syndicated loan is granted to a security trustee who is able to enforce the security at the direction of the lenders (or the agent for the lenders) and is required to distribute the proceeds of enforcement in accordance with the security trust deed.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Australia.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Transfer and substitution mechanics are typically documented in the facility agreement and security trust arrangements. They set out the agreed manner in which rights and obligations of an outgoing lender are assigned or novated to an incoming lender with the consent of all parties where required. Other than the specified documentary requirements (including obtaining necessary consents), nothing additional is required.

In some circumstances, depending on the location of the loan and security, stamp duty may be chargeable in connection with an assignment of a loan.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Australia levies interest withholding tax ("**IWT**") on interest payments (which is broadly defined for these purposes and includes amounts in the nature of, or in substitution for, interest and certain other amounts) under debt interests made by an Australian borrower in Australia to an offshore lender, unless an exemption applies. The rate of IWT is 10% of the gross amount of interest paid.

The common exemptions to this are:

- a lending that is an issuing of "debentures" (such as bonds and notes) or a "syndicated loan" which results from a public offer in a particular manner; and
- the "financial institution" exemption which is contained in certain double tax treaties which the Australian government has with a number of countries.

It is currently unclear whether or not any payment by a guarantor under a guarantee on account of interest owing by the borrower would be subject to IWT. The better view is that such payments (other than interest paid on an overdue amount) do not constitute "interest" for IWT purposes, and, if so, would not be subject to IWT.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are none.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

In most cases, the entry by a foreign lender into a loan agreement with an Australian borrower or taking security over assets in Australia will not of itself subject the lender to income taxation in Australia. However, this will depend on the circumstances, including whether or not the lender conducts any other business or has any relevant presence in Australia.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

None other than as discussed above.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

None, provided that the parties are unrelated and dealing on an arm's length basis.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

In Australia, parties to a contract are free to select the governing law of the contract. However, to be enforceable, the choice of law must be made in good faith and must not contravene public policy.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

England

Generally yes, subject to fulfilment of registration requirements.

Under the *Foreign Judgments Act 1992* (Cth) and related regulations, English judgments can be registered and take on the status of an Australian judgment, subject to satisfying the following requirements:

- the judgment needs to be a "money judgment". That is it must be a judgment under which money is payable;
- the judgment must not be under appeal;
- the judgment must not be wholly satisfied;
- the judgment must be enforceable in England; and
- the application for registration must be within six years of the date of the English judgment.

New York

There is no reciprocal bilateral arrangement for recognition of judgments between Australia and the United States. Instead, common law principles for recognition and enforcement of foreign judgments apply. To be enforceable at common law:

- the judgment must be final and conclusive;
- the New York court must have exercised its jurisdiction over the defendant;
- the defendant must have submitted (or be deemed to have submitted) to the jurisdiction of the New York Court; and
- the judgment must be for a monetary sum.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

It is not possible to specify a typical timeframe to finalise enforcement against assets. The timetable will be subject to variables including the type and complexity of the claim, the exact nature of the enforcement process, whether a formal insolvency process or liquidation is involved and whether the borrower or guarantor is cooperative.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

The process of enforcement will be governed by the terms of the security documents and loan agreements, by the PPSA and by the Corporations Act.

In most circumstances no regulatory consents are required in order to enforce. However, as set out in question 3.11, FIRB approval may be an issue in limited circumstances.

Restrictions also apply to enforcing collateral security in the event of insolvency, dependent upon the type of insolvency proceedings undertaken. We discuss this in section 8.

A receiver appointed by creditors under a security document is subject to statutory duties. This includes an obligation to sell collateral at market value or, if market value is not known, at the best price reasonably obtainable. While this does not of itself require a public auction in many circumstances, a public auction or other transparent sale process will be required in order to demonstrate that the receiver has complied with its duties. This may have timing implications for recovery depending on the nature of the assets involved.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

Subject to our comments about FIRB in question 3.11, there are no restrictions which apply specifically to foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

In a voluntary administration there is a moratorium period which runs from the date an administrator is appointed. A voluntary administration can be commenced in a number of ways, including by the directors of the company or a person with a perfected security interest over all or substantially all of the property of the company.

The length of this moratorium period varies, and the moratorium prohibits any enforcement proceedings being commenced against the company or in relation to its property. However, a person with a perfected security interest over all or substantially all of a grantor's property can enforce its security interest during a decision period of 13 business days from commencement of the administration.

While an Australian company is being wound up in insolvency or by a court, or a provisional liquidator of an Australian company is acting, a person is prohibited from commencing certain proceedings or enforcement processes except with the leave of the liquidator or the court. This prohibition does not apply to a secured party's right to realise or otherwise deal with its perfected security interest.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes, foreign arbitral awards may be enforceable by courts in Australia without re-examination of the merits under the *International Arbitration Act 1974* (Cth).

The arbitral award must be either:

- made under an "arbitral agreement" and made in a "Contracting State" under the *New York 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards*; or
- the person enforcing the arbitral award must be domiciled or ordinarily reside in Australia or a "Contracting State".

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The extent to which the enforcement rights of a secured party may be affected depends on the type of bankruptcy proceedings undertaken.

As outlined in question 7.6, in a voluntary administration, only a secured party with a perfected security interest over all or substantially all of a grantor's property can enforce its security. Alternatively, while an Australian company is being wound up in insolvency or by a court, or a provisional liquidator is acting, a person cannot begin or proceed with certain proceedings or enforcement process except with the leave of the liquidator or the court. However, this restriction does not apply to a secured party's right to realise or otherwise deal with a perfected security interest.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

A liquidator can seek court orders to set aside certain transactions prior to winding up the company. In practice, the two types of "voidable transactions" are:

- uncommercial transactions – a transaction which was entered into by a company when it was insolvent and which a reasonable person would not have entered into; and
- unfair preferences – a transaction between an insolvent company and a creditor which gives that creditor an unfair preference in that it receives more for its unsecured debt than it would have in a winding up.

A liquidator can seek to clawback uncommercial transactions entered into two years prior to a winding up and can seek to clawback an unfair preference within six months of the liquidator's appointment (or four years if such transactions are with a related party).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Security interests over circulating assets (including receivables, inventory and cash in bank accounts) which are not subject to control will rank in a winding up behind certain statutory preferred creditors such as employee entitlements, auditor's fees, administrator's indemnity for debts and remuneration, and other preferred creditors.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

No. However, banks, other ADIs and insurers are subject to different and specific insolvency regimes under legislation including the *Banking Act 1959* (Cth) and the *Insurance Act 1973* (Cth).

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes. A receiver is in most cases able to enforce its security without first obtaining a court order.

Appointment and powers of a receiver is governed by the terms of the security document. The PPSA also provides certain notice requirements which may apply to enforcement against personal property. In addition, the PPSA provides a range of statutory enforcement options, but these do not apply where a privately appointed receiver or other controller is realising assets of a corporate borrower or guarantor. The PPSA provisions are in many instances contracted out of.

Where the relevant security is a real property mortgage a secured party can either appoint a receiver or enter into possession as mortgagee under the relevant State or Territory laws. A mortgagor can restrain the sale where it can be shown that the power of sale has not become exercisable or the mortgagee is in breach of the duty to sell.

Some statutes provide other remedies as well.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes. Under the *Foreign Judgments Act 1991* (Cth), a party's submission to a foreign jurisdiction is legally binding and enforceable in Australia provided that the subject matter is not illegal and not contrary to public policy.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

As a general rule, a party's waiver of sovereign immunity will be legally binding and enforceable under the *Foreign States Immunities Act 1985* (Cth).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

If a person provides a "financial service" it must obtain an Australian Financial Services Licence from ASIC under the Corporations Act and comply with a range of conduct obligations. Although loan facilities are excluded from the Corporations Act, issuing, acquiring or arranging a derivative, swap or deposit product will constitute a financial service, as will providing advice in connection with those products.

There are no licensing or registration requirements in Australia that apply specifically to entities that act as agent or security trustee.

Approval is required from the Australian Prudential Regulation Authority ("**APRA**") before an entity (including a bank) carries on banking business in Australia. The use of the word "bank", "banking", "credit union" and related words when a company or bank carries on business in Australia is also restricted unless the company is registered as a bank or has approval from APRA.

In most cases the making of a single loan in Australia or taking of security in Australia by any entity does not require the lender or secured party to be registered or licensed in Australia. However, this is a complex issue that depends on the circumstances, including the amount of business that the entity carries on in Australia and the presence that the entity has in Australia.

Registration and reporting requirements apply under the *Financial Sector (Collection of Data) Act 2001* (Cth) to lenders, depending on the nature and scale of their lending activities in Australia.

Breaches of applicable legislation may results in fines or penalties being imposed.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The issues outlined above provide a general overview of the main legal considerations which are most likely to be relevant to secured lenders in Australia.

Acknowledgment

The authors would like to thank Chris Robertson, David Kennedy and Edmund Bao for their assistance in preparing this chapter.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Yuen-Yee Cho
King & Wood Mallesons
Level 61, Governor Phillip Tower
1 Farrer Place, Sydney NSW 2000
Australia

Tel: *+61 2 9296 2343*
Fax: *+61 2 9296 3999*
Email: *yuen-yee.cho@au.kwm.com*
URL: *www.kwm.com/en*

Yuen-Yee Cho is a Banking and Finance Partner in the Sydney office of KWM and Global Practice Coordinator for Banking & Finance. She specialises in acquisition financings, project and infrastructure finance and general corporate finance.

Yuen-Yee is a recognised market leader, and has been ranked a leading practitioner in Banking & Finance (Acquisition Finance and Corporate Finance (Band 1 for both) in *Chambers' Global Guide* for several years, *Best Lawyers in Australia* 2008–16 and *Asian Legal Business's Legal Who's Who*.

Yuen-Yee's recent transactions include the pioneering Woolworth's A$400m syndicated fronted bank guarantee facility, Sydney Airport's $1.4bn refinancing, Origin Energy's $7.4bn refinancing facilities, and various leveraged finance transactions for KKR, Affinity Equity Partners, CHAMP Private Equity and Quadrant Private Equity.

Yuen-Yee has been on the APLMA Documentation Committee (Aust) since 2008 and is a regular speaker at industry forums, including the IBA Private Equity Symposium.

Richard Hayes
King & Wood Mallesons
Level 61, Governor Phillip Tower
1 Farrer Place, Sydney NSW 2000
Australia

Tel: *+61 2 9296 2080*
Fax: *+61 2 9296 3999*
Email: *richard.hayes@au.kwm.com*
URL: *www.kwm.com/en*

Richard Hayes is a Partner in KWM's Sydney office specialising in acquisition finance and general corporate finance.

Richard represents private equity sponsors and corporates on acquisitions and other financings. He has also represented many of the world's leading financial institutions in a wide range of lending transactions. His practice includes debt restructurings, recapitalisations and workouts.

Richard is listed as a Leading Individual for Banking and Finance: Acquisition Finance in *Chambers Global Guide* (2011–2016). According to *Chambers Global 2014*, he "*attracts praise for his acquisition finance work and his knowledge of the US markets*" and is "*always available and very easy to work with*". He is also a recommended Banking lawyer in the *Asia Pacific Legal 500* (2012–2016) and *Best Lawyers* in Australia (2013–2016).

Richard has published articles and presented seminars on various topics relating to banking and finance including co-authoring a chapter on Intercreditor Issues in *Australian Finance Law* and presenting at the APLMA's Loan Documentation seminars.

KING&WOOD
MALLESONS
金杜律师事务所

King & Wood Mallesons (**KWM**) is a unique leading global firm headquartered in Asia, with 2,700 lawyers across 30 offices around the world.

Specifically, our Global Banking & Finance team offers depth and breadth across acquisition and corporate finance, asset finance, property finance, project finance, capital markets, derivatives, structured products, financial services regulation and restructuring & insolvency.

Our clients include top commercial and investment banks, large listed and unlisted corporates, private equity and other financial sponsors, market infrastructure participants, regulators and industry bodies.

Recent industry recognition include *International Financial Law Review*'s 2016 Regional Law Firm of the Year and National Firm of the Year – China (for the 6th year), *Asia Legal* Awards' 2016 Finance Team of the Year, *Financial Times* Asia Innovative Lawyer Awards' 2014 Most Innovative Law Firm Asia Pacific, *FinanceAsia*'s 2015 Best Financial Law Firm (Australia/NZ) and Australian Banking & Finance Awards 2015 Law Firm of the Year.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Bermuda

MJM Limited

Jeremy Leese

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The downturn in the global economy over the past several years had decreased the level of business activity in the lending market in Bermuda. In response, lenders had been renegotiating and extending loans, and protecting their security positions. However, more recently, with the America's Cup coming to Bermuda in 2017, we have seen a renewed impetus in the local market, with new and renovated developments in the hospitality sector securing significant funding from the local banks.

This chapter concerns security matters relating to companies regulated by the Companies Act 1981 (*Companies Act*). There are three broad company categories:

Local companies: These provide goods or services in the local marketplace to Bermudians. They are subject to ownership and control restrictions.

Exempted companies: These are not permitted to conduct business in the local marketplace except in limited circumstances or under a licence issued on application to the Minister of Finance (*MOF*). The majority of foreign-owned companies that are incorporated in Bermuda are registered as exempted companies.

Overseas or permit companies: These are foreign companies that are entitled to do business in Bermuda under a permit issued by the MOF.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

There has been heightened activity with regard to the hospitality sector, in terms of provision of funds for hotel redevelopment and acquisition financing for purchases, as well as continuing borrowing by multinational groups whose holding company is incorporated in Bermuda, such as large shipping groups.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Guarantees are commonly used in financing transactions in Bermuda. The borrower's parent company or shareholders typically give guarantees to the lender. There is no equivalent in Bermuda to the English Statute of Frauds 1677, and no requirement that a guarantee obligation be evidenced in writing.

Guarantees can be created in a loan or facility agreement, provided that the guarantor is also a party to that agreement, or in a separate document. The guarantee can be limited to a pre-determined maximum amount or, in the case of guarantees given by regulated entities (for example, insurance companies), by reference to their statutory capital and liquidity requirements.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Generally, a Bermudian company can (unless its memorandum of association or bye-laws provide otherwise) guarantee the debts of another party. However, the directors of the company must exercise their powers in the best interests of the company. When meeting to consider a transaction, the directors should specifically discuss and form a view as to whether the proposed transaction is in the company's best interests. The minutes of the meeting should reflect that discussion and view.

Clearly the issue of whether any benefit ensues to the company as a result of giving a guarantee is a part of this discussion. However, it is not the only factor and absence of direct benefit alone would not rule out a guarantee being validly given by a Bermudian company.

2.3 Is lack of corporate power an issue?

It should not be, as Bermudian companies now have, by statute, the capacity, rights, powers and privileges of a natural person and their memoranda of association and bye-laws will generally be drafted widely enough to cover most obligations to be imposed thereon in a secured lending transaction.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental or other consents or filings are needed for a Bermudian company to give a guarantee. However, guarantees in connection with loans to the following are prohibited without the consent of shareholders holding 90% of the voting shares:

(i) directors;

(ii) spouses and children of directors; and

(iii) directors of certain related companies.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

This general prohibition does not apply to guarantees that a company gives in the ordinary course of its business.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

None specifically, but the directors must always act in what they consider to be the company's best interests. Clearly, if a company is in severe financial difficulty or even technically insolvent, it is hard for the directors thereof to justify that it is in its best interests to enter into a multi-million dollar guarantee.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are currently no restrictions in Bermuda on the making of payments by a company (local or exempted) to a foreign lender under a guarantee, and exempted companies have never been subject to foreign currency controls. However, Bermuda's exchange control legislation has not been repealed.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are very few restrictions on the types of collateral available to secure lending obligations under Bermuda law – real estate, shares in companies, plant and machinery, aircraft, ships and cash deposits are among the assets which can be used as security.

Certain assets may be incapable of assignment; for example, the company's rights under a licence granted by a governmental or regulatory body. Certain assets may also contain covenants against assignment without third party consent.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Security can usually be granted by a general security agreement, such as debenture-style security documents which set out, and cover, all assets of a company and provide for fixed and floating charges, as appropriate.

Certain types of asset require special consideration. Security can be granted over future assets – it is possible to create a fixed charge over specifically identified future assets, provided that safeguards are put in place to ensure that when the future assets come into existence, the assets are under the control of the chargee. Generally, it will not be possible to create a fixed charge over all future property, and it is likely that only a floating charge will be available.

Taking security over fungible tangible assets requires that the assets be appropriated to the agreement. It is possible to take charge over a class of assets, even where those assets are pooled and later changed, provided that the chargee has a sufficient degree of control over the changes and has the ability to decide that changes will not be made to the asset pool. To take effective security over a company's intangible fungible assets, it is necessary to identify those assets.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Real property

Real estate is comprised of:

(i) land, including land covered by water;

(ii) immovable items located on land, for example:
- buildings;
- pools;
- fixtures;
- walls;
- fences;
- improvements; and

(iii) any estate, interest, right or easement in or over any land or building.

Title to land is unregistered. Estates in land include freehold and leasehold. Leases can be long (typically 99 or 999 years) or short (typically three to five years).

Specific rules apply to companies acquiring land in Bermuda:

Local companies can:

- Acquire and hold land in Bermuda if:
  - permitted to do so under its memorandum of association;
  - it has obtained the MOF's authorisation; and
  - the acquisition or holding is required for the purpose of the company's business.
- Enter into a lease of land in Bermuda:
  - for a term not exceeding 50 years, provided that land is required for the purpose of the company's business; or
  - for a term not exceeding 21 years, with the MOF's consent, to provide accommodation or recreational facilities for its officers and employees.

Exempted companies can now, following legislative changes implemented in 2014, acquire land in Bermuda, but only to the extent that it is either commercial property exclusively used for business purposes or, with the appropriate governmental consent and in accordance with immigration policy, only if available for purchase by non-Bermudians, residential property to house employees and officers (*Companies Amendment Act 2014*).

The following forms of security are commonly used:

Legal mortgage. A legal mortgage transfers the legal interest from the borrower (mortgagor) to the lender (mortgagee), subject to the borrower's right to redeem the property. The lender holds the legal title and the borrower retains possession.

Equitable mortgage. An equitable mortgage is a contract that can be enforced under a court's equitable jurisdiction. The borrower transfers the beneficial or equitable interest to the lender and retains the legal interest and possession.

Equitable charge. An equitable charge does not involve the transfer of the legal or equitable interest in, or possession of, property. It is an encumbrance on the borrower's property giving the lender the equitable right to sell the property for payment. A charge can be either fixed (attaches immediately to the borrower's asset) or floating (that is, a charge over a class of assets, which can later "crystallise" when certain events occur) and can potentially cover a rental lease forming part of the company's assets.

The following formalities must be complied with:

Legal mortgage. The mortgage must be created by a deed, and validly executed by the parties. The deed attracts stamp duty (*see*

© Published and reproduced with kind permission by Global Legal Group Ltd, London

question 3.9 below). The deed (and prescribed memorandum setting out the mortgage particulars) must be submitted to the Office of the Registrar General (*section 1(1), Mortgage Registration Act 1786* (MRA)). An entry is made in the book of mortgages maintained by the Registrar General in relation to land and the deed returned with the registration details noted on it. Priority is governed by the order in which mortgage deeds are deposited for registration. The lender then holds the title deeds.

Equitable mortgage. The mortgage must be in writing (a deed is not required). It is commonly created by a memorandum of deposit of deeds outlining the terms under which the title deeds are deposited, which creates the equitable mortgage. All other formalities are the same as for a legal mortgage.

Charge. The charge must be in writing and registered under the MRA, and the MRA determines the charge's priority. Charges usually must be registered with the Registrar of Companies (ROC) under section 55 of the Companies Act to protect priority over assets relating to property (such as lease payments).

Most mortgages over Bermuda real estate are held by Bermuda banks. An overseas company (which, for this purpose, includes an exempted company) can hold a mortgage over land in its corporate name in the same way as a local company. However, if the total sum secured exceeds BD$50,000, the MOF's consent is required (*section 144(1), Companies Act*). If the overseas company takes title to the property as part of the enforcement, the land must be sold within five years of taking possession. An overseas company also requires the approval of the MOF to enter into a mortgage or charge over land, as the company is considered a restricted person (*section 80, Bermuda Immigration and Protection Act 1956*), unless the company is either:

- licensed under the Banks and Deposit Companies Act 1999; or
- a non-resident insurance undertaking under the Non-Resident Insurance Undertaking Act 1967.

Plant, machinery and equipment

There is no statutory definition of tangible property. Common law principles determine whether something is tangible personal property. However, it is generally accepted that plant, machinery and equipment fall within the ambit of what constitutes tangible movable property.

The Companies Act defines the expression "charge" in very broad terms, and any interest created in property by way of security, including any mortgage, charge, assignment, pledge, lien or hypothecation of the assets of a company can be registered with the ROC. The nature of the specific tangible movable property determines the most suitable form of security. The most common form of security for plant, machinery and equipment is a fixed charge created by a debenture or a general security agreement.

Charges by Bermudian companies over Bermuda property do not need to be registered to be valid and enforceable. However, the date of the registration of security documents determines the priority of charges or mortgages or other security documents, and therefore they are usually registered. Most charges are registered at the ROC under section 55 of the Companies Act for a local or exempted company and section 61 for an overseas company granting security over Bermuda property. The following must be filed with the ROC:

- an original of the security document (certified copies will generally be accepted);
- a Form 9 (particulars of a mortgage or charge); and
- the appropriate fee (*see later*).

The registration is effective as at the time of filing, and not the time the certificate of registration is issued. Special registration requirements apply to certain assets such as aircraft and ships (*see below*).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

The benefit of contractual rights claims under insurance policies and debts are the most common types of claim or receivable over which security is granted in Bermudian legal practice. In certain limited circumstances, it is possible to assign a cause of action, but in practice such assignments are very rare because of the public policy rules against maintenance and champerty. The proceeds of a cause of action may be assigned.

Contractual rights may be mortgaged by way of assignment, and an "all assets" debenture will typically provide a mechanism for taking security over the benefit of the security provider's interest in specific "material contracts". In addition, rights under insurance policies and the proceeds of any claims thereunder may be assigned. In both instances, the assignment is perfected by giving notice in writing of the assignment to the counterparty to the material contract or the relevant insurer, and the secured creditor may also require that its interest in the proceeds of an insurance policy is noted on the policy by the insurer.

Debts may be mortgaged by way of assignment, in which case the secured creditor becomes the owner of the debt. Alternatively, debts may be charged where security is being taken over a large pool of receivables; the security will usually take the form of a floating charge.

Security over large individual debts, such as inter-company loans, is usually granted through a mortgage of the debt, effected by assignment to the secured creditor, with a proviso for reassignment to the mortgagor when the secured obligations have been discharged.

The Supreme Court Act 1905 provides that a legal assignment (an unconditional assignment of the debt for the time being not by way of charge only) may be made by giving the debtor notice in writing of the assignment. An equitable assignment may be made without any requirement for notice or other formalities.

A legal assignment entitles the assignee to enforce the debt directly against the debtor. Where there has been an equitable assignment, the assignee may convert it into a legal assignment by giving the debtor written notice of the assignment.

Both assignments and charges are generally registered with the ROC to protect the second creditor's priority.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

In 1990, Bermuda enacted special legislation to deal with the uncertainty caused by the decision in *Re Charge Card Services Ltd.* [1987] Ch. 150. The Charge and Security (Special Provisions) Act 1990 expressly provides that a bank may take security over its own indebtedness to its customers.

The most common form of security over cash deposit is a "charge back", whereby a bank takes security over cash deposited with it, or otherwise over indebtedness which it owes to the chargor. A "charge back" is perfected by attachment without further act.

Where security is created in favour of a foreign bank over a deposit with a Bermuda bank, the most common form of security is a control agreement whereby the Bermuda bank agrees it will not exercise any rights of set off against the relevant account and will not permit any withdrawals from the relevant account without the consent of the foreign bank. The security provider and the foreign bank will agree that the security provider is not permitted to make

© Published and reproduced with kind permission by Global Legal Group Ltd, London

withdrawals from the relevant account or otherwise exercise any of its rights as beneficial owner of the cash deposit until the secured obligations have been discharged, with the result that the security provider's cash deposit becomes a "flawed asset".

Charges over deposits are normally registered with the ROC.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

The most common types of collateral over which security is granted is shares issued by privately held companies.

Bermudian companies are prohibited from issuing bearer shares. The usual security granted over certificated shares is an equitable mortgage. Legal mortgages of shares are rare in Bermuda.

Where shares are uncertificated, it is generally advisable to require that the shares be certificated for the purposes of obtaining an equitable mortgage, failing which, a fixed charge may be taken over uncertificated shares.

Where a Bermudian company gives security over dematerialised securities traded in a market outside Bermuda the usual practice is that security will be created in accordance with the laws of the place where the securities are situated and transferred.

On the other hand, where the relevant dematerialised securities are traded electronically on the Bermuda Stock Exchange (BSX) within the Bermuda Securities Depositary (BSD), then the BSD regulations apply. All securities held in the BSD are registered in the name of BSD Nominee Ltd., which is a subsidiary of the BSX. All of the Bermuda banks are member participants in the BSD ("Member Banks"). When a Member Bank proposes to make a loan secured by the security provider's interests in securities held within the BSD, the security provider as beneficial owner ("BO") will instruct its broker to deliver the relevant securities within the BSD to the Member Bank as custodian on an intra-member basis.

The BO will also grant the Member Bank authority to sell the securities on an event of default, and thereby realise its security. For its part, the Member Bank as custodian will agree to re-deliver the securities to the BSD's broker when the BO discharges its obligations to the Member Bank.

It is not mandatory for Bermuda law to govern a charge over the shares of a Bermudian company, although it is recommended. A charge over shares governed by Bermuda law will typically be executed as a deed. A share charge generally requires the delivery of ancillary documents to the chargee, including:

(i) executed but undated share transfer forms and share certificates;

(ii) undated letters of resignation, letters of authority, and powers of attorney from the directors, and an irrevocable proxy from the shareholder;

(iii) evidence of approval of the directors of the company whose shares are being charged, if the bye-laws of that company so require;

(iv) certified copies of directors' resolutions approving the granting of the charge; and

(v) an undertaking from the company, in the form of a deed, that it will register the share transfer form.

Share charges are generally registered with the ROC to protect priority.

Except in the case of shares listed on an appointed stock exchange, prior permission must be obtained from the Bermuda Monetary Authority (BMA) for the transfer of shares of an exempted company or a local company owned by a non-Bermudian. However, the BMA has granted a general permission under the Exchange Control Regulations 1973 for the granting of a charge to a licensed bank or licensed lending institution in Canada, the US, Australia, EU countries, Bermuda, Hong Kong, Singapore, Norway, Switzerland and Japan (*Notice to the Public dated 1 June 2005*). This permission extends to transfers to those licensed lenders on enforcement of the charge.

The general permission does not extend to:

(i) charges over shares of Bermuda insurance companies; and

(ii) sales by the licensed lenders to third parties as part of the enforcement process.

BMA permission is not required where the securities being charged either do not carry the right to vote, or appoint one or more directors of the issuer, or are not by their terms convertible into securities carrying such rights.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Inventory falls within the ambit of what constitutes tangible property, which can be secured under Bermuda law. The most common form of security for inventory is a floating charge, which can be registered with the ROC.

Charges by Bermudian companies over Bermuda property do not need to be registered to be valid and enforceable. However, the date of the registration of security documents determines the priority of charges or mortgages or other security documents, and therefore they are usually registered. Most charges are registered at the ROC under section 55 of the Companies Act for a local or exempted company and section 61 for an overseas company granting security over a Bermuda property. The following must be filed with the ROC:

- an original of the security document (certified copies will generally be accepted);
- a Form 9 (particulars of a mortgage or charge); and
- the appropriate fee (*see later*).

The registration is effective as at the time of filing, and not the time the certificate of registration is issued.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, these are both very common circumstances in which a Bermudian company will grant a security interest over its assets.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The Stamp Duties (International Business Relief) Act 1990 abolished stamp duty on most documents (including loan and security documents) executed by "international businesses" (including exempted and overseas companies). However, this exemption does not extend to stamp duty payable on instruments involving Bermuda real estate.

A legal mortgage attracts:

(i) stamp duty at the rate of 0.25%, where the sum secured is no more than BM$400,000; and

© Published and reproduced with kind permission by Global Legal Group Ltd, London

(ii) stamp duty at the rate of 0.5%, where the sum secured is more than BM$400,000.

Local companies are liable for stamp duty on the execution of most documents unless the relevant transaction can be brought within the relatively narrow statutory exemptions in section 46(c) of the Stamp Duties Act 1976.

The following registration fees are payable for a charge against a company at the ROC:

(i) over exempted or overseas companies, BM$344 where the amount secured is less than BM$1 million, and BM$603 where the amount secured is greater than BM$1 million (*sections 55 and 61, Companies Act*); and

(ii) over local companies: BM$172.

The fees for registration of an aircraft mortgage:

(i) where the amount secured by the mortgage does not exceed BM$5 million, the fee is BM$200;

(ii) where the amount secured by the mortgage does not exceed BM$20 million, the fee is BM$400; and

(iii) where the amount secured by the mortgage does exceed BM$20 million, the fee is BM$800.

Stamp duty in the amount of BM$25 is payable on all notarial acts, except for protests on bills of exchange or promissory notes. If there are exhibits to the document, an additional BM$25 must be affixed to each exhibit.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Usually, provided all documentation required to be filed or registered is provided promptly, filings and registrations can be completed quickly after security has been executed, and notifications received as to their acceptance for filing or registration, and any certificates of registration returned in a matter of a few days.

As for expense, please see the answer to question 3.9. However, it is worth pointing out that stamp duty generally is not payable when security is granted over the assets of an exempted company, so there is no need to structure a transaction to minimise Bermuda tax consequences. Where local companies are granting security, there may be ways to minimise the stamp duty payable, such as using one composite security document to cover various assets. It is also possible to minimise registration fees by using a single document. However, registration fees usually are not a material issue in determining the structure of security arrangements.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Subject to the specific circumstances highlighted above with regard to the BMA's consent being required for the granting of security over the shares of certain types of companies or over the assets of certain regulated entities (such as insurance companies), no such consents are required for a Bermuda company to grant security over its assets.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no specifically Bermudian concerns to note, but the usual issues, about ensuring that there is sufficient collateral to secure the variable amount outstanding under the credit facility, and that the definition of secured obligations is drafted widely enough to encompass all amounts so borrowed, subsist.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

As long as documents are executed in accordance with a Bermudian company's memorandum of association and bye-laws, the Companies Act and authorising board resolutions, there is no need for Bermuda law purposes for anything more than execution under hand by one authorised signatory (who does not have to be, although usually is, a director of the company). For foreign law-governed security documents, one needs to ensure compliance with any requirements of such laws with regard to enforceability, security filing/registration and admissibility into evidence in court proceedings.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

The statutory rule against financial assistance being given by Bermudian companies was abolished by amendments to the Companies Act passed in 2011.

(b) Shares of any company which directly or indirectly owns shares in the company

See above.

(c) Shares in a sister subsidiary

See above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The concept of both agency and trustee is well recognised in Bermuda.

The agent bank is often the arranger of the facility, and is normally chosen by the syndicate members. An agency arrangement governed by foreign laws will be recognised by Bermuda courts. Typically, the agent acts as a conduit for payments, and for dissemination of information to syndicate members. In a pre-insolvency situation, the agent bank usually represents the syndicate members in dealing with the enforcement of the lenders' remedies. On the liquidation of the debtor company, each lender bank may submit proof of debt or the agent bank may do this on behalf of the syndicate members, provided that the agent bank is able to submit a proof of debt on its own account.

With regard to security trustees, generally, only the security trustee can enforce the security on the creditors' behalf, and the borrower's individual creditor is precluded from taking independent action against the borrower. By virtue of the UK Recognition of Trusts Act 1987 (Overseas Territories) Order 1989, trusts from other common law jurisdictions and certain types of similar concepts that apply in civil law jurisdictions generally are recognised in Bermuda.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Bermuda.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

There are no special requirements to ensure a transferred loan is enforceable by the new lender. However, to ensure priority of registration of any related security, notification of the transfer of the secured obligations should be notified to the Registrar of Companies on the appropriate form.

6 Withholding, Stamp and other Taxes; Notarial and other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

No Bermudian company is required or entitled under Bermuda law to make any deduction or withholding in respect of any Bermuda taxes from or with respect to any payment to be made by it under a facility agreement it has entered into, whether of principal, interest, fees or otherwise.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No foreign lender will be deemed to be resident, domiciled or carrying on business, or subject to any tax, in Bermuda by reason only of the execution, delivery, performance and/or enforcement of any loan facility agreement or related security document where the borrower or guarantor is incorporated in Bermuda.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Please see the answer to question 6.2 above.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

None, other than the fees set out in answer to question 3.9.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

The fact that the lenders are overseas makes no difference to a Bermudian borrower's position.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in Bermuda enforce a contract that has a foreign governing law?

The express choice of the applicable foreign governing law as the governing laws of any loan facility agreement or related security document would be deemed a proper, valid and binding choice of law, and would be recognised and given effect to in any action brought before a court of competent jurisdiction in Bermuda, except for those laws:

(i) which such courts consider to be procedural in nature;
(ii) which are revenue or penal laws; or
(iii) the application of which would be inconsistent with public policy, as that term is interpreted under Bermuda law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A foreign judgment given by a New York court or an English court (a "foreign court") is not of itself enforceable in Bermuda, but a final and conclusive judgment *in personam* obtained in a foreign court against any Bermudian company based upon any loan facility agreement or related security document under which a sum of money is payable (other than a sum of money payable in respect of taxes or other charges of a like nature or in respect of a fine or other penalty), may be enforced by separate action before a Bermuda court, provided that:

(i) the foreign court had jurisdiction in relation to the subject matter of the dispute under all applicable laws and Bermuda conflicts of laws rules (and an express, contractual submission to jurisdiction is sufficient for these purposes);
(ii) the judgment was not obtained by fraud or in a manner opposed to natural justice;
(iii) the relevant obligor received notice of the proceedings and was afforded an adequate opportunity to present its defence;
(iv) the enforcement of the judgment would not involve the enforcement of foreign revenue, penal or other public laws or otherwise be contrary to Bermuda public policy;
(v) there has been due compliance with the provisions of the Judgments (Reciprocal Enforcement) Act 1958, as amended, where applicable (it applies to English courts, and those of most of the commonwealth countries, but not the courts of the United States);
(vi) enforcement of the judgment is not precluded by the Protection of Trading Interest Act 1981, as amended (which prohibits the enforcement of judgments for multiple damages and certain other foreign judgments); and
(vii) the proceedings to enforce the judgment of the foreign court are commenced within six years of the date of such judgment.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The court system in Bermuda is efficient and responsive. A liquidated money claim for recovery pursuant to obligations set out in a loan agreement or guarantee is normally issued in the Commercial Court or the Supreme Court by way of a writ of summons under Order 6 Rules of the Supreme Court 1985. If the company is registered in Bermuda, the Defendant must file a memorandum of appearance through its attorneys within 14 days of service of the writ of summons in accordance with Order 12 Rules of the Supreme Court 1985. The time limit is extended if it is necessary to serve proceedings on a Defendant out of the jurisdiction.

If the Defendant does not enter an appearance within the period allowed, the Plaintiff may have a judgment entered for the liquidated claim in accordance with Order 13 Rule 1 Rules of the Supreme Court 1985.

If a notice of appearance is served but it is considered that the Defendant has no legal merit in defending the claim, an application for Summary Judgment can be made by the Plaintiff under Order 14 Rules of the Supreme Court 1985. This application is made by summons and supported by affidavit.

If the application is not defended then judgment can be entered on the first return date, which would be approximately 4–5 weeks from the issue of proceedings. If the application is defended, then directions are given at the application return date and the Defendant will have leave to serve an affidavit in answer and the Plaintiff a further affidavit in reply. The application is then relisted for a hearing, which would normally take place 12–14 weeks after the original proceedings were served on the Defendant.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

There are no significant restrictions other than following due process in any proceedings to enforce judgment, obtain possession of property or obtain an order for the sale of the property.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

There are no specific restrictions that apply to a foreign lender in the event of filing suit against a company in Bermuda or foreclosing on collateral security. However, it should be noted that the Defendant to any writ of summons or court-controlled enforcement process by a foreign lender can apply for security for costs pursuant to Order 23 Rules of the Supreme Court 1985 on the basis that the Plaintiff is ordinarily resident out of the jurisdiction. Following application for security, the court may order the granting of an appropriate security for the payment of the Defendant's costs as a condition of the Plaintiff continuing with the litigation. The grant of such an order is intended to protect the Defendant in the event that the Defence to the Claim is successful. The security is released if the Plaintiff is ultimately successful at trial or prior summary determination of the claim.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

In a compulsory winding-up of a company in Bermuda, following the presentation of a petition, the company or a creditor or contributory may apply to court under s.165 Companies Act 1981 to have any creditor's claim stayed. The court may stay the proceedings on such terms as it thinks fit. Following the grant of a winding-up order or the appointment of a provisional liquidator, no action or proceeding may be commenced or continued without the leave of the court, pursuant to section 167(4) of the Companies Act. The generic rationale is for the claims of unsecured creditors to be stayed to allow an orderly distribution to creditors *pari passu* following the winding-up of the company.

The position of a secured creditor is largely unaffected by the insolvency regime as the security interest is normally a property right of the secured creditor and as such stands outside the insolvency regime which is designed to effect the orderly distribution of the company's assets. If, on the basis of the security documents, the lender is entitled to take possession of and title to the secured property, he may after realising the security prove in the liquidation for the balance of any debt as an unsecured creditor. In the event that the assistance of the court is needed to enforce the security then an application has to be made to the court for permission to proceed.

Under Rule 98 of the Companies (Winding-Up) Rules 1982, the liquidator may require a creditor to give up security on payment of the estimated value of the security plus a 20% uplift.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

An arbitration award made in a foreign country other than the United Kingdom that is a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards adopted by the United Nations Conference on International Commercial Arbitration on 19 June 1958 (the "New York Convention") in respect of any loan facility agreement or related security document for a definite sum obtained against the Bermudian company may be enforced with the Bermuda courts and judgment entered in the terms of the award. The Bermuda courts may only exercise their discretion to refuse leave if:

(i) a party to the arbitration agreement was, under the law applicable to him, under some incapacity;

(ii) the arbitration agreement was not valid under the governing law of the arbitration agreement;

(iii) the Bermudian company was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings, or was otherwise unable to present its case;

(iv) the award deals with an issue not contemplated by or not falling within the terms of the submission to arbitration, or contains matters beyond the scope of the arbitration, subject to the proviso that an award which contains decisions on matters submitted to arbitration which can be separated from those matters was not so submitted;

(v) the composition of the arbitral authority was not in accordance with the agreement of the parties or, failing such agreement, with the foreign governing law;

© Published and reproduced with kind permission by Global Legal Group Ltd, London

(vi) the award has not yet become binding upon the parties, or has been set aside or suspended by a competent authority, either pursuant to the foreign governing law, or pursuant to the law of the arbitration agreement;

(vii) the subject matter of the award was not capable of resolution by arbitration; or

(viii) enforcement would be contrary to public policy.

An award made pursuant to an arbitration agreement in a foreign country including the United Kingdom that is not a party to the New York Convention may be registered under the provisions of the Arbitration Act (Cap 6) and enforced as a judgment of the Bermuda courts. There is no statutory test for the exercise of the courts' discretion in relation to registration in this manner, but in our view the court would be likely to exercise its discretion in a similar matter to the requirements for enforcing awards under the New York Convention where the award was made in a jurisdiction which is a signatory of the New York Convention.

If any such final and conclusive monetary award in an arbitration has the force of a judgment under the foreign governing law, then it may be registered and enforced as a judgment of the Bermuda court as set out above.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The start of insolvency proceedings against a Bermudian company may affect a creditor's ability to enforce its rights. All or part of a transaction may be attacked as constituting a fraudulent conveyance or a fraudulent preference. In certain circumstances, floating charges can also be attacked. Please see the answer to question 8.2 below.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Security created within six months of the start of a Bermudian company's winding-up can be set aside on the application of the liquidator where the purpose of creating the security was to give a secured creditor preference over other creditors (*section 237, Companies Act*). Section 237 cross-references Bermuda's bankruptcy law regime, and section 47 of the Bankruptcy Act 1989 reproduces section 44 of the English Bankruptcy Act 1914. English or Commonwealth cases on the meaning and effect of those provisions will be relevant to their interpretation in Bermuda courts.

The start of the winding-up is either:

(i) the date that the company resolves that it be wound up; or

(ii) if there is no such resolution, the time of presentation of the petition that led to the winding-up.

The legislation's intention is to avoid preferences at the expense of unsecured creditors. The presence of "fraud" on the company's part or the person who is being preferred is not required. However, it is necessary to show that the company's "dominant intention" was to prefer one creditor over other creditors. The burden of proof is on the liquidator, although the court can draw inferences about intention from all the relevant facts. Payments to secured creditors are normally not preferences. However, the granting of security may be a preferential transaction that can be set aside if the relevant intention exists.

Floating charges that are created within 12 months before winding-up commences can be set aside (*section 239, Companies Act*). This provision takes automatic effect, and is not dependent on the liquidator or creditor applying to set the floating charge aside. Floating charges are valid if the creditor provided new value (cash paid) at the time of, or in consideration for, the security. Otherwise, they are void to the extent that the creditor did not provide new value, unless the creditor can prove that the company was not insolvent at the time of the charge. The creditor is entitled to recover interest on the amount of money paid to the company at a statutory rate.

Notwithstanding the above, secured creditors with fixed charges may realise their security outside the winding-up regime. Secured creditors also may recover the full proceeds of realisation without deductions other than for enforcement expenses. Other creditors are usually paid in the following order on an insolvency:

(i) secured creditors with fixed charges;

(ii) preferred creditors set out in section 236(1) of the Companies Act, including the government and municipalities' claims over taxes and rates;

(iii) employees, for up to BM$2,500 of wages or salary relating to the four months before the liquidation or winding-up, and accrued holiday pay;

(iv) all amounts due in respect of:
- contributions payable by the company for the preceding 12 months under the Contributory Pensions Act 1970;
- any contract of insurance;
- any accrued compensation; or
- liability for compensation under the Workmen's Compensation Act 1965;

(v) secured creditors with floating charges; and

(vi) unsecured creditors.

The ranking of subordinated creditors depends on the nature of the subordination. A junior secured creditor is paid after a senior secured creditor, but before unsecured creditors. However, an unsecured subordinated creditor normally ranks after other general unsecured creditors. The priority of security depends on the registration date of the security document, priority notice or, in the case of aircraft, the notice of intention to file a mortgage.

The registration of security is not mandatory and is not essential to the creation of valid security. On insolvency, the failure of a secured creditor to perfect its security or register it as a charge does not entitle a liquidator to have the security set aside for the benefit of the company's unsecured creditors. The general position is that registration does not constitute perfection and so the method of perfection for a particular asset class is a matter of common law. Where a creditor has failed to perfect their security, there is a risk that a subsequent creditor with a security interest in the same asset may be able to achieve priority by being the first to register their security as a "charge".

On insolvency, secured creditors with fixed charges have priority over all other secured and unsecured creditors. Registration affects priority between secured lenders. If no secured creditor has registered their security, priority is determined by the time of creation.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The insolvency regime contained in the Companies Act generally applies to all Bermudian companies. The insolvency of individuals is dealt with by the Bankruptcy Act 1989 and the Bankruptcy Rules 1990. The insolvency of partnerships is governed by the Bankruptcy Act 1989 and sections 33–40 of the Partnership Act 1902.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The mechanisms for enforcement depend on the remedies contained in the security documents:

(i) **Powers of sale**: Mortgages (over land or other assets) or charges generally contain powers of sale. In the case of mortgages over land, the Conveyancing Act provides for limited rights of sale and foreclosure.

(ii) **Appointment of receiver**: The terms of the security may enable the lender to appoint the receiver. Alternatively, it may be possible to apply to the court for the appointment of a receiver.

(iii) **Possession of assets**: A lender may be able to take possession of charged assets or be noted as the registered owner in the case of a security interest over shares (*see section 3 above*).

What is the best enforcement action depends on the particular circumstances at the time.

An alternative to enforcement is a scheme of arrangement, which is available under section 99 of the Companies Act. A scheme may be used to effect the reorganisation of a company. There is a substantial body of English case law on schemes to effect the reorganisation of a company and on the relevant provisions of the Companies Act. Bermuda applies English law principles to the interpretation and implementation of schemes. A scheme must be approved by a 75% majority in value and a number majority of each distinct class of creditors (and shareholders, if the scheme also involves shareholders) and sanctioned by the court.

The court has wide powers under section 102 of the Companies Act to deal with various ancillary matters under the scheme.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission by any Bermudian company in any loan facility agreement and related security document to which it is a party to the jurisdiction of the relevant foreign courts would be deemed valid and binding upon such Bermudian company and would be recognised as such by the Bermuda courts, if such submission is accepted by the relevant foreign courts and is valid and binding under the foreign governing law.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of Bermuda?

The signature, delivery and performance of any loan facility agreement and related security document to which it is a party by any Bermudian company constitutes private and commercial acts by such company rather than public or governmental acts and, accordingly, such company is subject to suit under private commercial laws. Neither it nor any of its property has any right of immunity on any grounds from suit or from jurisdiction or execution of judgments.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

It is not necessary or advisable in order to enable any secured party, whether lender, or security agent or trustee, whether a bank or other lending party, to enforce their respective rights under any Transaction Document that any of them should be licensed, qualified or otherwise entitled to carry on business in Bermuda.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

None that are material.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Jeremy Leese
MJM Limited
Thistle House, 4 Burnaby Street
Hamilton, HM11
Bermuda

Tel: +1 441 292 1345
Fax: +1 441 292 9151
Email: jleese@mjm.bm
URL: www.mjm.bm

Jeremy's practice focuses on corporate finance, shipping and aviation finance, mergers and acquisitions, corporate reorganisations and restructurings, banking and international real estate finance, structured finance, as well as regulatory and legislative compliance. After studying at Oxford University and the College of Law (York), Jeremy was admitted as a solicitor of the Supreme Court of England and Wales (now non-practising) in 1995, and called to the Bermuda Bar in 2003. He was also admitted as a solicitor of the Eastern Caribbean Supreme Court (BVI Circuit) in 2008, and as a solicitor of the Eastern Caribbean Supreme Court (Anguilla Circuit) in 2011. Following qualification with a magic circle firm in the UK, Jeremy practised corporate law there for four years before a move in 1999 to a leading offshore law firm and working in their Bermuda, Hong Kong, Jersey and British Virgin Islands offices. After a spell heading the Corporate team at a firm in Anguilla, Jeremy returned to Bermuda with MJM in August 2012. Jeremy is ranked a Leader in his Field by *Chambers Global*.

MJM is one of Bermuda's leading law firms. We have a broad-ranging practice with an emphasis on civil and commercial litigation, banking and finance, general corporate, trusts, insolvency and restructuring. We also offer advice and services to international individual and commercial private clients.

MJM is regularly retained by leading international law firms. We offer practical, common sense advice based on an in-depth knowledge of the legal, regulatory and commercial environment in Bermuda. We also offer a high degree of partner involvement in the work that we do. Each practice area is led by a partner who is recognised as a leading practitioner in Bermuda in their respective field of specialisation. Five of our attorneys, including three partners, are ranked 'Leaders in their Field' by *Chambers Global* this year, namely Peter Martin, Andrew Martin, Alan Dunch, Jeremy Leese and Brian Holdipp. Our collective knowledge and experience across practice areas enables us to offer a comprehensive and thorough service to our clients.

Corporate & Finance

Our highly experienced team advises on all aspects of corporate and business law. Key practice areas include: aviation and ship finance; corporate borrowing and bank lending; mergers & acquisitions; joint ventures and shareholder agreements; global equity offerings and listings (IPOs); investment funds; international real estate finance; and regulatory compliance.

We have extensive experience in forming Bermuda local and exempted companies and partnerships. Our Quorum group provides a full range of corporate management and secretarial services to local and international clients.

MJM attorneys are regularly listed in international guides to legal practitioners in Bermuda, including *Chambers Global – The World's Leading Lawyers*, *The Legal 500*, and *IFLR1000*.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Bolivia

Andrea Mariah Urcullo Pereira

Criales, Urcullo & Antezana

Daniel Mariaca Alvarez

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

In 2014, several changes regarding financial intermediaries were established by the Financial Services Law, with the objective of creating specialised bodies and aiming to have a stronger government presence in this specific area by means of a regulatory entity. In early July of 2014, specific regulations were issued in order to establish loan rates that must be applied by financial intermediaries, especially for lending transactions completed in the industry sector and for social housing loans. These specific regulations are expected to allow portfolio growth in priority sectors defined by the national government, specifically production credits and access to social housing.

Specific regulations for financial institutions, SME banks, multiple banks and others, and especially Supreme Decrees (DS) 1842 and 2055, both issued in 2014, regulate interest rates for loans for social housing, loans for the industry sector and deposit rates. These regulations also establish minimum levels for the credit portfolio of financial entities operating in Bolivia. This kind of regulation aims to strengthen the industry sector and to improve the quality of life in Bolivian households through more affordable loans and higher returns on their savings.

Regarding social housing loans, new specific regulations oblige financial entities to give the total amount requested by lenders. This change has been made because of the obligation of these entities to constitute a guarantee fund by providing 6% of their profits in order to allow lenders to have access to housing loans without the need of paying in advance 10% or 20% of the final price, which was the way it had to be done in the past.

The transformation of financial entities organised under the framework of the Financial Services Law is expected, especially of Private Financial Funds (PFF), multiple banks and banks SMEs. It is also expected that there will be a regulation of fees for financial institutions that provide credits to the industry sector, and to make the credits prioritised by the Bolivian State more dynamic. It is important to mention that credit expansion will be accompanied by prudential regulatory measures in order to safeguard the quality of assets.

According to the Private Banks Association of Bolivia (ASOBAN), the credit portfolio of Banks in Bolivia reached US$ 14,899 million in October 2015, which means it exceeded the sum reached in 2014 by US $1,867 million, surpassing the required minimum levels for the credit portfolio established by regulations since 2014. Most of the loans that were given by banks in 2015 were granted to the industry and housing loans sectors, while loans granted to SMEs decreased significantly.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The Financial Services Law distinguishes three types of financial institutions: (1) State-owned or State-controlled financial institutions, which include (a) development banks, (b) public banks, and (c) financial development institutions; (2) private financial institutions, which include (a) private development banks, (b) private banks, (c) small and medium companies-focused banks, (d) savings and loans cooperatives, (e) housing loans-focused financial institutions, (f) financial development institutions, and (g) rural communities financial institutions; and (3) complementary financial services companies, which include (a) leasing companies, (b) factoring, (c) warrant companies, (d) clearing houses, (e) financial information bureaus, (f) money transferal companies, (g) electronic cards administration companies, (h) money exchange companies, and (i) mobile transfer or payment companies.

At the end of 2015, the financial intermediation system in Bolivia remained strong and stable, with good levels of financial performance as a result of continued deposits and loan portfolio growth, accompanied by a low level of credit defaults and adequate patrimonial support.

Public deposits closed at a balance of US$ 21,000 million, an increase of 20.4% compared to 2014.

Loans Portfolio

Until July 2015, the loans portfolio closed at US$ 14,257 million, an increase of US$ 71 million compared to the end of 2014. US$ 2,945 million of the total credit portfolio of the Bolivian financial intermediation system focused on commercial banking, US$ 2,656 million on small and medium companies, US$ 4,296 million on microcredit, US$ 2,947 million on mortgage credits and US$ 1,413 million on consumer credits.

Industry, Commercial and Services Sector Portfolios

Up until July 2015, the loan portfolio for the industry sector, which comprises entrepreneurs' credits, microcredits and SMEs credits for all types of activities and industries (such as agriculture, hunting, forestry and fishing, extraction of crude oil and natural gas, metallic and non-metallic mineral mining, manufacturing, electricity, gas, water and construction) amounts to US$ 5,077 million. The commercial sector loan portfolio reached US$ 2,885 million and the services sector reached US$ 1,935 million.

Social Housing Sector Portfolio

The Financial Services Law of Bolivia No. 393 dated August 21st 2013, introduced Social Interest Housing loans as a new category for bank loans, which is targeted at middle income families or individuals that want to buy or build their first house or department.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

One of the main conditions required in order to apply for this type of loan is that the cost of said house must not exceed the US$ 120,000 barrier, or US$ 100,000 in the case of apartments.

This particular type of loan has a State-regulated fixed interest rate, which can only vary from 5.5% to 6.5%, depending on the amount of the specific loan.

Another particular characteristic of this type of loan is that no down payment or guarantee is required. In order to guarantee these loans, the Bolivian government issued a regulation that forces private banks to invest 6% of their annual earnings into special guarantee funds created by them for that sole purpose.

As of July 2015, the social housing sector portfolio in Bolivia reached US$ 1,068 million.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

In Bolivia, companies within a corporate group can secure loans from their companies provided that they belong to the same group and the same category (e.g. electricity); however, companies that belong to a different business group cannot guarantee loans to any of their members. On the other hand, companies that belong to financial groups are prohibited from securing loans unless they are companies dedicated to investments.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

If the company is dedicated to guaranteeing investment, the responsibility lies with those who have approved the transaction. In general, however, directors also have responsibility as the operation is guaranteed by the goods of the company.

If the directors of a company ensure an operation and such directors do not have the authority to perform such act, they are also responsible for their own assets.

2.3 Is lack of corporate power an issue?

Indeed; the lack of authority enabling a person or persons to act on behalf of a company is a grave and a serious problem. There are certain powers that enable people to carry out the activities and business of a company, and any person who acts without such authority is liable to penalties which are provided by law. All further acts performed by those people and the company might be void or voidable.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Bolivian law does not provide for State authorisation and credit approval for the creation of securities, except concerning State enterprises.

However, when a company applies for a loan the application must have the appropriate support, such as financial analysis of the company demonstrating the need for a loan, and, overall, approval of the shareholders of the company.

In the stock market, it is necessary to have the approval of shareholders in order to issue bonds.

For the granting of guarantees, such guarantees must be fully sanitised and free from all liens. If the security has a lien, the creditor will require permission for the property to be used as security for other creditors.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

It depends on the amount requested. If the company has some financial indicators that are not in line with the credit policy of the entity, it may request the granting of additional collateral to support the operation.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

For the enforcement of a guarantee there are no exchange controls. The main obstacle is the time it takes to enforce a guarantee in the judicial system; such time frame depends on the individual case (please see the answers in section 8).

For the enforcement of a security with no exchange controls, the obstacles encountered are the extended time frames required for the judicial system and the processing of guarantees.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In Bolivia, lending obligations are secured by mortgages, collateral and unsecured personal guarantees.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

The creation of securities depends on the type of loan requested. The procedure is to sign a contract, and each contract must be guaranteed. The contract also specifies the kind of guarantee given by the borrower, its characteristics, its value, its usefulness and for how long the collateral will be in force.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes, once the loan has been approved, the borrower delivers all relevant documents pertaining to the guarantee. These documents remain in the custody of the lender, which is usually a bank. The appropriate authorities then keep track of whether the property is collateral for a bank or institutional lender. However, this does not mean that the borrower transfers his ownership of the property to the bank, except where there is breach of property ownership, in which case it may be transferred to third parties to honour the debt.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Bolivian law does not provide for this.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Generally not, but most loan agreements in Bolivia provide that the borrower has to keep a bank account where there is enough money to cover the monthly loan instalments; if the account is declared to have no money, the bank has the power to debit the money from other accounts that the borrower may have with the bank, after communicating these actions to the debtor.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Bolivian law does not allow companies to give their shares in warranty as in other countries. What is usually done is that the shareholders of a company must agree to be guarantors of the credit operations of the company and they guarantee the loan with their shares.

In Bolivia shares have to be issued certificates, which must be registered in the books of the company's shareholders.

As part of a loan agreement, a clause allowing the resolution of disputes and enforcement of a security to be resolved under the laws of another country may be included. This is not a usual practice in Bolivia, but it is allowed, depending on the terms of the agreement between parties.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes it can. Collateral may be taken over goods in process, finished goods or raw materials. The debtor must request a warrant from the company storing the materials. The bank has control of such materials and each time the debtor needs to access the materials it has to apply for the bank's authorisation. In this way, the bank has control over the debtor's production and is satisfied that the debtor will honour its debt.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

No it cannot. In Bolivia this is regulated by the Supervisory Authority of the Financial System (ASFI) and is punishable under the law.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notary fees on guarantees are 4/1,000 of the loan amount for warranty registration in the office of real rights. Further legal costs of around US$ 150 also apply, along with the cost of registration at the Commercial Register in Bolivia, which is US$ 25.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

For the registration of a guarantee, on average a time period of 30 to 45 days is required. On top of this notary processes will also take between 10 and 15 days. A total of 60 days, on average, is required, and the costs vary in relation to the amount of each loan.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No consents are required for the creation of a security.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

The priority on the enforcement of a guarantee is given by the number of loans that were requested in that line, taking into account that the line of credit has a limit and that limit defines how many loans can be requested. This also dictates if the warranty covers all of the borrowing in that line of credit.

The priority is given predominantly by the order in which the loans were requested; if the guarantee is executed, the amount collected will first cover the oldest operations and then operations that were requested at a later date.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

For the enforcement of a security, financial institutions have to give their representatives power of attorney, enabling them to pursue the enforcement of the security. These powers must be registered in the Commercial Register of Bolivia, which is also responsible for their validation.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

In Bolivia, it is expressly forbidden by law for a company to acquire its own shares.

(b) Shares of any company which directly or indirectly owns shares in the company

Cross shareholding is not legally possible in Bolivia.

(c) Shares in a sister subsidiary

Bolivian law does not provide any restrictions in this case.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

In Bolivia, the law does not prohibit the role of an agent or trustee

© Published and reproduced with kind permission by Global Legal Group Ltd, London

and thus its capacity to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of a group of lenders of the same borrower.

The Bolivian Civil Code states that all of the assets of a multiple debtor constitute their common guarantee.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

In Bolivia, agents are recognised as long as they have a written legal mandate from the lenders, so they are responsible for performing the collection and enforcement of security granted by banks to borrowers. This does not mean, however, a transfer of the portfolio of the banks to the agent.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

No, because the lender has cancelled the amount due. The requirement for this transfer is that Lender A has to lift the lien on the collateral so that Lender B can record the loan and have the right to charge his debt and the guarantee.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

No, since the legislation does not provide this figure, the only thing that sets the tax law is that if a borrower is foreign, payments made by the debtor for interest are taxed at a rate of 12.5%, as long as the loan agreement was signed in Bolivia. If a loan agreement was not signed in Bolivia, the rate of 12.5% applies to the total amount including principal and interest, as it is considered a remittance abroad.

The debtor is liable to pay agent retention and replacement of tax liability.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Bolivian tax legislation does not provide any tax incentives or benefits; the taxes that apply are detailed in question 6.1.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Applicable taxes are detailed in question 6.1.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No, just those listed in question 3.9.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

If the loan agreement is made under the laws of a foreign country (e.g. USA), and under such legislation consequences exist for lenders, such adverse consequences apply in Bolivia.

On the contrary, if the loan is carried out under Bolivian legislation, there are no consequences because Bolivia does not have experience and jurisprudence in such cases.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Bolivian courts recognise and enforce contracts subject to foreign law, provided they contain two elements: first, that the benefits arising out of these contracts are to be utilised in Bolivia; and second, that the foreign law under which the contract was created is not contrary to Bolivian laws.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The courts in Bolivia execute foreign judgments as long as there is a treaty in place with the country concerned. Following the principle of reciprocity, and in the absence of treaties on the matter, Bolivian courts will grant these judgments the same force that the nation in question gives to Bolivian judgments. However, if a foreign judgment was enforceable, it would be necessary to follow a procedure in which the concerned party must seek the enforcement of the judgment at the Supreme Court, and later request the answers of the other party within 10 days. With or without such answers, and after a fiscal opinion (which involves additional time), the court will determine whether or not to enforce the judgment. The enforcement of the judgment shall correspond to the tribunal which would have been the case at first instance in Bolivia.

The new Bolivian Procedure Code (which has come fully into force in February 2016) maintains the same principles and procedure on this matter that were established in the previous Procedure Code.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

However, it specifies that even though it is not necessary for courts in Bolivia to re-examine the merits of the case, it is necessary for the Supreme Court to recognise the foreign judgment (to determine whether the judgment meets the requirements and procedural basic principles) in order to proceed to its execution (only if the judgment concerns the compliance of an obligation or if it is the intention of a party to validate its probative effects).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

A suit for non-payment can be filed as soon as the deadline the parties have agreed has expired. Generally, it will be possible to act by the way of an executive process, which is quite quick (the suit is filed, the judge examines the procedural requirements of executive judgment, and if appropriate he shall issue a formal notice to be fulfilled within three days, besides having the injunction of the debtor's assets). The executive process should take about a month (depending on which exceptions shall be made, counting also the evidence term which will take 10 additional days). In the case the loan agreement included a waiver clause regarding the executive procedure, the obligation may also be required by way of coercive procedure, which takes less time than the executive procedure. In all cases, the enforcement of the judgment will depend on if it is enforceable and if so, the court will execute the judgment within the time established or, failing that, within three days.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

It depends on the guarantee. In general, a public auction is required. This involves a procedure that might take over a month. However, no regulatory consents are needed to enforce collateral securities.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

No. If the requirements are met, there is no restriction on the lender to filing a law suit against the borrower or the guarantee it has granted.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Please see the answer to question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Bolivia has signed and ratified the New York Convention on the enforcement of arbitral awards. In this sense, the Bolivian courts do recognise such decisions without needing to re-examine their merits. Moreover, the new Civil Procedure Code prescribes that arbitral awards enable a lender to initiate a coercive enforcement of a debt, and it is not necessary for the judge to re-examine the merits of such arbitral award.

The procedure to enforce a foreign arbitral award is the same as described in question 7.2 for foreign judgments.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The ability of a lender is affected because the entire bankruptcy process is handled by a judge. In this sense, the affected lender cannot seek the enforcement of its security as freely as in the case of not being subject to the debtor company's bankruptcy. However, bankruptcy does not involve any other violation of the right of the lender to make a debt enforceable and the debt shall be paid by means of the security given by the debtor.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

All guarantees have priorities on the enforcement of the goods or assets given as such. However, tax debts and employee claims are always taken as preferential creditors' rights in the case of bankruptcy of the borrower.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes; financial intermediaries, for example, are only subject to a process of "intervention", after which it is to be decided whether to give it a solution or to proceed to compulsory liquidation.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The only way other than court proceedings to seize the assets of a company in enforcement is a process called "*dación en pago*", which consists of a new transaction between the creditor and the debtor through which the creditor receives a new asset, or the asset given as a guarantee, as a payment of his credit.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Please see the answer to question 7.1. However, a party cannot submit to a foreign jurisdiction on his own, for it takes both parties to choose the jurisdiction that will rule the contract and its enforcement.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

If the sovereign immunity was awarded to a party in Bolivia, it would be by means of a law; therefore it would not be a disposable right, which implies that a party's waiver of sovereign immunity would not be legally binding and enforceable under the laws of Bolivia. Nevertheless, in the event a party's sovereign immunity was awarded in a country the laws of which allow the waiver of sovereign immunity, then it would be legally binding and enforceable in Bolivia.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Bolivian law provides that a bank or financial institution is that of domestic or foreign origin, and dedicated to perform financial intermediation and financial services to the public, both in the country and outside the country.

The financial intermediation and auxiliary financial services will be carried out by financial institutions authorised by the Supervisory Authority of the Financial System (ASFI). No person, natural or legal, will perform regularly in the territory of Bolivia the activities of financial intermediaries and financial auxiliaries services described by law, without prior permission of incorporation and operation granted by ASFI, with the formalities established by law.

Any natural or legal person, domestic or foreign, domiciled in the country or not, who does not meet the requirements and formalities concerning the organisation and functioning of financial intermediaries and financial auxiliaries services under the Act is prohibited from making announcements, publications and circulating papers, written or printed, the terms of which imply that such person has legal authorisation to perform activities reserved by law to the said banks. In the same way, any natural or legal person may not use in its name, in Spanish or another language, terms that may lead the public to be confused with legally authorised financial institutions.

The requirements for the establishment of a financial institution in Bolivia and for obtaining the operating licence are as follows:

A) Founders may not:
1. Be declared legally incapable to engage in commerce.
2. Have an indictment or conviction for committing crimes.
3. Have outstanding debts related to the financial system or running off loans.

B) In order to obtain an operating licence, a financial institution must:
1. Have conducted a study of economic and financial feasibility.
2. Have drafted articles of incorporation and bylaws of a corporation.
3. Have a certified personal history for individuals – issued by the competent authority.
4. Have a certificate of fiscal solvency and disclosure of assets of the founders.

Additionally, in August 2015, ASFI issued a regulation establishing the criteria to determine if a loan, a financial intermediation activity or any activity reserved for financial institutions exclusively, is made in a "massive" or in a "regular" way. Those criteria are based on the frequency of the activities aforementioned (weekly, monthly, quarterly, semi-annually and annually) and/or on the gross incomes earned monthly, quarterly, semi-annually and annually by the lender. According to this regulation, if a natural or legal person acts as a lender or as a financial intermediary meeting the criteria set out in the regulation, such activity is considered illegal and has the following consequences: a) ASFI will issue a stopping order for the person performing the illegal activity; b) if an unauthorised lender has any office in Bolivia, ASFI will be able to close it permanently; and finally c) unauthorised financial intermediation activities can be prosecuted as crimes before Bolivian courts.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The considerations that should be taken into account are those that are provided by law and detailed in this chapter.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Andrea Mariah Urcullo Pereira

Criales, Urcullo & Antezana
Vitruvio II # 7979, 5th floor, office "D"
Calacoto, 9th street, La Paz
Bolivia

Tel: +591 2277 5656
Fax: +591 2279 9682
Email: aurcullo@bolivialaw.com
URL: www.bolivialaw.com

Andrea Mariah Urcullo Pereira graduated as a lawyer from Universidad Católica Boliviana San Pablo in La Paz in 2010. She also holds a history degree. She joined Criales, Urcullo & Antezana in 2012 as an associate lawyer. Her main practice areas are corporate and commercial law, financial law and procedure law.

Daniel Mariaca Alvarez

Criales, Urcullo & Antezana
Vitruvio II # 7979, 5th floor, office "D"
Calacoto, 9th street, La Paz
Bolivia

Tel: +591 2277 5656
Fax: +591 2279 9682
Email: dmariaca@bolivialaw.com
URL: www.bolivialaw.com

Daniel Mariaca was born in La Paz in 1980. He graduated from Universidad Católica Boliviana in 2005.

Daniel holds a diploma in administrative and regulatory law, awarded in 2005, from the Universidad del Valle, a diploma on commercial law awarded in 2006 from Universidad de los Andes and a diploma on taxation awarded in 2007 from the Universidad Privada Boliviana. Additionally, Daniel holds a Master's degree in law awarded in 2008 from the Universidad Privada Boliviana.

Daniel joined Criales, Urcullo & Antezana in 2006 and worked there until 2012 when he went to work for YPFB Andina S.A., the biggest oil and gas company in Bolivia. In 2013, he was hired by Sinchi Wayra S.A., one of the biggest mining companies in the country. In 2015 he rejoined Criales, Urcullo & Antezana as an associate.

His practice focuses on Corporate and Administrative Law.

Criales, Urcullo & Antezana is a full-service law firm serving the needs of businesses, governmental entities, non-profit organisations and individual clients in Bolivia and other Latin American countries. At Criales, Urcullo & Antezana we measure our success by the success of our clients and the longevity of their relationships with us.

Our law firm is the most significant legal services provider to the securities market in Bolivia. Our clients in this sector are the Bolivian Stock Exchange, the Bolivian Central Depository, and the biggest stock exchange brokers and investment funds.

Three reputable Of Counsel members joined the firm in 2011, reinforcing our practice in tax law, administrative law and environmental law. These three lawyers are considered to be the most significant experts in their respective fields.

We continue to provide services to our clients in the electricity sector in Chile and Brazil, in matters unrelated to the Bolivian jurisdiction.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Botswana

Khan Corporate Law

Shakila Khan

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The bank lending sector has seen strong competition in the corporate lending markets from the non-bank sector in recent years (statutory financial institutions, asset managers acting on behalf of insurance companies and pension funds). The current lack of liquidity in the banking sector has put this sector under further pressure. There has also been a corresponding tendency to raise capital from the capital markets and this has similarly put pressure on the bank corporate lending sector.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

There have been significant lending transactions in the area of project finance and there has been increasing interest in public-private partnerships that involve bank finance.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, it can.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

No, there are not.

2.3 Is lack of corporate power an issue?

Not in general; the Companies Act, CAP 42:01 of the Laws of Botswana provides that "*a company has, both within and outside Botswana- (a) full capacity to carry on or undertake any business or activity, do any act which it may by law do, or enter into any transaction; and (b) for the purposes of paragraph (a), full rights, powers and privileges. (2) The constitution of a company may contain a provision relating to the capacity, rights, powers, or privileges of the company if the provision restricts the capacity of the company or those rights, powers and privileges*".

The following types of documents as applicable would need to be reviewed to see if they contain any restrictions on a particular entity:

1. Articles of Association or Constitution of the company (or enabling statute in the case of a statutory corporation);
2. any licence that the company may require (e.g. a banking licence, or pension fund licence); and
3. any internal rules and regulations of the company concerned.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

The Articles of Association or Constitution might specify if shareholder approval is required for entry into a guarantee. Otherwise, for a guarantee in the absence of any other security or charge on the guarantor's assets, no other consents or filings are generally required.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no statutory limitations, save for those in the Companies Act on financial assistance; please see section 4 below.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange controls in operation in Botswana. There is still legislation on exchange control in the statute books, which has not been repealed. However, it has not been operational since 1998 when the Minister of Finance declared that exchange controls would be abolished in the Budget Speech. The fact that the legislation has not been repealed is treated as a technicality. As such there are no restrictions on the repatriation of funds. There are no other obstacles to the enforcement of a guarantee provided that the guarantee refers to an underlying and primary obligation that the guarantor is guaranteeing and that is owed to the lender.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

A wide range of assets may be used to secure lending obligations – moveable and immoveable property, intangible property (such as shares), receivables, cash in bank accounts, stock in trade, machinery, etc.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is not possible to pass security over all asset classes by means of a general security agreement. The widest security is afforded by the general notarial bond and by a statutory pledge called a Deed of Hypothecation, both of which can only be passed over moveables. Therefore, other security must be passed over immoveable property (explained in question 3.3 below).

A general notarial bond is a mortgage by a borrower of all of its tangible moveable property in favour of a lender as security for a debt or other obligation. However, a general notarial bond does not (in the absence of attachment of the property before insolvency) make the lender a secured creditor of the borrower, it only offers a limited statutory preference above the claims of concurrent creditors in respect of the free residue of the estate on insolvency. A general notarial bond is required to be registered with the Deeds Registry; it must be prepared by a notary public and is subject to prescribed notarial fees.

The Deed of Hypothecation is a form of statutory pledge by a borrower and can cover both tangible and intangible moveables. A Deed of Hypothecation provides a first ranking security. It can only be granted to a creditor who has been approved by the Minister for Finance and Development Planning under the Hypothecation Act, CAP 46:05 of the Laws of Botswana. A Deed of Hypothecation can secure all, or certain specified, moveable assets of the borrower and can include future assets (such as receivables). In addition, with a Deed of Hypothecation, a creditor is deemed to be in possession of the secured assets at all material times; that is to say, the creditor is not obliged to take steps to attach the secured assets in order to perfect the hypothecation, and so in a liquidation, the assets remain secured in terms of the Deed of Hypothecation without the requirement of an attachment being effected by the creditor prior to the winding up order, or delivery of a statement of the book debts. A Deed of Hypothecation requires registration at the Deeds Registry Office to be perfected. A Deed of Hypothecation cannot be transferred. The Deed of Hypothecation must be prepared by a conveyancer or notary public and is subject to prescribed notarial fees.

As a Deed of Hypothecation affords secured creditor status, it is much more widely used than the general notarial bond in Botswana.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Immoveable property, such as land held by freehold, and land held by way of long-term interest (exceeding 10 years) whose interest is registered in the Deeds Office, and all improvement made thereon (e.g. buildings) can be secured by way of a mortgage bond. A mortgage bond grants a real right of security in insolvency/bankruptcy. A mortgage bond may be ceded as between creditors, provided that the cause of debt and amount of debt necessary remains the same. Mortgage bonds are generally enforceable in accordance with their terms. A mortgage bond is perfected by registration at the Deeds Registry Office must be prepared by a conveyancer and is subject to prescribed conveyancing fees.

Machinery and equipment are not able to be secured by a mortgage bond and a separate Deed of Hypothecation is required to secure these and any other tangible moveables.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, collateral security can be taken over receivables either by way of a Deed of Hypothecation (described in question 3.2) or by way of a cession.

In terms of an out-and-out cession, where title to the property is transferred to the cessionary (chargor), subject to the cedant's right to have the property transferred back to it by the cessionary once the debt owed to the cessionary has been discharged, a cession does not require registration and is not subject to conveyancing or notarial fees. (There is a risk of recharacterisation of the agreement by the courts, and this point has not been judicially tested in Botswana.)

(There are two types of cession recognised in Botswana law, an out-and-out cession and a cession in security (cession *in securitatem debiti*). The cessionary would not be free to collect the receivables in the absence of a default with a cession *in securitatem debiti*. A cession *in securitatem debiti* which is granted in respect of receivables (book debts, rentals, etc.) does not require registration but does require delivery for its perfection. Such delivery has in case law been interpreted to mean delivery of documents evidencing the debt. A cession *in securitatem debiti* requires a court order for enforcement.)

Debtors are not required to be notified of the security, registration of a Deed of Hypothecation at the Registrar of Deeds satisfies the notification requirement and all charges on property must be recorded in the statutory register of charges of a company and details of the charge lodge with the Registrar of Companies – again the registration satisfies the notification requirement

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, by way of cession in *securitatem debiti* or by way of a Deed of Hypothecation (explained in question 2.1 above).

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Security can be taken over certificated shares by way of a pledge. A pledge, which is granted in respect of tangible moveables and requires possession or delivery for its perfection. The fact of delivery and the nature of the possession must be demonstrated to any third party which may have a competing interest. (In respect of a private company, therefore, the pre-emptive right of other shareholders must be considered and, if possible, waived on entry into the pledge.) Delivery is effected by delivery of the original share certificates, notation of the pledge on the share register (as the share register represents *prima facie* evidence of title) and delivery

© Published and reproduced with kind permission by Global Legal Group Ltd, London

of share transfer forms signed by the transferor and left blank as to the transferee. A pledge requires a court order for enforcement. There are no registration fees associated with a pledge.

It is also possible to pass a Deed of Hypothecation over shares, both certificated and uncertificated.

Uncertificated shares are held in respect of publicly listed entities and these shares are held in accounts with the Central Securities Depository of Botswana (CSDB). A security interest over an intangible right (uncertificated securities) that is not the subject of a Deed of Hypothecation would be by way of a cession *in securitatem debiti*. The cession in security is concluded on the understanding that the intangible property or right will be retained by the cessionary until such time when the debt secured by the cession has been extinguished. Again the cession requires delivery to be effective. The incorporeal property will then revert back to the cedent. There is no statutory provision, nor is there Botswana precedent as to what constitutes delivery of an intangible right and or especially of uncertificated shares in particular. The CSDB participants with whom entities open accounts have the ability to note a cession on the account, and this, together with a transfer instruction relating to the account, should be secured for any cession of uncertificated shares.

Security, in terms of a pledge or a cession, can validly be granted under a New York or English law governed document; however, the local law perfection requirements must be incorporated into the document.

Where a Deed of Hypothecation is opted for, this must be according to Botswana law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, by way of a pledge or a Deed of Hypothecation as described above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes to both; please see the responses below on financial assistance.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

There is no stamp duty in Botswana. A pledge or a cession does not need to be registered or prepared by a notary and therefore attracts no registration fees. A special or general notarial bond (passed over tangible moveables), Deed of Hypothecation (passed over tangible or intangible moveables) and a mortgage bond (passed over immoveable property) all attract notary/conveyancing fees according to a prescribed tariff. The fees are calculated on an *ad valorem* basis.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

In order for a lender to have a Deed of Hypothecation passed in its favour, it must be an Authorised Creditor approved as such by the Minister of Finance and Development Planning. Where not already approved, an application for Authorised Creditor status can take in the region of two to four months.

Registration for notarial bonds, Deeds of Hypothecation and mortgage bonds can take anywhere from ten days to three weeks depending on the volume of registrations pending at the Deeds Registry Office at any one time.

As discussed above, notarial bonds, Deeds of Hypothecation and mortgage bonds are subject to a prescribed tariff in terms of the fees payable to the conveyancer and/or notary public. The fees are calculated on an *ad valorem* basis and, therefore, the cost of these forms of security can be significant.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In respect of plant, machinery and equipment, where a lender seeks to have a Deed of Hypothecation passed in its favour, it must first be approved by the Minister of Finance and Development Planning as an Authorised Creditor. Authorised Creditor status, once gazetted, can be used in respect of transactions with different borrowers, i.e. it is not specific to a single transaction.

Apart from registration formalities, provided that the borrower has registered title to land, no further consents are required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

These are explained in questions 3.2 and 3.3 above, where applicable.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Section 76 of the Companies Act places the following restrictions on a company giving financial assistance to purchase its own shares:

"*(1) A company shall not give financial assistance directly or indirectly to any person for the purpose of or in connection with the acquisition of its own shares, other than in accordance with this section.*

(2) A company may give financial assistance for the purpose of, or in connection with, the acquisition of its own shares if the Board has previously resolved that -

(a) giving the assistance is in the interests of the company;

(b) the terms and conditions on which the assistance is given are fair and reasonable to the company and to any shareholders not receiving that assistance; and

(c) immediately after giving the assistance, the company will satisfy the solvency test.

Botswana

© Published and reproduced with kind permission by Global Legal Group Ltd, London

(3) *If the amount of any financial assistance approved under subsection (2) together with the amount of any other financial assistance given by the company which is still outstanding exceeds 10 per cent of the company's stated capital, the company shall not give the assistance unless it first obtains from its auditor or, if it does not have an auditor, from a person qualified to act as its auditor, a certificate that -*

(a) *the person has inquired into the state of affairs of the company; and*

(b) *the person is not aware of anything to indicate that the opinion of the Board as to the matters in paragraph (b) of subsection (2) is unreasonable in all the circumstances.*"

Subsection 76 (5) provides that "*the term "financial assistance" includes giving a loan or guarantee, or the provision of security*".

(b) Shares of any company which directly or indirectly owns shares in the company

The Companies Act does not specify the same restrictions on the giving of financial assistance for the acquisition of shares in a holding company, but a board resolution following the above is recommended. Any assistance cannot result in a subsidiary owning shares in its holding company, as this is prohibited except in the limited instance of a percentage of treasury shares.

(c) Shares in a sister subsidiary

As above, except there is no restriction on holding shares in a sister company.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Whilst a trustee or agent can enforce the loan documentation, the use of a security trustee or agent to enforce security is problematic. Botswana law recognises the concept of a trust; however, where the security to be held is mortgage bonds over immoveable property, or notarial bonds, the security trustee arrangement is prevented by statute in that the Deeds Registry Act, CAP 32:02 of the Laws of Botswana provides that "*no bond shall be passed in favour of any person as the agent of a principal*". In respect of other types of security such as a pledge or cession in security, in terms of common law these require an underlying legally valid and primary obligation owed by the grantor of the security to the recipient. The security trustee would not have this nexus with the grantor of the security.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Parallel debt obligations and the security SPV structure have been used in jurisdictions with similar laws to Botswana and there is precedent for the security SPV structure being used in Botswana. (The security SPV is where the security is transferred to an SPV that holds the security constituting the security package. The SPV would then issue guarantees and indemnities to the various lenders on the basis that such claims be limited to the value of the security held and the particular lender's relative exposure to the borrower from time to time. The SPV's obligation to the lender is in turn guaranteed and indemnified by the borrower. The SPV is usually managed by one of the members of the lending group or consortium (as the case may be).

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

There will be no special requirements to make the loan and guarantee enforceable by Lender B so long as Lender A had the right to cede its rights under both the loan agreement and the guarantee without any further formalities.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

There is a withholding tax on the remittance of interest payments to a foreign entity. In general, and subject to any Double Taxation Avoidance Agreement that may be in place, payments of interest to non-residents are subject to a 15% withholding tax. Payment of interest to a resident are subject to a 10% withholding tax.

There are no requirements to deduct or withhold tax from proceeds from a payment under a guarantee or the enforcement of a security.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax or other incentives for foreign lenders specifically. Tax incentives provided to foreign investors are in respect of the International Financial Services Centre, which offers tax and other benefits to investors (both domestic and foreign) that seek to set up Botswana companies that will provide financial services outside of Botswana. The term "financial services" has been widely construed and includes International Business Companies (IBCs). These IBCs are companies that cut across sectors and have operations/projects in several Sub-Saharan countries and are typically structured as Investment Holding companies or Regional Head quarter operations.

The following table summarises the tax advantages of the Botswana IFSC:

Tax	Botswana IFSC Company	Other Companies
Capital Gains Tax	Exempt	15%
Withholding Tax	Exempt	15%
Corporate Tax Rate	15%	22%
Value Added Tax	Zero-rated	12%

Other tax incentives are offered to companies established in Botswana that are involved in the manufacturing and/or export sectors. In addition to this, Botswana has entered into a network of DTAAs that

© Published and reproduced with kind permission by Global Legal Group Ltd, London

reduce the tax withheld in Botswana on remittances to companies in those jurisdictions. DTAAs are in place with the following countries at present: Barbados; China; France; India; Lesotho; Mozambique; Namibia; the Russian Federation; the Seychelles; South Africa; Swaziland; Sweden; the United Kingdom; Zambia; and Zimbabwe. DTAAs with at least nine other countries are in various stages of negotiation.

Taxes: There are no taxes that apply to foreign investments, loans, mortgages or other security documents specifically for the purposes of effectiveness or registration. Withholding taxes on the remittances of interest have been discussed above.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Outside of the withholding tax considerations on interest payments, the income of a foreign lender will not become taxable in Botswana solely because of a loan to, or guarantee or grant of security from, a company in Botswana.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are no costs that pertain to foreign lenders that would not apply to local lenders. The main costs are around registration and notarial fees of security such as notarial bonds, mortgage bonds and Deeds of Hypothecation.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there will be no such consequences for the borrower.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Choice of foreign law and jurisdiction clauses are upheld by the courts in Botswana. Where the law of a foreign jurisdiction is chosen, the court will require expert evidence on the foreign law to be applied, but in the event that no expert evidence is adduced before the court as to the effect of the foreign law, the court will determine the dispute the between the parties in terms of Botswana law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The Judgments (International Enforcement) Act CAP 11:04 of the Laws of Botswana allows for the enforcement of foreign judgments in Botswana where reciprocal treatment is given to Botswana judgments in that country. The President must declare by statutory instrument in the Gazette the countries deemed to give reciprocal treatment to Botswana judgments.

However, there are no Orders made pursuant to this Act that have been published in the Laws of Botswana in recent years, as to which countries are recognised as giving reciprocal treatment to orders of the Botswana Courts, there is only a published order relating to reciprocal countries in respect of maintenance orders. However, the Act also recognises those countries that were recognised as affording reciprocal treatment under the United Kingdom Judgments Act that was in force in 1981, prior to commencement of the Botswana Act.

There is, in addition, a procedure at common law whereby a fresh application for summary judgment is brought before the High Court. The foreign judgment is then submitted as evidence in a hearing that hears the matter afresh before the High Court of Botswana. Certain conditions must, however, be satisfied by a litigant who proposes to take advantage of that procedure. The main points to be satisfied are that the judgment must be final and conclusive. In addition, all documents necessary to prove the judgment must be in order and the judgment relied upon as a cause of action should be annexed to the application. A Botswana court order is thus obtained and can be executed.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) The answer to question 7.1 is yes, and the estimated timeline to obtain and enforce the judgment is anywhere from three weeks to three months where there is no legal defence.

(b) Enforcement of a foreign judgment can take anywhere from one month if the procedure in statute is followed, to up to three months if the matter is to be heard afresh. Where matters are brought on urgency time periods can be reduced for obtaining the order, enforcement proceedings by way of a sale in execution will take a further few weeks.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Botswana law does not recognise self-help when it comes to enforcement of security, and all real security must be enforced through the courts where an order for a public auction will be sought. This procedure can result in delay and the value of the asset that is being secured may differ significantly upon a forced sale.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

There are no such restrictions.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Court blocking procedures are available upon presentation of the petition for winding up of a company, by the company itself or any shareholder or creditor. Once the winding up by court has commenced no execution or attachment order for the enforcement of collateral security may be made. The same applies upon a petition to place the company under judicial management.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes, the Recognition of Foreign Arbitral Awards Act CAP 06:02 of the Laws of Botswana provides that an arbitral award made in any country which is a party to the Convention on Recognition and Enforcement of Foreign Arbitral Awards shall be binding and may be enforced in Botswana in accordance with the Convention and in such manner as an award may be enforced under the provisions of the Arbitration Act. This means that on application to the High Court, a foreign arbitral award (as with a local award) may be made an order of the Court.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Once winding up or judicial management proceedings have commenced, a secured creditor cannot commence enforcement or attachment proceedings, and a creditor holding moveable or immoveable property as security cannot realise that security itself, but must deliver it to the liquidator for realisation. Secured creditors are paid out before other creditors and will be paid in respect of the realisation proceeds of the sale of the asset that is the subject of the security, after the deduction of liquidation costs. The creditor is responsible for those costs, which represent the costs of maintaining, conserving and realising the property. Where secured creditors have security over the same asset, the creditor granted security earlier in time has a higher-ranking claim in respect of that asset. Secured creditors include holders of a mortgage bond, deed of hypothecation, cession in security and pledge. A notarial bond does not afford secured creditor status, merely a preference in respect of the free residue.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In respect of suspect periods and clawback rights, the liquidator may challenge the following type of transaction, and apply to the court to have these transactions set aside:

(a) Transactions at undervalue: where in a period of one year before the commencement of the winding up, the company entered into a transaction where the value of the consideration or benefit received by the company was less than the value of the consideration provided by the company or the company received no consideration or benefit, and when the transaction was entered into, the company:
   - (i) was unable to pay its due debts;
   - (ii) was engaged or about to engage in business for which its financial resources were unreasonably small; or
   - (iii) incurred an obligation knowing that the company would not be able to perform the obligation when required to do so; and
   - (iv) when the transaction was entered into the other party to the transaction knew or ought to have known of whichever of the above applies. Or where the company entered into a transaction as for above, but where because of the transaction, the company became unable to pay its debts.

(b) Voidable preferences: where within six months before the commencement of winding up proceedings, the company made a disposition and immediately after the disposition, the liabilities of the company exceeded its assets (unless the person to whom the disposition was made proves it was done so in the ordinary course of business and did not prefer one creditor over another).

(c) Undue preferences: where on any disposition, notwithstanding any number of years having passed between the disposition and the commencement of winding up proceedings, the company's liabilities exceeded its assets, and the disposition was made with the intention of preferring one creditor over another.

(d) Collusive practices: where within three years of the commencement of proceedings to wind up the company, a transaction was entered into by the company, and the transaction was for either inadequate consideration in respect of a disposal, issue of shares to or provision of services to a director or other related party, or where the transaction was for excessive consideration in respect of an acquisition or the provision of services by the director or related party.

(e) Where a transaction that is proved by the liquidator to be at undervalue or as a result of collusive practices, the liquidator may recover from any other party to the transaction any amount by which the value of the consideration provided by the company exceeded the value of the consideration received by the company.

(f) Where a liquidator has proved a voidable or undue preference, the transaction will be set aside and the court may order any one or more of the following orders: an order requiring a person to pay to the liquidator in respect of benefits received by that person as a result of the transaction or charge such sums as fairly represent those benefits; an order requiring property transferred as part of the transaction to be restored to the company; an order requiring property to be vested in the company where such property represents either the proceeds of sale of property or of money which has been paid and transferred where such property or money is in the hands of the person against whom the transaction or charge is set aside; an order releasing in whole or in part a charge given by the company; an order requiring security to be given for the discharge of an order made under this section of the Companies Act; and/or an order specifying the extent to which a person affected by the setting aside of a transaction or by an order made under this provision is entitled to claim as a creditor in the liquidation.

There are preferential creditors' rights such as the costs of the liquidator in administering the estate, the claims of employees for up to three months' unpaid salaries and the claim of the Commissioner of Taxes for unpaid taxes. These are paid after the secured creditors but before any preferred creditors in respect of the free residue and concurrent creditors.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

There are no entities that are explicitly excluded from bankruptcy proceedings; however, many statutory corporations are protected from bankruptcy through a *de facto* guarantee from the government.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No, please see the response to question 7.4 above.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, it is.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, it is.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licensing requirements for lenders in this jurisdiction (save that micro lenders need to be licensed with the Non-Bank Financial Institutions Regulatory Authority, as do any finance and leasing companies that are not licensed banks).

Banks are licensed with the Central Bank: the Bank of Botswana, and it is the deposit taking activity that attracts the duty to be licensed as a bank. As the activity of lending itself (apart from the two instances noted above) does not attract a licensing requirement, there are no consequences for a non-bank lender making a loan in this jurisdiction.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

No, the central issues have been discussed above.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Shakila Khan

Khan Corporate Law
5th Floor, North Wing, Exponential Building
Plot 54351, New CBD
Gaborone
Botswana

Tel: +267 3911 694
Email: shakilakhan@kcl.co.bw
URL: www.kcl.co.bw (from May 2016)

Shakila Khan is a corporate attorney practising in Botswana. She is the Lead Attorney and Sole Proprietor of Khan Corporate Law. Shakila is a citizen of Botswana and was called to the Bar of England and Wales in 2004. She has an LL.M. from the University of London with a special emphasis on law and development issues, and was admitted as an Attorney of the High Court of Botswana in 2007.

Shakila's practice areas include corporate mergers and acquisitions, debt and equity capital markets, structured finance, banking and financial services regulation, competition law, general corporate/commercial law, mining, energy and infrastructure.

KHAN CORPORATE LAW
RESULTS DRIVEN

Khan Corporate Law ("KCL") is a boutique corporate law firm in Botswana that focuses on providing legal services to banking and finance institutions, corporate advisory firms, large corporates, multinationals, private equity funds, the government and parastatals.

KCL has handled some significant transactions since it was established and as a result, domestic and international market recognition for its strengths continues to grow. Shakila Khan has been ranked in the *Chambers Global* guide since 2013, and is the first female lawyer from Botswana to be recognised as a leading lawyer in this prestigious guide. Shakila was again recognised as a "leader in her field" in *Chambers Global 2014* and has moved up the rankings to be listed in Band 2 in *Chambers Global 2015*.

Khan Corporate Law has been endorsed as a Recognised Firm in the *International Financial Law Review (IFLR1000) Petroleum Economist: Energy and Infrastructure Guide (2014)* and Shakila Khan has been endorsed as a "Rising Star Lawyer" in the same Guide. Shakila Khan has since been endorsed as a "Leading Lawyer" in the *IFLR1000 Petroleum Economist: Energy and Infrastructure Guide (2015)*.

Khan Corporate Law has been endorsed as a Recognised Firm in the *IFLR1000 Financial and Corporate Guide (2015)* and Shakila Khan has recently been recognised as a "Leading Lawyer" in the *IFLR1000 Financial and Corporate Guide (2016)*.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Brazil

Ricardo Simões Russo

Pinheiro Neto Advogados

Leonardo Baptista Rodrigues Cruz

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Brazil has a highly sophisticated financial system, with a set of detailed and specific rules and regulations that must be observed, on the one hand, by local lenders (banks and financial institutions) and creditors (investment funds, securitisation vehicles and market investors) and, on the other hand, by borrowers and/or issuers of debt instruments (in terms of disclosure rules, registration requirements, exposure regarding specific lenders, collateral creation requirements, among others).

Given a stable and promising economic scenario in the early 2000s, the level of debt incurred by local companies over the past 10 years doubled, reaching approximately R$1.7 trillion at the end of December 2015. Such growth in debt transactions was also verified due to the creation by the local government of a set of rules which provided better security to creditors such as: the creation of types of collateral with a more expeditious foreclosure proceedings (fiduciary sale/assignment of immovable and movable assets); better clarification on the rules governing extrajudicial and in-court debt reorganisations; the creation of new debt instruments better evidencing credit transactions (such as banking credit notes – *cédulas de crédito bancário* – and banking financial notes – *letras financeiras*); and the enactment of incentives for the use of the local capital markets for the private funding of local companies (through the issuance of debentures, for instance).

During such period, an increase of lending/credit transactions was verified in a number of local market segments, including: typical commercial lending transactions, the proceeds of which being used for the short-/medium-term cash needs of local companies; foreign currency denominated bond offerings, implemented by companies whose revenues are indexed to foreign currency (such as agribusiness and the oil & gas sector, as well as large exporters); and syndicated loan transactions (local and international lenders), in which short-term debt of local companies was converted into long-term ones with better conditions.

Given the shortage of infrastructure in Brazil, the local government is promoting a number of public bids to try to bring local and foreign private investors to manage a number of infrastructure sectors, including energy generation and transmission, renewable energy projects, state and federal highways, ports, airports, logistics and urban mobility, among others. The funding needs of such long-term infrastructure projects is being provided not only by the local federal Exim bank (BNDES), but also by private banks (granting of bank guarantees and bridge loans) and the local capital markets (in this regard, a specific debt instrument was created by the government in 2011 – infrastructure debentures – which granted tax exemptions to local and foreign investors).

As from 2013, the crisis affecting emerging markets globally had a relevant impact on the Brazilian economy which was evidenced in a decrease in lending transactions and a rise in interest rates, promoting a scenario in which lenders became more selective and companies began to try to renegotiate previous transactions (as opposed to entering into new debt).

Currently, given the present economic scenario, local lending markets are: implementing structures aimed at providing credit transactions with more attractive interest rates (such as capital markets transactions, with comprehensive collateral packages); renegotiating or exchanging lending transactions that will mature within a short-/medium-term period; and using mechanisms or implementing structured transactions that may have a lower impact in the debt obligations of local companies (such as securitisation transactions). This scenario is expected to be verified when the local economy becomes more stable.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Recently, certain relevant lending transactions were completed in the local markets, such as: the issuance of US$2.5bn centennial bonds by Petrobras (June 2015); issuances of infrastructure debentures in the local market (energy company EDP – Energias do Brasil issued approx. R$900m on October 2015; local gas distribution company Comgas issued approx. R$650m on December 2015); the private international credit transaction granted by China Development Bank Corporation to local company Telemar/Oi, in the amount of US$1.2bn on December 2015; financial transactions to electricity distributors totalled R$20.1 billion (in 2014 and 2015).

For the near future, in the infrastructure sector only, it is expected that over the next five years an amount of approximately R$70bn to R$100bn will be needed by local companies given their long-term financial needs.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes. Pursuant to Brazilian laws and regulations, there is no limitation for a company to guarantee borrowings of one or more other members of its corporate group.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

There are no enforceability concerns if all the required corporate approvals (as required by the companies' by-laws or articles of association) are in place. Brazilian law defines personal guarantees, such as surety (*fiança)* as an accessory personal obligation which depends on a main obligation to which it is bound. If the main obligation ceases to exist, the *fiança* will not endure.

It is important to bear in mind, however, that such guarantees are usually granted without any consideration to be received by the guarantor and, in the event that a guarantor were to become insolvent or subject to a reorganisation proceeding (*recuperação judicial ou extrajudicial*) or to bankruptcy, the guarantees, if granted up to two years before the declaration of bankruptcy, may be deemed to have been fraudulent and declared void, based upon such guarantor being deemed not to have received fair consideration in exchange for its guarantee.

2.3 Is lack of corporate power an issue?

Yes. In order to execute a legal, valid and enforceable guarantee, the representative of the guarantor, executing the appropriate document, must have all corporate powers, pursuant to the company's by-laws or articles of association and power-of-attorney, otherwise the guarantee can be declared null and void.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Generally, depending on the amount of the guarantee, it will be necessary to obtain approval from a shareholders' or management's meeting of the company, pursuant to its by-laws or articles of association.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No. The amount of a guarantee can be established freely by the parties.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no specific exchange controls for the enforcement of a guarantee. Brazilian exchange controls are focused on remittances from and to Brazil, registering such remittances on the Brazilian Central Bank's system. Additionally, it is worth noting that remittances abroad can only be made by financial institutions.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under Brazilian law, collateral arrangements (*in rem* guarantees) are usually created by either a pledge (*penhor*), a fiduciary sale/assignment (*alienação/cessão fiduciária*) or a mortgage (*hipoteca*).

A pledge is an *in rem* guarantee and consists of the delivery of transferable movable property by a debtor (or by a third party on his behalf) to its creditor (or to the creditor's representative) in guarantee of the debt. It is important to note that a pledge generally requires *tradição*, i.e., the actual physical transfer of possession of the asset from the pledgor to the pledgee. A pledge creates a lien on movable property upon delivery thereof by the pledgor to the pledgee, with the express understanding that the asset shall be retained solely as security for a certain debt. Accordingly, the pledgee has the right to retain possession over the pledged asset, but it is not allowed to create any other type of interest over it. The pledge does not transfer title over the assets to the pledgee.

The fiduciary sale/assignment is a type of security interest pursuant to which the debtor assigns to the creditor the title to ("*resolutory property*") and the "*indirect possession*" of a certain asset, holding, therefore, only its physical possession (or "*direct possession*"). The debtor has direct possession of the property and is liable for the duties of a bailee, or a trust, in relation to it. The debtor will have full title and indirect possession of the asset back when he has fulfilled all of its obligations under the guaranteed credit (that is why the title of the creditor is called "*resolutory property*"). Such guarantee mechanisms have the effect of transferring to the creditor title to certain fungible movable assets (fiduciary sale) or to certain fungible rights over movable assets (fiduciary assignment), as the case may be.

Mortgage is an *in rem* guarantee lying over real estate granted by a debtor (or by a third party on its behalf) in favour of its creditor to secure payment of a relevant debt.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Pledge and *alienação/cessão fiduciária* agreements and deeds of mortgages are formal documents which must comply with certain requirements for purposes of the perfection of the security interest created thereby, having specific formalities for each type. In this sense, the relevant security documents must, generally: (i) be in writing; (ii) be executed by both creditor and debtor and attested by two witnesses; (iii) contain, at a minimum, information pertaining to the amount, maturity and interest rate (whenever applicable) of the underlying obligation, as well as a description (including particulars) of the collateral; and (iv) be registered with the appropriate Brazilian Public Registry of the domicile of the debtor (e.g., the Registry of Deeds and Documents in the case of common pledges and of *alienação/cessão fiduciária* and the Real Estate Registry in case of mortgages or *alienação fiduciária* of real estate properties). Registration is a mandatory requirement for the perfection of the security interest.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Please refer to the answers to questions 3.1 and 3.2 above.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, it is possible to take a collateral security over receivables, pursuant to Brazilian law. The collateral is usually formalised through a fiduciary assignment of the receivables, together with a fiduciary assignment over the accounts that will receive such receivables. As for the procedure, please refer to the answer to question 3.2 above.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, it is possible to take a collateral security over cash deposited in bank accounts, pursuant to Brazilian law. The collateral is usually formalised through a fiduciary assignment over the accounts. As for the procedure, please refer to the answer to question 3.2 above.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, it is possible to take a collateral security over shares/quotas in companies incorporated in Brazil. The most common type of collateral over shares is *alienação fiduciária*. As the *alienação/ cessão fiduciária* transfers the ownership of the shares to the creditor, the creditor, in general, will have priority in case of insolvency of the debtor, as provided by the Brazilian Bankruptcy Law. The creation of the security interest over shares is evidenced by formal documents which must comply with certain requirements for purposes of the perfection of the security interest created thereby. In this sense, the security documents must, generally: (i) be in writing; (ii) be executed by both creditor and debtor (as well as by the custodian, as the case may be) and attested by two witnesses; (iii) contain, at a minimum, information pertaining to the amount (either the exact, estimate or maximum amount), maturity and interest rate (whenever applicable) of the underlying obligation, as well as a description (including particulars) of the collateral; and (iv) be registered with the Registry of Deeds and Documents of the domicile of the debtor and creditor.

In addition to registration before the Registry of Deeds and Documents, the security interest of registered shares is only created and perfected when the security interest is duly noted in the Share Registry Book. In order to be valid in Brazil, security interests over shares held in custody with the stock exchange or other agent must be duly registered in such system.

As regards quotas of limited liability companies, the most common type of collateral is pledge. Such collateral is usually registered through an amendment to the company's articles of association and filing of the respective quota pledge agreement before the Registry of Deeds and Documents.

In Brazil, shares are not usually issued in certificated form, despite the fact that the Brazilian Corporations Law allows such issuances. Shares are commonly issued as book entry records in the share registry book of the company issuer of the shares or registered with a bookkeeping entity.

Considering that the abovementioned type of collaterals are Brazilian types of collateral, the agreements creating such liens must be governed by Brazilian law; nevertheless, the main agreement, with terms and conditions of the credit being secured, can be governed by New York or English law.

Finally, it is worth mentioning that since January 2016, BM&FBOVESPA has been operating a new collateral system over shares of publicly held companies. Such new system enhanced the foreclosure procedures of collateral over shares of publicly held companies.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, it is possible to take security over inventory. For the procedures involved, please refer to the answer to question 3.2 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, under Brazilian law, a company can grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility. It is worth mentioning that a thorough analysis of the company's by-laws or articles of association is required in order to assess, for each specific company, what are the required corporate approvals.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Usually, regardless of the type of assets being given as collateral, the registration fees (either for the Real Estate Registry or Registry of Deeds and Document) involve a percentage of the amount being secured by the collateral, limited to a cap. There are also notarisation fees; nevertheless, neither the notarisation nor the registration fees vary according to the region the competent registry is located.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The period for registering security over different types of assets can vary from one to 30 days if there are no requirements made by the competent registry. Please note that registrations before the Real Estate Registry take longer than before the Registry of Deeds and Documents. It is also worth noting that registrations before registry offices located in smaller cities may take longer.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally, no regulatory or similar consent is required with respect to the creation of securities, except for companies that operate in regulated business such as energy, telecoms, etc., which may need authorisation from the regulatory agencies regulating such sectors.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No. The amount secured will always be the amount (or maximum amount) established on the respective agreement that formalises the collateral.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

No particular documentary or execution requirements are needed, with the exception of mortgages which must be made through a public deed. It is also worth mentioning that if the agreements are in the English language they must be translated into Portuguese before

© Published and reproduced with kind permission by Global Legal Group Ltd, London

being registered. If the document is executed abroad, in order to be registered in Brazil, it must be notarised and legalised by the nearest Brazilian consulate of the place of execution. However, Brazil is about to adopt the apostille system in the next few months.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Until 2015, there was an overall restriction for publicly held companies becoming (by means of succession – i.e. merger) a debtor of financial obligations initially incurred by its controlling shareholder. Since June 2015, this restriction is no longer applicable.

(b) Shares of any company which directly or indirectly owns shares in the company

Generally, there are no restrictions for this hypothetical situation. However, please note the following: (i) it is not uncommon to find provisions in by-laws that prevent corporations from giving guarantees or security for the benefit of third parties; and (ii) in case the so-called company (guarantor) is a Brazilian financial institution, insurance company or pension plan corporation, there could be a restriction depending on the amount of equity interest held by the beneficiary of the collateral/guarantee in the guarantor. Basically, such entities are not allowed to extend loans or give guarantees/security for the benefit of certain persons (e.g. controlling shareholders and managers).

(c) Shares in a sister subsidiary

The same comments mentioned in item (b) above apply to this item. Also, generally, publicly held companies shall not offer collateral to secure obligations of a third party, especially if such third party is in any way related to the controlling shareholder of the said publicly held company.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

As lenders are not the direct beneficiaries of collateral agreements, should the lenders unilaterally file a lawsuit in Brazil to enforce the security interests created thereunder, it could be alleged that, by not being direct beneficiary under the collateral agreements, such party does not have legitimacy (*legitimidade*) to file a lawsuit and, if such allegation prevails, the lenders would not be able to enforce their security interest in courts on a unilateral basis. However, we understand that there are good arguments to sustain that the onshore collateral agent (trustee) has legitimacy (*legitimidade*) to represent the lenders, and any successor in lawsuits against the borrower and the guarantor, if the onshore collateral agent (trustee) is appointed as such by the lenders in the financing document governed by a foreign law.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Please refer to the answer to question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Unless there is an express prohibition in the loan agreement, credit assignments are valid under the laws of Brazil so long as the debtor is notified of the assignment. Generally, the collateral agreement is deemed as an ancillary obligation of the loan agreement (main obligation), which means that when the latter is assigned the former is assigned too. From a practical perspective, it is advisable to amend both the loan agreement and respective collateral document with the names of the new debtor/guarantor to simplify the enforcement and avoid disputes on formal issues.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) Interest payable by a Brazilian debtor to a foreign lender is generally subject to the withholding of income tax at a rate of 15% or 25% if the creditor is located in a blacklisted low-tax jurisdictions as defined in the applicable regulations. Interest payable by a Brazilian debtor to a local lender is also generally subject to the withholding of the income tax (not applicable to financial institutions) based on a regressive rates regime that varies from 22.5% to 15% according to the days elapsed since the loan was granted and the payment date. Note that, in this case, the tax withheld will be deemed a payment in advance of the corporate income tax locally due by the lender (at a general 34% rate for corporations and at a current 45% rate for financial institutions).

(b) The proceeds of a claim under a guarantee or enforcing security shall observe the same rules above, that is, the interest component paid by the lender would be subject to taxation, whereas principal should not be impacted by taxes. Other taxes may apply to either onshore and offshore loans transactions, although not under a withholding systematic.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

One can highlight that cross-border loans whose proceeds are destined to the financing of Brazilian exports benefit from the 0% withholding income tax on interest. Offshore fundraising executed by means of

© Published and reproduced with kind permission by Global Legal Group Ltd, London

the issuance of the so-called infrastructure debentures also benefit from the 0% rate of the withholding income tax, provided certain requirements are met. On top of that, certain tax treaties entered into by Brazil with other jurisdictions also provide a beneficial tax treatment for interest income paid out to foreign lenders.

Moreover, another tax advantage of foreign lender regards to the different treatment of the Tax on Financial Transactions in these cases. In effect, as a general rule onshore loans with principal previously defined by the parties are impacted by the assessment of the Tax on Financial Transactions ("IOF/Credit"), which is generally levied at a daily 0.0041% rate, capped to 365 days, plus a flat 0.38%, thus leading to a combined 1.88% rate for transactions older than one year. On the other hand, cross-border loans, whose average maturity term is set for a term longer than 181 days, benefit from the 0% rate of the so-called IOF/FX – another modality of the Tax on Financial Transactions, which is triggered upon the execution of inbound/outbound FX transactions. However, the IOF/FX rate is increased to 6% if the loan average maturity term is lower than 181 days. Please note that FX transactions executed in connection with the payment of principal and interest by a Brazilian debt under a cross-border loan benefit from the 0% rate of the IOF/FX. Cross-border loans are not subject to the IOF/Credit.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

As a general rule, no, since Brazilian tax rules concerning permanent establishments do not encompass cross-border lending transactions.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No. The tax impact to foreign lenders is generally limited to the withholding tax on income derived from the loans.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Under Brazilian tax regulations, certain tax constraints in respect to the tax-deductibility of interest expense at the level of the Brazilian debtor may apply, if the foreign lender is: (a) a related party to the Brazilian borrower; or (b) located in a blacklisted (tax haven) or greylisted (privileged tax regime) low-tax jurisdiction. Such tax limitations may apply due to (a) thin capitalisation, and (b) transfer pricing regulations.

Pursuant to current thin capitalisation rules, interest paid by sources located in Brazil to individuals or legal entities resident abroad will only be deductible for corporate tax purposes (IRPJ/CSL) if: (i) the debt with a related party (not located in a blacklisted jurisdiction) does not exceed two times the net equity of the Brazilian borrower (if the debt exceeds the threshold, the interest assessed on the excess amount will not be deductible); or (ii) the debts with entities located in a blacklisted jurisdiction does not exceed 30% of the net equity value of the legal entity resident in Brazil (if the debt exceeds the threshold, the interest assessed on the excess amount will not be deductible).

Cumulatively, one should also observe transfer pricing limits for the tax-deductibility expense arising from interest payments made to foreign lenders that are a related party to the borrower or located in black/greylisted jurisdictions. Under transfer pricing rules, depending on certain features of the relevant cross-border loan agreement, different tax-deductibility thresholds based on the interest of the contract shall apply: (i) for transactions denominated in US dollars at a fixed rate, the market rate for Brazilian government bonds issued in the foreign market, also in US dollars, will be adopted, plus a 3.5% spread; (ii) for transactions denominated in BRL at a fixed rate, the market rate for Brazilian government bonds issued in the foreign market in Brazilian Reais will be adopted, plus a 3.5% spread; and (iii) in other cases, the six-month LIBOR will be adopted, plus a 3.5% spread.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, Brazilian courts would recognise a foreign governing law in an agreement, provided that such law does not offend Brazilian national sovereignty, public policy or good morals.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

If any final judgment of a court outside Brazil is rendered, such judgment would be recognised and enforced by the courts in Brazil without any retrial or re-examination of the merits of the original action, provided that it is ratified (*homologado*) by the Superior Court of Justice of Brazil (*Superior Tribunal de Justiça*), such ratification (*homologação*) only occurs if the following procedures are observed: (i) the judgment complies with all formalities necessary for its enforcement under the laws of the place where it was rendered and with the legal requirements of the jurisdiction of the court rendering such judgment; (ii) the judgment has been given by a competent court after the proper service of process on the parties, or after sufficient evidence of the party's absence has been given as established pursuant to applicable law; (iii) the judgment is not subject to appeal; (iv) the judgment does not offend Brazilian national sovereignty, public policy or good morals; and (v) the judgment has been duly authenticated by a competent Brazilian consulate and is accompanied by a sworn translation thereof into the Portuguese language.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In Brazil it is very difficult to predict how long it takes for a court to render a decision over a lawsuit, as it varies between each city and, even in the same court, varies between each judge; nevertheless, it

© Published and reproduced with kind permission by Global Legal Group Ltd, London

is possible to estimate that, on average, in case of (a) above, it would take between two and three years and, in case of (b) above, around two years.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

As regards pledges and fiduciary sale/assignment, if the debtor defaults pursuant to the security documents or the main agreement, the trustee owner, security trustee or creditor should notify him of the delay (through a simple registered letter, by a registered letter issued by the Registry of Deeds and Documents or bill of protest) and may sell the assets to third parties, irrespective of public sale, auction or any other judicial or extrajudicial measure.

As regards mortgages, in case the debtor defaults under the debt, in the absence of an insolvency scenario, the foreclosure proceeding for mortgages shall be the following: (i) upon default, the debtor is summoned to pay the debt plus interest, monetary correction, court costs and attorneys' fees within the cure period determined by the relevant security agreement. If the debtor does not perform its payment obligations within said period, the attached property shall be foreclosed; (ii) the next step is the appraisal of the attached property; (iii) at this stage, the creditor may opt for adjudication (i.e. judicially transferring the asset's property and possession to the creditor) of the property for the value of appraisal (if the appraisal amount is lower than debt amount, the creditor would still have an unsecured claim over the remaining amount); (iv) if the creditor does not opt for adjudication, the next step is the out-of-court sale; (v) the out-of-court sale shall take place through two public auctions: (a) in the 1st public auction, real estate property must be sold by at least its appraisal value; or (b) in the 2nd public auction real estate property must be sold by at least a fair (*non-vile*) amount; (vi) if the property is not sold in the first and second auctions a new option of adjudication of the property by creditor may be determined (at the discretion of the court); and (vii) no "mutual release" event is verified in mortgage foreclosures. Thus, if upon the sale of the real estate property or its adjudication the debt amount is not totally repaid to the creditor, the creditor still has an unsecured claim against the debtor for the remaining amounts due under the credit transaction (and other guarantees may be foreclosed).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

Any plaintiff not resident in Brazil will be required to place a bond as security for court costs and for third party attorneys' fees if it does not possess any real property in Brazil, except in case of collection claims based on an instrument that may be enforced in Brazilian courts without review of its merits (*título executivo extrajudicial*) or counterclaims.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Within the context of bankruptcy proceedings, there is an automatic stay which derives from the decision which actually declares the bankruptcy. In this sense, bankruptcy declaration stays the course for all judicial actions and enforcements against the guarantor. Accordingly, to the extent bankruptcy proceedings – in principle – attach to all the guarantor's creditors, the secured party holding the collateral will be affected by the automatic stay of bankruptcy proceedings. In this scenario, the assets constituting the collateral will not be delivered to the secured party for payment of the secured debt. More significantly, the secured party will not be able to take any legal action to enforce and liquidate the collateral. The assets given in collateral will be gathered by the trustee for subsequent liquidation and payment of creditors that eventually hold a privilege or preference.

Within the context of judicial reorganisation proceedings, the automatic stay derives from the court decision that grants the processing of the judicial reorganisation application filed by the guarantor. Granting of the judicial reorganisation proceedings stays the course for all legal actions and enforcements proceedings against the guarantor related to all creditors subject to/affected by the judicial reorganisation proceedings. Under no circumstances can the automatic stay in judicial reorganisation proceedings exceed 180 days.

Within the context of extra-judicial reorganisation proceedings, the mere filing of such procedure does not entail the suspension of any court proceedings against the guarantor.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Please refer to the answer to question 7.2.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Under judicial reorganisation, upon the filing, the Court will eventually accept the filing and grant the processing order ("Processing Order"). As a result of the Processing Order, the debtor enjoys a stay period of 180 calendar days ("Stay Period"). During the Stay Period, all actions, enforcement and foreclosure proceedings against the debtor are generally stayed (or cannot be commenced). The Stay Period is designed to provide the debtor with breathing room to formulate, negotiate and eventually obtain creditors' support and approval of a Plan of Reorganisation. During the Stay Period, creditors holding collateral in the form of a fiduciary lien (a bankruptcy-remote collateral) are not entitled to remove the respective asset from the debtor's possession in case such asset is deemed to be essential to the debtor's activities.

Further, in case bankruptcy liquidation is adjudicated, as a rule all assets should be scheduled by the court-appointed trustee to be subsequently sold. Creditors holding securities in the form of a fiduciary lien should be entitled to remove the respective asset from the bankrupt estate through the filing of a claim for restitution, as the case may be.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The Brazilian Bankruptcy Law ("BBL") regulates scenarios where antecedent transactions are deemed ineffective or voidable. Indeed, certain specific acts and contracts performed under a statutory period

© Published and reproduced with kind permission by Global Legal Group Ltd, London

before the adjudication of the debtor's bankruptcy liquidation (*falência*) are considered ineffective. Further, acts performed with the intent to hinder or defraud creditors may also be declared null and void.

Section 129 of the BBL establishes that certain acts performed during a claw-back (look-back) period (*termo legal*) shall be declared ineffective in relation to the estate. The claw-back can generally retroactively apply up to 90 days prior to: (a) the filing of a bankruptcy liquidation (involuntary) request by debtor's creditor; (b) the filing for court-protection under judicial reorganisation (in case judicial reorganisation has been subsequently converted into bankruptcy liquidation proceedings); or (c) outstanding protest of a debtor's title due to lack of payment.

Ineffectiveness declaration should apply regardless of whether the involved parties were aware of the financial condition of the debtor or had the intention to defraud creditors. The following actions (*inter alia*), if consummated during the claw-back period, shall be considered objectively ineffective: (i) payment of unmatured obligations (i.e. preferred payment); (ii) payment of matured obligations in a different manner than originally established by the parties in the relevant contracts; and (iii) creation of collateral (security) to secure an existing unsecured debt. The transfer of substantially all of a debtor's assets shall also be ineffective if consummated without consent or payment of all creditors existing at the time of the transfer.

In addition, transactions implemented before or after debtor's bankruptcy liquidation adjudication (including the implementation of a security) may be revoked through the filing of a claw-back lawsuit (*ação recocatória*) if they were performed fraudulently, irrespective if they were committed during the claw-back period. Indeed, section 130 of the BBL establishes that acts performed with the intent to defraud creditors may be revoked, provided there is evidence of (i) fraudulent collusion between the debtor and the contracting third party, and (ii) actual loss suffered by the estate.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The BBL (which regulates bankruptcy liquidation proceedings) does not apply to government-owned entities, mixed-capital companies, public or private financial institutions, credit unions, consortia, supplementary pension companies, healthcare plan companies, insurance companies and special saving companies.

Financial institutions' insolvency (except federal institutions) is regulated by Law No. 6,024/74, which contemplates the intervention and extrajudicial liquidation regimes. Ultimately, both the intervention and extrajudicial liquidation may be converted to bankruptcy liquidation as regulated by the BBL, as the case may be.

Other regulated entities, such as healthcare plan companies and insurance companies will follow insolvency proceedings as established before the respective regulatory framework, as applicable.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Although certain types of fiduciary lien collaterals may be foreclosed in an extra judicial basis, in a contested case a creditor should necessarily resort to in-court proceedings to seize and expropriate assets of the debtor in the context of an enforcement proceeding.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission of a party to the non-exclusive jurisdiction of a foreign jurisdiction is legal, valid and binding under the laws of Brazil and will be accepted by the Brazilian courts, subject to certain assumptions and qualifications.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Generally, no non-public owned entities have immunity from suit, proceedings, the enforcement of any judgment, any attachment or from any other legal process (whether on the grounds of sovereign immunity or otherwise) under Brazilian law in respect of their respective obligations under the pledge agreements.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Any individual or legal entity may enter into a loan agreement subject to certain interest limitation in case the lender is not a financial entity under the supervision of the Central Bank. Therefore, only financial entities have the authorisation to extend loans without pre-defined limits on interest rates. It is a criminal offence in Brazil to carry out any activity that is reserved exclusively for financial institutions. Generally, no specific requirements apply for agents (*trustees*) in syndicated facilities.

Treatment for corporate lending activities under Brazilian law is different depending on whether the transactions are domestic or made offshore.

If the corporate lending transaction is entered into by a Brazilian counterparty with an offshore financial institution, such transactions (direct foreign loans) shall observe Law No. 4131, of September 3, 1962, Brazilian Monetary Council Resolution No. 3.844, of March 23, 2010, and Central Bank Circular No. 3.491, of March 24, 2010.

Such regulations expressly allow legal entities located in Brazil to contract loans with legal entities located abroad. In this case, the funds raised abroad by Brazilian entities should be necessarily invested in "economic activities", although the regulations have not defined such a concept. It is, however, generally understood that such funds obtained abroad should not be used for speculative purposes in Brazil.

Considering that, as long as the loan is contracted in accordance with the applicable regulation, it will not constitute the carrying on of the business of banking in Brazil, nor will it subject the lender (or any of its affiliates) to any oversight by the Brazilian regulatory authorities.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Apart from that mentioned herein, loan transactions do not require any approval from, or notice to, any Brazilian regulatory authority. However, it is important to mention that although no physical documents are involved in the Central Bank registration process, the Brazilian debtor shall keep the loan agreement (and guarantees, if any) in its files for five years as from the date when the loan is granted.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are no further considerations that need to be mentioned.

Acknowledgment

The authors would like to thank Luiz Felipe Fleury Vaz Guimarães, associate at Pinheiro Neto, for his invaluable assistance in the preparation of this chapter.

Ricardo Simões Russo
Pinheiro Neto Advogados
Rua Hungria, 1100
01455-906
São Paulo – SP
Brazil

Tel: +55 11 3247 8720
Email: rrusso@pn.com.br
URL: www.pinheironeto.com.br

Ricardo Simões Russo is a partner in Pinheiro Neto Advogados' corporate department, practising in the São Paulo office. He advises corporate and investment banking clients on public and private financing transactions, securities offerings and listings, and M&A transactions, with particular experience in financing and restructuring transactions. He also provides advice on corporate governance matters and corporate and securities law and regulation. Ricardo is acknowledged as having built a prominent reputation in both the DCM and private financing markets and has been recognised as a leading corporate finance lawyer by a number of industry publications.

Leonardo Baptista Rodrigues Cruz
Pinheiro Neto Advogados
Rua Hungria, 1100
01455-906
São Paulo – SP
Brazil

Tel: +55 11 3247 8656
Email: lcruz@pn.com.br
URL: www.pinheironeto.com.br

Leonardo Baptista Rodrigues Cruz is a senior associate in Pinheiro Neto Advogados' corporate department, practising in the São Paulo office. He advises corporate and investment banking clients on banking regulation, corporate finance and M&A transactions. He also provides advice on corporate governance matters and securities law regulation.

PINHEIRONETO
ADVOGADOS

Credibility, innovation and commitment are the hallmarks of Pinheiro Neto Advogados. Since 1942, through its commitment to excellence, the firm has played a prominent role in shaping the Brazilian legal and economic scenario. Pioneering and world-class services have made Pinheiro Neto Advogados one of the leading full-service law firms in Latin America, highly specialised in the four major areas of law – Corporate, Tax, Labour and Litigation – and their branches. With a network of 800 professionals, including around 400 lawyers, offices in São Paulo, Rio de Janeiro and Brasília, and correspondents throughout Brazil, the firm maintains a solid relationship with major international law firms. Named Latin American Firm of the Year in 2013 by the Global edition of *Chambers & Partners*, Pinheiro Neto Advogados has also been awarded Brazilian Firm of the Year (2009 and 2011) and Latin American Firm of the Year (2009, 2010 and 2014) by its Latin American edition. Pinheiro Neto Advogados was also named Brazil Firm of the Year for the 10th consecutive year (2006 through 2015) by *Who's Who Legal*.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

British Virgin Islands

Michael Gagie

Matthew Gilbert

Maples and Calder

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The British Virgin Islands continues to be a jurisdiction of choice for corporate vehicles entering into secured finance transactions, and remains a markedly creditor-friendly jurisdiction. In January 2016, amendments to the key corporate legislation, the BVI Business Companies Act (as amended) (the "**Act**") have enhanced the protection of secured creditors. For example, where a British Virgin Islands company wishes to continue/redomicile to another jurisdiction and there are charges registered over the property of the company, a written declaration must be provided to the Registrar of Corporate Affairs (the "**Registrar**") that the company will either: (i) discharge the charge; (ii) obtain the consent of secured creditor; or (iii) certify to the Registrar that the chargee's interest will not be diminished or compromised by the continuation. On a liquidation, the liquidator now has an express statutory obligation to give effect to the rights and priority of the claims of the company's secured creditors. In line with commercial practice, the amendments to the Act have also provided greater flexibility and certainty for the execution of deeds, which from a practical perspective will assist virtual closings. The amendments to the Act also tightened record-keeping obligations on companies. Also in 2016, the jurisdiction has implemented the OECD Common Reporting Standards.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

British Virgin Islands obligors continue to feature prominently in financed holding structures and joint ventures, notably: in the oil and gas and mining sectors; in development finance and infrastructure projects throughout Africa, Asia and Eastern Europe, CIS, Latin America and elsewhere; in high end property developments in London; and in shipping, drillships and other asset finance facilities.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

The giving of a guarantee by a British Virgin Islands company is governed by the Act, and the company's memorandum and articles of association. Subject to its memorandum and articles of association, the powers of a company include (among other things) the power to guarantee a liability or obligation of any person and secure any obligations by mortgage, pledge or other charge of any of its assets for that purpose.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Under the Act, and subject to its memorandum and articles of association, a company has, irrespective of corporate benefit, full capacity to carry on or undertake any business or activity, do any act or enter any transaction and, for those purposes, full rights, powers and privileges.

The directors of a company have fiduciary and statutory duties to act honestly and in good faith and in the best interests of the company. A director who is in breach of his duties may be liable to the company for the resulting loss to the company.

In the event that there is a disproportionately small (or no) benefit to the company, the transaction may be open to challenge, for example as a transaction at an undervalue, in the event of the insolvency of the company (see below).

2.3 Is lack of corporate power an issue?

Under the Act, no act of a company and no transfer of an asset by or to a company is invalid by reason only of the fact the company did not have the capacity, right or power to perform the act or to transfer or receive the asset.

It should be noted that members' remedies have been codified in the Act, and, for example, if a company or a director of a company engages in, proposes to engage in, or has engaged in conduct that contravenes the Act or the memorandum or articles of the company, the British Virgin Islands court may, on the application of a member or a director of the company, make an order directing the company or director to comply with, or restraining the company or director from engaging in conduct that contravenes, the Act or the memorandum or articles.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

It is not necessary to ensure the legality, validity, enforceability or admissibility in evidence of a guarantee that any document be filed,

© Published and reproduced with kind permission by Global Legal Group Ltd, London

recorded or enrolled with any governmental authority or agency or any official body in the British Virgin Islands. Shareholder approval would be required only in the event that the company's memorandum and articles of association require it.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

To the extent that under the applicable governing law the guarantee is characterised as a debt incurred on behalf of a member of the company, it may be deemed to be a distribution and accordingly be subject to the requirement on the directors to determine that the company will pass the basic solvency test immediately after the deemed distribution. Under the solvency test, the company's assets must exceed its liabilities and the company must be able to pay its debts as they fall due. For former International Business Companies that still have a share capital, the requirements for satisfying the solvency test differ.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There is no exchange control legislation under British Virgin Islands law and accordingly there are no exchange control regulations imposed under British Virgin Islands law.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are no limits under British Virgin Islands law on the types of collateral that a company may give.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A company may enter into a general security agreement such as a debenture.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

It should be noted that assets would typically be held outside the British Virgin Islands and collateral instruments would typically be governed by a governing law relevant to the jurisdiction in which the asset is sited. In the event that the company holds an interest in real estate or other assets physically located in the British Virgin Islands, there are certain licensing, registration and stamp duty considerations.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

British Virgin Islands law does not make statutory provision for an assignment by way of security. An assignment of receivables governed by British Virgin Islands law would require the written agreement of the debtor in order to take effect as a legal assignment, failing which the assignee would likely take an equitable assignment only.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A company may give security over cash held in its bank accounts in any jurisdiction. British Virgin Islands law does not make statutory provision for collateral security over cash deposited in bank accounts located in the British Virgin Islands, and the cooperation of the account holding branch would be required.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Collateral security may be taken over shares in companies incorporated in the British Virgin Islands and this is a popular and frequently used type of security. Such security can validly be granted under a foreign law-governed document, and New York or English law-governed security is common. In the case of an English law-governed document, the application of the Financial Collateral Arrangements (No 2) Regulations 2003 to shares in a British Virgin Islands company has been confirmed by the Privy Council in *Cukurova Finance International Limited and Cukurova Holdings A.S (Appellants) v Alfa Telecom Turkey Ltd (Respondent)* [2013] UKPC 2. Shares are in registered form and share security is typically taken by way of an equitable mortgage. The Act provides a mechanism for particulars of a charge over shares to be noted on the register of members, a copy of which the company may file publicly at the Registry of Corporate Affairs in order for a person carrying out a company search to be on notice of the equitable security. The Act now enables a chargee to enforce immediately upon an event of default. The Act also provides for the powers of the chargee or a receiver which may be modified or supplemented by the security instrument.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

A company may give security over inventory. The applicable procedure would be driven by the jurisdiction in which the inventory is located.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Subject to its memorandum and articles of association, a company may grant a security interest to secure its obligations as a borrower, or the obligations of others.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No steps are required as a matter of British Virgin Islands law to perfect a security interest where assets are not located in the British Virgin Islands. It is a requirement of the Act that a company keep a register of all relevant charges created by the company, either at the company's registered office, or at the office of the company's

© Published and reproduced with kind permission by Global Legal Group Ltd, London

registered agent. For the purposes of priority, an application may be made to the Registrar to register the charges created, providing an advantage to secured creditors that is not available in some offshore jurisdictions. Subject to such registration, and any prior security interests registered on the applicable register, the security interest will, as a matter of British Virgin Islands law, have priority over any claims by third parties (other than those preferred by law) including any liquidator or a creditor of the company, subject in the case of a winding up of the company in a jurisdiction other than the British Virgin Islands to any provisions of the laws of that jurisdiction as to priority of claims in a winding up. A floating charge will rank behind a subsequently registered fixed charge unless the floating charge contains a prohibition or restriction on the power of the company to create any future security interest ranking ahead in priority to or equally with the floating charge.

No taxes, fees or charges (including stamp duty) are payable (either by direct assessment or withholding) to the government or other taxing authority in the British Virgin Islands under the laws of the British Virgin Islands in respect of the execution or delivery, or the enforcement, of security documentation. In the event that the company holds an interest in real estate or other assets physically located in the British Virgin Islands, there are certain perfection, licensing, registration and stamp duty considerations.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The Registry fee for registering a register of charges is US$100. A small amount of time will be required for the preparation of the particulars at the registration.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No, they are not.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

No, there are not.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Subject to its memorandum or articles, the powers of a company include the power to give financial assistance to any person in connection with the acquisition of its own shares.

(b) Shares of any company which directly or indirectly owns shares in the company

There are no restrictions on the giving of financial assistance to any person in connection with the acquisition of shares of any company which directly or indirectly owns shares in the company.

(c) Shares in a sister subsidiary

There are no restrictions on the giving of financial assistance to any person in connection with the acquisition of shares in a sister subsidiary.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The British Virgin Islands courts will recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders, where that is provided for pursuant to the provisions of the applicable security documentation.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not necessary in the British Virgin Islands.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

This would be dependent on the applicable governing laws of the loan and the assignment documentation. British Virgin Islands law does not make statutory provision for the assignment of intangibles. An assignment of receivables governed by British Virgin Islands law would require the written agreement of the debtor in order to take effect as a legal assignment, failing which the assignee would likely take an equitable assignment only. A deed of novation would more typically be used to transfer a loan governed by British Virgin Islands law.

6 Withholding, Stamp and other Taxes; Notarial and other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

No taxes are required to be deducted or withheld under the laws of the British Virgin Islands from (a) interest payable on loans made to

© Published and reproduced with kind permission by Global Legal Group Ltd, London

domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security. The British Virgin Islands complies with the EU Taxation of Savings Directive through the automatic exchange of information on savings income with tax authorities in EU Member States.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No taxes are payable to the government or other taxing authority in the British Virgin Islands under the laws of the British Virgin Islands in respect of the execution or delivery, or the enforcement, of security documentation. In the event that the company holds an interest in real estate or other assets physically located in the British Virgin Islands, there are certain perfection, licensing, registration and stamp duty considerations.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

No income of a foreign lender will become taxable in the British Virgin Islands solely because of a loan to, or guarantee and/or grant of security from, a company in the British Virgin Islands.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are no significant costs such as notarial fees which would be incurred by foreign lenders in a loan to or guarantee and/or grant of security from a company in the British Virgin Islands.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The British Virgin Islands courts will recognise a governing law that is the law of another jurisdiction, subject to the considerations applicable generally to choice of law provisions.

The British Virgin Islands courts may decline to exercise jurisdiction in relation to substantive proceedings brought under or in relation to a contract that has a foreign governing law in matters where they determine that such proceedings may be tried in a more appropriate forum.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Any final and conclusive monetary judgment obtained against a company in the courts of England and Wales, for a definite sum, may be registered and enforced as a judgment of the British Virgin Islands court if application is made for registration of the judgment within 12 months or such longer period as the court may allow, and if the British Virgin Islands court considers it just and convenient that the judgment be so enforced. Alternatively, the judgment may be treated as a cause of action in itself so that no retrial of the issues would be necessary. In either case, it will be necessary that in respect of the foreign judgment:

(a) the foreign court issuing the judgment had jurisdiction in the matter and the judgment debtor either submitted to such jurisdiction or was resident or carrying on business within such jurisdiction and was duly served with process;

(b) the judgment given by the foreign court was not in respect of penalties, taxes, fines or similar fiscal or revenue obligations of the company;

(c) in obtaining judgment there was no fraud on the part of the person in whose favour judgment was given, or on the part of the foreign court;

(d) recognition or enforcement of the judgment in the British Virgin Islands would not be contrary to public policy;

(e) the proceedings pursuant to which judgment was obtained were not contrary to natural justice; and

(f) the judgment given by the foreign court is not the subject of an appeal.

Any final and conclusive monetary judgment obtained against a company in the courts of New York, for a definite sum, may be treated by the British Virgin Islands courts as a cause of action in itself so that no retrial of the issues would be necessary provided that in respect of the foreign judgment:

(a) the foreign court issuing the judgment had jurisdiction in the matter and the company either submitted to such jurisdiction or was resident or carrying on business within such jurisdiction and was duly served with process;

(b) the judgment given by the foreign court was not in respect of penalties, taxes, fines or similar fiscal or revenue obligations of the company;

(c) there was no fraud on the part of the person in whose favour judgment was given or on the part of the court, in obtaining judgment;

(d) recognition or enforcement of the judgment in the British Virgin Islands would not be contrary to public policy; and

(e) the proceedings pursuant to which judgment was obtained were not contrary to natural justice.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

There is no set timetable for such proceedings, and the time involved will depend on the nature of the enforcement proceedings

© Published and reproduced with kind permission by Global Legal Group Ltd, London

(for example, an application to appoint liquidators on the ground of insolvency may be quicker than an action to judgment on the debt claim). If there is no defence to the claim and it is unopposed, judgment may be obtained in proceedings against a British Virgin Islands company in approximately one month from the commencement of proceedings. If the proceedings are defended, then the time involved will depend upon the facts and circumstances of the case. Broadly the same considerations apply to an application to enforce a foreign judgment in the British Virgin Islands.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

No, there are not.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

There are no restrictions applicable to foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The appointment of liquidators against a company under the BVI Insolvency Act, 2003 (2013 Revision) (the "**Insolvency Act**") brings about a moratorium on claims against the company, but this does not prevent the enforcement of security.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The Arbitration Act 2013 came into force on 1 October 2014. The principal change from the previous position is that United Kingdom and British Virgin Islands arbitral awards will now be treated in the British Virgin Islands as New York Convention awards. The British Virgin Islands is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the "**Convention**"). A court in the British Virgin Islands is required by law to enforce, without re-examination of the merits of the case or re-litigation of the matters arbitrated upon, a Convention award. However, enforcement of a Convention award may be refused if the person against whom it is invoked proves:

(a) that a party to the arbitration agreement was, under the law applicable to him, under some incapacity;

(b) that the arbitration agreement was not valid under the law to which the parties subjected it or, failing any indication thereon, under the law of the country where the award was made;

(c) that he was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case;

(d) that the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration or contains decisions on matters beyond the scope of the submission to arbitration;

(e) that the composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties or failing such agreement, with the law of the country where the arbitration took place; or

(f) that the award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, it was made.

Enforcement of a Convention award may also be refused if the award is in respect of a matter which is not capable of settlement by arbitration under the laws of the British Virgin Islands, or if it would be contrary to public policy to enforce the award.

A Convention award which contains decisions on matters not submitted to arbitration may be enforced to the extent that it contains decisions on matters submitted to arbitration which can be separated from those on matters not so submitted.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Security over the assets of a company in liquidation may be enforced by the chargee directly over those assets, which fall outside the custody and control of the liquidator.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In the event of the insolvency of a company, there are four types of voidable transaction provided for in the Insolvency Act:

1. Unfair Preferences: Under section 245 of the Insolvency Act, a transaction entered into by a company, if it is entered into within the hardening period (see below) at a time when the company is insolvent, or it causes the company to become insolvent (an "**insolvency transaction**"), and which has the effect of putting the creditor into a position which, in the event of the company going into insolvent liquidation, will be better than the position it would have been in if the transaction had not been entered into, will be deemed an unfair preference. A transaction is not an unfair preference if the transaction took place in the ordinary course of business. It should be noted that this provision applies regardless of whether the payment or transfer is made for value or at an undervalue.
2. Undervalue Transactions: Under section 246 of the Insolvency Act, the making of a gift or the entering into of a transaction on terms that the company is to receive no consideration, or where the value of the consideration for the transaction, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company will (if it is an insolvency transaction entered into within the hardening period) be deemed an undervalue transaction. A company does not enter into a transaction at an undervalue if it is entered into in good faith and for the purposes of its business and, at the time the transaction was entered into, there were reasonable grounds for believing the transaction would benefit the company.
3. Voidable Floating Charges: Under section 247 of the Insolvency Act a floating charge created by a company is voidable if it is an insolvency transaction created within the hardening period. A floating charge is not voidable to the extent that it secures:
   (a) money advanced or paid to the company, or at its direction, at the same time as, or after, the creation of the charge;
   (b) the amount of any liability of the company discharged or reduced at the same time as, or after, the creation of the charge;

© Published and reproduced with kind permission by Global Legal Group Ltd, London

(c) the value of assets sold or supplied, or services supplied, to the company at the same time as, or after, the creation of the charge; and

(d) the interest, if any, payable on the amount referred to in (a) to (c) pursuant to any agreement under which the money was advanced or paid, the liability was discharged or reduced, the assets were sold or supplied or the services were supplied.

4. Extortionate Credit Transactions: Under section 248 of the Insolvency Act, an insolvency transaction entered into by a company for, or involving the provision of, credit to the company, may be regarded as an extortionate credit transaction if, having regard to the risk accepted by the person providing the credit, the terms of the transaction are or were such to require grossly exorbitant payments to be made in respect of the provision of the credit, or the transaction otherwise grossly contravenes ordinary principles of fair trading and such transaction takes place within the hardening period.

The hardening period (known in the Insolvency Act as the vulnerability period) in respect of each voidable transaction provision set out above is as follows:

(a) for the purposes of sections 245, 246 and 247 of the Insolvency Act, the period differs depending on whether the person(s) that the transaction is entered into with, or the preference is given to, are connected persons of the company within the meaning of the Insolvency Act. In the case of connected persons the hardening period is the period beginning two years prior to the onset of insolvency (see below) and ending on the appointment of a liquidator of the company. In the case of any other person, the hardening period is the period beginning six months prior to the onset of insolvency and ending on the appointment of a liquidator of the company; and

(b) for the purposes of section 248 of the Insolvency Act, the hardening period is the period beginning five years prior to the onset of insolvency and ending on the appointment of a liquidator of the company regardless of whether the person(s) that the transaction is entered into with is a connected person.

The onset of insolvency for these purposes is the date on which an application for the appointment of a liquidator was filed (if the liquidator was appointed by the Court) or the date of the appointment of the liquidator (where the liquidator was appointed by the members).

A conveyance made by a person with intent to defraud creditors is voidable at the instance of the person thereby prejudiced. There is no requirement that the relevant transaction was entered into at a time when one party was insolvent or became insolvent as a result of the transaction, and there is no requirement that the transferring party subsequently went into liquidation. However, no conveyance entered into for valuable consideration and in good faith to a person who did not have notice of the intention to defraud may be impugned.

There are limited preferential creditors under British Virgin Islands law.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Certain sovereign entities and treaty-based organisations are protected. For example, the State Immunity (Overseas Territories) Order 1979 extended the State Immunity Act 1978 to the British Virgin Islands, and the International Finance Corporation Order 1955 extends to the British Virgin Islands.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Enforcement of a charge over the shares in a British Virgin Islands company could be effected without recourse to the courts, where the necessary documentation has been provided by the chargor, the issuer company and the registered agent prior to the date of enforcement. As stated above, the remedy of appropriation that may be contained in an English law-governed share charge has been upheld by the Privy Council as applicable to shares in a British Virgin Islands company.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The British Virgin Islands courts will recognise that a foreign jurisdiction may be the more appropriate forum for enforcement.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A relevant entity may waive immunity pursuant to the State Immunity Act 1978.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Assuming that the lender is not doing business in the British Virgin Islands, it will not be caught by the regulatory legislation, or requirements for licensing, in the jurisdiction. Significantly, business is not carried on "in the British Virgin Islands" by a lender by reason only of it being carried on with a company or limited partnership incorporated or registered in the British Virgin Islands.

There is no distinction between a lender that is a bank *versus* a lender that is a non-bank.

In the unlikely event that, based on the facts of a specific scenario, a foreign lender is found to be carrying on business in the British Virgin Islands without holding the requisite licence, the loan may be unenforceable by the lender.

As above, assuming that the agent is not conducting business in the British Virgin Islands, there are no licensing and eligibility requirements for an agent under a syndicated facility.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The British Virgin Islands is a dependable common law jurisdiction, and other attractions for lenders not mentioned above include, for example, the statutory recognition of netting, set off and subordination arrangements, and the ability for a creditor to restore a dissolved company where it is just to do so.

Michael Gagie
Maples and Calder
1 Raffles Place
#32-02A One Raffles Place
048616, Singapore

Tel: +65 6922 8402
Fax: +65 6222 2236
Email: michael.gagie@maplesandcalder.com
URL: www.maplesandcalder.com

Michael Gagie is the global head of the BVI law practice of Maples and Calder and Managing Partner of the Singapore office. Michael practises both BVI and Cayman Islands law and his experience and areas of practice cover corporate, downstream private equity work, commercial, banking and structured finance. Michael is ranked as a leader in his field in *Chambers Global* and *IFLR1000*.

Matthew Gilbert
Maples and Calder
11th Floor, 200 Aldersgate Street
London EC1A 4HD
United Kingdom

Tel: +44 20 7466 1608
Fax: +44 20 7466 1700
Email: matthew.gilbert@maplesandcalder.com
URL: www.maplesandcalder.com

Matthew Gilbert is a partner in the London office of Maples and Calder. He is the head of the firm's BVI team in London, and advises on finance, banking and corporate law matters involving BVI companies and partnerships, including public and private mergers and acquisitions; partnerships and joint ventures; debt and equity financings; and project, real estate and asset financing. Matthew specialises in the listing of BVI companies on international stock exchanges, including the London Stock Exchange/AIM, Tel Aviv Stock Exchange, NASDAQ and Toronto Stock Exchange. Matthew also advises on BVI insurance and regulatory law. Matthew is ranked as a leader in his field in *Chambers UK* and is recommended in *The Legal 500* and *Chambers Global*.

MAPLES

With almost 50 years in the industry and over 800 staff, Maples and Calder is a leading international law firm advising global financial, institutional, business and private clients on the laws of the Cayman Islands, Ireland and the British Virgin Islands.

Maples and Calder is known worldwide for the quality of its lawyers. This extensive experience, the depth of the team and a collegiate approach are main characteristics of the firm, enabling it to provide the highest quality legal advice on a wide range of transactions.

Maples and Calder offices are located in the British Virgin Islands, Cayman Islands, Dubai, Dublin, Hong Kong, London and Singapore. The service provided is enhanced by the strong relationships the firm has developed. For fiduciary and fund services requirements, the firm provides a seamless "one stop shop" capability through its affiliate, MaplesFS.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Canada

Jeff Rogers

Don Waters

McMillan LLP

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Canadian banks have been widely recognised internationally as well-capitalised, well-managed and well-regulated, and a major contributing force in the Canadian economy, remaining healthy and strong despite the international financial crisis. The lending market in Canada is characterised by a wide range of domestic banks, pension funds, credit unions and insurance companies, as well as major foreign banks and finance companies, offering a range of commercial lending services and financial products on par with those offered anywhere else in the world. In 2015, the Bank of Canada twice lowered its overnight rate in response to challenges to the resource sector of the Canadian economy and a sluggish retail sector that saw the exit of Target from Canada. The chartered banks' prime rates followed, although they notably lowered their rates by a lesser amount. With continued active participation by US and other foreign lenders, the Canadian lending market remained very competitive and lending margins remained tight throughout North America. The year 2015 also saw General Electric Capital continue the disposition of its finance businesses including the following and their respective Canadian businesses: (i) the sale of its sponsor finance business to CPPIB for $12 billion; (ii) its $26 billion real estate finance business to Blackstone and Wells Fargo; (iii) its proposed $8.7 billion transportation finance business to Bank of Montreal; and (iv) its proposed $32 billion commercial lending and leasing business to Wells Fargo.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

One of the largest finance transactions in 2015 was the Ontario government's $1.83 billion initial public offering of 15% of its shares in Hydro One, Ontario's largest transmission and distribution company, which was accompanied by new $1 billion syndicated revolving term credit facilities. In addition, despite weakness in a number of sectors of the economy, lending to both the infrastructure and real property space remained very active in 2015. The Government of Canada procured the design, build, finance, operation, maintenance and rehabilitation of the Champlain Bridge in Montreal which was financed by a $4.2 billion secured syndicated financing and bond issuance – the then largest infrastructure financing in North America to date. Meanwhile, Northern Property Real Estate Investment Trust financed the largest multifamily real estate acquisition to date in Canada under a $325 million senior secured term facility. In 2014, the Canadian market also saw the first issuance of "green bonds", including an issuance of green bonds to finance the North Island Hospitals Project in the province of British Columbia – the first green bonds issuance to fund a public-private partnership project in North America.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, it can.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In some circumstances, the enforceability of a guarantee could be challenged by stakeholders on the basis that it was granted in a manner that was oppressive, unfairly prejudicial or that unfairly disregards the interest of creditors or minority shareholders under the oppression provisions of applicable corporate legislation. A guarantee could also be subject to challenge under provisions of applicable insolvency legislation dealing with transactions at under value or preference claims. Directors and officers would only be subject to personal liability in such cases if specific facts were pleaded to justify such a remedy (e.g. wrongdoing).

2.3 Is lack of corporate power an issue?

If the guarantor is a corporation, it must have the corporate power and capacity to give guarantees. Most business corporations have the powers and capacity of a natural person and it is unusual to see restrictions on the power to issue guarantees in the guarantor's constating documents. However, certain corporations created by statute for a public purpose (such as school boards) may still be subject to the doctrine of *ultra vires* and therefore may require express legislative authority to give guarantees.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Other than typical corporate authorising resolutions, no formal approvals are generally required. Where a corporation provides

© Published and reproduced with kind permission by Global Legal Group Ltd, London

financial assistance by way of guarantee or otherwise, in some provinces the corporation is required to disclose the financial assistance to its shareholders after such assistance is given.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Not for corporations incorporated federally or under the laws of most provinces. However, the corporate laws in a few Atlantic Provinces and in the territories continue to prohibit financial assistance to members of an intercompany group if there are reasonable grounds to believe that the corporation would be unable to meet prescribed solvency tests after giving the assistance, subject to specific exceptions.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, subject to the provisions of applicable Canadian federal money laundering and anti-terrorism legislation.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Most types of personal property and real property are available to secure lending obligations, subject to certain limitations by contract (e.g. contractual restrictions on assignment) or by law (e.g. government receivables, permits, licences and quotas).

Provincial legislation generally governs the creation and enforcement of security. All Canadian provinces (except Québec) have adopted comprehensive personal property security acts (PPSAs) conceptually similar to Article 9 of the United States *Uniform Commercial Code* (UCC). The PPSAs govern the creation, perfection and enforcement of security interests in a debtor's personal property, and create a scheme for determining the priority of competing interests in the same collateral. The PPSAs applies to any transaction that in substance creates a security interest in personal property, regardless of the form of document used to grant the interest.

Québec, Canada's only civil law jurisdiction, has a European style Civil Code (the *Civil Code of Québec*) that governs the creation and enforcement of security on movable (personal) and immovable (real) property.

Certain types of property continue to be subject to additional federal registration and filing regimes (examples include intellectual property and assets in shipping, aircraft and railways). The federal *Bank Act* also has a special security regime available as an option available only to licensed banks for certain classes of debtors and collateral.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A general security agreement (GSA) can be and often is used to grant security over all of the debtor's present and after-acquired personal property of every type and description. Separate agreements are not required for each type of asset. The GSA or other security agreement must contain a description of the collateral sufficient to enable it to be identified. However, a GSA typically does not extend to real property and separate requirements apply to registration and documentation of security against land, as described under question 3.3 below.

In most cases, the secured party perfects the security interest by registering a financing statement under the PPSA filing regime in the applicable province. Where the financing statement should be registered depends on the type of collateral. In general, security interests in most tangible personal property are registered in the province in which they are located at the time of attachment. Security interests in most intangibles and certain types of goods normally used in more than one jurisdiction must be registered in the province in which the debtor is deemed to be located under the relevant debtor location rules. Except in Ontario, a debtor with multiple places of business is deemed to be located at its "chief executive office". Under amendments to Ontario's PPSA that came into force on December 31, 2015, most debtors are deemed to be located in the jurisdictions in which they were incorporated or organised, similar to the more generally applicable debtor location rules under Article 9 of the UCC.

The hypothec, Québec's only form of consensual security, may be granted by a debtor to secure any obligation, and may create a charge on existing and after-acquired movable (personal) or immovable (real) property. It may be made with or without delivery, allowing the grantor of the hypothec to retain certain rights to use the property.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

A lender may take collateral security over land or real property by way of a mortgage of the land, a mortgage of lease, a debenture, or, if the real property charged is in Québec, an immovable deed of hypothec. Interests in real property are registered in the land registry system of the relevant province. In Québec, the immovable hypothec is usually registered by a Québec notary in accordance with applicable formalities.

It should be noted that a higher rate of interest on amounts in arrears secured by a real estate mortgage may be unenforceable under the *Interest Act* (Canada).

The procedure for taking security over plant, machinery and equipment that constitutes personal property under the PPSA or movables under the *Civil Code of Québec* is described in question 3.2 above.

Personal property may include "fixtures" (goods that become affixed to real property) but if the security interest has not attached prior to affixation, the creditors registered against the land gain priority, with limited exceptions. What constitutes a fixture is a factual question and the common law has taken a contextual approach. To protect the priority of its interest in a fixture, a secured party must both 1) perfect its security interest under the PPSA, and 2) register its interest in the land registry system. Under the *Civil Code of Québec*, the rules for determining what constitutes movable or immovable property are different – but the end results are comparable.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. The procedure for taking security over receivables is the same as described in question 3.2 above.

Notice to account debtors is not required to create a perfected security interest in accounts receivable under the PPSA. However, account debtors for the receivables are obligated to pay the receivable directly to the secured party only after receiving notice from the secured party that the receivable has been assigned to it.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

In addition, an absolute assignment of receivables constitutes a "security interest" regardless of whether it secures any obligations.

Under the *Civil Code of Québec*, an assignment of receivables must be registered to be set up against third parties (i.e. perfected) if the assigned receivables constitute a "universality of claims". If the receivables do not constitute a universality of claims, the assignment may be perfected with respect to Québec obligors only by actual notice of the assignment to such obligors.

Under Canadian federal legislation, subject to prescribed exceptions, receivables owed by the federal government can be assigned only absolutely (not as security) and only with appropriate notice to the government of Canada, which must be acknowledged. Some provinces have similar legislation covering receivables owed by the provincial government. In Canada, asset-based lenders frequently exclude government receivables from the borrowing base.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

The PPSA and *Civil Code of Québec* permit a lender to take security over deposit accounts. Under the PPSA, deposits in bank accounts are treated as receivables owed by the depository bank to the depositor and under the *Civil Code of Québec* as claims against the bank. Accordingly, security interests in deposit accounts are perfected by registering a financing statement in the province where the debtor is deemed to be located under the applicable debtor location rules (see question 3.2 above). Traditionally, a bank lender that maintained deposit accounts for its debtor and wished to take security in such accounts would do so by way of set off and a "flawed asset" approach. However, in light of recent Canadian case law, the lender should also register a PPSA financing statement against the debtor.

No PPSA jurisdiction has adopted control as a means of perfecting security interests in deposit accounts. However, as of January 1, 2016, certain amendments to the *Civil Code of Québec* came into force whereby it is now possible to perfect hypothecs over cash deposits in bank accounts (referred to as monetary claims) by "control". Where the creditor is also the account bank, the creditor obtains control by the debtor (i.e. the account holder) consenting to such monetary claims securing performance of its obligations to the creditor. Where the creditor is not the account bank, the creditor obtains control by either: (i) entering into a control agreement with the account bank and the debtor, pursuant to which the account bank agrees to comply with the creditor's instructions, without the additional consent of the debtor; or (ii) becoming the account holder.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

A security interest in shares issued by companies incorporated in any jurisdiction is typically documented by way of a standalone pledge agreement or included in a general security agreement. While the jurisdiction governing validity, perfection or non-perfection of the pledge will be determined under applicable conflict of laws rules, the security interest may be granted under a document governed by New York or English law, subject to the principles discussed in question 7.1 below.

Under the PPSA and the *Securities Transfer Act, 2006* (STA), versions of which are in force in most Canadian PPSA jurisdictions (harmonised legislation is in force in Québec), a secured party can perfect its security interest in shares by registering under the PPSA or by taking control under the STA (or both). An interest perfected by control has priority over one perfected only by registration.

Shares may be either certificated or uncertificated. For certificated shares, taking physical possession of the share certificates, together with a suitable endorsement, meets the STA requirement for control. For uncertificated shares, control is obtained by being registered as the shareholder. Control over securities held indirectly through securities accounts can be achieved by other means (for example, a control agreement with the relevant intermediary). In addition, a private company's constating documents must include a restriction on the right to transfer its shares. This restriction usually states that each transfer of the company's shares requires approval by the company's directors or shareholders.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. The procedure is the same as described in question 3.2.

The security interest may be perfected by registering a financing statement in the province or territory in which the inventory is situated at the time the security interest attaches, except that inventory of a type normally used in more than one jurisdiction that is leased or held for lease by the debtor to others requires registration in the province in which the debtor is deemed to be located.

The purchase of inventory is often financed by way of a purchase money security interest (or PMSI). A PMSI in collateral is, in substance, a security interest given by either the seller or a third party to finance the purchase of the collateral by the debtor. The PPSA provides that a PMSI in inventory and other types of collateral (other than investment property or its proceeds) has priority over any other security interest in the same collateral given by the same debtor (even if that other security interest was registered first) so long as certain timing and (and, in the case of inventory) third party notice requirements are satisfied. The *Civil Code of Québec* does not offer a comparable approach and subordination or cession of rank is required from any prior ranking secured creditor.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, it can.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Registration fees are payable in connection with the filing of PPSA financing statements, increasing with the length of the registration period.

A modest tax is payable upon registering real property security in certain Canadian jurisdictions. The tax is based on a fee and where the face amount of the registration exceeds the value of the lands, one is permitted to pay on the basis of a percentage of the property value.

No Canadian jurisdiction imposes stamp taxes or duties in relation to security. In Québec, if a notarial deed of hypothec is used, the notary will generally charge a fee for execution, keeping it in its notarial records and for issuing copies; however there is no additional material cost.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The registration requirements in most cases are relatively straightforward and inexpensive.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

For certain special types of regulated property, consents or approvals may be required by governmental authorities or agencies for both the creation and enforcement of security. Governmental licences, permits and quotas are subject to specific regimes requiring notice or consent in many cases. See question 3.4 regarding government receivables.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

A security interest and hypothec in personal property or movable property may secure both present and future advances under a revolving credit facility. Where future advances are made while a security interest is perfected, the security interest has the same priority with respect to each future advance as it has with respect to the first advance, with certain limited exceptions in favour of unsecured execution and other creditors that seize the collateral if the secured party makes the advance after receiving notice of their interests. A security interest in personal property is not automatically discharged by reason of the fact that the outstanding balance under a revolving line of credit has been paid down to zero and subsequently re-advanced.

Generally, advances on a real property mortgage made without actual notice of a subsequent claim will typically have priority over such subsequent claims and, accordingly, mortgages securing revolving credit normally provide that subsequent liens are prohibited. Certain priority exceptions apply such as in respect of construction liens. Real property mortgages securing revolving credit should be properly worded to address situations where the borrowing is fully or partially repaid and thereafter re-advanced.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In Québec, security over immovable property or in favour of a collateral agent on behalf of multiple secured parties (referred to as "hypothecary representative") requires execution of the deed of hypothec before an authorised Québec notary.

Each province has different requirements with respect to real property, including specific registration forms, evidence of corporate authority, affidavits and, in some jurisdictions, originals for registration.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Most Canadian corporations are not subject to such restrictions, except those created under the laws of a few Atlantic Provinces (New Brunswick, Prince Edward Island and Newfoundland) and the territories (the Northwest Territories, the Yukon and Nunavut).

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. The agency concept is recognised in Canadian common law and agents are commonly used in syndicated lending for both administration of loans and holding collateral security in Canada. Indenture trustees are typically used in public bond transactions.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

For purposes of holding collateral security in the province of Québec, the mechanism commonly used requires the appointment of the collateral agent as a "hypothecary representative", together with a notarial deed of hypothec in favour of such hypothecary representative.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Assignments of debt, guarantees and security can be effected by contract pursuant to a standard assignment and assumption agreement. Where the assignor is also the secured party of record (whether as collateral agent or otherwise), PPSA financing statements (and the Québec equivalent) are typically amended to record the assignment, although such amendments are not required for enforceability. Mortgage or security assignments are required to be filed under the applicable land registry to give effect to the assignment.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

There are generally no requirements to deduct or withhold tax on payments of interest by a debtor or guarantor (whether by voluntary payment, enforcement or otherwise) made to domestic lenders.

Conventional interest payments made to arm's length lenders that are non-residents of Canada are generally not subject to Canadian

© Published and reproduced with kind permission by Global Legal Group Ltd, London

withholding tax, regardless of their country of residence. In addition, conventional interest payments made to certain non-arm's length US resident lenders may qualify for an exemption from Canadian withholding tax under the Canada-US Tax Treaty. In the absence of these or other applicable exemptions under treaties or under the *Income Tax Act* (Canada), withholding tax on interest payments may apply at rates of up to 25%.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Generally, there is no material tax or other incentives provided preferentially to foreign investors or creditors and no taxes apply to security documents for the purposes of effectiveness or registration.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

While each lender's tax position must be examined individually, generally the non-resident lender's income should not be taxable in Canada solely because of a single secured loan transaction in the absence of a fixed presence in Canada or other connecting factors.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

(See questions 3.9 and 3.10 for the filing and notarial fees.) There are no stamp taxes, registration taxes or documentary taxes that are generally applicable in connection with authorisation, delivery or performance of loans, guarantees or security.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Thin capitalisation rules under the *Income Tax Act* (Canada) determine whether a Canadian corporation may deduct interest on the amount borrowed from a "specified non-resident shareholder" of the corporation or from a non-resident person who does not deal at arm's length with a "specified shareholder" (collectively "specified non-residents"). A "specified shareholder" of a corporation is, in general terms, a person who, either alone or together with persons with whom they do not deal at arm's length, owns 25% or more of the voting shares, or the fair market value of the issued and outstanding shares of the corporation.

Under the thin capitalisation rules, Canadian corporations are effectively prevented from deducting interest on the portion of loans from specified non-residents that exceeds one-and-a-half times the corporation's specified equity (in highly simplified terms, retained earnings, share capital and contributed surplus attributable to specified non-residents). In addition, any interest expenses that are disallowed under these rules are deemed to be dividends paid to the lender for non-resident withholding tax purposes, and subject to withholding tax.

The thin capitalisation rules also apply (with appropriate modifications) to (i) Canadian resident trusts, (ii) non-resident corporations or trusts that carry on business in Canada (in respect of loans that are used in the course of that Canadian business), and (iii) partnerships in which a Canadian resident corporation or trust or a non-resident corporation or trust is a member.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Subject to certain exceptions and conditions, Canadian courts will recognise and apply the parties' choice of governing law if it is specifically pleaded and proven by expert testimony.

Canadian courts will not apply the foreign law if the choice of law is not *bona fide* or is contrary to public policy or if so doing would be considered enforcement of foreign revenue, or expropriatory or penal law. Additionally, Canadian courts will apply Canadian procedural law and certain provincial and federal laws that have overriding effect, such as bankruptcy and insolvency statutes, federal crime legislation, employment legislation and consumer protection legislation.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A foreign monetary judgment may be enforced in Canada if the judgment is final and the foreign court properly assumed jurisdiction. As long as these requirements are met, a Canadian court will not examine whether the foreign court correctly applied its own substantive and procedural laws.

In considering the issue of jurisdiction, Canadian courts will apply their own principles of jurisdiction. Generally a contractual submission to the jurisdiction of the foreign court will be sufficient, but in the absence of such submission, the Canadian court will examine whether there was a "real and substantial connection" between the foreign court and the cause of action or the defendant. While the test is often applied generously and flexibly by the courts, a fleeting or relatively unimportant connection will not support a foreign court's assumption of jurisdiction.

There are certain limited defences which preclude recognition related to circumstances under which the foreign judgment was obtained (such as by fraud or in a manner breaching principles of natural justice) and whether there is any reason it would be improper or contrary to public policy to recognise the foreign judgment. In practice these defences rarely succeed.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) In Ontario, if no defence is filed in response to a claim, default judgment may be obtained between 20 and 60 days after the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

claim has been served on the defendant, depending on where the defendant is located. After any judgment is obtained, and subject to it being stayed by the filing of a notice of appeal, enforcement proceedings may be commenced immediately.

(b) An application hearing to enforce a foreign judgment in Ontario may generally be obtained within approximately two to three months.

Procedural and substantive law differs by province, but the timing described above is similar in most other provinces.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

A secured creditor must give the debtor reasonable time to pay following demand, before taking action to enforce against its collateral security (even if the debtor purported to waive these rights).

Where a secured creditor intends to enforce security over substantially all of an insolvent debtor's inventory, accounts receivable or other property used in relation to the debtor's business, in addition to delivering a demand, the secured creditor must also deliver a notice of intention to enforce security in the form prescribed under the *Bankruptcy and Insolvency Act* (BIA) at least 10 days before such enforcement, unless the debtor consents to an earlier enforcement.

If a secured creditor intends to deal with the collateral itself or through a privately appointed receiver (where applicable), it must also give advance notice to the debtor and other interested parties of its intention to dispose of the collateral or accept the collateral as final settlement of the debtor's obligations. This notice period is typically 15–20 days depending on the applicable PPSA and can run concurrently with the BIA enforcement notice.

Although there is no requirement for a public auction, a secured creditor (and any receiver) must act in good faith and in a commercially reasonable manner when selling or otherwise disposing of the collateral. However, if a lender wishes to buy the collateral, it may only do so at a public sale, unless otherwise permitted by a court. Generally speaking, no regulatory consents are required to enforce on collateral security.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

(a) To maintain an action in certain provinces, foreign lenders may be required to become extra-provincially registered.

(b) There are no specific restrictions on a foreign lender's ability to enforce security in Canada. However, if the lender chooses to exercise those remedies to either foreclose on the collateral security or to credit bid its debt, such that the foreign lender ends up owning the debtor's Canadian assets, the foreign lender may be subject to restrictions imposed by the *Investment Canada Act* or the *Competition Act*.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, a stay of proceedings may affect the rights of secured and unsecured creditors in some circumstances to the extent set out in question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Provincial arbitration acts provide for the enforcement of arbitral awards by application to the court. Canadian courts will not re-examine the merits of an arbitral award; however the award may be set aside on specified grounds including, but not limited to, an invalid arbitration agreement, an award outside of the jurisdiction of the arbitrator or a reasonable apprehension of bias on the part of the arbitrator.

The Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the *UNCITRAL Model Law on International Commercial Arbitration* have been adopted in all Canadian provinces and provide rules for the enforcement of international arbitral awards. Subject to limited grounds on which enforcement of an international arbitral award may be refused, the awards are generally enforceable in Canada.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy and insolvency in Canada are primarily governed by two federal statutes: the BIA; and the *Companies' Creditors Arrangement Act* (CCAA). The BIA provides a comprehensive liquidation scheme for companies and individuals, along with a streamlined reorganisation regime. The CCAA is Canada's large company reorganisation statute. Although some aspects of creditors' rights are determined by provincial statutes, bankruptcy and insolvency law is mostly uniform across Canada. Insolvency proceedings under the BIA or CCAA will result in the imposition of a stay of proceedings either by a Canadian court or pursuant to the relevant statute.

Under the BIA liquidation proceedings, the automatic stay of proceedings imposed upon commencement will not prevent a secured creditor from realising or otherwise dealing with its collateral. By contrast, in a court-appointed receivership (an alternative form of liquidation proceeding governed by the BIA), receivership orders routinely contain language staying the actions of secured creditors.

If a debtor files a notice of intention to make a proposal (NOI) or a proposal to creditors under the BIA (a reorganisation proceeding), a secured creditor's enforcement rights will be automatically stayed during the reorganisation proceeding, unless: (i) the secured creditor took possession of the collateral before the filing; (ii) the secured creditor delivered its BIA enforcement notice more than 10 days prior to the filing of the NOI; or (iii) the debtor consents to the secured creditor exercising its enforcement rights.

Reorganisation proceedings under the CCAA are commenced when an initial order is granted by the court. The CCAA explicitly empowers a court to grant a stay of proceedings against the debtor on any terms that it may impose. The stay provision in the CCAA initial order typically prohibits secured creditors from enforcing their security interests against the debtor's property during the proceeding.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

(a) *Preferential transactions*

Under the BIA and the CCAA, certain transactions, including the granting of security, the transfer of property and other obligations are

© Published and reproduced with kind permission by Global Legal Group Ltd, London

voidable if incurred during specified pre-bankruptcy time periods. Subject to certain conditions and exemptions, if such transactions are made with a view to giving one creditor a preference over others, they may be set aside if entered into during the period that is: (i) three months before the initial bankruptcy event for transactions at arm's length; and (ii) one year before the initial bankruptcy event for transactions not at arm's length.

Transfers of property (or services sold), in which the consideration the debtor receives is less than the fair market value, subject to certain other conditions and exemptions, may be set aside under the BIA or CCAA if entered into during the period that is: (i) one year before the initial bankruptcy event for transactions at arm's length; and (ii) five years before the initial bankruptcy event for transactions not at arm's length.

There is also provincial legislation providing for setting aside other fraudulent conveyances or preferential transactions.

(b) *Statutory priority claims*

In Canada, a number of statutory claims may "prime", or take priority over, a secured creditor. Priming liens commonly arise from a debtor's obligation to remit amounts collected or withheld on behalf of the government. Such amounts include unremitted employee deductions for income tax, government pension plan contributions, government employment insurance premiums and unremitted federal goods and services taxes, provincial sales taxes, municipal taxes and workers' compensation assessments. In Ontario, statutory deemed trusts may give rise to a priority claim for certain unpaid claims of employees, including a deemed trust arising upon wind-up of a defined benefit pension plan for any deficiency amounts. In addition, there are a number of statutes that create priming liens in specific industries (for example, repair and storage liens, construction liens and brokerage liens). These priming liens may attach to all of the property of the debtor. In some cases, the priority of statutory claimants and secured creditors is sometimes reversed by the commencement of an insolvency proceeding against the debtor.

(c) *Priority claims – insolvency*

An insolvency proceeding in respect of the debtor may give rise to a number of additional liens that would rank in priority to a secured creditor's claims.

The BIA provides employees of a bankrupt employer or an employer in receivership with a priority charge on the employer's "current assets" for unpaid wages and vacation pay (but not for severance or termination pay) for the six-month period prior to bankruptcy or receivership to a maximum of $2,000 per employee (plus up to $1,000 for certain travelling expenses). The priority charge ranks ahead of all other claims, including secured claims, except unpaid supplier rights.

The BIA also grants a priority charge in bankruptcies and receiverships for outstanding current service pension plan contributions, subject only to the wage earners' priority. The pension contribution priority extends to all assets, not just current assets, and is unlimited in amount.

The pension charge secures (i) amounts deducted as pension contributions from employee wages but not contributed to the plan prior to a bankruptcy or receivership, and (ii) amounts required to be contributed by the employer to a pension plan for "normal costs". The charge does not extend to unfunded deficits arising upon a wind-up of a defined benefit plan and should not include scheduled catch-up or special payments required to be made by an employer because of the existence of a solvency deficiency.

The CCAA and the reorganisation provisions of the BIA expressly prohibit a court from sanctioning a proposal, compromise or arrangement or a sale of assets, unless it is satisfied that the debtor has arranged to pay an amount equal to the amounts secured by the wage and pension priority charges discussed above.

(d) *Priority claims – court charges*

In CCAA and BIA reorganisations, debtors may obtain interim financing (often referred to as debtor in possession (DIP) financing). Both the CCAA and the BIA expressly authorise the court to grant fresh security over a debtor's assets to DIP lenders in priority to existing security interests up to a specified amount approved by the court.

In addition to the priming liens noted above, in a CCAA or BIA reorganisation, the court has the authority to order priming charges to secure payment of directors' post-filing liabilities and to secure the fees and disbursements of experts, court-appointed officials and certain other "interested parties" in the court's discretion. The court may also order priming charges to secure payment to designated "critical suppliers", typically restricted to securing payment for post-filing supply.

The priority of the DIP charge, directors' charge, expense charge and any critical supplier charge in respect of the debtor's assets is determined by the court.

(e) *Unpaid suppliers' rights*

The BIA provides certain unpaid suppliers with a right to repossess goods sold and delivered to a purchaser within 30 days before the date of bankruptcy or receivership of such purchaser. The unpaid supplier's right to repossess goods effectively ranks ahead of a secured creditor.

An unpaid supplier claim is rarely successful as the supplier has the burden of demonstrating that all requirements have been met, including: (i) that the bankrupt has possession of the goods; (ii) that the goods are identifiable; (iii) that the goods are in the same state; and (iv) that the goods have not yet been sold.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Banks (including the Canadian business of foreign banks authorised to do business in Canada), insurance companies and trust corporations are excluded from the BIA and CCAA and their wind up is governed by the *Winding-Up and Restructuring Act* (Canada). The BIA and CCAA also exclude railway and telegraph companies. However, in a recent case a court granted a railway company relief under the CCAA. Both the BIA and CCAA apply to income trusts.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Upon default, a secured creditor may exercise "self-help" remedies to take possession and control of collateral individually or through the appointment of a private receiver (if provided in its security documents). Secured creditors may also seek court appointment of an interim receiver to preserve and protect collateral on an expedited basis.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission by a party to the non-exclusive jurisdiction of the courts of a foreign jurisdiction should be recognised as valid,

© Published and reproduced with kind permission by Global Legal Group Ltd, London

provided that service of process requirements are complied with. The submission by a party to the exclusive jurisdiction of the courts of a foreign jurisdiction is generally recognised unless there is "strong cause" not to do so.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The *State Immunity Act* (Canada) governs sovereign immunity of foreign states and any separate agency of a foreign state (e.g. state trading corporations). Private corporations that are not "organs" of a foreign state are not entitled to sovereign immunity.

Sovereign immunity may be waived if the state or agency submits to the jurisdiction of the Canadian court by agreement, either before or after commencement of the proceedings. Sovereign immunity is subject to certain exceptions (e.g. commercial activities and property damage actions, terrorist activities and certain maritime claims).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no specific eligibility requirements for lenders solely as a result of entering into a secured lending transaction as lender or agent.

Under the *Bank Act* (Canada), a "foreign bank" is generally not permitted to engage in or carry on business in Canada except through a foreign bank subsidiary, an authorised foreign branch or other approved entity. A "foreign bank" is broadly defined in the Act and includes any foreign entity that (i) is a bank under the laws of a foreign country in which it carries on business or carries on business in a foreign country which would be considered the business of banking, (ii) provides financial services and uses the word "bank" in its name, (iii) is in the business of lending money and accepting deposit liabilities transferable by cheque or other instrument, (iv) provides financial services and is affiliated with a foreign bank, or (v) controls a foreign bank or a Canadian bank.

However, the *Bank Act* would not prohibit a foreign bank from making a loan to a Canadian borrower as long as the nature and extent of its activities in Canada do not amount to engaging in or carrying on business in Canada. Whether a foreign bank would be considered to be engaging in or carrying on business in Canada by reason of making a particular loan to a Canadian borrower will depend on the relevant facts and circumstances.

A non-bank lender may be required to obtain an extra-provincial licence in each province in which it is considered to be carrying on business under provincial corporate law. Such determination may vary somewhat in each province; however similar factors to those above will be relevant. A corporation which owns or leases real property in, or has an employee or agent that is resident in, such province will generally be considered to be carrying on business in that province.

In the case of either a bank or non-bank lender, a loan transaction involving a Canadian borrower would not be void or voidable by reason of such lender's failure to comply with applicable regulatory requirements in Canada.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The *Criminal Code* (Canada) makes it a criminal offence to receive interest at a criminal rate, defined as an effective annual rate of interest that exceeds 60%. Interest in the *Criminal Code* (Canada) is broadly defined to include interest, fees, fines, penalties, commission and similar charges and expenses that a borrower pays in connection with the credit advanced. This section has been considered almost exclusively in civil (not criminal) cases where the borrower seeks to avoid repayment by arguing that the contract was illegal. Courts have struggled with deciding which, if any, contractual provisions should be enforced when a contract imposes a criminal rate of interest.

Note

Please note that the answers in this chapter are up to date as of January 31, 2016. Readers are cautioned against making decisions based on this material alone. Rather, any proposal to do business in Canada should be discussed with qualified professional advisors.

Acknowledgment

The authors would like to acknowledge the assistance of their colleague, Iana Namestnikova, an associate in the firm's Financial Services group, in the preparation of this chapter.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Jeff Rogers

McMillan LLP
181 Bay Street, Suite 4400
Toronto, Ontario M5J 2T3
Canada

Tel: +1 416 865 7000
Fax: +1 416 865 7048
Email: jeff.rogers@mcmillan.ca
URL: www.mcmillan.ca

Jeff practises in the business law area with a focus on debt financing transactions including syndicated lending, leveraged acquisition financings, tender offer financing, asset-based lending, second lien, debtor-in-possession financings, private placement and subordinated debt offerings. He is a regular speaker at conferences and client in-house training programmes on financial transactions and secured lending. Jeff has been recommended in the *Lexpert/American Lawyer Guide* to the Leading 500 Lawyers in Canada as an asset-based lending expert, and is recognised as a leader in banking and finance law in *Chambers Global*, *Chambers Canada*, *Best Lawyers* in Canada, *Who's Who Legal* and *IFLR1000* in Financial and Corporate.

Jeff acts routinely for major Canadian and foreign financial institutions and borrowers on domestic and cross-border transactions.

Don Waters

McMillan LLP
181 Bay Street, Suite 4400
Toronto, Ontario M5J 2T3
Canada

Tel: +1 416 865 7000
Fax: +1 416 865 7048
Email: don.waters@mcmillan.ca
URL: www.mcmillan.ca

Don's practice is focused on debt finance and structured finance transactions, including syndicated and cross-border debt financings, asset-based lending, infrastructure and project financing, private equity and acquisition financings, debtor-in-possession financings and securitisation. Don is recognised in *Best Lawyers* in Canada in Structured Finance Law and *IFLR1000* in Banking, Capital Markets, Structured Finance and Securitisation.

Don regularly represents Canadian and foreign financial institutions, borrowers and private equity sponsors. Recent transactions include financings for Canadian Tire, Honda Canada Finance, Porter Airlines, Porsche Canada, Merus Labs, Redknee Solutions, Sprague Canada and Wesco International.

mcmillan

McMillan is a leading Canadian business law firm committed to client service and professional excellence. With recognised expertise and acknowledged leadership in financial services, restructuring and other major business sectors, McMillan provides specialised transaction and corporate advice to businesses, financial institutions, governments and individuals in Canada, the United States and internationally. The firm's financial services practice group acts for an extensive list of Canadian and foreign financial institutions, investment banks, governments, corporations, pension funds and hedge funds on a wide range of financial products and services. The firm has offices in Vancouver, Calgary, Toronto, Ottawa, Montréal and Hong Kong. McMillan stands as a truly modern and ambitious law firm with enhanced scope, deep bench strength and a broad range of expertise offering effective, innovative solutions to Canadian and international clients.

For more information, please visit our website at www.mcmillan.ca.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Chapter 28

Cayman Islands

Tina Meigh

Maples and Calder

Nick Herrod

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

There have been no changes to the Companies Law (2013 Revision) of the Cayman Islands in the last 12 months that impact the Cayman Islands' reputation as an influential, innovative and creditor-friendly jurisdiction. Financial institutions and corporate borrowers alike continue to rely on the current regime that recognises bilateral and multilateral set-off and netting upon the insolvency of a Cayman Islands company and statutory provisions allowing secured creditors to enforce their security without the leave of the court or a liquidator. These legislative provisions continue to support the view that the Cayman Islands is the leading, preferred offshore jurisdiction of choice for any lending and security structure.

We have continued to see an increased focus on securities and netting principles in the last 12 months, specifically following the introduction of the Basel III Capital Adequacy requirements applicable to lenders in the market. This increased focus has continued to lead to increased opinion requirements and extended analysis on security issues, in particular, in relation to perfection and priority of security interests.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The most significant lending transactions continue to occur in the investment funds space, especially to Cayman Islands domiciled private equity funds. These transactions tend to be governed by New York and English law finance documents with security taken over Cayman Islands assets being governed by both Cayman Islands law and non-Cayman Islands law. Although the courts in the Cayman Islands generally recognise foreign law documents, lenders often prefer, for commercial purposes, to have dual Cayman Islands security.

The main types of security are, in the case of funds established in the form of exempted limited partnerships, security over capital calls and more generally security over Cayman Islands equity interests either in the form of registered shares or limited partnership interests. This is particularly common where there is a "master-feeder" structure or underlying blocker entities are used to hold assets.

In both private equity and hedge funds, borrowing is required for both leverage and liquidity purposes using a variety of different instruments including subscription facilities, variable funding notes and total return swaps.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, a company can grant a guarantee in these circumstances assuming there is sufficient commercial rationale and benefit to the company.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

The directors of the company providing a guarantee must ensure that any proposed transaction is in the best interests of the company as a whole. Guarantee arrangements may be construed as not being in the best interests of a company (and not for the company's corporate benefit) if the granting company receives no commercial benefit from the underlying financing arrangements.

2.3 Is lack of corporate power an issue?

In accordance with the Companies Law (2013 Revision), the lack of capacity of a company to enter into a transaction by reason of anything in the company's memorandum will not affect the validity of the transaction. However, where the company is acting without the necessary capacity, shareholders may issue proceedings prohibiting the company from performing its obligations under the transaction (including disposing of any property) and proceedings may be brought against present and past directors or officers of the company for loss or damage caused by them binding the company in this manner contrary to the objects in the memorandum.

If a shareholder brings proceedings to restrict the company from performing its obligations, we believe such action would not affect the other party's rights under the transaction. If the company fails to perform, the other party would have the usual remedies.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Subject to any licensing restrictions that may apply to a regulated entity, no authorisations or consents are required by law from any

© Published and reproduced with kind permission by Global Legal Group Ltd, London

governmental authorities or agencies or other official bodies in the Cayman Islands in connection with the grant of a guarantee. In addition, it is not necessary to ensure the enforceability or admissibility in evidence of a guarantee that any document be filed, recorded or enrolled with any governmental authority or agency or any official body in the Cayman Islands.

The directors of the company giving the guarantee should approve the terms and execution of the guarantee by way of board resolution in accordance with the company's articles of association. If there is any question of lack of corporate benefit or a potential breach of director's duties, it is recommended that the company also obtain a shareholders' resolution also approving the grant of the guarantee.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no legislative restrictions imposed on the amount of any guarantee due to net worth or the solvency of a company. However, the directors of a company should, as part of fulfilling their fiduciary duties, consider the terms of any guarantee, particularly in the context of the company's asset base.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control regulations imposed under Cayman Islands law that would act as an obstacle to enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are no legislative restrictions on the form of collateral and, accordingly, all property of a company is potentially available as security for lending obligations.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is possible for security to be taken by means of a general security agreement, such as a debenture, over a range of asset types. The main types of security under Cayman Islands law are mortgages (legal and equitable), charges (fixed and floating), liens and assignments of rights by way of security (albeit that this is deemed to be a form of mortgage). Formalities and perfection of such security interests will depend upon the nature of the underlying collateral and the applicable *lex situs* of such collateral.

Special regimes apply to the taking of security over certain assets, including ships, aircrafts and land.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over land is usually granted by way of legal or equitable mortgage and by way of fixed charge over plant, machinery and equipment. In relation to chattels, security can also be created by a conditional bill of sale which must be recorded in accordance with the Bill of Sale Law (2000 Revision).

A legal mortgage is granted by execution of a mortgage agreement between the mortgagor and the secured creditor. The terms of the mortgage will vary, but essentially a mortgage (i) requires transfer of legal title in the land to the secured creditor, subject to a requirement to re-transfer the land upon satisfaction of the underlying secured obligations, and (ii) grants the secured creditor certain powers to deal with the land upon a default.

An equitable mortgage can be created by (i) the execution of an equitable mortgage, (ii) an agreement to create a legal mortgage, (iii) a transfer of land which is not perfected by registering the secured creditor in the Land Registry in accordance with the Registered Lands Law, and (iv) the deposit of the relevant title deeds by way of security.

Fixed and floating charges are usually evidenced by an agreement between the parties reflecting the grant of the security interest and setting out the commercial terms.

A company must make an entry in its register of mortgages and charges in respect of any security interest created by it in order to comply with section 54 of the Companies Law (2013 Revision). However, failure to comply with this requirement does not invalidate the security interest.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Receivables arising under contract are examples of "choses in action", being a right which can only be asserted by bringing an action and not by taking possession of a physical thing. Receivables can be mortgaged or charged where that mortgage or charge takes the form of an assignment with an express or implied provision for reassignment on redemption. If a chose in action is charged, the charge can be either fixed or floating.

An assignment can be either legal or equitable, depending on the circumstances. The key requirements of a legal assignment are that it is: (i) an absolute assignment of the whole of a present (not future) chose in action; and (ii) the assignment must be both in writing and signed by the assignor and notified in writing to the debtor. An equitable assignment generally only relates to part of a chose in action and/or does not involve the notification of the debtor.

A company must make an entry in its register of mortgages and charges in respect of any security interest created by it. See question 3.3 above.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A security interest over cash deposits is most commonly created by either a fixed or floating charge, depending on the commercial intention of the parties and the level of control maintained over such cash deposits. The secured creditor should ensure that there is an agreement (usually a deed). Cash deposits are classified as chose in action. Accordingly, the analysis in question 3.4 above applies.

In accordance with Cayman Islands conflict of law rules, the appropriate law to govern any security over cash deposited with a bank will be the law applicable where the bank is located (or the location of the bank branch with which the deposit is made).

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Security over shares in Cayman Islands companies, where the register of members is maintained in the Cayman Islands, is usually

© Published and reproduced with kind permission by Global Legal Group Ltd, London

taken in the form of a legal or equitable mortgage, depending on whether the secured party wishes to take legal title to the shares prior to a default of the secured obligation. Different rules may apply if the register of members is maintained outside of the Cayman Islands or if the shares are in bearer form.

In accordance with Cayman Islands conflict of law rules, the appropriate law to govern any security over registered shares in a Cayman Islands company is determined according to the law applicable to the location of the register of members. Whilst it is possible to grant security over shares as a matter of other laws, enforcement of such security may prove problematic or difficult.

It is not possible to pledge registered shares under Cayman Islands law because title to the shares cannot be transferred by physical delivery. Any grant of security over registered shares that is called a "pledge" will typically fall into one of the mortgage categories, depending on its terms, or it may be entirely ineffective.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security can be taken over inventory or stock by way of a fixed or floating charge. A floating charge is more common given the changing nature of inventory in the usual course of a grantor's business.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company can grant a security interest in order to secure its obligations as a borrower under a credit facility or as a guarantor of the obligations of other parties. Usual fiduciary duties applicable to directors' actions will apply in each case.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No stamp duties or other similar taxes are payable, unless the applicable security document is executed in or brought into the Cayman Islands. The amount of any applicable stamp duty will vary depending on the type of security document and the identity of the assets subject to the security interest. Unless the document needs to be executed in the Cayman Islands, it is common practice to execute documents outside of the Cayman Islands so that stamp duty is not levied. Court fees (of a nominal value) will fall due as part of any enforcement process.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

A company must make an entry in its register of mortgages and charges in respect of any security interest created by it in order to comply with section 54 of the Companies Law (2013 Revision). This step is usually undertaken by the registered office service provider of the company and can be completed in a very short time period.

Charges over certain assets, such as land, intellectual property rights, ships and aircraft, need to be registered at other specialist registries related to the asset in question.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Subject to any licensing restrictions that may apply to a regulated entity, no authorisations or consents are required by law from any governmental authorities or agencies or other official bodies in the Cayman Islands in connection with the grant of a security interest.

The directors of the company granting the security interest should approve the terms and execution of the security document by way of board resolution in accordance with the company's articles of association. If there is any question of lack of corporate benefit or a potential breach of directors' duties, it is recommended that the company also obtain a shareholders' resolution also approving the grant of the security interest.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no special priority concerns regarding revolving a credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

A number of key documentation issues exist, each of which depend on the form of the security document, whether the document contains a power of attorney and if the document is to be executed by way of deed. The key issues of note are: (i) an agreement to create a legal mortgage over land should be executed and delivered as a deed; (ii) a legal assignment must be in writing and signed by both parties; (iii) any power of attorney or security document containing a power of attorney must be executed by way of a deed to ensure compliance with the Powers of Attorney Law (1996 Revision); and (iv) where a deed is required, the relevant execution formalities are set out in the Companies Law (2013 Revision).

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

No, there are no legislative prohibitions or restrictions under Cayman Islands law equivalent to the English law financial assistance rule.

(b) Shares of any company which directly or indirectly owns shares in the company

No, there are no legislative prohibitions or restrictions under Cayman Islands law equivalent to the English law financial assistance rule.

(c) Shares in a sister subsidiary

No, there are no legislative prohibitions or restrictions under Cayman Islands law equivalent to the English law financial assistance rule.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Cayman Islands law recognises the role of an agent or trustee, acting on behalf of all lenders, assuming the transaction documents provide for the relevant trust mechanics and the trust is properly constituted.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

There are no special requirements under Cayman Islands law to make the loan and guarantee enforceable by Lender B, provided that the novation/transfer mechanics in the applicable facility agreement are adhered to as a matter of the applicable governing law.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

The Cayman Islands currently have no form of income, corporate or capital gains tax and no estate duty, inheritance tax or gift tax. Accordingly, no taxes, fees or charges (other than stamp duty) are payable either by direct assessment or withholding to the government or another taxing authority in the Cayman Islands under the laws of the Cayman Islands.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives or other incentives under Cayman Islands law. See question 6.1.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

No income of a foreign lender will become taxable in the Cayman Islands.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Other than, potentially, the payment of stamp duty and applicable court fees on enforcement, no other significant costs should be incurred by foreign lenders in the grant of any loan or the taking of the benefit of any guarantee or security interest.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Assuming that the lenders are not connected to the borrower, in principle there are no adverse consequences if the lenders are organised in a jurisdiction other than the Cayman Islands.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The courts of the Cayman Islands will observe and give effect to the choice of the applicable governing law (the "**Relevant Law**") of a contract assuming that the choice of the Relevant Law as the governing law of the applicable contract has been made in good faith and would be regarded as a valid and binding selection which will be upheld by the courts of that jurisdiction and any other relevant jurisdiction as a matter of the Relevant Law and all other relevant laws.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Assuming that the choice of the Relevant Law (as defined in question 7.1 above) as the governing law of the applicable contract has been made in good faith and would be regarded as a valid and binding selection which will be upheld by the courts of the applicable jurisdiction (the "**Relevant Jurisdiction**") and any other relevant jurisdiction (other than the Cayman Islands) as a matter of the Relevant Law and all other relevant laws (other than the laws of the Cayman Islands), then although there is no statutory enforcement in the Cayman Islands of judgments obtained in the Relevant Jurisdiction, a judgment obtained in such jurisdiction will be recognised and enforced in the courts of the Cayman Islands at common law, without any re-examination of the merits of the underlying dispute, by an action commenced on the foreign judgment debt in the Grand Court

© Published and reproduced with kind permission by Global Legal Group Ltd, London

of the Cayman Islands, provided such judgment is given by a foreign court of competent jurisdiction and is final, for a liquidated sum, not in respect of taxes or a fine or a penalty, and was not obtained in a manner, and is not of a kind the enforcement of which is contrary to the public policy of the Cayman Islands.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Timing of any litigation will inevitably be dependent on a large number of variable factors (such as location of the defendant, defences raised, complexity of the proceedings and resistance to enforcement). Assuming the defendant is in the Cayman Islands and the matter is straightforward and uncontested, it is possible to obtain default or summary judgment within a short time period. Assuming there is no resistance to enforcement, it may be possible to complete the process in six months. If the defendant is outside the jurisdiction, the process may take substantially longer. The timing for enforcement of a judgment is also dependent on a number of variable factors. It may be possible to complete the process in two to three months, but it could take substantially longer.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Whilst there are no legislative requirements for a public auction or similar process in the Cayman Islands, liquidators owe fiduciary duties to the creditors and shareholders of a company to recover the best price possible (usually market value) for all assets of a company upon a liquidation. Recent case law has set a precedent for this in the case of enforcement over land located in the Cayman Islands. Receivers owe their primary duty to the secured party and will seek to recover sufficient funds to repay the debt due; however, they also have a duty to the obligor to recover the best price reasonably obtainable on a sale of the secured assets. Accordingly, public auction or a similar process may be appropriate in certain circumstances. Certain consents may also be required from the Monetary Authority if the obligor is a regulated entity.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

There are no legislative restrictions on foreign lenders filing suit against a company in the Cayman Islands assuming that they can establish that the Cayman Islands court has jurisdiction over the suit. There are no legislative restrictions applicable to foreclosure on collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Under the Companies Law (2013 Revision), there is no formal corporate rehabilitation procedure as in England and Wales or in the United States that would give a company the benefit of moratorium provisions in the payment of its debts, including certain secured debts. A Cayman Islands company is subject to voluntary or involuntary winding up proceedings under the Companies Law (2013 Revision) although it is possible for a court to appoint a provisional liquidator after the presentation of a petition for the winding up of a company but before an order for the winding up of a company is made where, for example, there is an immediate need to take actions to safeguard assets for creditors. There is a growing practice in the Cayman Islands for provisional liquidators to be appointed with the principal objective of preparing a scheme of arrangement with the aim of avoiding a formal winding up. Although there is an automatic stay of proceedings against the company when an order for winding up has been made and on the appointment of a provisional liquidator, the stay does not prevent a secured creditor from enforcing its security interest.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The courts of the Cayman Islands will recognise and enforce arbitral awards made pursuant to an arbitration agreement in a jurisdiction which is a party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "**New York Convention**").

Although there is no statutory enforcement of arbitral awards made in jurisdictions not party to the New York Convention, the courts of the Cayman Islands will recognise and enforce such arbitral awards provided that (a) the parties have submitted to the arbitration by an agreement which is valid by its governing law, and (b) the arbitral award is valid and final according to the law which governs the arbitration proceedings. The arbitral award will not be regarded as final by a Cayman Islands court unless the arbitral tribunal has disposed of all the issues itself. A Cayman Islands court will not, however, recognise or enforce such arbitral awards if: (a) under the submission agreement and the law applicable thereto, the arbitrators have no jurisdiction to make the award; (b) it was obtained by fraud; (c) its recognition or, as the case may be, enforcement would be contrary to public policy; or (d) the proceedings in which it was obtained were opposed to natural justice.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In accordance with the Companies Law (2013 Revision), when a winding up order is made or a provisional liquidator is appointed, no suit, action or other proceedings, including criminal proceedings, shall be proceeded with or commenced against the company except with the leave of the court and subject to such terms as the court may impose. This prohibition in our view extends to judicial proceedings and does not include security enforcement methods which do not require an order of the court in the Cayman Islands. Furthermore, subject to any debts preferred by law, the Companies Law (2013 Revision) also provides that secured creditors may enforce their security notwithstanding that a winding up order has been made in respect of the applicable company.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The enforceability of any security document will be subject to general insolvency rules applicable to companies in the Cayman Islands including voidable preferences and transactions effected at an undervalue.

A secured party holding a fixed charge will, notwithstanding that a winding up order has been made, be entitled to enforce his security without the leave of the Cayman Islands court and without reference to the liquidator. However, if the security created by the relevant security document is treated as a floating charge then debts preferred under Cayman Islands law will have priority over the secured party on a liquidation of the company.

In addition, subsequent purchasers, mortgagees, chargees, lienholders and execution creditors in respect of the assets subject to the floating charge are likely to have priority over the secured party, although this will depend upon such factors as the terms of the floating charge, in particular the scope of any restrictions, whether any subsequent purchasers, mortgagees or chargees have knowledge of any restrictions and the circumstances in which any subsequent transactions arise.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Companies incorporated in the Cayman Islands are not excluded from proceedings under the Companies Law (2013 Revision) or any other applicable laws or regulations.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The Companies Law provides that, at any time after the presentation of a winding up petition and before a winding up order has been made, the company or any creditor or contributory may (a) where any action or proceeding against the company, including a criminal proceeding, is pending in a summary court, the Cayman Islands court, the Court of Appeal or the Privy Council, apply to the court in which the action or proceeding is pending for a stay of proceedings therein, and (b) where any action or proceeding is pending against the company in a foreign court, apply to the court for an injunction to restrain further proceedings therein, and the court to which application is made may, as the case may be, stay or restrain the proceedings accordingly on such terms as it thinks fit. On a voluntary winding up, there is no automatic moratorium. The Cayman Islands court does, however, have discretion to impose a moratorium on a blanket or a case-by-case basis. In practice, the court would only exercise its discretion if there was any doubt about the company's solvency.

A creditor of a company may have a compromise or arrangement imposed upon him under the Companies Law if a majority in number representing three quarters or more in value of the creditors (or class of creditors including the affected creditor) have approved the compromise or arrangement and it has been sanctioned by the Grand Court of the Cayman Islands. Although this is not a mandatory insolvency provision, it is a circumstance in which a creditor of a company may be made subject to an arrangement or compromise affecting his rights without his consent. It would not, however, affect the enforcement of security rights.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission by a company in a security document to the jurisdiction of the courts of a particular jurisdiction will be legal, valid and binding on the company assuming that the same is true under the governing law of the security document and under the laws, rules and procedures applying in the courts of that jurisdiction.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Companies can, as a matter of contract, waive immunity for any legal proceedings in the Cayman Islands. However, subject to certain exceptions, companies may receive the benefit of sovereign immunity under the State Immunity Act of the United Kingdom, which has been extended to the Cayman Islands by statutory order.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licensing or eligibility requirements under Cayman Islands law for lenders to a company. Assuming that the lenders are not incorporated in or registered under Cayman Islands law and all the activities of such parties have not been and will not be carried on through a place of business in the Cayman Islands, then the lenders will not be required to be licensed in the Cayman Islands solely in order to provide a loan to a company.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The questions and answers set out in this chapter cover the main legal considerations for secured financings under Cayman Islands law.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Tina Meigh

Maples and Calder
PO Box 309, Ugland House
South Church Street
George Town, Grand Cayman KY1-1104
Cayman Islands

Tel: +1 345 814 5242
Fax: +1 345 949 8080
Email: tina.meigh@maplesandcalder.com
URL: www.maplesandcalder.com

Tina Meigh is a partner in the Finance practice group of Maples and Calder in the Cayman Islands. Tina specialises in structured finance transactions and has extensive experience in all aspects of banking, fund financing, derivatives and securitisations. She represents hedge funds, private equity funds and large bank syndicates on lending transactions, bank products, deal structures and on all types of secured transactions. Tina advises a large number of international associations and financial institutions on derivatives and issues surrounding related collateral packages in the context of insolvency in the Cayman Islands. Tina also has significant experience of general corporate and commercial matters and the establishment of offshore investment funds. Tina is head of the fund financing group in the firm's Cayman Islands office.

Nick Herrod

Maples and Calder
PO Box 309, Ugland House
South Church Street
George Town, Grand Cayman KY1-1104
Cayman Islands

Tel: +1 345 814 5654
Fax: +1 345 949 8080
Email: nick.herrod@maplesandcalder.com
URL: www.maplesandcalder.com

Nick Herrod is an associate in both the Litigation and Finance teams at Maples and Calder. He provides a wide range of advice on international restructuring and contentious and non-contentious insolvency, in addition to finance matters more generally. In particular, Nick specialises in cross-border insolvency, schemes of arrangement and structuring transactions to mitigate against the risks of insolvency. Nick is co-chair of the Insolvency Lawyers' Association's technical committee.

MAPLES

With almost 50 years in the industry and over 800 staff, Maples and Calder is a leading international law firm advising global financial, institutional, business and private clients on the laws of the Cayman Islands, Ireland and the British Virgin Islands.

Maples and Calder is known worldwide for the quality of its lawyers. This extensive experience, the depth of the team and a collegiate approach are main characteristics of the firm, enabling it to provide the highest quality legal advice on a wide range of transactions.

Maples and Calder offices are located in the British Virgin Islands, Cayman Islands, Dubai, Dublin, Hong Kong, London and Singapore. The service provided is enhanced by the strong relationships the firm has developed. For fiduciary and fund services requirements, the firm provides a seamless "one stop shop" capability through its affiliate, MaplesFS.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Chile

Diego Peralta

Carey

Elena Yubero

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

According to the Chilean Banks and Financial Institutions Association ("**ABIF**"), during 2015 the growth of credit was a modest 4.2% with respect to 2014. The housing sector played a significant role due to certain amendments to the value added tax ("**VAT**") regime on the sale of real estate introduced by the 2014 tax reform, which produced an acceleration in this sector in order to benefit from an exemption regime. The energy sector continued being very active, with local banks increasing their involvement, where the trend is to step away from exposure to spot market prices and accept power purchase agreements ("**PPAs**") with distribution companies as acceptable alternatives to the traditional PPAs. Finally, it is worth noting, the enactment of Law No. 20,855, in force since January 23, 2016, which in general terms, allocates to lenders the obligation to formally release mortgages or pledges without conveyance once the secured obligations have been fully paid.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

By amount and relevance in the banking industry, an unsecured loan from Scotiabank Chile to Cencosud Administradora de Tarjetas ("**CAT**"), a card issuer in the retail sector, for up to USD3 billion, as part of the acquisition by Scotiabank Chile of 51% of CAT, and the indirect acquisition of other related companies (including an insurance broker company).

By parties involved, the financing credit facility for up to USD 1,217 million for the development of the Alto Maipo Hydroelectric Project, a 531 MW run-of-the-river plant, owned by AES Gener (60%) and Antofagasta Minerals (40%). The deal involved the IFC, OPIC and IDB and several local and foreign banks in a highly controversial project in the vicinity of Chile's capital.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Following certain corporate requirements depending on the type of company involved, provided the guarantor benefits somehow from these operations, and subject to applicable insolvency, liquidation, reorganisation, moratorium or similar laws relating to or affecting creditors' rights generally, and general principles of fairness, including, without limitation, concepts of materiality, reasonableness, good faith and fair dealing (regardless of whether considered in a proceeding in equity or at law), there is no restriction for this type of guarantee.

Additionally, note that, under Chilean General Banking Law, banks are not authorised to grant mortgages or pledges over physical assets, unless these agreements are granted in order to guarantee payment of the purchase price of those assets. Considering this, it has been construed that banks can provide guarantees over assets other than physical assets and subject to certain restrictions regulated by the Superintendency of Banks and Financial Institutions.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Third party creditors or non-controlling equity holders could object to the transaction if it is not clear that it is in the best interest of the guarantor, or if the secured obligations are so disproportionate to the company's assets and other obligations that its enforcement could cause the company to become insolvent. For example, under Chilean Corporations Law, directors of corporations are jointly and severally liable for any damages caused to shareholders for their negligent or malicious actions, making it highly unlikely that the approval of a board would be secured for such a disadvantageous operation. Should the agreements cause the company's insolvency, there are actions for revocation which apply once the reorganisation or liquidation procedures have started according to the Chilean Insolvency Law. Among the agreements that can be revoked are any pledge or mortgage granted by the insolvent company within a year before the insolvency proceedings (to guarantee debts previously acquired), and any act or agreement (including granting guarantees) entered into within two years before the insolvency proceedings, provided that (i) the counterparty has known the company's bad state of business, and (ii) that the agreement has caused damage to the other creditors, where damage means that terms and conditions were distant from the market's at the time of the agreement. On the other hand, article 2,468 of the Chilean Civil Code grants the creditors of an insolvent debtor the right to request the revocation of certain agreements entered by such debtor (*acción pauliana*) provided that: (i) the transaction causes damages to the creditors (the transaction executed increased the insolvency of the debtor); (ii) the debtor was aware of its poor business condition at the time of entering into such act or contract; and (iii) in the case of an onerous act or contract, the counterparty of the debtor was also aware of the poor business condition of the debtor.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.3 Is lack of corporate power an issue?

Yes. The Chilean Civil Code establishes in its articles 2,151 and 2,160 that the principal shall not be obliged toward third parties by acts or agreements entered into by its agent if (i) the latter did not mention that he was acting on behalf of the principal, and (ii) if the agent acts beyond the limits of its mandate. Therefore, if the agent does not have sufficient powers of attorney, and does not show to the counterparty the agreement by means of which the powers were granted to him, he would not be able to act on behalf of the principal.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

It depends on the company's structure and on the type of guarantee. In order to guarantee third party obligations, and if the guaranteed obligations exceed 50% of the corporation's assets, an extraordinary shareholders' meeting must be summoned in order to obtain approval. Nevertheless, if the guaranteed company is a subsidiary, the board's approval suffices. Filings will depend on the type of guarantee, especially when the asset over which the guarantee is granted has been awarded by a public entity (e.g. concessions over public goods).

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No. Nevertheless, please note that any operation executed between related parties needs to be done on the company's benefit, complying with the market's standards for price, terms and conditions, as previously explained above.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Currently there are no exchange control regulations. Payment in foreign currency is possible to the extent the parties have agreed such form of payment. Please note that in order to enforce a guarantee (as an accessory obligation) it is required that the obligations being secured comply with certain requirements, and in case of obligations governed by foreign law and subject to foreign jurisdiction, *exequatur* procedures have to be conducted. Subject to Law No. 18,010, regarding lending operations, transactions agreed in a foreign currency shall be payable according to the seller exchange rate of the payment date, which must be certified by a Chilean commercial bank. Please refer to our answers to questions 7.2, 7.3 and 7.7 in regards to the enforcement of foreign judgments procedure.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Chilean law establishes several types of security regulated under different bodies of law. They can be classified in two big groups, i) guarantees over assets or rights *in rem*, and ii) personal guarantees.

(i) Guarantees over assets: are divided between guarantees over moveable assets (pledge agreements); and guarantees over real estate (mortgage agreements).

a) Guarantees over moveable assets: these are made through the pledge agreement, which has four variations. These are:

- Civil Pledge: the first one to be recognised by Chilean law and therefore the pattern for the other types of pledges. It has a wide scope as it may apply to any moveable property, including all kinds of personal rights and credits. Any obligation may be secured by this pledge including obligations to act, or to refrain from acting. However, it is not commonly used, as the pledgor must deliver the pledged asset, and therefore the ability to use and enjoy the asset is lost.
- Commercial Pledge: The commercial pledge aims to secure obligations of merchants or commercial nature obligations. Though it is very similar to the civil pledge, unlike this, the material possession by the pledgee is not required, as it may be delivered to a third party bailee. It is not possible to secure future obligations – only currently existing and determined obligations – and its only requirement is that the material possession of the pledged property is not held by the pledgor. The Commerce Code requires certain formalities for granting the pledge, in order for the pledgee to be able to exercise its right to be paid preferentially. These formalities are: (i) the execution of the pledge agreement by means of a public deed, or by private instrument entered into a Chilean Notary Public's registry; (ii) reference made, on such instrument, to the amount of the debt secured and a description pledged asset; and (iii) if the pledge is granted over a credit, in order for the pledge to be enforceable upon the debtor, the creditor shall also notify the debtor prohibiting him/her to make any payment under the pledged credit to any person other than the creditor.
- Banking Pledge over Moveable Assets ("**Banking Pledge**"): the banking pledge was created as a way of facilitating the granting of pledges over bearer instruments of any kind, credits payable to the order, and shares in favour of banks and other financial institutions, even foreign. Except if otherwise expressed, this pledge may secure all current or future obligations of the pledgor with the pledgee. Formalities for bearer instruments are only handing over the instrument by the pledgor to the pledgee. Credits payable to the order (i.e., not in bearer form) must be endorsed as a guarantee to the pledgee. Finally, shares shall be pledged by means of a public deed or private instrument, which must be notified to the company which issued the shares by a Notary Public. As the civil pledge and the commercial pledge this pledge does not allows the pledgor to remain in material possession of the pledged asset.
- Pledge without Conveyance ("**PwC**"): this allows any kind of corporeal or incorporeal, present or future, moveable assets to be pledged in order to secure own or third parties obligations, present or future, irrespective of the fact that such obligations are determined or undetermined at the time of the pledge agreement. It must be executed either by means of a public deed or a private instrument, in which case the signatures of the appearing parties must be authorised by a Chilean Notary Public and then the instrument entered into a Chilean Notary Public's registry. The PwC agreement must contain the following minimum references: (i) the individualisation of the parties entering the agreement; (ii) the existing secured obligations or the specification that the pledge secures present and future obligations (*cláusula de garantía general*); (iii) the identification of the pledged assets; and (iv) the determined or undetermined amount to which the pledge is limited or the fraction in which the pledge secures several obligations, if applicable. The PwC agreement must be registered in a special registry

© Published and reproduced with kind permission by Global Legal Group Ltd, London

called the Pledge without Conveyance Registry. Upon its registration, the pledge without conveyance is enforceable upon third parties.

b) Guarantees over Real Estate: are granted by means of a mortgage agreement, which is regulated by articles 2407 *et seq.* of the Chilean Civil Code. By means of a mortgage it is possible not only to secure existing and determined obligations but to secure all present and future obligations of the borrower (*cláusula de garantía general*). The mortgage must be executed by means of a public deed between the owner of the immoveable asset and the mortgagee. The mortgage is later perfected by means of the registration of an abstract thereof in the relevant Mortgage Lien Registry and in the Prohibitions Registry (commonly, the mortgage deed will also contemplate a prohibition to transfer, convey and enter into acts or contracts with respect to the mortgaged property) of the correspondent Real Estate Custodian.

According to Chilean Civil, Commercial and Aeronautical Codes, mortgages can be granted over vessels and airplanes fulfilling certain requirements such as the vessel or airplane to be duly registered in the corresponding registry and the agreement to be granted by means of a public deed.

Likewise, mortgages can be granted over mining concessions and water rights, which need to be registered in the same manner in the Custodian of Mines' Registry or the Real Estate Registrar Property Registry, as appropriate.

(ii) Personal Guarantees: The most common personal guarantees in Chile are sureties (*fianzas*) and joint and several guarantees (*fianzas y codeudas solidarias*). By means of sureties, one or more third parties are compelled to pay the debtor's obligation in the event that such debtor does not pay the secured obligation. By virtue of joint and several guarantees, the liability for default is enforceable directly against all of the debtor(s) and guarantors as a group or against any one of them as an individual at the choice of the enforcing creditor. The main characteristic of the joint and several guarantees is that guarantors become equally liable to the creditor, just as the primary debtor. Therefore, they are not entitled to request that (i) the debt be claimed first from the borrowers and only if they do not pay, then be collected from them, and (ii) the debt be divided equally or proportionally among the various guarantors. Please note that guarantees under Chilean law are accessory to the main obligations and cannot exceed the amount of such obligations. This is expressly regulated for sureties, where it is stated that they cannot exceed the main obligation being guaranteed and cannot be granted in terms more onerous than those of the main obligor, but can be granted in terms more effective (like securing its obligations as guarantor through a mortgage, for example). Chilean Civil Code does not provide for any formalities at all to grant sureties but if the obligation intended to be secure is a commercial obligation, it must be granted in writing. Where the guarantor of a surety and a joint several co-debt is an individual married under joint ownership of the matrimonial estate (*sociedad conyugal*), the prior spouse's consent is required.

(iii) Conditional Assignments of Rights: this agreement is widely used in the Chilean jurisdiction as a useful tool to safeguard creditors' rights in an event of default.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is not possible to dispose or grant a security over all of an entity's assets. The guarantee must clearly identify which assets are being granted. Additionally, each type of security requires specific formalities for perfection (see our answer to question 3.1 above), and although it is possible to grant different types of security interests in the same agreement as long as these formalities are complied with, it is not advisable as it could delay registration and other perfection requirements.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Please refer to question 3.1.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, since the receivables are ultimately credits. As previously said in question 3.1, both the civil and the commercial pledges as well as PwCs can be granted over a credit. The creditor shall notify the debtor of the pledged credit, judicially or through a Chilean Notary Public, prohibiting him/her from making any payment under the pledged credit to any person other than the creditor. In case of pledges without conveyance, it is also required that a copy of the document evidencing the pledged credit is notarised with the Notary Public at the time of executing the pledge, and a reference to such must be made in the pledge itself.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, it can be taken by means of either commercial pledge or a PwC. The procedure is briefly explained in question 3.1.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes. All the pledges set forth by Chilean Law can be granted over shares. Nevertheless, the most commonly used are PwCs and commercial pledges. Please refer to question 3.3. The Corporations Law states that any liens or rights *in rem* over shares of a company will not be enforceable against it unless it has been notified by a minister of faith, who must leave a record of it in the company's shareholders' registry. Shares can be either in certificated form, or dematerialised in case of corporations and companies limited by shares.

According to the Chilean Civil Code, assets located in Chile are subject to Chilean Law, and hence, the pledge shall be granted in accordance with Chilean law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. Please refer to question 3.1 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, it can. Please refer to question 2.4 above.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

It depends mainly on the kind of collateral the company is granting. Excepting civil and commercial pledges, all other collateral agreements must be executed by means of a public deed or by a private document which must be authorised and registered by a Notary Public. Although it is not a requirement, civil and commercial pledges are in most cases granted by means of a public deed because of its advantages in the Chilean legal system (mainly for enforceability and proof in trial). Therefore, notarisation expenses are common to all kinds of collateral over all kinds of assets.

In case of mortgages, as mentioned above, the agreement has to be registered in the relevant Mortgage Lien Registry and in the Prohibitions Registry of the Real Estate Custodian, which charges a fee as well.

In case of a PwC, it is necessary to register it in the PwC Registry, which also charges a fee. If a PwC is granted over shares which are deposited in the Central Securities Deposit, these must be registered in an electronic pledge registry, which also charges a fee for its services.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No, expenses are not very high, and in general, registration and other administrative procedures do not take long, although it depends on the registrar and workload at the time of the registration request (it can vary between 10 and 40 business days). Regarding notarisation expenses, these depend on different aspects, such as the amount guaranteed. The PwC Registry charges a fixed CLP30,000 (approx. USD 42.85) fee for each registration.

3.11 Are any regulatory or similar consent required with respect to the creation of security?

No, but please consider that some assets are granted through administrative acts, and they may eventually require an authorisation of the relevant authority in order to grant security over them.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priorities or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Yes; please refer to the answers above. In case of the execution of foreign agreements in Chile, legalisations by the Foreign Relations Ministry and the Justice Ministry must be carried out. From August 30, 2016 the Apostille Convention will come into force, replacing these legalisation requirements.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

There are no such prohibitions or restrictions under Chilean Law.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. Law No. 20,190 regulates the appointment of a collateral agent, which shall comply with certain formalities. This appointment requires the existence of at least two creditors and may require the authorities to manage the collateral as well as enforcement and release of the same in case of an event of default, among other duties and attributions.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Although an agency collateral agreement is recognised in Chile, similar results could be obtained through the granting of special powers of attorney with the necessary authorities.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Yes. Under the Chilean Civil Code, it is necessary to duly notify the credit assignment to the debtor. Otherwise, the assignment cannot be enforced against the debtor.

Every credit assignment in which the debtor is the Treasury, or any governmental entity, must be notified to the President of the Defense of the State Council.

Regarding the guarantees, the Chilean Civil Code provides that assignment of credits encompasses assignment of guarantees securing the same, by operation of law.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) As a general rule, interests paid by Chilean taxpayers to foreign lenders are subject to a 35% withholding tax. However, a reduced 4% tax rate is applicable to certain interest payments (see question 6.2). The above is notwithstanding the existence of double taxation treaties. The payment of interests by Chilean taxpayers to domestic lenders is not subject to withholding tax.

(b) Payments of interest abroad upon enforcement of a guarantee could be subject to withholding tax depending on the reimbursement rights that the guarantor has against the main obligor.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Interest paid to foreign banks or foreign financial institutions complying with the requirements set by Chilean tax legislation are benefitted by a reduced withholding tax rate of 4%. Interest payments to foreign individuals resident in a country where there is a tax treaty in place with Chile may also benefit from a reduced withholding tax rate.

Stamp tax applies to documents evidencing indebtedness for borrowed money, including loan documents, notes and bond issuances. The tax is applied over the principal amount of the loan and its current rate is 0.066% multiplied by the number of months-to-maturity of the loan, with a maximum of 0.8%. In case of loans payable on-demand, the applicable rate is 0.332%.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

No, it will not.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Even though there are fees and translation costs, as explained in our answer above in question 3.9, they are not significant.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Under Chilean Income Tax Law, thin capitalisation rules are triggered when a Chilean-resident taxpayer pays interest or other financing expenses (e.g. services, commissions, expense reimbursements) to a related party abroad under a reduced withholding tax rate from the 35%. Per the thin capitalisation rules, any interest (or similar) payments made abroad to a related party and attributed to excessive indebtedness are subject to a 35% tax. The withholding tax applicable to the payments made by the Chilean resident taxpayer can be used as a credit against such 35% tax.

A taxpayer will be deemed to have “excessive indebtedness” if its total indebtedness (related and non-related) is larger than three times its tax equity at the end of the corresponding year that payments were made to related parties.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a “foreign governing law”)? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, taking into consideration the existence of a connecting factor with the parties involved. However, according to article 16 of the Chilean Civil Code and article 105 of the Private International Law Code (the “**Bustamante Code**”), assets are governed by the *lex situs* (the law of the jurisdiction where the assets are located), thus assets of any kind located in Chile are governed by Chilean laws. In consequence, generally speaking, a choice of law of a court in Chile will be based on the *lex situs* of the charged assets.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a “foreign judgment”) without re-examination of the merits of the case?

Yes. Chilean courts would enforce an English/New York judgment, to the extent this judgment complies with a proceeding called “*exequatur*” which must be followed before the Chilean Supreme Court.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) In general, disputes are resolved in first instance by a lower court, which may take from two to four years. Rulings and judgments of a lower court may be reviewed in second instance by a Court of Appeals, which make take from one to two years. Beyond that, some remedies may be claimed before the Supreme Court, which may take from one to two years. Therefore, a common civil proceeding may take up to eight years. In addition, enforcement of judgments is generally executed by means of an enforcement proceeding, which may take around one year.

(b) The *exequatur* proceeding itself may usually take around six to eight months. Once the *exequatur* is obtained, the enforcement proceeding may usually take around one year.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Yes. The enforcement of collateral security shall be made in Chile, before the competent Chilean court, in accordance with the rules for the so-called summary proceeding (*juicio ejecutivo*) contained in the Chilean Code of Civil Procedure. This procedure provides a very brief discussion stage, a stage of liquidation and subsequent public auction, which is held by auctioneers appointed by the court. This last stage can take a long time and the results of auctioned goods may be drastically different from the expected ones.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

No, they do not.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. According to article 57 of the Chilean Insolvency Law, during a term of 30 days as of the legal notice of the reorganisation resolution which appoints a supervisor for the insolvency proceeding ("**Veedor**"), the debtor will have Insolvency Financial Protection (*Protección Financiera Concursal*), during which neither the declaration nor the initiation of a liquidation proceeding against the debtor can take place, nor individual foreclosures, any kind of executions or restitutions in lease trials may be initiated and, among others, all agreements executed by the debtor will maintain their effectiveness and payment conditions. Therefore, the guarantees granted may not be unilaterally terminated nor be enforced or foreclosed in advance, based upon the initiation of an insolvency proceeding as the cause of the same. The credits of a creditor that contravene this restriction will be postponed in payment until all of the creditors to whom the reorganisation agreement affects have been paid off, including creditors who are related parties to the debtor. This period may be extended under certain circumstances by up to 120 days.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. A domestic arbitral award may be enforced by the same arbitrator who rendered it, provided he/she is assisted by an ordinary court if the seizure of property, the use of police, etc., becomes necessary. Foreign arbitral awards are recognised and enforced in Chile, subject to an *exequatur* from the Supreme Court, which will be granted provided legal requirements are met and there are no public order considerations, without re-examination of the merits.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

According to Chilean Insolvency Law, once a company has filed for a reorganisation plan upon insolvency, there is a temporary financial protection for the insolvent company known as the "**Financial Protection Period**". During this period, foreclosure procedures against the insolvent company, as a judgment execution of obligations, are suspended. New procedures cannot be started either. During this period, early termination of agreements are banned as well, and with them, the execution of the agreed guarantees.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

According to the Chilean Insolvency Law and the Chilean Civil Code, there is a scale of preference according to which debts are paid. The first class, which includes judicial costs, administration and liquidation fees, labour wages, compensation, severance payments and taxes, prefers all other credits. The second class includes the rights of the pledgee over the pledged asset. Mortgagees prefer every other credit, including first class credits, over the mortgaged asset; nevertheless, if there are not enough assets to cover the debts, the first class prefers the mortgagee over the mortgaged asset.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Banks are excluded, as there is a special regime of liquidation for them established in the General Banking Law. Public institutions, such as municipalities, ministries and others, and in general any governmental institution, are excluded from the Chilean Insolvency Law. In relation to funds, in Chile mutual, investments and pension funds are deemed a created patrimony that adopt an independent existence from their owner in order to serve a particular and autonomous purpose, which are not considered a legal entity. Their managers (corporations) might be declared insolvent.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No, there are not.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, it is.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, it is.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licence or permission requirements in Chile to perform lending operations.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are pre-payment mandatory regulations for local loans, but these regulations are not applicable to cross-border loans. Additionally, there is no interest rate limit for loans granted by foreign or international financial institutions or banks.

Acknowledgment

The authors would like to thank Gabriel Acuña for his invaluable contribution to this chapter.

Diego Peralta
Carey
Isidora Goyenechea 2800 piso 43
Las Condes, Santiago
Chile

Tel: +56 2 2928 2216
Fax: +56 2 2928 2228
Email: dperalta@carey.cl
URL: www.carey.cl

Diego Peralta is a Partner at Carey, Chile's largest law firm, where he co-heads the Banking and Finance Group.

His main professional practice is focused on: the creation and structuring of financial products and financing for all kinds of businesses, both from the lender or the borrower's perspective; in the purchases and sales of companies; and in the issuance and placement of debt and equity securities either in Chile or elsewhere.

He studied Law at Universidad de Chile.

He has been recognised as a Leading Private Practitioner in Banking & Finance by LACCA and in Banking and Finance, Corporate and M&A, Project Finance and Development Practice and Structured Finance Law by Best Lawyers.

He is a member of the Chilean Bar Association, counsel and member of the Executive Committee of The Interamerican Federation of Lawyers, and was part of a working group which analysed a new General Banking Law in Chile (2015).

Elena Yubero
Carey
Isidora Goyenechea 2800 piso 43
Las Condes, Santiago
Chile

Tel: +56 2 2928 2216
Fax: +56 2 2928 2228
Email: eyubero@carey.cl
URL: www.carey.cl

Elena Yubero is an Associate in Carey's Banking and Finance Group.

Her professional practice focuses on the creation and structuring of financial products and financing for all kinds of businesses, including multinational corporations, banks and financial advisors, foreign investment and the issuance and placement of debt and equity securities both in Chile and abroad.

She studied Law at Universidad Católica de Chile and has an LL.M. in International Public Law, Investments, Trade and Arbitration from Ruprecht-Karls University, Heidelberg and Universidad de Chile.

She is member of the Chilean Bar Association and the New York City Bar Association.

/Carey

Carey is Chile's largest full-service law firm. Our various corporate, litigation and regulatory groups include highly specialised attorneys and practice areas covering all areas of law. Our clients include some of the world's largest multinationals, international organisations, and some of the most important local companies and institutions. We are perceived as one of the best-managed law firms in the country and among the very top in Latin America. The firm is a member of the Pacific Rim Advisory Council, World Services Group, Terralex, The Interlex Group, TalkLaw and Employment Law Alliance.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

China

Jack Wang

King & Wood Mallesons

Stanley Zhou

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

A significant development in the PRC's lending market in 2015 was the legalisation of intercompany lending. In the past, the making of intercompany loans directly between PRC companies was not allowed. Article 61 of the General Rules for Loans, promulgated by the People's Bank of China ("**PBOC**") in 1996, did not recognise the legality of any intercompany loan. On 6 August 2015, the Supreme Court of the PRC issued the Regulations on Application of Laws to Certain Issues for Hearing of Private Lending Cases ("**Regulations**"), which became effective on 1 September 2015. The Regulations are important for the development of the onshore financing market, as it is the first time that the legality of intercompany loan agreements are expressly recognised by the PRC judiciary.

Another significant development was the removal of the long-held maximum loan-to-deposit ratio of 75 per cent which has been in place since 1997 when the PRC Commercial Bank Law was promulgated. The removal aims to relax the funding constraints on banks to encourage more lending to the real economy.

The year 2015 also witnessed a giant step towards interest liberalisation in China. In October 2015, PBOC cut the benchmark interest for the fifth time in 2015 and also declared that it will no longer set the upper limit of the floating deposit interest rates for commercial banks and rural cooperative financial institutions.

In the area of foreign exchange, China continued the trend of streamlining foreign debt administration, foreign direct investment and outbound investment. Some of the changes in this area have implications on cross-border lending and security arrangements. For example, in the past, conversion of FX denominated loan proceeds borrowed from offshore ("**Foreign Debt**") could only be made on an as-needed basis and was subject to strict scrutiny by the relevant account bank. As of December 2015, companies in the Shanghai Free Trade Zone were permitted to freely convert FX foreign debt into RMB, which gives the borrower more control.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The year 2015 was very active for US-listed PRC companies to 'go private' (which involves de-listing in the US and potentially subsequently re-listing in PRC/HK). We expect that this trend will continue. WuXi PharmaTech (US$3.3 billion) is one of the largest going-private transactions of a US-listed PRC company in the medical industry, financed by syndicated loans with both onshore and offshore financing support.

Outbound investment activity by Chinese companies continues to remain strong and has given rise to several significant lending transactions, including the €1.29 billion financing for Jinjiang Group's acquisition of Groupe de Louvre, a European hotel manager.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company can generally guarantee borrowings of one or more other members of its corporate group. According to PRC company law, any guarantee provided by a company for a third party must be approved by its board of directors or its shareholders in accordance with the provisions of its articles of associations ("**AOA**"). However, if a company guarantees the liabilities of one of its shareholders or actual controller, the guarantee must be approved by affirmative votes of more than half of the shareholders at a shareholders' meeting excluding the shareholder whose liabilities are guaranteed.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

There are no corporate benefit rules under the PRC law. Accordingly there are no enforceability or other concerns under PRC law where benefit is difficult to demonstrate, as long as that the guarantee/security is provided in accordance with the applicable PRC law as well as the AOA of the guarantor/security provider.

2.3 Is lack of corporate power an issue?

PRC company law does require appropriate corporate action to be taken to authorise the giving of guarantee by a company for the benefit of a third party. Lenders should review a guarantor's AOA and verify that necessary corporate and shareholder authorisations are in place. However, there is case law which supports the view that a guarantee will not necessarily be invalid just because such authorisations were not obtained.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

A guarantee/security given by an onshore company securing an obligation of an offshore borrower owing to an offshore lender may be subject to approval by or filing with the State Administration for Foreign Exchange ("**SAFE**"). See question 2.1 above on board and shareholder approvals. No other formalities are required for a company to grant a guarantee/security.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

A company's AOA may limit the amount that the company can guarantee. If the guarantor is a listed company, there are additional mandatory requirements which require shareholder approval for: (1) any guarantee/security given when the aggregate amount of the external guarantee given by the listed company and its controlling subsidiary companies has exceeded 50% of the listed company's latest audited net assets; (2) any guarantee/security given to secure the obligation of a debtor whose asset to liability ratio exceeds 70%; (3) any guarantee to secure an amount exceeding 10% of the latest audited net assets of the guarantor; and (4) any guarantee provided to secure obligation of any shareholder, actual controller or their affiliated parties.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control or similar obstacles to enforce a guarantee for so long as the giving of the guarantee complies with the regulations of the SAFE. For example, a guarantee given by a PRC company to secure the obligations of an offshore debtor owing to an offshore creditor must be registered with the SAFE within 15 business days after the date of the guarantee. The use of proceeds will also need to comply with the SAFE regulations.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

According to the PRC law, the following collateral is available to secure lending obligations:

(1) land, buildings or other fixtures;
(2) manufacturing facilities, raw materials, semi-manufactured goods and products;
(3) transportation vessels;
(4) drafts, checks, promissory notes, bonds, deposit certificates, warehouse receipts, bills of lading;
(5) transferable shares and fund units;
(6) trademark rights, patent rights, copyright or other property rights in intellectual property that can be transferred;
(7) accounts receivable;
(8) any other property that is not prohibited by the laws;
(9) construction-in-progress; and
(10) any other property that is not prohibited by the PRC law to be mortgaged, or any other rights that can be pledged as stipulated by the PRC law.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is not possible to give asset security by means of a general security agreement, as security created over different types of assets is subject to different perfection procedures.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. A mortgage over real property, machinery or equipment is recognised by PRC law. Mortgages over real property need to be registered with the property bureau at the place where the property is located. Mortgages over machinery and equipment need to be registered with the State Administration of Industry and Commerce ("**SAIC**") at the place where the mortgagor is located. Mortgages over real property, machinery or equipment all have to be created by a written contract.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. A pledge over receivables is recognised by PRC law. The pledge has to be registered with the Credit Information Centre of the PBOC. This registration is generally done by the pledgee. The Credit Information Centre does not conduct any review or impose any other conditions. According to the PBOC regulations, receivables over which pledge could be created must be generated from: (i) the sale of goods, the supply of water, power, gas and heat; (ii) a lease of movable or immovable property; (iii) fees for rendering services; (iv) fees for the use of immovables such as highways, bridges, tunnels and ferries; and (v) rights under loans or other credit. PRC law does not require notice of the security to be given to the debtor. However, it is good practice for notice to be given.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. A pledge over a cash deposit is recognised by PRC law. To create a pledge over a cash deposit, cash in the bank account must be ascertained and identified at the time of the creation of the pledge. The general understanding is that the bank account balance must not change. However there has been a recent court case indicating that fluctuation of the amount in the bank account balance may be permitted under certain circumstances.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes. A pledge of shares can be created over shares in companies incorporated in China. The documents granting security over the shares must be governed by PRC law. If not, the security interest would not be enforceable in China. The procedures to create a pledge of shares differ depending on the type of company. In the case of shares of a listed company, the pledge must be registered with the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

China Securities Deposit and Clearing Corporation Limited. In the case of shares of a foreign invested enterprise ("**FIE**"), the pledge is subject to approval from the Ministry of Commerce or its local branch ("**MOFCOM**") and registration with the local SAIC. In the case of shares of a non-listed and non-FIE company, the pledge must be registered with local SAIC where the company whose shares are being pledged is registered.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. PRC Property Law provides that a party may create a mortgage over manufacturing equipment, raw materials, semi-finished products and finished products owned by it at the present or in the future. This is a concept similar to the concept of a floating charge under the common law. The mortgage must be in writing and registered with the SAIC. Without SAIC registration the claim of the mortgagee is vulnerable to third party claims.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes. The conditions outlined in questions 2.1 and 2.6 also apply here.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Generally, no notarisation or stamp duty is required for creating security over different types of assets. If a security document involves a non-PRC party, notarisation by a notary and legalisation by a Chinese embassy or consulate may be required. In respect of registration requirements, see questions 3.3 to 3.7. Registration fees may be charged depending on the types of assets but the fees are mostly nominal.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Timing for security perfection varies depending on the type of security. For example, perfection of pledge of shares of a FIE requires MOFCOM approval and SAIC registration which may take several months. A mortgage of equipment or property on the other hand can take a considerably shorter period of time. When a foreign party is involved, notarisation and legalisation may be required, in which case, the security perfection process is longer. Other than registration fees there are no other governmental charges in respect of the creation of security.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

There are no regulatory or similar consents required with respect to the creation of security except for the limited circumstances discussed in questions 2.6 and 3.6.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

If the borrowings to be secured are under a revolving credit facility, usually a "maximum amount security" will need to be used. Under the PRC law, a maximum amount security refers to a security created to secure obligations incurred during a period of time and the aggregate secured amount is subject to a maximum cap agreed by the parties. When applying a maximum amount security under a revolving credit facility it is necessary for the lender to calculate the maximum loan amount and the interest with a cushion.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

If a PRC law governed contract requires both signing and affixing of company chop, due execution of the contract requires both signing by authorised signatory(ies) as well as affixing of company chop. If a contract does not require both signing and affixing of company chop, either signing by authorised signatory(ies) or affixing of company chop would be considered as due execution of the contract. A company is bound by execution by its legal representative. There are no special requirements on notarisation, execution under power of attorney, counterparts or deeds by a PRC party. If a signing party is a non-PRC party, notarisation and legalisation may be required in respect of the non-PRC party's execution of the relevant security documents.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

There is no general prohibition on financial assistance. However, the restrictions on granting of a guarantee outlined in question 2.1 also apply to the grant of security. Where a loan is extended from an offshore lender to an offshore borrower supported by a security and/or guarantee given by a PRC company to finance or refinance an offshore acquisition, SAFE regulations require that PRC outbound investment procedures are to be duly complied with.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The role of agent for a syndicate of banks who may change from time to time is recognised under PRC law. Trustees are not generally used in the context of syndicated lending in China. It is usual for syndicated loan lenders to appoint a facility agent or security agent to act for and on behalf of the syndicate. Subject to the provisions

© Published and reproduced with kind permission by Global Legal Group Ltd, London

of the transaction documents, the agent bank may claim the whole amount of the loan from the obligors and distribute the proceeds to the syndicate banks in accordance with the provisions of the transaction documents.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in the PRC.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

According to PRC contract law, a party to a contract may transfer its rights to a third party by notifying the obligor of the transfer of the contractual right and a party to a contract may assign its obligations after getting consent from the obligee, unless otherwise agreed in a contract. Accordingly, unless the loan agreement provides otherwise, Lender A may transfer its right to a loan already disbursed to the borrower by giving notice to the borrower. If a loan is yet to be disbursed, Lender A may only assign the obligation to disburse a loan if the borrower's consent is obtained. The notice or the consent must be in writing. No consent is required from a guarantor for the transfer or assignment of the loan from Lender A to Lender B unless the guarantee document expressly required this. It is good practice to notify the guarantor of the transfer or assignment.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Income received by a lender from loans extended by it to a PRC borrower will be subject to PRC income tax. Such income may include (a) interest received by it on the loans, and (b) the proceeds of a claim under a guarantee or of enforcing security which constitutes payment of interest. For a PRC onshore lender in general the income tax rate is 25% of its annual net profit. Tax payable by an offshore lender will be withheld from the PRC obligor's payment – the usual rate is 10% income tax and 5% business tax on the interest amount, but preferential rates may be applied depending on the applicable tax treaty.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no preferential tax incentives or other incentives provided specifically to foreign lenders, except that foreign lenders may enjoy a preferential income tax rate provided by the applicable tax treaty between the PRC government and the government of the offshore lender's place of business. As of the end of December 2015, the PRC government has entered into tax treaties with 101 countries, and Hong Kong and Macau Special Administrative Regions, of which 97 have come into force. In addition to income tax, stamp duty is payable at 0.05% of the loan amount by both the lender and the borrower respectively. A lender will also be subject to a business tax. Apart than these, there is no other tax in relation to a loan transaction.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

See question 6.1 above. A foreign lender may be subject to business tax and income tax with respect to income received by it from loans provided to a PRC obligor.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Except for stamp duty, registration fees (e.g. for mortgage registration) and notary costs (if applicable), there are no other government fees or costs.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

If some or all of the lenders are foreign lenders, the loan made to PRC companies is considered as Foreign Debt. There are restrictions as whether a company could borrow Foreign Debt and how much it can borrow. Treatment is different for a FIE in China or non-FIE. Generally speaking, a non-FIE company may only raise medium- and long-term Foreign Debt upon approval by the National Development and Reform Commission and its local branches. A FIE could borrow Foreign Debt without approval provided that amount of the foreign debt shall not exceed the difference between its "total investment" and its "registered capital", each as approved by the MOFCOM. Foreign Debts need to be registered with SAFE.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The PRC courts will recognise and enforce a governing law in a contract that is the law of another jurisdiction if there is a foreign element in connection with the contract, for example, if one of the parties to the contract is a foreign party or if the subject matter is located outside of China. The choice of foreign governing law must not violate China's public order.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A judgment rendered by a New York court or English court is currently not enforceable in China. This is because a PRC court will only recognise and enforce a foreign court judgment if (a) a bilateral judicial assistance treaty exists between China and the country of the foreign court, (b) both countries have joined an international convention on recognising and enforcing foreign court judgments or written orders, or (c) precedents of reciprocity exist. There is no reciprocal recognition or enforcement of judgments or written order between China and the UK or the US.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

A foreign lender may immediately file a suit against the company as soon as all the required court papers are in order. It will generally take up to six months to obtain a first instance judgment which shall be final if no party makes an appeal. If either party makes an appeal to a second instance court, it will generally take up to three months to obtain a second instance judgment, which shall be the final judgment. It is difficult to predict how long it will take to enforce the judgment.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Enforcement of security could be either on a consensual basis, i.e. the creditor and the security provider agree on the realisation of the collateral by conversion to value, or the creditor and security provider arrange auction or sale without going to the court. If the security provider is not cooperative, the creditor will need to bring proceedings in a competent PRC court seeking a judgment. If a favourable judgment is rendered, the creditor may commence an enforcement proceeding during which the collateral could be auctioned or sold at the oversight of the court. Consents from government bodies are generally not required unless state-owned assets or FIE shares are involved.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

The fact a lender is a foreign lender does not in itself impose additional restriction in enforcing a loan or security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

After a Chinese court accepts a bankruptcy application, any preservation measure in respect of the bankrupt debtor's assets shall be released and any enforcement proceeding shall be suspended. Further, pending civil proceedings or arbitrations relating to the bankrupt debtor shall also be suspended and such proceedings may resume after the administrator has taken over the assets of the bankrupt debtor.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Chinese courts will not examine the substance of the arbitral award given by a foreign arbitration tribunal and will give effect to and enforce the award provided that it is in compliance with the New York Convention.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

According to PRC Bankruptcy Law, once a PRC court accepts an application for bankruptcy petition in relation to a bankrupt debtor, both secured creditors and unsecured creditors will need to declare their claims to the administrator for such claims to be registered. All creditors can then participate in the distribution of the assets of the bankrupt debtor.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In order to protect the interests of the creditors and the equity-owners of the debtor, PRC bankruptcy law allows the administrator to petition the court to invalidate certain types of transactions conducted by the debtor within one year before the court accepts the bankruptcy petition, and to clawback the relevant assets back into the debtor's assets pool for subsequent distribution to the creditors and the equity-owners: (1) transfers of assets without consideration; (2) trading at an obviously unreasonable price; (3) providing assets-based security for debts not secured by property; (4) paying off undue debts in advance; or (5) giving up its right as a creditor.

The administrator may also petition the court to clawback payment made by the bankrupt debtor to certain creditors within six months before the court accepts the bankruptcy petition provided that at the time of the payment the bankrupt debtor was insolvent.

The secured creditor's rights rank behind any outstanding salaries, pensions for the disabled, basic pension insurance, basic medical insurance or other compensation incurred before 27 August 2006 (the date on which the PRC Bankruptcy Law was adopted and promulgated) and payable to the employees of the bankrupt debtor according to relevant laws and regulations. These employee's claims, if incurred after 27 August 2006, will rank behind the secured creditor's secured obligations. In addition, if the security is created after incurring overdue tax payment, the tax payment shall rank ahead of the security.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

PRC bankruptcy law applies to PRC companies in general, but does not apply to PRC financial institutions. The bankruptcy proceedings of financial institutions shall be governed by rules which are yet to be promulgated by the State Council.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No, seizing the assets of a company in an enforcement scenario may only occur following court proceedings.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

If a contract has no foreign elements, the subject matter shall be deemed as in the exclusive jurisdiction of the Chinese courts. The submission to a foreign jurisdiction shall be valid under PRC law if the subject matter is not under exclusive jurisdiction of PRC courts. As for the enforcement of judgment made in a foreign jurisdiction, it depends on the applicable bilateral treaties, or otherwise on the basis of reciprocity.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

China adopts the "absolute immunity" principle, which provides complete immunity to the sovereign state. Therefore any waiver of sovereign immunity is not legally binding and not enforceable if it is made by a Chinese governmental body. Please note, however, that state-owned enterprises are considered separate legal entities rather than Chinese government bodies, and therefore sovereign immunity does not apply to state-owned enterprises.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Only financial institutions or quasi-financial institutions with lending as one of its approved business scope (e.g. banks, trust companies, auto-financial companies, micro-lending companies) can engage in the lending business. A foreign lender who makes a loan to a PRC company cross-border is not required to be licensed, qualified or otherwise entitled to carry on business in the PRC. A lender which carries out a lending business without lending as its approved business scope will be deemed to be carrying on illegal financial services and be sanctioned accordingly. In China, it is usual for a facility and security agent under a syndicated facility to also be a syndicate lender. A foreign lender can be an agent without any licence in the PRC.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

In addition to all other issues covered in this chapter, it is worth noting the following when participating in financing in China:

(1) loans extended to a PRC borrower could be denominated in FX or RMB; RMB-denominated loans are generally supervised by PBOC. In addition, it is feasible to accept an RMB-denominated guarantee from a PRC company; and

(2) on 14 September 2015, the National Development and Reform Commission issued the Circular on Promoting the Reform of the Filing and Registration Regime for Issuance of Foreign Debt by Corporate Entities ("**Circular 2044**"), replacing the previous approval system with a national quota and filing regime for foreign debts. Among other things, Circular 2044 requires PRC companies to file with NDRC if they are loans extended to it or offshore subsidiaries controlled by it from an offshore lender. The same filing requirement applies if the company or offshore subsidiaries controlled by it issue a bond. The practices of local NDRC offices vary.

Acknowledgment

The authors would like to thank Janet Gu, counsel at the Shanghai office of King & Wood Mallesons, for her invaluable assistance in the preparation of the chapter.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Jack Wang
King & Wood Mallesons
17th Floor, One ICC, Shanghai ICC
999 Middle Huai Hai Road, Xuhui District
Shanghai 200031
People's Republic of China

Tel: +86 21 2412 6051
Email: jackwang@cn.kwm.com
URL: www.kwm.com/en

Jack Wang is a banking and finance partner in the Shanghai office of KWM. He has extensive experience in international finance, covering general banking business, bilateral financing, syndicated loans, financial derivative instruments, trade financing, structured financing in M&A and real estate, incorporation and acquisition of financial institutions, NPL dispositions, online purchase technologies, debt restructuring, the issuance of bonds, and commercial paper on capital markets among other areas.

Jack is a recognised market leader, and is ranked as a "Leading Individual" by *Chambers Asia Pacific Guide 2016*, and as one of the world's leading banking lawyers by *IFLR1000*, *Chambers & Partners*, *Who's Who Legal* and *Expert Guides*.

Jack has handled many large transactions in industries such as power, petrochemicals, expressways, water plants, bridges, aluminium plants, and MTR. He has also represented various international companies in their incorporation of foreign-invested enterprises or acquisitions of domestic companies.

Prior to joining KWM in 2003, Jack was in charge of the Department of International Finance, at the Global Law Office in Beijing. Before that, Jack worked at Shearman & Sterling (New York) and Linklaters (HK).

Jack is qualified to practise law in China and in New York State, and is fluent in Chinese and English.

Stanley Zhou
King & Wood Mallesons
17th Floor, One ICC, Shanghai ICC
999 Middle Huai Hai Road, Xuhui District
Shanghai 200031
People's Republic of China

Tel: +86 21 2412 6056
Email: stanley.zhou@cn.kwm.com
URL: www.kwm.com/en

Stanley Zhou is a partner in KWM's Shanghai office, specialising in general banking, structured financing, property financing, financial regulation and compliance, financial institutions, Internet-financing, financial lease, commercial factoring.

Stanley advises domestic and international banks and other financial institutions and corporate borrowers on a wide range of banking and finance transactions, including merger and acquisition of financial institutions, syndicated loans, property finance, cross-border RMB trade, pre-IPO finance, privatisation finance, cross-border transactions, derivatives transactions, structured products and wealth management. Stanley also has strong expertise in the bank card industry, payment service institutions and payment business, pre-paid card and Internet-financing.

Stanley has been recognised as an "Up and Coming" lawyer in Banking & Finance by *Chambers Asia-Pacific* 2015–2016. Clients describe Stanley as: "*Very good with response times, and knows the banking market and regulations in China very well*." In 2016, Stanley was awarded the "Recommended Lawyer" in Banking & Finance – PRC by *The Legal 500*, and as the exclusive "Client Choice" for PRC Banking & Finance by *Globe Business Media Group*.

Stanley is fluent in Chinese and English.

KING&WOOD
MALLESONS
金杜律师事务所

King & Wood Mallesons (**KWM**) is a unique leading global firm headquartered in Asia, with 2,700 lawyers across 30 offices around the world.

Specifically, our Global Banking & Finance team offers depth and breadth across acquisition and corporate finance, asset finance, property finance, project finance, capital markets, derivatives, structured products, financial services regulation and restructuring & insolvency.

Our clients include top commercial and investment banks, large listed and unlisted corporates, private equity and other financial sponsors, market infrastructure participants, regulators and industry bodies.

Recent industry recognition include *International Financial Law Review*'s 2016 Regional Law Firm of the Year and National Firm of the Year – China (for the 6th year), *Asia Legal* Awards' 2016 Finance Team of the Year, *Financial Times* Asia Innovative Lawyer Awards' 2014 Most Innovative Law Firm Asia Pacific, *FinanceAsia*'s 2015 Best Financial Law Firm (Australia/NZ) and Australian Banking & Finance Awards 2015 Law Firm of the Year.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Costa Rica

Hernán Cordero Maduro

Cordero & Cordero Abogados

Ricardo Cordero Baltodano

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The most recent report from the World Bank on Doing Business shows that Costa Rica moved from 90th position to 7th position (an increase of 83 positions in only one year) in the Getting Credit Index of this report. This particular index measures the scope, access and quality of credit in a particular country. This rise in the ranking is a result of several regulatory changes that have recently been approved such as, but not limited to, the enactment of the Moveable Guarantee Law ("*Ley de Garantías Mobiliarias*") which we will refer to below, as well as the enactment of the Banking System for Development Law ("*Ley Sistema de Banca para el Desarrollo*") which grants access to the lending markets to small and very small enterprises and/or entrepreneurs which previously did not have access. Notwithstanding the above changes, it should be noted that Costa Rican economic growth has seen a slight slowdown in comparison to 2015; interest rates have began to decrease due to a recent change in the methodology established by the Costa Rican Central Bank ("*BCCR*"), and as a result, it is expected that financial institutions' profits may be affected in the near future. As indicated before, we expect that local banks and financial institutions will continue to generate innovative products and services that try to add value to the regular personal and corporate loan business they conduct.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

As transpired in 2014 and most of 2015, the most significant lending transactions that have taken place in Costa Rica have been related to infrastructure projects. In this area, there are several important projects such as: the San Jose-San Ramon Toll Road which is currently being negotiated and funded; a World Bank financing to the local health authorities ("*Caja Costarricense del Seguro Social*") for several health-related projects such as the digital medical file and several new hospital constructions; and the Moin container terminal currently being built in the province of Limon by Netherlands-based APM Terminals. In addition, several large-scale hydro electrical plants and wind farms are in the midst of being completed during 2015 by the state-owned *Instituto Costarricense de Electricidad*.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, it can. However, there should be no limitation to undertaking such act or contract in the company's corporate statutes or by-laws. Notwithstanding the above, and assuming that the corporate statutes or by-laws establish no limits, in order to comply with corporate mandate rules established in articles 1262 and 1263 of the Costa Rican Civil Code, the guaranteeing company shall hold an Extraordinary Shareholders' Meeting in which it analyses the terms and conditions of the transaction and authorises its legal representative (or any other person) to act on behalf of the company in order to authorise the guarantee of the borrowings of that related third party (a member of its corporate group or an independent third party company).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Pursuant to Costa Rican laws, if a company intends to guarantee or secure related third party borrowings, it is required to show or justify a benefit or expressly indicate that it shall receive a financial retribution in some way. As indicated in question 2.1 above, in order to comply with corporate mandate rules, the company should analyse such retribution (whether small or significant) and expressly authorise its legal representative, by means of an Extraordinary Shareholders' Meeting, to represent the company in such act or contract.

2.3 Is lack of corporate power an issue?

Yes. All corporate undertakings must be executed by a legal representative of the company with sufficient power or else duly authorised – by the company's shareholders in a duly held shareholders' assembly – to execute the corresponding act or contract. If there is a lack of corporate power by the legal representative, then the act or contract may be rendered null and void. In addition, if a guarantee is subject to registration and the legal representative's power or authorisation is not duly recognised, then the guarantee will not be properly recorded and as a result the guaranteed party may be negatively affected. The corporate powers for legal representatives are governed pursuant to Title VIII of the Costa Rican Civil Code.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Under Costa Rican laws, government filings or consents for granting guarantees are not required. With regard to shareholder approval, this will be subject to the limitations (if any) that the company and/or its legal representatives may have in its corporate statute or by-laws. If there are no registered limitations to the corporate statute or by-laws, shareholder approval is not required for guaranteeing its own borrowings, as long as the legal representative has sufficient corporate power to execute the corresponding act or contract. As indicated in question 2.1, this shareholders' approval shall be required for guaranteeing the borrowings of its own shareholders and/or officers of the company, and it is also required for borrowings of third parties. If there are registered limitations or restrictions to the corporate statute or by-laws and/or limitations or restrictions to the appointment of legal representatives, then as established in question 2.3 above, the shareholders' approval is also required.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Under Costa Rican laws and regulations, this is not a requirement. Nevertheless, upon granting a guarantee to a lender, the debtor should not be in a critical financial position that could be considered a technical insolvency affecting other lenders. Any acts or contracts executed under a technical insolvency may render those acts and contracts null and void. Upon the confirmation of a company's insolvency, acts or contracts executed up to six months prior to that confirmation (of insolvency) may be presumed null and void. Despite the above, local banks and/or financing entities that are subject to supervision by the Financial Entities Superintendence ("*SUGEF*") are obligated to comply with the SUGEF 1-05 Regulations, whose intended purpose is for banks and financing entities to quantify their clients' credit capacity and related risks and force them to establish the corresponding solvency safeguards.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No. There are no obstacles of this sort in order to enforce a guarantee. As a matter of fact, the Organic Law of the Costa Rican Central Bank ("*Ley Orgánica del Banco Central de Costa Rica*") specifically authorises private and public entities and/or individuals to enter into and execute private and public agreements using a foreign currency.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Based on the definition of collateral as "*property that is pledged as security against a debt or property subject to a security interest*", the following are some collateral available to secure lending obligations in Costa Rica: mortgage or common mortgage ("*hipoteca*"); pledge ("*prenda*"); mortgage certificate ("*cédula hipotecaria*"); trust agreement ("*fideicomiso de garantía*"); and moveable guarantee ("*garantía mobiliaria*"). These types of collateral shall be explained in detail below.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Yes, it is possible. In Costa Rica, trust agreements (also referred to as guarantee trust agreements) are usually used as a general security agreement in which real property (fee simple), concession rights, moveable assets, machinery, equipment and assignable rights can be transferred or assigned by the debtor or a third party (also referred to as the "Trustor") to a designated third party identified as a Trustee. The Trustee shall hold the title of the assets or rights placed in trust as a collateral guarantee towards the lender (also referred to as the "Beneficiary") and shall execute the Trust Agreement according to the instructions expressly indicated in such document. It is required that the instructions established in the Trust Agreement follow certain minimum due process rules of procedure.

The transfer of assets or rights to the Trustee can be executed by means of a private agreement, with the exception of registrable assets such as real property and certain vehicles and machinery, which have to be transferred through a public deed ("*escritura pública*") executed exclusively by a Notary Public.

Upon the occurrence of an event of default by the debtor or Trustor under the Trust Agreement or the other loan documents, and failure to cure or at least take specific actions to cure the default, the Beneficiary shall give written notice of the default to the Trustee and to the debtor or Trustor. If the debtor or Trustor fail to timely cure the event of default within the term granted in the Trust Agreement for this purpose, the Trustee shall proceed to execute the auction of the trust estate.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Collateral security can be taken over real property (fee simple) and moveable assets such as any type of plant, machinery, equipment, inventory, fungible goods as well as assignable rights.

The most common type of collateral security over real property is through a mortgage, in which the debtor provides a property as a security to guarantee a specific loan. The lender and debtor agree on all terms and conditions, such as, but not limited to, mortgage grade, lender's name, debtor's name, loan amount, term, advance payment penalty, interest, loan currency, place of payment and the usual contractual clauses that will govern the loan and the mortgage. The mortgage lien – granted through a public deed before a Notary Public – is imposed over the registered real property and has to be recorded before the National Registry. The mortgage entry will be recorded on the property's ownership entry and will be publicly available.

Another type of security over real property is by means of a mortgage certificate. This security has the same legal force as a common mortgage. The National Registry issues the mortgage certificate that identifies the amount for which the certificate is issued and, unlike the common mortgage where there is an established lender, these certificates may be transferred by endorsement. In such cases, the mortgage certificate is also recorded as a lien on the property's ownership entry.

With regard to moveable assets, the most common type of collateral security is the pledge. All moveable assets that are legally subject to an auction and judicial prosecution may be pledged to secure or guarantee a loan. Like mortgages, the pledge agreement must include certain terms and conditions such as: lender's name; debtor's

© Published and reproduced with kind permission by Global Legal Group Ltd, London

name; loan amount; term; advance payment penalty; interest; loan currency; place of payment, and the characteristic contractual clauses that will govern the financing. The pledge lien imposed over registered or registrable moveable assets shall be granted through a public deed before a Notary Public and recorded at the National Registry. Moveable assets which are non-registerable can also be granted as collateral pursuant to the Moveable Guarantee Law. This type of collateral is executed by means of a private document and recorded at the Moveable Guarantee Registry. This moveable guarantee provides more flexibility to the parties in order to be able to receive other types of moveable assets as collateral and register that collateral in a verifiable registry. In addition to the above-indicated collateral security (mortgage and pledge), as indicated in question 3.2 above, another type of security is the trust agreement.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Pursuant to Costa Rican law, a pledge collateral security can be taken over receivables as well as any other debt or credit. In order for the pledge to have legal value, it is required for the debtor to deliver or assign the receivable to the lender by way of a formal assignment, who is automatically appointed legal depositary (free of charge) of the receivable.

The lender shall not be allowed to dispose or take control of the collateral without the express consent of the debtor. Any agreement that violates the above shall be considered null and void. It is customary to execute this pledge before a Notary Public in a public deed and/or a private document and register the security before the Moveable Guarantee Registry.

In addition, collateral security can be taken over these types of documents through a trust agreement. As established above, the receivable shall be transferred to the Trustee, who shall execute the Trust Agreement according to the instructions expressly indicated in such document.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Although a pledge collateral security can be taken over cash deposited in bank accounts in the same way as a receivable (see question 3.4 above), this is not common practice unless the lender is the same bank that grants the loan, manages the bank account and receives such security. The procedure is the same as the one established above.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, collateral security can be taken over shares in companies (whether a Corporation ("*Sociedad Anónima*") or Limited Liability Company ("*Sociedad de Responsabilidad Limitada*")). The most common way to take security over shares is through a pledge, which has to be executed according to Costa Rican Law. In the case of Corporations (which have shares in the form of certificates), in order for the pledge to have legal value, it is required for the debtor to deliver the share certificates to the lender, who is automatically appointed legal depositary (free of charge) of the share certificates. In the case of Limited Liability Companies (which shares, called "*quotas*", are not in a certificate form), in order for the pledge to have legal value, it should be registered in the company's Quota Holders Registry Book, and the Quota Holders should approve it through a Quota Holders General Assembly.

The lender shall not be allowed to dispose or take control of the shares unless the established execution process is followed. In order for this execution to be valid it should follow the established due process. Any agreement that violates the above due process shall be considered null and void. Nevertheless, in case there is a non-fulfilment on behalf of the debtor, the lender can enforce the security either through a court of law or through a private executor ("*corredor jurado*") and recover regular and delayed payment interest.

In addition, collateral security can be taken over shares through a trust agreement. As established above, the shares are transferred to the Trustee, who shall execute the Trust Agreement according to the instructions expressly indicated in such document.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, collateral security can be taken over inventory. Inventory in Costa Rica is described as the moveable assets that a person or entity holds for its sale or lease in the due course of its normal business activity, such as raw materials and/or goods required for transformation into sellable assets. As indicated in question 3.3 above, any moveable asset that is legally subject to an auction and judicial persecution may be pledged to secure or guarantee. These types of assets may also be subject to the registration as a moveable guarantee under the special registry for these types of assets. Taking into consideration that inventory is a moveable asset, it is subject to a pledge collateral security as indicated above. In addition, inventory can be transferred to a trust agreement as established in question 3.2 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, a company can grant a security interest in order to secure both its obligations as a borrower under a credit facility and as a guarantor of the obligations of another borrower under a credit facility.

However, as established in question 2.1 above, in order to comply with corporate mandate rules established in articles 1262 and 1263 of the Costa Rican Civil Code, if the company grants a security interest as a guarantor of obligations of other borrowers, it is the guaranteeing company which shall hold an Extraordinary Shareholders' Meeting in which it analyses the terms and conditions of the transaction and authorises its legal representative (or any other person) to guarantee the borrowings of a third party (a member of its corporate group or an independent third party company) on its behalf.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

In Costa Rica, the notarisation, registration, stamp duty and other fees are established pursuant to the following legislation: (i) National Registry Tariff Law No. 4564; (ii) Notarial Code No. 7764; and (iii)

© Published and reproduced with kind permission by Global Legal Group Ltd, London

General Tariff for Fees for Law and Notary Public Professionals No. 36562-JP. In this regard, depending on the act or contract that is being executed, there is a standardised cost for the notarisation and registration of security. In all instances, if the act or contract has an estimated amount, such fees and stamps are proportional to the estimated amount. If for some reason the amount cannot be estimated, then the fees and stamps will be subject to the type of act or contract and type of security taken.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The time required to execute a specific security shall ultimately depend on the type of security. For example, registration of a mortgage, mortgage certificate or pledge over registered or registrable assets before the National Registry shall take approximately eight (8) working days, taking into consideration that no formal or draft errors are identified by the National Registry.

With regard to expenses, it also varies on the type of security. In general, a security that is subject to registration (see question 3.11 below) will usually have filing and registration expenses that range between 0.60% and 2% of the estimated amount. Security that is not subject to registration will usually have filing and notification expenses that range between 0.15% and 1% of the estimated amount.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No specific regulatory consents are required with respect to the creation of security. However, some securities such as a mortgage or a pledge over registered/registrable assets require registration before the National Registry and, as a result, certain legal and regulatory requirements need to be met in order to register such collateral security. If these securities are not registered, then they are not going to be applicable to/enforceable on third parties. Nevertheless, consent is not required.

In addition, certain specific concessions (i.e. maritime zone concessions located under certain legal frameworks such as the *Polo Turísitico de Papagayo*) may require administrative consent with respect to the creation of security.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

When dealing with revolving credit facilities, it is customary to guarantee the total amount of the facility with a type of secured collateral such as mortgage, mortgage certificate, pledge or trust agreement. As established in question 8.1, creditors with these types of collateral shall have a privilege over non-secured creditors.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Pursuant to Costa Rican laws and general practice, most securities are executed through a public deed before a Notary Public. Notarised documents such as public deeds ("*escritura pública*") are subject to very detailed formalisms established in Notarial Code No. 7764, and the Notary Public in charge of such execution shall comply with documentary formalities and strictly follow corporate mandate rules (see questions 2.1 and 2.3 above). Notwithstanding the above, in recent years the trend has been to liberalise loans from these general formalities in order to grant more access to credit and financing possibilities.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

The Costa Rican Code of Commerce establishes that a company cannot purchase shares of its own capital stock, unless the purchase is made with funds obtained from the company's gross profits from its legally approved balance. Thus, a company cannot finance or borrow money to purchase its own shares. As a result, a company is restricted from guaranteeing or supporting borrowings for the purchase of shares of the same company. In any case, a company is legally limited to own more than 50% of its own capital stock.

(b) Shares of any company which directly or indirectly owns shares in the company

There is no specific prohibition or restriction for a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of shares of any company which directly or indirectly owns shares in the company.

(c) Shares in a sister subsidiary

There is no specific prohibition or restriction for a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of shares in a sister subsidiary.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

When dealing with syndicated loans, Costa Rica will recognise the role of an agent who will hold the security in its name and on behalf of the remaining lenders. In this regard, it is important to clearly establish in the financing documents the role of the agent within the syndication and the rules that it shall follow for the repayment of the loan, execution of the collateral, communication with the borrower, etc.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

A trust agreement is an alternative mechanism to that of the syndicated loan in which an agent is not recognised. In the trust agreement, the Beneficiaries shall be all the lenders; the Trustor shall be the borrower

© Published and reproduced with kind permission by Global Legal Group Ltd, London

and/or that who provides the collateral; and the Trustee shall be a third party which receives the assets in trust and holds them (see question 3.2). Under Costa Rican laws, there can be several Beneficiaries or lenders, as well as several Trustors or borrowers. Upon enforcement, the trust agreement shall clearly stipulate who shall be responsible to execute the instructions under the trust agreement, which should always be a representative of the Trustee.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Assuming there is no limit to assign or transfer the loan from Lender A to Lender B, in order for the assignment or transfer to be valid and enforceable against the borrower, the borrower must be duly notified of the assignment of the loan. In addition, it is important to certify the date of the assignment through a public deed granted before a Notary Public ("*fecha cierta de la cesión*"). The assignment will be valid to third parties from the moment it is certified pursuant to the above.

6 Withholding, Stamp and other Taxes; Notarial and other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

According to the Costa Rican Income Tax Law, interest payments made by Costa Rican corporations or entities to foreign lenders or financial institutions, as a result of the repayment of any loan, are subject to a 15% withholding tax in Costa Rica. If such interest payment is made to a foreign lender that is part of a bank group that is supervised locally, there is a withholding tax that ranges from 5.5% to 15%. In addition, if such interest payments are made by Costa Rica corporations to multilateral banks, development banks or other non-profit financial entitles, the above-indicated withholding tax shall not apply.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Please see question 6.1.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Costa Rica has a territorial tax system; thus, if a foreign lender grants a loan from abroad to a company established in Costa Rica, income generated through that loan or guarantee or grant of security shall not be taxable in Costa Rica. Nevertheless, as established in question 6.1 above, the remittances of interest may be subject to a withholding tax, depending on the type of entity.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Generally, other than the established withholding tax indicated above, lenders do not assume any other cost in order to grant a loan and secure such loan in Costa Rica. As established in this document, most collateral is executed through a Notary Public in a public deed that is usually registered before the corresponding Section of the National Registry. These costs, which are more specifically referred to in question 3.10 above, are always assumed by the borrower.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No. There are no adverse consequences.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The courts in Costa Rica shall always recognise a governing law in a contract and enforce that contract, unless the specific subject matter goes against a public policy law ("*ley de orden público*") that strictly prohibits such subjection to foreign law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes. However, the following requirements have to be met: (a) the foreign judgment has been legalised by means of the Apostille Treaty or through the Costa Rican Consulate and translated into Spanish; (b) the foreign courts have followed the established due process; (c) the subject matter of the foreign judgment was not tried in a Costa Rican court; (d) there is no former adjudication or *res judicata* on the same case by a Costa Rican court; (e) the rights declared in the foreign judgment are subject to execution in the forum where the judgment was rendered; and (f) the rights declared in the foreign judgment do not go against Costa Rican public policy laws.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In general terms, if the default under a loan agreement has been well established, the time to prepare and file a lawsuit is immediate.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

In order to obtain a judgment, assuming that the debtor raises procedural issues, an approximate time would be 6 to 10 months, minimum. In addition, enforcement of the judgment against assets of the company can take an additional four months.

If we assume that all the legal requirements of the foreign judgment are in place, enforcement of such judgment in Costa Rica can take approximately 6 to 10 months.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Under Costa Rican laws, some of the most important restrictions which impact the timing and value of enforcements are when it is required to serve notice of the commencement of the legal proceeding. This first step in an enforcement case can be cumbersome and delay the proceeding. Once this is executed in accordance with due process and the established notification laws, there are no consents that might delay the process. Notwithstanding the above, the most recent notification laws have significantly reduced the notification process, making the entire enforcement process less problematic.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

No, there are no restrictions that apply to foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Upon declaration of bankruptcy, a moratorium on interest payments is declared to all borrowings not secured by means of a mortgage, mortgage certificate, pledge or similar. Although this moratorium does not apply to secured lenders, they cannot demand payment of the interest until the assets have been auctioned and proceedings paid.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Please see question 7.2.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Under Costa Rican law, lenders who have collateral security such as a perfected mortgage, pledge, mortgage certificates or trust agreement shall have a privileged right to enforce their security over unsecured creditors. The above-indicated statement applies as long as the perfection of the security is not declared judicially fraudulent. In any event, any collection procedure that the lender executes shall be brought before the same civil court where the bankruptcy proceeding is taking place.

Our law establishes a specific remedy ("*Acción Pauliana*") in order to request the nullity of any act or contract that has been executed up to two years prior to the declaration of bankruptcy which might affect unsecured creditors. In such case, the administrator of the bankruptcy shall have the power to begin such remedy action and the unsecured creditors may assist in such action.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

There are certain limited debts and obligations that have preference with respect to security. These have to be declared by a judge and the resulting liens are also known as legal mortgages which are established such as unpaid taxes, duly executed homeowners' association fees and some administrative charges. In this regard, these types of obligations have a priority with respect to the security.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

There are only certain legal entities not subject to bankruptcy. These include the Government of Costa Rica, all public and autonomous institutions, local municipalities and State-owned banks.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes, there are several processes other than court proceedings available to seize the assets of a company during enforcement. Under most trust agreements, in which assets are transferred to the Trustee to hold them in trust to secure an obligation, upon the occurrence of an event of default by the debtor or Trustor (according to the terms and conditions of the trust agreement or the other loan documents) and failure to cure or at least take specific actions to cure the default, the creditor – also referred to as the Beneficiary – shall give written notice of the default to the Trustee and to the Trustor. If the Trustor fails to timely cure the event of default within the term granted in the trust agreement for this purpose, the Trustee shall proceed to execute the auction of the Trust Estate. The trust agreement shall establish the rules to hold a private auction of the entrusted assets and, if there are no offers to the auction, the Trustee shall have the power to transfer the entrusted assets to the creditor or Beneficiary.

For a pledge agreement in which certain moveable assets are taken as collateral security (see question 3.6 above), upon an event of default, the lender can enforce the security through a private executor ("*corredor jurado*") and recover regular and delayed payment interest.

In addition, if a security contains an arbitration or conciliation clause, this process may be followed in order to seize – with the consent of the borrower – assets of a company.

In any case, under Costa Rican laws it is strictly prohibited for creditors to immediately seize assets of a company upon non-fulfilment of the terms and conditions or an event of default such as lack of payment. This immediate seizure is also known as "*pacto comisorio*". All documents and processes shall refer to an execution process (whether private or public, judicial or non-judicial) where due process is followed. Any agreement that violates the above shall be considered null and void.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

A party's submission to a foreign jurisdiction is legally binding and enforceable under the laws of Costa Rica, unless there is a public policy law ("*ley de orden público*") that strictly prohibits such avoidance of domestic laws.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Generally, yes.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Lenders – whether local or foreign – do not need to be licensed or authorised in Costa Rica or in their jurisdiction of incorporation in order to be able to grant loans in Costa Rica. In addition, there are no eligibility requirements for lenders to local entities or individuals. Nonetheless, as indicated in question 2.5 above, local banks and/or financing entities that are registered in Costa Rica and as a result are subject to supervision by *SUGEF*, are obligated to comply with certain provisions such as *SUGEF* 1-05, among other local supervision regulations.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Although foreign lenders do not require authorisation to grant loans in Costa Rica, they shall have a corporate identification number ("*cédula jurídica*") in order to be identified as the lender in the financing documents to be registered at the corresponding Section of the National Registry. This corporate identification number is granted by the National Registry and it does not generate any legal or tax consequences.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Hernán Cordero Maduro
Cordero & Cordero Abogados
Barrio Don Bosco, Ave. 2, Calles 24-26
San José
Costa Rica

Tel: *+506 2258 2525*
Fax: *+506 2258 3820*
Email: *hcm@corderoabogados.com*
URL: *www.corderoabogados.com*

Professional Experience: Mr. Cordero is a second-generation attorney at *Cordero & Cordero Abogados* and is currently the Senior Partner at the firm. He has practised law for more than 35 years and his wide experience ranges from Civil Litigation, Banking Law to Foreign Investments and Complex Real Estate Transactions. His experience in these fields includes: lead counsel on several complex civil and commercial litigations involving foreign and domestic parties; head outside counsel to many U.S. and Costa Rican importing and exporting companies with offices in Costa Rica; and head outside counsel to several Foreign and National Banks and Financial Institutions such as Banco Nacional de Costa Rica, Banco Lyon, Banco del Istmo, Societé Genérale and Inter-American Investment Corporation.

In the political arena, he has been appointed as a Board Member at several entities such as: CR-USA Foundation (2000–2003); Junta de Protección Social de Costa Rica (1994–1998); and the Instituto Costarricense de Turismo (1996–1998). He was also designated as Personal Adviser of the Ministry of Public Security (1990–1992).

Education: Universidad de Costa Rica; Licenciado en Derecho. Universidad de Costa Rica; Business Administration Studies. Several Seminars on Banking Law, Complex Transactions, Mergers & Acquisitions, Contracts, etc.

Professional Associations: Costa Rican Bar Association. Costa Rica – American Chamber of Commerce.

Languages: Spanish and English.

Ricardo Cordero Baltodano
Cordero & Cordero Abogados
Barrio Don Bosco, Ave. 2, Calles 24-26
San José
Costa Rica

Tel: *+506 2258 2525*
Fax: *+506 2258 3820*
Email: *rcb@corderoabogados.com*
URL: *www.corderoabogados.com*

Professional Experience: Ricardo is a Partner at Cordero & Cordero Abogados, mainly focused on Financial-Insurance Law, Corporate Law and Foreign Investment. In these areas he has: acted as legal counsel to local and international financial institutions on project finance transactions, international loan facilities, trust structures, etc.; has assisted foreign companies investing and doing business in Costa Rica to successfully set up and operate; and has acted as legal counsel to several regional companies investing in insurance-related matters. After completing an LL.M. (Master's Degree Programme) in International Legal Studies at Georgetown University Law Center, he worked as a Foreign Associate at the Washington D.C. offices of Thompson Hine LLP (2005 to 2006). He is the Co-Author of "Doing Business in Costa Rica: A Legal Overview" San José, Costa Rica", 2006, as well as other articles on current legal topics. Ricardo is recognised by international legal directories such as Chambers & Partners as a recommended attorney in the areas of Banking & Finance and Insurance Law. In addition, he is referred to by the U.S. Department of Commerce's Buyusa.gov agency in Costa Rica, CINDE, as well as the U.S. Consulate in Costa Rica.

Education: Georgetown University Law Center; LL.M.; 2005. Universidad de Costa Rica; Licenciado en Derecho; 2002. *Honorary Distinction* for thesis: "International State Responsibility for Acts of Private Individuals". Georgetown University Law Center; Foundations of American Law; 2004. Team Captain, Philip C. Jessup International Law Moot Court Competition.

Professional Associations: Costa Rican Bar Association. American Bar Association. Inter-American Bar Association. Costa Rica – American Chamber of Commerce.

Languages: Spanish and English.

CORDERO & CORDERO
ABOGADOS
EST. 1940

Cordero & Cordero Abogados is a full-service law firm that specialises in Business and Financial Law in Costa Rica. Among our main areas of practice are: Banking & Finance; Corporate and Contract Law; Foreign Investment; Real Estate; Insurance & Reinsurance; Mergers & Acquisitions; Civil Litigation Practice; Intellectual Property; Labour & Immigration; Energy; and Information Technologies & Telecommunications. The firm, established in 1940, currently has offices in San José and Guanacaste, and has been ranked by international directories such as *Chambers & Partners*, *ILFR* and *The Legal 500* and is currently referred to by the U.S. Commercial Service as well as other regional Bar associations. ***Cordero & Cordero Abogados*** is a member of the prestigious *International Lawyers Network* (www.iln.com), an association of 91 high-quality, full-service law firms with over 5,000 lawyers worldwide.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Cyprus

Marinella Kilikitas

E & G Economides LLC

George Economides

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Cyprus has come a long way since the collapse and virtual financial meltdown of its banking sector back in March 2013. The MoU between Cyprus and the Troika paved the way for the recovery of the Cypriot banking and financial system by focusing on certain key objectives, including the implementation of structural reforms aimed at enhancing competitiveness and sustainable and balanced growth.

Three years on, the measures have made a positive impact: deposits have stabilised and the record-high levels of non-performing loans (NPLs) are experiencing a slow, albeit marked, downturn (the total value of NPLs fell by €703.1m between November 2015 and December 2015 to €26.7bn). Furthermore, Cyprus is experiencing a gradual growth phase and forecasts estimate that the Cypriot economy will continue to grow at more than 1.5–2% in real terms over the next three years. Finally, it is noteworthy that Cyprus has been highly commended for its strict compliance with austerity measures and its implementation of reforms which have led the way to Cyprus' early exit from its €10m bailout programme.

Although the outlook for Cyprus nonetheless remains positive – there is still a long way to go, particularly given that the level of NPLs continue to remain extraordinarily high. Local banks have taken major steps in reducing inordinately high levels of NPLs on their balance sheets through various restructuring methods including the conversion of debt to equity (with optional share buy-back schemes) thus enabling the debtor to continue as a business whilst at the same time ensuring its long-term profitability (and consequently its ability to repay its debts). Equally important are the new foreclosure and insolvency legal frameworks which have gone a long way in expediting loan restructurings and reducing the level of non-performing loans by introducing, *inter alia*, a 120-day moratorium on lender claims to allow for a company reorganisation. This will be examined later.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Increased availability of debt leverage deals has had a significant impact on transaction volumes. Generally, however, new lending remains at a low level.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Generally speaking, a Cypriot company can provide guarantees for the borrowings of one or more members of its group, provided that (i) there is commercial benefit in it doing so (whether direct or indirect), and (ii) it has the corporate capacity to grant such guarantee.

By way of example, a parent company granting a downstream guarantee to its subsidiary to secure the latter's borrowing obligations towards a third party is likely to result in evident benefits; especially where the giving of such guarantee results in sustained upward profitability in the subsidiary, and in turn, the distribution of increased dividend payments to the parent.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Directors owe certain duties to the company which derive from both statute and common law. Under common law, these fiduciary duties include the paramount duty of the directors to exercise their powers in good faith for the purposes for which they were conferred and in the best interests of the company as a whole; i.e. all the shareholders of the company as a general body and not in the interests of a particular shareholder and/or shareholders.

In the absence of judicial guidance on the matter, it is not clear whether the absence (or lack) of corporate benefit would render a guarantee void, and consequently a creditor's rights thereunder, unenforceable. In discharging their fiduciary duties, directors should therefore pay high regard to potential risk factors including the likelihood of the guarantee being called (as against the benefit to be derived by the company entering into the guarantee) and, if so called, whether the company is able to meet its financial obligations thereunder and still remain solvent.

Notwithstanding the above, relief from directors' duties may be obtained in a company's general meeting, provided there is no fraud on the minority; as such, it is considered good practice to have in place a shareholders' resolution to ratify, confirm and approve any such decision of the directors. Relief may also be sought under statute in proceedings brought against a director for breach of duty provided that the director acted honestly and reasonably, having regard to all the circumstances.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.3 Is lack of corporate power an issue?

The memorandum and articles of association of a company should be carefully vetted in order to determine whether the granting of guarantees is within the company's objects. Even if no express power is granted, and provided they are not expressly prohibited, the objects may be so broadly drafted, so as to include the granting of guarantees as being ancillary to and in furtherance of the objects of the company. An act which is not authorised by the objects clause of the memorandum is *ultra vires*, i.e. beyond the company's powers as set out in its memorandum and void *ab initio*, and may not be remedied by any subsequent act of the shareholders.

Section 33A of the Companies Law, Cap 113 ("Companies Law") attempted to do away with the *ultra vires* doctrine by providing that a company will be bound *vis-à-vis* third parties by acts or transactions of its officers, even if they do not fall within the objects of the company, provided that (i) the third party acted in 'good faith', and (ii) the acts in question do not exceed the powers prescribed by law, or which the law permits to be prescribed, to the officers concerned. Publication of the memorandum and articles does not in itself constitute sufficient proof of knowledge *vis-à-vis* the third party.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

See question 3.9 below on stamp duty.

No governmental consents, filings or registration requirements are needed in order to grant a guarantee.

Whether a shareholder resolution is required is a matter for the articles of association of a company. In certain circumstances, shareholder approval may be required to whitewash any transactions which constitute prohibited financial assistance (see section 4 below) and/or to eliminate lack of corporate benefit issues. More often than not, however, and irrespective of whether the articles of association require it, a shareholders' resolution will be put in place as a matter of good corporate practice.

Guarantees, being contracts, must comply with certain essential elements to ensure their validity and enforceability including an offer, an acceptance, the intention to create legal relations and consideration. Typically, the beneficiary of the guarantee must also provide consideration for the guarantor's promise (which may often prove difficult to demonstrate) and so to avoid a guarantee falling foul of contract law requirements for want of consideration, it is often executed as a deed.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No net worth, solvency or similar limitations are imposed on the amount of a guarantee. However, any guarantee given by a company should not exceed the value of the underlying obligation it secures given that the liability of a guarantor is co-extensive with (and should therefore not be greater than) that of the principal debtor, unless otherwise provided by the contract.

Please also see question 8.2 below.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control restrictions to enforcement of a guarantee.

A guarantee may be subject to stamp duty in Cyprus. An unstamped guarantee may not be adduced as evidence in Cyprus court enforcement proceedings unless stamp duty fees (including any penalties for late payment) have been settled.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Generally speaking, any type of asset may be encumbered or charged to secure lending obligations in Cyprus.

The most common forms of collateral are:

- immovable property (such as land and/or any building, structure or thing affixed to it);
- tangible movable property (chattels);
- financial instruments such as shares and debt securities (claims and receivables);
- cash; and
- intangible movable property, such as intellectual property.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is possible to give asset security by means of a general security agreement in the form of a single fixed and floating charge debenture over various asset classes owned by a chargor.

The debenture will standardly include a fixed charge over particular assets, thereby giving a chargee control over any dealings or disposals of a particular asset by the chargor. It will also include a floating charge in relation to that part of the chargor's asset pool which is less ascertainable from time to time and which confers on the chargee the right to deal with the assets subject to the floating charge in the ordinary course of business. A debenture will also generally extend to include any assignment of receivables and contracts as well as any mortgages on immovable property and shares.

Practically speaking, however, it is more common to have in place specific security agreements in relation to certain assets such as land and shares (see question 3.3 and 3.6 below, respectively), with any other assets being caught by an all-encompassing debenture agreement creating security over all asset classes owned by a chargor. This is important to ensure that any additional statutory perfection requirements and formalities affecting the validity and enforceability of a particular security arrangement have been adhered to.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral security may be taken over plant, machinery and equipment by way of a fixed charge debenture.

In terms of real or immovable property, security is taken by way of a mortgage of the property in favour of the mortgagee, pursuant to the provisions of the Immovable Property (Transfer & Mortgage) Law, Law 9/1965, as amended; which requires, as a priority point, for the mortgage instrument to be deposited with the District Lands Office in the district where the relevant property is located. Upon registration, no subsequent transfer or further mortgaging of the mortgaged property is possible except with the mortgagees' prior consent.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Collateral security over receivables is possible as either: (i) an assignment by way of security (subject to the assignability of the receivables in question); (ii) a fixed charge; or (iii) a floating charge (see question 3.2 above).

Cypriot law does not recognise the concept of a legal assignment and the assignment of a receivable, as a chose in action, will invariably take the form of an equitable assignment. Provided that the intention to assign has been notified, being both a perfection and priority requirement as against subsequent creditors, equity will recognise it. The assignment is effective only once notified to the assignee.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

It is possible to take collateral security over cash deposited in a Cyprus bank account by way of a fixed or floating charge.

It is common to take a fixed charge over a blocked deposit account with any withdrawals from that account by the chargor made possible only with creditor consent. On the contrary, a floating charge will be given over a trading account to circumvent the impracticability of lender consent each time outbound payments need to be made from the account. In this way, the chargor is given the flexibility to continue to use the account for ordinary business purposes until the occurrence of a trigger event (such as a default), at which time the floating charge will crystallise, and attach to all the relevant assets secured by it, including, in the case of bank account charges, any cash held in the chargor's account subject to the charge.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

The creation of security over shares in a Cyprus company takes the form of a pledge of shares or fixed charge. The most commonly used mechanism is the share pledge which involves the physical delivery to the pledgee of the share certificates representing the pledged shares.

A pledge, as a possessory form of security, creates upon the execution of the relevant security instrument an equitable charge over the shares, and on delivery to the pledgee of the share certificate or certificates representing those shares, a legal charge over the share certificates themselves.

On the borrowers' default the pledgee is afforded a common law right to sell the pledged assets without recourse to court, provided of course that the security instrument includes a mechanism enabling the pledgee to transfer the pledged shares (using certain aids to enforcement of the pledge which are usually annexed to the charge instrument itself) without additional consent from the pledgor or other formalities or approvals. The aids to enforcement will often include: the original share certificates representing the pledged shares; undated blank instruments of transfer of shares duly executed by the Pledgor; a resolution of the board of directors of the company approving the pledging of the shares and the transfer of such shares on default; and waivers of pre-emption rights (if any).

Unless the terms of the security instrument provide otherwise, the pledgor remains the owner of the pledged shares throughout the life of the pledge and continues to enjoy the rights attaching to the shares in a manner which does not prejudice the rights of the pledgee, until and unless a default event occurs.

Section 138 of the Contract Laws of Cyprus, Cap. 149 as amended, prescribes the formalities required to create of a valid and enforceable pledge over the shares of a Cyprus company (namely it must be signed by the pledgor and made in the presence of two witnesses). Over and above these requirements, section 138(2) sets certain additional requirements for a pledge of shares to be valid and enforceable which include: (a) the giving of notice of pledge by the pledgee to the company in which the shares are pledged; (b) the company making a memorandum of such pledge in the register of shareholders against the shares in respect of which the notice is given; and (c) the subsequent delivery by the company of a certificate confirming (b) above.

Finally, security may also be taken over shares of public companies listed on the Cyprus Stock Exchange. As these shares are in dematerialised form, there will be no "pledge" of the share certificates as such but instead a charge created over the special account of a particular investors share account which will be registered in the Central Securities Depository and Central Registry of the Cyprus Stock Exchange. A charge over dematerialised securities is valid from the moment of its registration. The requirements of section 138 of the Contract Law do not apply in the case of pledge of dematerialised securities.

Although the security could theoretically be governed by New York or English law, given that the subject matter of the pledge are shares of a Cyprus company, any transfer of those shares to the pledgee or some other third party on enforcement is subject to mandatory provisions of Cypriot law, and will be determined in light of the Companies Laws of Cyprus, as well as the memorandum and articles of association of the Cyprus company concerned.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over inventory usually takes the form of a fixed and floating charge debenture, although a floating charge is the most commonly used form of security due to the constantly fluctuating nature of the asset and the inability of the chargee to exercise control (as in the case of a fixed charge).

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company may grant a security interest in order to secure its own obligations as borrower or to guarantee the borrowings of a third party. The provision of third party security by a company will however be subject to corporate benefit, capacity, solvency and financial assistance issues – see questions 2.5, 4.1 and 8.2.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notarisation fees are not applicable in Cyprus.

The Registration fees that will apply in Cyprus are as follows:

(i) Under the Companies Law

Section 90 of the Companies Law provides that every charge (as well as every amendment, assignment or change to it) created by a

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Cyprus company and conferring security on the company's property or undertaking shall be void against the liquidator and any creditor of the company, unless the prescribed particulars of the charge and a certified copy of the instrument creating it, are delivered to the Registrar of Companies in Cyprus for registration within 21 days after the date of its creation. The prescribed period is extended to 42 days in the case of a charge created by a Cyprus company outside Cyprus, comprising property situated outside Cyprus. Section 90(2) provides an exhaustive list of categories of charge which are capable of registration.

Registration under section 90 of the Companies Law is not a priority point, but a perfection requirement. Registration has the effect of giving public notice of the security to third parties dealing with the company that the particular assets or part of the undertaking has been charged in in the chargee's favour. Failure to register will not affect the validity of the charge as between the parties to it *inter se*; however, as mentioned earlier, registration will be necessary to render the security enforceable against any third party creditor or liquidator.

Registration of a charge will incur the payment of filing fees in the region of approximately €680.00 per charge registered.

Pledges of shares in a Cyprus company are specifically exempted from the ambit of section 90.

Similarly, agreements for the provision of financial collateral which fall within the within the ambit of the Financial Collateral Arrangements Law (Law 43(I) of 2004) are exempted from registration.

Other statutorily prescribed registration fees over specific assets:

Certain additional registration requirements apply in relation to charges over specific classes of assets. A legal mortgage over immovable property requires registration with the District Lands Office Land (see question 3.3). Registration fees of one thousandth of the amount secured are payable. A mortgage over a vessel or any share in a vessel is registered with the Department of Merchant Shipping, with registration fees dependent on the gross tonnage of the vessel (€0.034172 per gross tonne for the first 10,000 tonnes and half that rate above 10,000 tonnes).

(ii) Stamp Duty

Cyprus stamp duty is charged on 'documents' (i.e. agreements or contracts made in writing) relating to assets located in Cyprus and/or matters or things taking place in Cyprus. In general, agreements which do not involve assets situated in Cyprus are generally exempt from stamp duty; however, the final adjudicator on whether or not stamp duty is payable on any document, will be the Commissioner of Stamp Duties.

Stamp Duty is calculated on the value of the agreement and is capped to a maximum amount of €20,000 on the principal document. Any documents relating to the same transaction and which are considered ancillary to the principal document will incur a nominal rate of stamp duty.

Stamp Duty rates:

- €0–€5,000: nil.
- €5,001–€170,000: 0.15%.
- Over €170,000: 0.20%.

Stamp duty must be paid within 30 days from the date of the 'signing' of the relevant document. If for whatever reason the agreement is considered stampable and was not stamped, then a penalty will be payable. Failure to stamp a document which is subject to stamp duty does not invalidate the document of the acts contemplated thereby, but it cannot be adduced as evidence in enforcement proceedings brought before a Cyprus court unless the stamp duty and any penalties for late payment have been paid.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Filing or registration fees are not significant (see question 3.9 above). In terms of timing, registration occurs upon filing which, in most cases, is a same-day procedure. A certificate of registration of charge (in the case of shares) may be issued by the Registrar of Companies within a matter of days after filing.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consents are needed, although if regulated entities are involved, they may be subject to additional requirements.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no special priority or other concerns if the borrowings to be secured are under a revolving credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

There are specific statutory requirements and formalities that will need to be met in relation to the creation a pledge over shares in a Cyprus company pursuant to the Contract laws of Cyprus, Cap. 149, as amended. See further question 3.6 above.

In the case of deeds, it is no longer a requirement for these to be executed under seal; however if a company chooses to affix its common seal this must be done in accordance with the articles of association of the company.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Section 53(1) of the Companies Law imposes a prohibition on Cypriot companies to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription of shares made, or to be made, by any person in the company or in its holding company.

The general prohibition is subject to certain permitted exceptions such as where the lending of money is part of the ordinary business of the company. Similarly, where an otherwise prohibited transaction has been whitewashed under 53(3) a private company may proceed in giving financial assistance without falling foul of the general prohibition imposed by section 53(1).

The whitewash mechanism requires that (i) the private company concerned is not a subsidiary of a public company registered in

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Cyprus, and (ii) the transaction has been approved (at any time) by a resolution passed by holders of 90% of all issued voting capital in the company acting in general meeting.

Apart from any action brought against a director for misappropriation of company funds, or breach of duty, any contravention of section 53 (1) will subject the company and every officer to a default fine.

(b) Shares of any company which directly or indirectly owns shares in the company

Yes, see (a) above.

(c) Shares in a sister subsidiary

No prohibition would apply in this scenario.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

As a common law jurisdiction, Cyprus law will recognise the role of a security agent or trustee who will hold the security over assets of the borrower on trust for the benefit of a pool of creditors. The duties and responsibilities of the security agent or trustee will be governed by the agency provisions in loan instrument and the proceeds from enforcement of the loan or collateral security will be administered in accordance with the terms of the intercreditor agreement.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Not applicable – see question 5.1.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

There are no special requirements under the laws of Cyprus to make the loan and guarantee enforceable by Lender B, subject to any requirements specified in the loan agreement having been met.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Generally, Cyprus tax legislation does not provide for a withholding tax on interest payable on loans made to domestic or foreign lenders, or the proceeds of a claim under a guarantee or the proceeds of enforcing security.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No specific tax incentives exist for foreign lenders. Generally, foreign lenders are not subject to Cyprus tax or subject to Cyprus withholding tax on any interest payments.

Cyprus Stamp Duty may be applicable on the loan documentation (see the response to question 3.9).

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

A foreign lender is not subject to Cyprus tax solely because of a loan to or a guarantee or security given by a local company.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are no other significant costs other than those described in question 3.9 above.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Cyprus tax legislation does not specifically provide for thin capitalisation or similar rules.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The courts of Cyprus will recognise and give effect to a contractual foreign choice of governing law in any action brought before a Cyprus court pursuant to the Rome I Regulation (Reg. (EC) No. 593/2008). The cornerstone of the Regulation is to enshrine the principle of party autonomy and flexibility in respect of choice of law. Where parties choose a foreign governing law which is not the law most closely connected with the contract (assuming this would otherwise be Cypriot law) the courts in Cyprus will tend to give effect to it subject to (i) such choice of foreign law being pleaded and proved, (ii) mandatory provisions of Cypriot law which cannot be derogated from by agreement (penal, revenue and court procedural rules), and (iii) laws which are manifestly inconsistent with public policy.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Recognition and enforcement of judgments given by New York courts

There is no bilateral treaty between Cyprus and the USA on the enforcement of foreign judgments. Although a judgment of a New York court will be recognised under the Recognition, Enforcement and Execution of Foreign Judgments Law, Law No. 121(I)/2000, enforcement is not immediate. Section 5 of that law sets the procedural requirements to be followed, which commences by way of an application by summons accompanied by an affidavit. The hearing is set four weeks after the date of filing of the application and the respondent is given the right to file an objection (relating to jurisdictional matters and issues of substance).

Recognition and enforcement of judgments given by English courts

The courts in Cyprus will recognise and enforce judgments issued by English courts in accordance with the Brussels I Regulation (Reg. (EC) No. 44/2001) without any special procedure being required as to its recognition, which is an automatic process. Under the Regulation, a judgment given by the courts of an EU country may not be reviewed as to its substance although a court may refuse to recognise a judgment issued in another Member State under certain limited circumstances (e.g. where it is contrary to public policy). As soon as the judgment is recognised, the competent Cyprus court issues an order for its enforcement and the judgment will be executed as though issued by a Cyprus court.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The answer is specific to the facts and circumstances of each case and depends on the caseload of the court examining the matter.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

No. Certain types of borrowers or assets may be subject to their own regulatory requirements and may need prior approval from their respective supervisory authorities.

In exercising the enforcement rights afforded to them under the relevant security documents, a secured creditor is obliged under common law to obtain a fair price when realising assets subject to security and to pay regard to the principle of unjust enrichment.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

Foreign lenders can file a suit against a company in Cyprus and foreclose on collateral security without restriction.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Recent amendments to the Companies Laws (Law 62(I) of 2015) have introduced a process of "examinership". The amendments make provision for the appointment of a licensed insolvency practitioner as the "examiner" whose role is to examine the state of the company's affairs and agree restructuring proposals with shareholders during a four-month moratorium, in which the company is considered to be under the protection of the court, and immune from creditor action. Such examiner is appointed pursuant to a petition filed at court and once the court deems that, *inter alia*, a company is unable to pay its debts (i.e. the net asset value of the company is negative, taking into account potential and future liabilities).

Additionally, a court can make an order authorising the examiner to dispose of assets subject to security pursuant to section 202H(1)(d) of the Companies Law if it is satisfied that this would be advantageous to do so. The relevant section provides that where any claim against the company is secured by a mortgage, charge, lien or other encumbrance or a pledge of, on or affecting the whole or any part of the property, no action may be taken to realise the whole or any part of that security, except with the consent of the examiner. Specifically in relation to floating charges an examiner may, by order of the Court, realise the charged property (as if it was not subject to the charge) if in doing so would be to facilitate the survival of the company concerned as a going concern. Any net proceeds from the sale of secured assets pursuant to this section are used first to repay the secured debt with any surplus being distributed among unsecured creditors.

Bankruptcy under the Bankruptcy Law, Cap. 5 (as amended by Law 61(I)/2015)

Cypriot courts have the power (in accordance with Cap. 5) to order a 95-day moratorium on any enforcement action by creditors for the purpose of enabling a debtor to agree an arrangement (referred to as a "personal repayment plan") with them. If the plan is approved by a 75% majority of creditors in value and is sanctioned by the court, the arrangement will be binding on the debtor and all creditors. Dissenting creditors are given a right to be heard in court.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

As a contracting state to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958, a Cyprus court will enforce an arbitral award without re-examining the merits, provided that certain requirements as set out in the Convention have been met.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The main provisions relating to corporate insolvency in Cyprus are contained in the Companies Law (s202–305 inclusive) as amended by Law 62(I)/2015. The lender's ability to enforce its rights as a

© Published and reproduced with kind permission by Global Legal Group Ltd, London

secured party over the collateral security will invariably be affected by its inability to enforce the security during the protected period without the consent of the examiner – see question 7.7.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Under section 301 of the Companies Law, any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company within six months before the commencement of its winding-up, shall, within the context of a winding up, be considered a fraudulent preference against its creditors and invalid. In determining whether there is a fraudulent preference, the court looks at the dominant intention of giving the creditor a preference over other creditors coupled with a voluntary act made by the company. In establishing whether the intention to defraud existed, the burden of proof will rests with those asserting to avoid the transaction.

Section 303 of the Companies Law provides (in the context of a winding up) that a floating charge on the undertaking or property of the company created within 12 months of the commencement of winding-up shall, unless it is proved that immediately after the creation of the charge the company was solvent, be invalid. The onus of proof rests with the chargee.

Certain claims are treated preferentially in a winding-up and will therefore rank ahead of debts secured by a floating charge namely, the costs of the winding-up and preferential claims, which consist of all government and local taxes and duties due at the date of liquidation (due and payable within 12 months prior to that date) and where there are assessed taxes, taxes not exceeding one whole year's assessment; and all sums due to employees including wages, accrued holiday pay, deductions from wages and compensation for injury.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

No, all companies registered in accordance with the Companies Laws will be subject to the insolvency provisions contained therein. Additional requirements will apply to certain regulated entities and companies which carry on business in one or more Member States who will be subject to the provisions of the EU Insolvency Regulation.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Out of court proceedings available to a creditor to seize the assets of a company in an enforcement include powers of sale, taking possession, appointment of a manager or receiver and appropriation of financial collateral. The most common practice is for a receiver to be appointed.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

A party's submission to a foreign jurisdiction is legally binding and enforceable under the laws of Cyprus. See the response to question 7.2 above.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A party's waiver of sovereign immunity will be legally binding and enforceable under the laws of Cyprus.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no eligibility requirements in Cyprus in respect of lenders to a Cyprus company.

A lender licensed in their home jurisdiction does not need to be additionally licensed in Cyprus in order to lend funds to a local company.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are no special considerations that need to be borne in mind by lenders when participating in financings in Cyprus.

Acknowledgment

The authors would like to thank Maria Georgiou (Research Assistant) for her invaluable assistance with this project.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Marinella Kilikitas
E & G Economides LLC
30 Gr. Xenopoulou Street
3106 Limassol
(P.O. Box 58043, 3730 Limassol)
Cyprus

Tel: +357 25 866 480
Fax: +357 25 866 481
Email: marinella.kilikitas@economideslegal.com
URL: www.economideslegal.com

Marinella has over 10 years of post-qualification experience in her chosen practice areas. Marinella started her career in the corporate and commercial department of one of the largest law firms in Cyprus. During her career Marinella has had the opportunity to advise extensively on a number of high-profile blue-chip transactions for a vast range of multinationals and Magic Circle law firms.

Marinella specialises in cross-border mergers & acquisitions, joint ventures and corporate restructurings, corporate governance, banking and finance, financial services regulatory matters and equity capital markets where her experience has included advising both issuers and underwriters on IPOs as well as private placements. She is currently involved in a restructuring of existing debt facilities for one of the largest quarries in Cyprus (borrower's side).

George Economides
E & G Economides LLC
30 Gr. Xenopoulou Street
3106 Limassol
(P.O. Box 58043, 3730 Limassol)
Cyprus

Tel: +357 25 866 480
Fax: +357 25 866 481
Email: george.economides@economideslegal.com
URL: www.economideslegal.com

George focuses on tax, intellectual property, immigration and corporate and commercial law. He graduated from the University of Westminster and after completing his Bachelor's degree, he joined the audit and tax practice of a Cyprus major accountancy firm. He was later admitted to the Cyprus Bar association and is currently a partner with E & G Economides LLC. He is a member of the Cyprus Bar Association and the Individual Tax and Private Client Committee of the International Bar Association. In addition to the above, George is also involved in the firm's business development and marketing activities.

Economides
ADVOCATES & LEGAL CONSULTANTS

E & G Economides LLC, based in Limassol, specialises in Corporate & Commercial, Mergers & Acquisitions, Banking and Finance and Capital Markets work. Litigation, Financial Services and Private Client matters are also offered. With a team currently comprising over 20 advocates, the firm has continued to grow and expand its areas of practice with the support of an active network of global associates with long-standing ties to the corporate and financial communities.

The firm maintains a diverse client base and is regularly instructed by high-net-worth individuals, entrepreneurs, multinational corporations and tax firms, as well as global banking and credit institutions and both domestic and international transactions.

Our clients' interests often have a global focus and we are therefore frequently mandated to co-operate with international law firms on multijurisdictional projects and other cross-border engagements. Such assignments have been pivotal in yielding a globally minded perspective and have brought the firm in close co-operation with international law firms.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Czech Republic

Roman Šťastný

JŠK, advokátní kancelář, s.r.o.

Patrik Müller

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Loan documentation is becoming increasingly covenant heavy, and banks are tending to use documents based on the Loan Market Association standards even for smaller bilateral loan facilities. The banking loan market has started growing after the previous feeble years.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The largest lending transaction by volume in recent years has been the credit provided for the purpose of the acquisition of the Czech subsidiary of Telefónica by PPF Group. A substantial part of the total purchase price of CZK 60 billion was financed through a banking loan. Other significant banking transactions have occurred in the real estate and corporate markets with volumes between CZK 2 and 10 billion.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, but certain restrictions may apply.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Guarantees are regarded as unilateral acts under Czech law and so no consideration must be provided for a guarantee to be valid.

On the other hand, directors must be able to show that they are acting in the best interest of their company. If a company grants a guarantee (be it for the borrowings of a related or an unrelated party) and the relevant director is not able to demonstrate adequate benefits of the guarantee to the company, she/he can become personally liable for the damage caused to the company by issuing the guarantee. In addition, if a controlling company uses its influence over a controlled company to make the controlled company issue a guarantee, the controlling company will be liable to the controlled company for any resulting damage.

Certain guarantees provided without adequate consideration can be set aside (be considered ineffective) in insolvency proceedings over the party issuing the guarantee.

Additionally, in case of guarantees issued on behalf of a related party without any consideration or benefit, tax authorities could consider the guarantee a gift to the party on whose behalf it is issued and apply a gift tax on such transaction.

2.3 Is lack of corporate power an issue?

Generally, any business company can issue guarantees regardless of its object of activity. Bylaws of the company can restrict the power of its directors to issue guarantees, but such restriction will not normally be opposable to third parties acting in good faith.

However, in certain cases, the law requires the shareholders' consent or at least the notification of the shareholders before a company can issue a guarantee, and a lack of consent/notification can invalidate the guarantee.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Business companies do not need a governmental or similar consent for issuing a guarantee. However, if a company intends to issue a guarantee securing the obligations of its related party (including members of the same group, its directors or proxies) it must first obtain consent of or at least inform the general meeting of its shareholders. The shareholders may prohibit the company from granting such a guarantee.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Not specifically. However, a guarantee provided by a company with no adequate consideration when the company was insolvent or in the stage that led to the insolvency of the company (including the company's overindebtedness) will be set aside in insolvency proceedings.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Currently, no. However, the law authorises the government to adopt certain restrictive measures on the flow of capital during economic or financial emergencies in the Czech Republic.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

A broad range of assets can be used as a fixed collateral security, including real estate (land and buildings), movable (personal) assets, shares, bonds, receivables and certain rights (including certain intellectual property rights).

The law also enables the creation of floating charges over a defined set of assets (such as inventory or a collection of books) or over the whole enterprise of a company.

Certain financial transactions can be secured by additional collateral such as cash in bank accounts.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is possible to create a floating charge (pledge) over the whole enterprise of a person or over a defined set of assets. However, this charge does not affix to the individual assets forming part of the charged enterprise or set of assets. Consequently, if an asset forming part of the original enterprise or set of assets is sold by the owner, the charge will not extend to the sold item. The floating charge must be taken under a written agreement in the form of a notarial deed entered into between the owner of the enterprise or set of assets as the pledgor and the beneficiary of the secured obligation as the pledgee, and then perfected by registration in the notarial register of pledges.

For a fixed security over specific assets, please see our answer to question 3.3.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. The procedure differs according to the type of property.

A fixed pledge over a movable (personal) asset can be perfected either by possession (in which case it can be created under a simple agreement in writing between the pledgor and the pledgee) or by registration in the notarial register of pledges (in which case it is created under a written agreement between the pledgor and the pledgee, made in the form of a notarial deed).

Any real property registered in the cadastral (real estate) register (basically all the land and most buildings that are not a part of the land) can be mortgaged through a written agreement between the owner of the real estate as the mortgagor and the beneficiary of the secured obligation as the mortgagee, provided that the authenticity of signatures of both parties is verified by a notary. The mortgage must be registered in the cadastral register in order to become effective.

A pledge over real property that is not subject to registration in the cadastral register (certain minor or underground constructions) is taken through a notarial deed and registration in the notarial register of pledges.

The perfection of security over certain specific types of assets requires registration in specific registers (for example a mortgage over an aircraft registered in the Czech Republic must be registered with the Czech aviation register).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. The pledge agreement must be entered into in writing and must specify the pledged receivable as well as the secured obligation.

The pledge is not enforceable against the debtor of the pledged receivable until the pledge is notified to the debtor by the pledgor or evidenced by the pledgee.

Alternatively, the pledge agreement can be made in the form of a notarial deed and the pledge entered into the notarial register of pledges. Then the pledge becomes enforceable upon its registration.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. It is usually created as a pledge over the account holder's receivables for payments from the account. Certain financial transactions can be secured by the pledge over the cash directly.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, a pledge can be taken over the shares issued by a Czech joint stock company as well as over the ownership interests in a Czech limited liability company. Each must be created under a pledge agreement entered into in writing between the owner of the share (ownership interest) as pledgor and the beneficiary of the secured obligation as pledgee and specifying the pledged shares (ownership interest) and the secured obligation.

Shares of a Czech joint stock company can be issued in a certificated form (only in case of registered shares) or book-entered. The perfection of a pledge over certificated registered (*au nom*) shares requires a pledge endorsement in addition to the hand-over of the shares to the pledgee or a custodian.

A pledge over book-entered shares is perfected by its registration with the central depositary. A pledge over immobilised shares is perfected by the notification of the relevant depositary of the pledge. A pledge over an ownership interest in a limited liability company requires registration with the commercial register.

The relevant pledge agreement could, in theory, be governed by a foreign law but would still have to satisfy the requirements of Czech law in respect of the creation of the pledge if it was to be enforced in the Czech Republic.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, a floating pledge can be taken over the inventory defined as a certain set of assets. A fixed pledge can be created over the individual assets forming part of the inventory (but not over an asset which is pledged as a part of a set of assets). For the procedure see the answers to questions 3.2 and 3.3.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company can use its assets as a security for its obligations as well as for obligations of other parties (certain restrictions as to consideration and internal approval requirements may apply in the same extent as to guarantees – see the answers in section 2).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Where a pledge agreement must be made in the form of a notarial deed, the fee is set according to the value of the secured obligation. The rate ranges from 1% to 0.05% of the obligation (the higher price the lower rate); the minimum fee is *ca*. EUR 32 and is charged only for secured amount up to *ca*. EUR 1,600,000. An additional fee is charged for each pledged item registered in the notarial register of pledges.

A fee for the registration of a mortgage over real estate in the cadastral register amounts to *ca*. EUR 40. Additional fees are payable for registration of security over certain other assets in amounts varying according to the type of the asset.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The time required for registration of a security can extend up to several weeks in case of real estate and certain specific assets such as aircraft or a trademark. Pledges over movable assets, enterprises or sets of assets are usually registered in the notarial register of pledges on the same day on which the pledge agreement is executed.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally, no regulatory consents are required for the creation of the security. However, the perfection of certain types of collateral security requires registration in public registers (cadastral register, aviation register, commercial register) and the registration is subject to consent of the authority maintaining the register.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No. In case of revolving facilities, the collateral secures all future obligations of the borrower under the relevant facility which will arise until a certain time up to a certain amount, and the priority of the security is governed from the time it was perfected.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Yes, pledges over movable assets that are not perfected by possession, pledges over sets of assets or enterprises, pledges of receivables in certain cases and pledges over real estate that are not subject to registration in the cadastral register are established under an agreement made in the form of a deed before a Czech notary public. If such pledge agreement is executed under the power of attorney, the power of attorney will also have to be made in the form of a notarial deed.

Signatures of parties on mortgage/pledge agreements in respect of real estate registered in the cadastral register or in respect of ownership interests in limited liability companies must be officially authenticated (by a notary public, an attorney or a municipal office).

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Yes, in all of the above cases, financial assistance is offered unless the company goes through a whitewash procedure.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

New provisions that should allow the use of security trustees have been recently introduced into Czech law. However, these provisions are not tested yet and banks tend to avoid them for now.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Yes, a parallel debt or a similar provision needs to make the security agent a joint and several beneficiary (creditor) of each secured obligation with each primary creditor (lender) of the obligation. The Czech law security is then created to the benefit of the security agent to secure all the obligations owed to the agent as the joint and several creditor with the lenders. The security agent can then enforce the security in its own name to the full extent of the secured obligations and distribute the proceeds to the lenders under the facility agreement.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

No (subject to different provisions in the facility agreement or the guarantee), but the transfer will be enforceable against the borrower and the guarantor only after Lender A notifies them of the transfer or Lender B evidences the transfer to them.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest payable by a Czech tax resident to a foreign entity which has no permanent establishment in the Czech Republic is subject to a 15% withholding tax. The withholding tax does not apply to interest payable to beneficiaries resident for tax purposes in EU or European Economic Area countries or in jurisdictions which have entered into a treaty with the Czech Republic reducing the withholding tax to zero. No specific withholding tax is applicable in respect of the proceeds of a claim under a guarantee or enforcement of security. However, to the extent the proceeds are used to satisfy the secured interest, the tax withholding from interest payments may apply.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no incentives aimed at foreign lenders in the Czech Republic. For the applicability of withholding tax and various notarial or registration fees see other parts of this questionnaire.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Generally not, as long as the lender is not considered to have a permanent establishment in the Czech Republic under the relevant treaty on double taxation or, in its absence, under Czech law.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

See our answer to question 3.9 for a discussion of the fees related to the creation and perfection of security.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, the courts not only recognise it but also enforce foreign governing law providing the contract includes a "foreign element". Usually a contract to which at least one of the parties has a seat outside the Czech Republic will have a sufficient foreign element for the choice of foreign law provision to be upheld by Czech courts. The recognition and enforcement of foreign law will always be subject to Czech public order and imperative norms.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Enforcement of English court decisions as well as decisions from other EU countries are subject to Brussels I and Brussels IIA regulations under which judgments in civil and commercial matters and matrimonial and parental matters, respectively, are decided by courts of EU Member States and may be recognised and enforceable in another Member State without any re-examination.

Recognition of judgments of other jurisdictions regarding commercial matters is subject, among other conditions, to reciprocity having been demonstrated. Several judgments of New York courts have already been recognised in the Czech Republic and reciprocity is believed to have been established between the Czech and New York courts.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

A suit can be filed within days (depending on the complexity of the matter and the time it requires to prepare it). In cases of a receivable lower than *ca*. EUR 40,000, an electronic action is available. The period for obtaining a judgment varies from one to several months depending on the cooperation of the defendant and complexity of the case. The process can take even up to three years in case of an appeal. Once a final judgment is obtained, the enforcement is enforced by an executor (i.e. authority appointed to execute judgments). Enforcement proceedings are usually faster and last a few months.

The enforcement of a foreign law judgment should not take longer than in case of a judgment of a Czech court.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Generally a secured creditor can satisfy its claim from the collateral only through a public auction or in a court-ordered auction. New provisions that should allow a direct enforcement of collateral security by the creditor have been recently introduced into Czech law but have not been tested in practice yet.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

No, the position of foreign lenders does not differ from that of their Czech counterparts. However, in practice they must expect that any

© Published and reproduced with kind permission by Global Legal Group Ltd, London

documents presented to Czech courts or other authorities need to be translated into Czech.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. The enforcement of lenders' claims and security is generally restricted after insolvency proceedings are initiated against the borrower or the owner of the collateral. For more details, see our answer to question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. The Czech Republic is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards signed in New York on 10 June 1958. Pursuant to this Convention, arbitration awards are recognised in the Czech Republic and enforced under the Czech law – arbitration awards are recognised automatically and for enforcement an order (court decision) is necessary. The courts will re-examine the case only from a procedural and public order perspective.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

After insolvency proceedings have been commenced against a company, no party may enforce its claim against the company or seek satisfaction from the assets owned by the company other than within the insolvency proceedings. However, creditors secured on an asset of the insolvent company have a right to be satisfied from the proceeds of the sale of the asset up to the amount of their claim.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes, generally any acts of the insolvent entity which prefer one creditor to the detriment of other creditors may be set aside and disregarded in insolvency proceedings if they occurred within three years preceding the commencement of the insolvency proceedings in favour of a related party creditor or within one year prior to the commencement in favour of an unrelated party creditor.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes, certain public entities such as the municipalities or the central bank are excluded from insolvency proceedings. Specific rules apply to financial institutions such as banks or insurance companies.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

There are only limited cases when a creditor can enforce its collateral directly without the involvement of a court. The law, for example, allows a creditor secured by a pledge over an ownership interest in a limited liability company or by a pledge over shares of a company to sell the interest or shares publicly in its own name and use the proceeds of the sale to satisfy its claim.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Generally yes, except where the Czech courts have exclusive jurisdiction, such as in the case of a dispute over real estate located in the Czech Republic.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes. Under Czech law, the state can validly waive its sovereign immunity. In addition, according to the decisions of Czech courts, in private legal matters (*acta iure gestionis*) between a state and a private entity no waiver is necessary, as such matters are outside the scope of the state's immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Lending to a company does not require a banking or any other specific licence. No specific licensing requirements apply to lenders' agents in syndicated facilities.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are a number of specific requirements and issues that may need to be addressed depending on the type of financing and collateral to be used. These should be always addressed on a case-by-case basis when a foreign lender intends to extend a loan to a Czech company or have a loan secured by assets located in the Czech Republic.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Roman Šťastný
JŠK, advokátní kancelář, s.r.o.
Ovocný trh 573/12
110 00, Prague 1
Czech Republic

Tel: +420 226 227 622
Fax: +420 226 227 609
Email: roman.stastny@jsklaw.cz
URL: www.jsklaw.cz

Roman graduated from the Law School of Charles University in 1997. Between 1994 and 1995 Roman also read French and EU law at the University of Provence (France) and between 1993 and 1998 studied international relations at the Prague School of Economics. Roman obtained an LL.M. degree from the University of Michigan Law School (USA) in 1999.

From 1995 to 2005 Roman worked for an international law firm in Prague and in 2006 became a partner of JŠK. Roman regularly represents various Czech and international banks, including UniCredit Bank and CSOB in real estate, project and other financing transactions. Roman has also advised in relation to the sale and lease-back of a hangar of Czech Airlines, and drafted or advised on several aircraft mortgage agreements, aircraft leasing and financing agreements and aircraft purchase agreements.

Patrik Müller
JŠK, advokátní kancelář, s.r.o.
Ovocný trh 573/12
110 00, Prague 1
Czech Republic

Tel: +420 226 227 669
Fax: +420 226 227 609
Email: patrik.muller@jsklaw.cz
URL: www.jsklaw.cz

Patrik graduated from the Law School of Masaryk University (Czech Republic) in 2007. Patrik also took a one-year course in international and EU law at the University of Salamanca (Spain) between 2004 and 2005.

Patrik has been working with JŠK since his graduation. He advised several lenders on the financing of a number of renewable energy source projects, including solar, wind and biomass power plants, as well as real estate projects. Patrik represented Moravan Aviation (now Zlin Aircraft), a Czech manufacturer of sport aircraft, before the Czech Civil Aviation Authority and EASA, and advised the client on certain insolvency- and restructuring-related matters.

In his practice, Patrik also deals with energy and public procurement law.

JŠK, advokátní kancelář, s.r.o. (***JŠK***) has serviced Czech and international clients since 2004. All of JŠK's partners have spent many years in major global law firms before they joined JŠK to accomplish their desire to provide top-class international services in close contact with the clients and the market.

JŠK often works for banks and insurance companies, as well as for local and multinational businesses ranging from energy generation to motorway construction and nanotechnology.

At the time of writing, JŠK has four partners and 15 other lawyers. In financing, JŠK normally works for banks or borrowers.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Dominican Republic

QUIROZ SANTRONI Abogados Consultores

Hipólito García C.

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The most significant progress in the lending markets in the Dominican Republic recently still results from the enactment in 2011 of a new law aimed at the development of the mortgage market and trusts in said jurisdiction, followed by the adoption of its provisions by the Monetary Board and the Executive Branch of the Dominican Republic. The law incorporated into Dominican legislation the possibility of settling trusts, made significant improvements in the legislation and regulation on the securitisation of mortgage loans, allowed for the use of security or collateral agents, and simplified the process of foreclosure over conventional mortgages. This law also allowed for trusts to be used for security purposes by conveying collateral directly to the trustee as security for a financial obligation. More recently, the Dominican Republic has embarked on the process of adopting a new law on securities over personal property, in an attempt to create uniform processes for the creation of securities over all types of personal property, provide better access to financial services, and allow for alternative methods of enforcement of collateral *in lieu* of conventional judicially administered foreclosure proceedings.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Major lending transactions in recent years include secured financing transactions over important mining concessions in the country, including a USD1.035bn finance operation over the Pueblo Viejo gold mine, leased to Barrick Corporation and Goldcorp, and corporate loans granted to one of the major energy generators in the country, EGE Haina, for the construction and/or expansion of conventional plants and wind farms.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Any subsidiary, local branch or other affiliates of a borrower can guarantee the obligations of its parent or related company or other members of its corporate group under Dominican law.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

There are no enforceability concerns in this respect addressed under Dominican law.

2.3 Is lack of corporate power an issue?

Lack of corporate power may invalidate a borrowing or its collateral; accordingly, presenting evidence of authority to enter into and execute any loan or security documents in the Dominican Republic is inexorably required, especially in connection with mortgages where presentation of such evidence to local registries is mandatory to allow recording of a security interest over real estate.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Shareholder approvals may be required under the bylaws of any company in the Dominican Republic, and such approval is mandatory in connection with the pledge over quotas in a limited liability company (SRL) under our Business Associations Law. Governmental consents are typically required to allow security interests to be granted over any governmental or municipal concessions or licences. Filings before special registries (Land Registry offices, Justices of the Peace, Mining Rights registries, etc.) and notices to third parties will also typically be necessary to perfect a security interest.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Limitations may result from asset valuation norms applicable and enforced by financial authorities in the Dominican Republic over local commercial banks. Limitations of the same nature apply in connection with non-possessory pledges over personal property and equipment under Law 6186 which limits borrowings to an amount not exceeding 70% of the value of the collateral.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Since the enactment of Monetary and Financial Law 183-02 in 2002, monetary obligations are to be paid in the agreed currency;

© Published and reproduced with kind permission by Global Legal Group Ltd, London

accordingly, a secured lender may benefit from security interests granted and enforceable in the same currency of the borrowing.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Conventional mortgages over real property, along with non-possessory pledges over personal property and equipment remain the main types of security interests granted over assets in the Dominican Republic. However, security interests are also available over other types of property and interests including intangible assets such as stock, funds in bank accounts, account receivables, interests in contracts, concessions or licences, and over other types of assets typically deemed immovable property such as aircraft, naval craft and mining concessions.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Currently, since almost all types of security interests are governed by different laws demanding for different creation and perfection requirements depending on the nature of the collateral, an agreement is typically required in relation to each type of asset. A mortgage agreement requires execution by both secured parties and the owner of the real estate as guarantor and must include all mandatory details required under the Land Registration Law and its rulings of enforcement, including a legal description of the land. Signatures placed on the agreement must be certified by a Notary Public.

For purposes of perfecting a non-possessory pledge, the law includes in this respect a requirement of specificity, which means that the assets subject to the security interest must be identified as well as possible. In the case of equipment, there must be a description of each machine and its serial number. Indicating the value of the pledge is also a requirement, as well as its location. The agreement embodying the pledge must be signed in the presence of a notary public or Justice of the Peace.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security may be taken as expressed above over real property, under the general provisions of the Civil Code of the Dominican Republic and the Land Registration Law, while security over machinery and equipment will typically be granted under non-possessory pledges, a type of security similar to the chattel mortgage and originally intended for crops and agricultural equipment but later expanded to cover virtually all sorts of personal property or movable assets, including industrial machinery and motor vehicles. This type of security is governed by the Agricultural Incentives Law 6186.

A mortgage will require filing before a Land Registrar's Office with jurisdiction over the real estate depending on its location. Recording fees include a 2% tax based on the secured amount; pledges over personal equipment will require for the pledge agreement to be placed on record at the office of the Justice of the Peace of the debtor's domicile in the Dominican Republic, except that in the case of motor vehicles, the document must additionally be recorded before the Tax Administration authorities. Recording fees are nominal.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Accounts receivable, as intangible assets, may be subject to pledges. These types of securities are governed by the provisions set forth in Articles 91 *et al*. of the Commercial Code which relate to the commercial pledge. A commercial pledge is usually the type of security considered for purposes of pledging all types of intangible assets.

Applicable to all pledges over intangible assets, perfection takes place through a notice of the pledge agreement by an appointed bailiff. The notice, which includes a copy of the corresponding pledge agreement, is given to the guarantor's counterpart under the relevant pledged agreement. Costs for perfection are nominal. The bailiff act is also registered before the Civil Registry held by the municipality; costs in connection with this registration process are also nominal.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Security may be taken over cash deposited in local bank accounts. The process is the same as required for the perfection of a security interest over intangible assets. The parties, however, will typically enter into special account control agreements with the depositary bank.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Collateral may be taken over shares in companies incorporated under Dominican law. Shares are usually issued in certificated form, except in connection with limited liability companies, where interests of the partners are represented by quotas, which may not be represented by negotiable instruments.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

A non-possessory pledge over inventory may be granted under Law 6186 in similar fashion to a pledge over equipment and machinery, provided, however, that the pledge agreement clearly identifies the assets comprising the inventory by including their nature and their quantity. Failure to include these details may render the security interest unenforceable.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company may grant a security interest over its own assets and interests to secure its own obligations, and to secure the obligations of other borrowers or guarantors under a credit facility, whether affiliated persons or third parties.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notarisation is mandatory for any mortgage agreement and non-possessory pledge agreements. Recordation of a mortgage will entail recording taxes determined as 2% of the secured amount; recording fees for pledges are nominal. Mortgages over non-registered land, aircrafts, naval crafts and mining concessions must be documented in authenticated form before a Notary Public and witnesses. Recording tariffs over these types of security interests may also be required by the registry authorities.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The costs for recording mortgages, whether over registered land or non-registered properties, including over movable assets and interests deemed under the law as immovable property (aircrafts, mining concessions, etc.) are certainly significant and although filing may be carried out in a timely fashion, the process of obtaining a security certificate or certification further evidencing the recordation of the security interest by the corresponding registry can take several months. Filings and notices are required in connection with pledges, however only involve nominal costs and may be carried out quickly. Recently, the Constitutional Court of the Dominican Republic declared as unconstitutional, and thereof null and void, certain provisions of law requiring the payment of these recording fees with respect to agreements in authenticated form; however, the effects of this declaration, as provided by the same judicial decision were delayed until January of 2017.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Consents from governmental authorities will typically be required in connection with pledges over concessions or similar licences over public services or works, including mining concessions, telecommunication concessions, energy generation or distribution concessions, and other general concessions granted by municipal authorities or the Central Government.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Revolving credit facilities may be secured by any type of security interest available under Dominican law, and the same may be perfected before any amount is disbursed under the facility. The amount secured under the facility or any disbursement thereof is limited to the amount stated in the corresponding security agreement.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

As explained above, certain mortgages are required to be documented in authenticated form before a Notary Public who maintains the original statement of the security in its protocol or records, and issues a certified copy for further registration or enforcement processes. The rest of the security interests may be documented in private form although signatures placed on the agreements are required to be certified also by a Notary Public. Under Dominican law, any agreement must be executed in as many counterparts as parties thereto, and in connection with security agreements, additional counterparts may be required to be executed for recordation in public registries.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Restrictions may apply in connection with limited liability companies (SRLs), and simplified stock companies (SASs) organised under Dominican law, where partners are prohibited from assuming financial commitments to be secured by the company when (i) the transactions exceed 15% of the net value of the company in the case of SRLs, and (ii) during the time the SAS is owned by a sole shareholder, the transactions exceed 25% of the net value of the company.

(b) Shares of any company which directly or indirectly owns shares in the company

The same restrictions explained above, to the extent the borrowing is taken by a partner or shareholder of the guaranteeing company.

(c) Shares in a sister subsidiary

The same restrictions explained above apply.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Following the enactment of Law 189-11, a security may be granted solely to a collateral or security agent, provided it is authorised to act as such by the Monetary and Financial authorities in the Dominican Republic, or by a trustee, also authorised to act as such under Dominican law and regulation. The security may be granted accordingly through security documents signed only with the security agent, and may be enforced by said agent also rather than by the lenders acting separately.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

The simple solution to avoiding any risks associated with an agent or trustee not being recognised in the Dominican Republic is for the security to be recorded in the name of each lender or secured party.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

This, however, would be too cumbersome if secured parties include holders of notes.

Parallel debt or similar structures, including schemes under which a mirror (parallel) debt is created in favour of the security or collateral agent (such debt resulting from a guarantee granted for the benefit of the original lenders by such agent, which would allow the agent to collect against the main guarantor or borrower) and such is the debt that is secured by the local guarantor, could be considered in these scenarios. In practice, however, these risks are often overlooked by law practitioners in the Dominican Republic, and no structures are designed whatsoever to mitigate the same, especially if security packages do not include mortgages over real estate properties, where registration costs and processes could result considerably high and cumbersome. Lenders may also resort to participation schemes where the security is only granted and perfected in the name of the lender of record, to be enforced directly by the same, although ultimately, for the benefit of participants in the loan which will be deemed to have a claim only against the lender of record, and not directly against the borrower or guarantor.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Any assignment of a loan from one lender to another, unless through a participation scheme where the assignor remains as the lender of records, requires, the loan and its security to be enforceable against the borrower or the guarantors directly by the assignee, that the assignment is notified to the borrower and the guarantors under Article 1690 of the Civil Code of the Dominican Republic, which governs in general assignments of intangible assets, including accounts receivable. This notice is usually carried out with the assistance of a bailiff.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

In general, any payment made abroad or credited into account of a non-domiciled or residing person which is deemed income of Dominican source will demand applying a withholding tax by the payer. In the case of loans payable to foreign lenders, the withholding tax is currently set at 10% over the interest portions of the payments. Principal portions of the loan are not subject to a withholding tax, nor are payments on interest paid to local lenders, provided these are corporations and not individuals.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Tax incentives are only available in connection with special legal regimes in force including for the development of tourism projects and renewable energy projects. Certain concessions over public works or services may also include tax exemptions for the persons providing finance to the underlying projects and operations of these concessions, provided the concession agreements are previously approved by the National Congress. Tax incentives may also apply in connection with the use of trust schemes for the financing of low income housing projects and the issuance of securities and their public offer in the Dominican Republic.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Interests from loans made to a Dominican company, or loans secured by real property in the Dominican Republic, are deemed income from a Dominican source and are therefore taxable in the Dominican Republic, typically through a withholding tax, as explained in previous questions. Normally, foreign lenders limit the ability to local borrowers in applying deductions over any payments, by having borrowers undertake the obligation to gross up payments – allowing the lender to receive net payments in amounts equal to those it would otherwise receive should no withholding or deduction for local taxes apply.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are no other significant costs to be incurred by foreign lenders in relation to those which would be otherwise incurred by a domestic lender.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

A company operating locally, taking loans from a lender which is organised in a tax haven or other jurisdiction with lower income tax rates, may have problems in deducting paid interest as an expense for purposes of determining its own net and taxable income, or if in connection with such interest payments failed to apply the withholding tax.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Courts in the Dominican Republic will recognise a foreign governing law and enforce a contract subject to a foreign governing law in general; however, security interests over assets or interests deemed to be located in the Dominican Republic can only be created and enforced under Dominican law, as well as any other matter deemed of public order or policy.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

In general, the courts of the Dominican Republic would recognise as a valid judgment, a final and conclusive judgment obtained from foreign courts and would give a judgment based thereon, provided that such judgment rendered by the foreign court is declared enforceable through the issuing of a writ of execution (locally called "*exequatur*") by the corresponding Dominican court. Based on existing law, Dominican courts will issue such writ of execution or *exequatur* without need for a retrial: (i) if there exists a treaty with the country where the judgment was issued; or (ii) if such judgment: (a) complies with all formalities required for the enforceability thereof under the laws of the country where the same was issued; (b) has been translated into Spanish, together with related documents, and satisfies the authentication requirements of Dominican law; (c) was issued by a competent court after valid service of process upon the parties to the action; (d) was issued after an opportunity was given to the defendant to present its defence; (e) is not subject to further appeal; and (f) is not against any public policy of the Dominican Republic.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

As with any litigation matter in the Dominican Republic, the process to obtain a favourable judgment from Dominican courts, enforceable against a defendant or its assets, could take in a best case scenario up to six months from the inception of the relevant judicial action, but up to one year or more in normal circumstances. The process of obtaining an exequatur, although it does not require a re-examination of the merits of the case, since there is no special procedure under Dominican law, can take the same time mentioned above for other general lawsuits.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Foreclosure on any type of collateral will demand judicial intervention, and in the case of security interests over real estate or personal property, public auctions are generally mandatory. In certain proceedings including governmental concessions and mining concessions, any bidder in a public auction may be required to be pre-approved by the granting authority. The same would apply if the concession is adjudicated to the secured party holding the security interest in the same, but intending to assign or sell it privately to a third party.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

Foreign lenders may be at a disadvantage when it comes to asserting their rights in Dominican courts by the potential need to post security to cover attorney fees and court costs incurred by the defendant, as well as any damages for wrongful prosecution in case the latter is successful. This requirement is referenced in Article 16 of the Civil Code, which reads: "*In all branches of the law and before all courts, a foreigner in transit acting as plaintiff or intervener is obligated to post security for the payment of the costs and damages resulting from the lawsuit, unless he possesses real property in the Republic of a value sufficient to cover the payment thereof*." The same principle is in force under Articles 166 and 167 of the Code of Civil Procedure. The defendant can request the placement of this security at the inception of the suit. In practice, the demand is for a very large bond and to the extent the request is granted, the foreign lender could be placed in a dilemma of either freezing a considerable part of its assets or of appealing against the amount of the bond, arguing that it is excessive, in which case the action will be stayed for a considerable amount of time until the amount of the bond is reset by the Court of Appeals. If it is lowered by any amount, the defendant, in order to gain time, can appeal to the Supreme Court. The need for foreign claimants to post security has thus become a means to prevent them from having their day in court. Foreign and international lenders are, however, and in principle, able to protect themselves by inserting a waiver to these provisions found in Dominican Codes into their loan agreements. In our opinion, such waivers are considered valid. Under certain laws including the Dominican Labour Code, the Laws on Industrial Property and copyrights and more recently under the current Business Associations Law of the Dominican Republic, the litigation bond requirement should not apply, and some courts have also found the requirement to violate Constitutional rights; however, the incorporation of the waiver explained above is still highly recommendable.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Under current insolvency laws in the Dominican Republic, proceedings governed by the same only affect unsecured creditors, or unsecured portions of a claim. Accordingly, most secured creditors may continue to enforce their collateral security against the bankrupt borrower, and would not be affected by moratoriums otherwise applicable upon the entry into force of a bankruptcy judgment.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958, as approved by Congress on July 10, 2002, will apply to a foreign arbitral award enforced in the Dominican Republic, provided it is final and conclusive between the parties thereto. In accordance with Article 3 of the aforementioned Convention, each of the contracting States undertakes the obligation to recognise the authority of arbitral awards and to grant its execution in accordance with the norms of procedure in force within the territory where the award is being invoked, with conformity to the conditions established in the Convention, while providing that the recognition and enforcement of arbitral awards will not be subject to conditions appreciably more rigorous, or higher fees or expenses, than those applicable to the recognition and enforcement of national arbitral awards. Based on the above, a debate had emerged on the enforceability of a foreign arbitral award within Dominican territory following the ratification of the New York Convention in

© Published and reproduced with kind permission by Global Legal Group Ltd, London

said jurisdiction. Currently, however, based on judicial precedents and the terms of the Commercial Arbitration Law in force in the Dominican Republic as adopted in 2008, the enforcement of an arbitral award is subject to basically the same rules to be observed in connection with the enforcement of foreign judgments, i.e., the obtainment of a writ of execution, called an *exequatur*.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Under insolvency laws still in force in the Dominican Republic, proceedings governed by the same only affect unsecured creditors, or unsecured portions of a claim. Accordingly, most secured creditors may continue to enforce their collateral security against the bankrupt borrower, and would not be affected by moratoriums otherwise applicable upon the entry into force of a bankruptcy judgment. Such moratoriums do apply, however, to unsecured creditors, and will apply upon the entry into force of a new insolvency law, which was enacted near the end of 2015 in the Dominican Republic.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

If a formal bankruptcy is declared against a person in the Dominican Republic, preferential payments and transfers of assets, and the granting of security for antecedent debts made by the debtor prior to bankruptcy during the time it was insolvent, can be set aside. This period, during which the effect of bankruptcy is retroactive, is known as the suspect period. Its inception is determined by the judge. Upon entry of a bankruptcy order, the judge will determine a date of cessation in payments. The following transactions by a debtor may be declared null and void should they be carried out after said date of cessation in payments or within the preceding 10 days of said date: all transfers of personal property or real property without consideration; all payments for unmatured debts; all other payments unless made in cash or with a negotiable instrument; and any security interest on property of the debtor, granted by the same as security for pre-existing debts. Any other transaction may be declared null and void should it be proven that the other party had knowledge of the debtor's state of insolvency.

Among the claims coming ahead of any claim, whether secured or unsecured, and even outside bankruptcy proceedings, are the rights of the Government to collect unpaid taxes followed by the rights of employees to their salaries and other rights derived thereof although such preferential right should not affect the priority interest deriving from a duly recorded mortgage over registered land; in the case of individuals, in addition to the foregoing, we may also include their obligations to support their wives and children, and the claims of retailers for food and lodging for the past six months. Also, a pledge over personal property fixed to a real estate property, recorded before a mortgage registered over such real estate property and its fixtures, will prime over such mortgage with respect to the fixtures, when such may be deemed as "real estate properties by destination".

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Special insolvency, reorganisation and liquidation proceedings apply to banking institutions under the Monetary and Financial Law 183-02, to insurance companies under the Insurance and Bonds Law 146-02, for pension funds under the Social Security Law 87-01, and trusts under Law 189-11. The general rules on insolvency in the Dominican Republic will only apply to merchants, including corporations, excluding thereof individuals not deemed as such. There are no special rules in connection with public entities.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Creditors in general may resort to prejudgment liens and cautionary measures to set aside assets or interests of the debtor in their benefit and to secure payment or their claims against the same, including: if the claim is for a liquid sum duly evidenced in a valid instrument such as a promissory note; for approved invoices, the possibility to garnish bank accounts and accounts receivable of the debtor; or, with an authorisation from a judge, to attach personal property of the borrower and register judicial mortgages on real estate owned by the same.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

In general, a party's submission to a foreign jurisdiction is legally binding and enforceable under the laws of the Dominican Republic, although certain matters relating to real estate or other matters of public policy are of the exclusive competition of local courts.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A party's waiver of sovereign immunity is legally binding and enforceable under the laws of the Dominican Republic.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

A foreign lender, unless it intends to enter into financial intermediation operations locally as defined under local law (the habitual obtainment of funds from the public, with the purpose of assigning them to third parties), does not require a special licence to originate a loan involving a local debtor. Before the enactment of the latest tax reform in 2012, payments on interest made abroad to a credited financial institution were set at a lower withholding tax rate than those paid to a non-credited financial institution; currently, however, the same rate (10%) applies irrespective of the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

beneficiary of the interest payment. As to agents, an administrative role will not trigger any licensing requirements in the Dominican Republic, but the role of a security trustee or collateral agent will be subject to a special licence issued by the Monetary and Financial Administration.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

As per the terms of Article 63 of the Currency Exchange Regulation, as adopted by the Monetary Board of the Dominican Republic, although provided solely for statistical purposes, failure by any local person or entity to report before the International Department of the Central Bank of the Dominican Republic obligations assumed in a foreign currency, may be construed by local monetary and financial authorities as an infraction punishable under the Monetary and Financial Law 183-02. Thereof, although explicitly provided as an obligation of the obligor, we recommend foreign lenders to require from their borrowers fulfilment of this reporting obligation, which is carried out by delivering a special form available from the Central Bank of the Dominican Republic.

Finally, in addition to proposed legislation relating to security interest over personal property and equipment creating uniform rules and publicity requirements for such type of guarantee, irrespective of the nature of the collateral, lenders should also take into account new insolvency legislation adopted at the end of 2015 in the Dominican Republic. Such proposed legislation extends insolvency proceedings, including towards the reorganisation of a failed business, to secured creditors, enforcement actions of which may be stayed upon initiation of the bankruptcy proceedings.

Hipólito García C.

QUIROZ SANTRONI Abogados Consultores
Ave. 27 de Febrero No. 495
Torre Forum, Suite 5B
Santo Domingo
Dominican Republic

Tel: +1 809 338 4200
Fax: +1 829 681 2100
Email: hipolito@laleyenverde.com
URL: www.laleyenverde.com

Hipólito García is a partner at Quiroz Santroni, leading the Banking and Finance practice of the firm. His vast experience and practice includes project and corporate finance, M&A, employees, bankruptcy, and corporate law in general, having participated in several of the most important transactions in the country, including the financing of one of the biggest investments in the Dominican mining sector, in which he acted as local attorney for the lenders. He has also been involved in the merger of major commercial banks and insurance companies in the country. He has assisted many of the most important international finance institutions, including development and multilateral banks, in the structuring of numerous corporate finance transactions for major energy and road infrastructure projects, characterised by the complexity of syndication, the use of trust and collateral agency schemes and the intricacy of regulated sectors. He studied law at the *Pontificia Universidad Católica Madre y Maestra*, graduating with honours in 1999. He was recipient of the Fulbright Scholarship, and later obtained the degree of Master of Laws (LL.M.) from Tulane University (USA) in 2002, where he focused on studies in financial law, payment systems and insurance law.

QUIROZ SANTRONI
ABOGADOS CONSULTORES

QUIROZ SANTRONI is an environmental, consulting, and business law firm, and is considered the leading environmental law firm in the Dominican Republic. It is also recognised for its corporate-commercial practice as well as for its assistance in connection with major tourism and real estate projects. Its particular strength lies in its ability to integrate legal, corporate and environmental aspects into investment projects, transforming them into truly sustainable businesses. Its team of lawyers and consultants implement an approach that is both different and proactive when advising their clients, having taken on a project management role in several cases assigned to the firm.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

England

Philip Bowden

Allen & Overy LLP

Darren Hanwell

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

When liquidity has been hard to access in the European market, many European issuers have been able to tap liquidity in the US and the same has been true in reverse. This flexibility has helped drive the continued convergence of documentation terms either side of the Atlantic. Up until recently, when the leveraged finance market has become relatively quiet given market uncertainty, European cov-lite loans were becoming more commonplace and often English law governed but with US term loan B style covenants. Unlike in the US, European deals have occasionally seen the adoption of bond covenants in place of the more traditional loan style or term loan B style undertakings. Generally, European documentation terms and styles have moved towards US terms and style but it remains important to ensure that these deals work in the context of European insolvency regimes, where one cannot rely on Chapter 11. As such, hybrid intercreditor arrangements are becoming more common which seek to accommodate European insolvency regimes whilst at the same time continuing to be acceptable to US investors who, until now, have been unfamiliar with such arrangements in domestic US deals given the protections afforded by Chapter 11. There has been a continued advance of direct lending funds who have increased their market share. They can do larger deals on a club basis but do not generally have distribution platforms. The market has shown that, for the right credit and situation, jumbo financings can be put together as evidenced by the USD75bn loan facility for Anheuser-Busch InBev's acquisition of SAB Miller.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The USD75bn loan for Anheuser-Busch InBev's acquisition of SAB Miller in 2015 was the largest commercial loan in the history of the global loan markets, far surpassing pre-crisis levels. Secondary buyouts are still commonplace. CVC's acquisition of Douglas Holding AG (from Advent) was one of the largest European private equity deals of 2015 which included over €2bn of high yield bonds and cov-lite term loan B which came to market at a challenging time during the Greek eurozone crisis. Apax Partners's acquisition of Azelis (from 3i) was clear evidence of the ability for US and European investors to co-invest and adapt to different documentation styles – the initial European acquisition was quickly followed by a US bolt-on acquisition which was originally committed to be funded under an incremental facility within the European facility before ultimately being funded by a US facility which also refinanced the initial European facility.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Generally yes, provided there is adequate corporate benefit and the company has the capacity to give such guarantee.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In these circumstances there would be a risk that the directors were not acting in accordance with their duties when causing the company to give the guarantee. In general, directors are required to act in good faith and have a duty to promote the success of the company for the benefit of its members as a whole. If solvency is a concern, this duty is displaced with a duty to have regard to the interests of the general creditors of the company (taking precedence over the interests of members). If the company is insolvent, directors should also be mindful of wrongful trading liability. In certain circumstances a guarantee may be set aside as a preference or due to the insolvency of the company (see question 8.2).

2.3 Is lack of corporate power an issue?

Lack of corporate power would not necessarily make a guarantee void, however the capacity for a company to enter into a guarantee should be diligenced by looking at its memorandum and articles of association. The company's objects may not include an express power to grant guarantees but may be wide enough to cover granting guarantees if that is ancillary to the business.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Generally no; however, there may be particular requirements in the case of regulated entities. A shareholder resolution is also often provided to alleviate corporate benefit concerns.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

A guarantee is required to be in writing, signed by the guarantor and for good consideration.

Guarantees are often executed as a deed to avoid any arguments regarding due consideration.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, although directors should consider the solvency of the company as part of promoting its best interests.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, although it is prudent to check whether non-English exchange control or sanctions considerations will apply.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

It is possible to take security over all the assets of an English company.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Security over all or substantially all of a company's assets is generally covered by a single debenture.

The debenture usually includes:

(a) a fixed charge over assets which are identifiable and can be controlled by the creditors (e.g. restricted accounts);

(b) a floating charge which is used to capture fluctuating and less identifiable assets (e.g. inventory);

(c) an assignment of receivables and contracts; and

(d) mortgages over real estate and shares.

If the debenture includes a real estate mortgage or a power of attorney it must be executed as a deed (see question 3.13).

Consideration should be given to whether additional formalities or documents should be used when securing assets of an English company which are not based in England or when taking security over particular types of assets, e.g. ships.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over land is ideally taken by way of a legal mortgage. A legal mortgage transfers legal title to the creditor and restricts the chargor from taking certain actions while the asset is subject to the mortgage e.g. disposing of or mortgaging the asset further without consent. A legal mortgage cannot be granted over future acquired assets.

It is also possible to have an equitable mortgage over land where the beneficial title in the land is transferred to the creditor but legal title remains with the chargor. We often see an equitable mortgage where the parties have agreed that a legal mortgage will only come into effect if certain events occur or where the formalities required for a legal mortgage cannot be met.

When taking security over land consider whether the chargor is required to obtain third party consents (for example from the freeholder).

Security over plant, machinery and equipment may be caught by any legal mortgage over the land if those assets are sufficiently attached to the mortgaged land; however, a fixed charge is usually granted over these types of assets. A fixed charge is generally only used for identifiable assets and where a creditor is able to show sufficient control over the asset. There are no specific documentation formalities required for creating a fixed charge.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, usually by way of an assignment (subject to such receivables being assignable) but can also be covered by a fixed charge (see question 3.2 above) or a floating charge (see question 3.5 below).

An assignment of receivables can be legal or equitable. A legal assignment must be in writing, signed by the assignor, absolute (unconditional and irrevocable) and notice must be given to the relevant third parties. If any of these conditions are not met then the assignment will be an equitable assignment. The main benefits of a legal assignment are (a) the creditor can sue in its own name (if it is an equitable assignment the creditor would have to join the assignor as a third party to any suit), and (b) the third party (once notice has been served) will only be able to discharge its obligations to, or as directed by, the creditor.

It is common for certain assignments to be equitable assignments until a trigger event occurs and the assignor is then required to give notice to the third party (and the legal assignment is perfected), but this is dependent upon negotiation. Acknowledgment of the notice by the third party is often requested but does not affect the nature of the assignment.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, by a fixed or floating charge.

A fixed charge over a bank account is generally only effective where the account is blocked such that the chargor can only make withdrawals with the creditor's permission. A floating charge allows the chargor to continue to deal with the account in the ordinary course until there is a trigger event (usually a default) at which point the creditor may notify the account bank that it controls the account. A trading account would only be subject to a floating charge as the business would need constant access to the account and seeking lender consent would be impractical.

Whether a charge is fixed or floating will be dependent on the level of control the creditor has over the account.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Shares in English companies are required to be registered and may be certificated or uncertificated (and held in a clearing system).

Shares are usually charged by way of a mortgage or fixed charge. A legal mortgage over certificated shares involves transferring ownership of the shares to the creditor and registering the creditor

© Published and reproduced with kind permission by Global Legal Group Ltd, London

in the shareholder register. The share certificate in the chargor's name will be cancelled and replaced with one in the creditor's name. A legal mortgage allows the lender to vote the shares, receive any dividends and any information about the shares until the debt is discharged.

Often an equitable mortgage is granted subject to the creditor being able to create a legal mortgage if certain trigger events occur. This is achieved by delivering share certificates and a signed but undated stock transfer form to the creditor. If the security becomes enforceable the creditor can complete the undated stock transfer form and any formalities required to become legal holder of the shares. Prior to the security being enforceable all voting rights, dividends and any communication about the shares will remain with the chargor.

Uncertificated shares can be secured by an equitable or legal mortgage. In order to hold uncertificated shares the creditor will need a securities account. A legal mortgage will be perfected by an instruction to the clearing system to transfer the shares to the securities account of the creditor.

An equitable mortgage of shares in a clearing system is created by depositing the shares into an escrow account with the clearing system and restricting withdrawals without the creditor's permission.

Other considerations include: stock exchange notification requirements; tax implications; and restrictions in the company's constitutional documents (such as liens, pre-emption rights or a right to refuse to register a transfer).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, typically by a floating charge given the fluctuating nature of inventory and inability to show sufficient control for a fixed charge. See question 3.5 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to corporate benefit and solvency considerations (see questions 2.1 to 2.3 above).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Registration requirements depend on the type of secured asset. The majority of charges created by an English company must be registered at Companies House within 21 days of its creation. Failure to register within this time means that the charge will be void against the liquidator, administrator or any creditor of the company and the money secured by the charge becomes immediately payable.

A prescribed form must be completed to register the security along with supporting documentation and payment of a fee (£13 paper filing and £10 online filing).

Security over English real estate must be registered at the land registry and security over certain other assets, such as IP, ships and aircraft, needs to be registered at applicable registries.

There are no notarisation requirements for security documents under English law.

See question 6.2 regarding stamp duty.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No, prescribed forms need to be completed (see question 3.9 above) and payment of minor fees.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally no; however, consider requirement for third party consents under underlying contracts. Additional consents may be required if involving regulated entities or assets.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Generally, no.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Creditors generally expect to receive board and/or shareholder minutes approving the documentation for evidentiary purposes and to ensure corporate benefit issues have been considered.

A legal mortgage over land must be in writing, signed by all parties, incorporate all terms expressly agreed and fulfil the requirements of a deed.

A deed must be in writing, clear from its face that it is a deed, validly executed as a deed and must be delivered.

Security agreements usually contain a power of attorney and therefore will need to be executed as a deed.

Other guidelines should be considered, such as law society practice notes and recent case law which states that each party must approve and intend for their signature to be attached to a final form document. Exchanging pre-signed signature pages is not sufficient to execute certain documents effectively.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

A private company can provide financial assistance (including guarantees and security) for the acquisition of its own shares.

Subject to limited exceptions, a public company is prohibited from giving financial assistance for the acquisition of its own shares.

(b) Shares of any company which directly or indirectly owns shares in the company

Private companies can provide financial assistance for the acquisition of shares in a private holding company but not a public holding company.

© Published and reproduced with permission by Global Legal Group Ltd, London

Public companies are prohibited from providing financial assistance to both public and private holding companies subject to limited exceptions.

(c) Shares in a sister subsidiary

There is no prohibition on financial assistance provided for the purchase of shares in a sister subsidiary.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes, this is usually governed by the agency provisions in the loan documentation and intercreditor or security agreement. The intercreditor will govern how proceeds from security enforcement will be applied.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Agency and trust relationships are well established in England.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Loans are generally structured so that they are transferable from one lender to another by using a prescribed form of transfer certificate subject to any restrictions in the loan documentation. A transfer of the loan will also transfer the benefit of any English security or guarantee.

6 Withholding, Stamp and other Taxes; Notarial and other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Yes, a company paying "yearly interest" that arises in the UK is required to withhold income tax from that interest at a rate of (currently) 20%. Interest will be "yearly interest" for these purposes if, in broad terms, the debt is capable of being outstanding for a year or more.

There are several exceptions. In the context of a commercial bank loan, the most important exception is that for interest payable on an advance from a "bank", where the person beneficially entitled to the interest is within the charge to UK corporation tax in respect of that interest, or would have been within the charge to UK corporation tax in respect of the interest but for the exemption from UK corporation tax for foreign branches of UK companies.

Other possible exemptions include: interest paid by a bank in the ordinary course of the bank's business; interest paid to a company within the charge to UK corporation tax; and interest payable without deduction under a direction to pay gross pursuant to a double tax treaty.

UK law is not clear on the treatment of payments made under a guarantee. They could be characterised as being of the same nature as the underlying obligation (i.e. interest or principal), or as a separate obligation.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no preferential tax incentives for foreign lenders lending into the UK.

Note that UK stamp duty could be payable on the transfer or assignment of certain loans (whether the lender is foreign or domestic). In addition, if the loan is a "chargeable security", UK stamp duty reserve tax (SDRT) could be chargeable in respect of an agreement to transfer the loan.

An exemption from UK stamp duty and SDRT applies to loans which are "exempt loan capital". A typical bank loan is likely to be "loan capital". However, if the loan has certain equity-like characteristics (e.g. convertibility, results-dependency, excessive rate of interest), it will not be "exempt". It is rare for bank loans to carry such rights, although there may be concerns where loans carry a margin ratchet or are limited recourse. Where a loan is not exempt loan capital, other exemptions from stamp duty and SDRT may be available.

The grant of security over assets should not be subject to UK stamp duties or taxes. There may be a liability to UK stamp duties or taxes on enforcement of security over shares or securities of a UK company or UK real estate.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

By themselves, these factors should not bring a non-UK lender into the charge to UK tax (although, as discussed above, a foreign lender may be subject to UK withholding tax).

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

See question 3.9 above.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Results-dependent interest will be characterised as a non-deductible distribution of the borrower for UK tax purposes. There is an exemption from this rule where the recipient of the interest is within

© Published and reproduced with kind permission by Global Legal Group Ltd, London

the charge to UK corporation tax. Therefore, a borrower might be disadvantaged in such circumstances where a lender is outside the UK tax net. There is, however, an exemption for certain margin ratchets which does not depend on the location of the lender. In certain circumstances, UK anti-arbitrage legislation may be potentially applicable to cross-border financing arrangements.

Otherwise, the location of an unconnected lender should not concern the borrower.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The English courts will generally apply a foreign law as the governing law of a contract if it is expressly chosen by the parties, subject to the following: (i) where all elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of law will not prejudice the application of non-derogable laws of that other country; (ii) where all elements relevant to the situation at the time of the choice are located in one or more EU Member States, the choice of a non-EU Member State law will not prejudice the application of non-derogable provisions of EU community law; (iii) the chosen law will not restrict the application of overriding mandatory provisions of English law; (iv) effect may be given to overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, insofar as those overriding mandatory provisions render the performance of the contract unlawful; (v) the English courts may refuse to apply a provision of the chosen law if such application is manifestly incompatible with English public policy; (vi) in relation to the manner of performance and the steps to be taken in the event of defective performance, regard will be given to the law of the country in which performance takes place; and (vii) the chosen law may not be applied to determine certain questions in relation to the existence and validity of a contract.

As well as potentially applying local public policy and mandatory rules, the English courts may in limited circumstances also apply non-derogable or mandatory rules of another country. Given that the circumstances in which the English courts will refuse to apply the chosen law are narrow, the basic position is that the English court will generally respect the chosen law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts (a "foreign judgment") without re-examination of the merits of the case?

A foreign judgment would generally be treated as constituting a cause of action against the judgment debtor and could be sued upon summarily in the English courts. The English courts should enter judgment in such proceedings, without re-examination of the merits of the original judgment, provided that: (i) the New York court was of competent jurisdiction and the foreign judgment is final and conclusive; (ii) the foreign judgment is not for multiple damages or on a claim for contribution in respect of multiple damages; (iii) the foreign judgment is for a fixed sum of money and not payable in respect of a tax, fine or penalty; (iv) the foreign judgment was not given in proceedings brought in breach of a dispute resolution agreement (unless the proceedings were brought with the agreement of judgment debtor or the judgment debtor counterclaimed in the proceedings or otherwise submitted to the jurisdiction); (v) the foreign judgment was not obtained by fraud, or in proceedings contrary (a) to natural justice, (b) to the Human Rights Act 1998, (c) to the principles of the European Convention on Human Rights, (d) to the Charter of Fundamental Rights of the European Union, or (e) to English public policy; (vi) enforcement proceedings are instituted within six years after the date of the judgment; (vii) the foreign judgment is not inconsistent with an earlier judgment in proceedings between the same parties or their privies; and (viii) the foreign judgment is not contrary to the Protection of Trading Interests Act 1980 or any powers exercised under the 1980 Act.

There is doubt as to the enforceability in England and Wales of U.S. judgments in respect of civil judgments predicated purely on U.S. securities laws.

Different considerations may apply if the judgment debtor is a state entity.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The answer is context-specific and dependent upon the court diary.

(a) If the enforcement of an English law governed contract in England is uncontested and there is no dispute as to jurisdiction, a judgment in default could be obtained in 1–2 months. If the company files a defence but the foreign lender is able to obtain summary judgment this could take 2–3 months. If the enforcement is heavily contested and there is a material dispute about the facts then it could take longer. If the governing law of the contract is not English law then the proceedings may take longer since the court will need to hear expert evidence on that foreign governing law. In terms of enforcing a judgment, once given, against assets, the time taken will depend upon which assets and what method of enforcement is chosen.

(b) For enforcement of a foreign judgment against assets, the timing would be no different.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Generally no, but regulatory consents may be required if the company is a regulated entity or the assets are regulated.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

No; foreign lenders are essentially treated the same as domestic lenders. It may, however, be easier to get security for costs against foreign lenders.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

In liquidation, the aim is to realise the unsecured assets of the company for the benefit of creditors as a whole (save for secured creditors). Security rights against the company remain enforceable but there is a moratorium on legal proceedings. In a compulsory liquidation, no action or proceedings can be commenced or proceeded with against the company or its property without court permission. In the case of a creditors' voluntary liquidation, the liquidator may apply for a stay of such proceedings to ensure equal distribution of the assets.

In administration, a statutory moratorium on creditor action comes into effect on the presentation of an administration application in court or the filing in court of a notice of intention to appoint an administrator. This prevents the enforcement of security and the commencement of legal proceedings without the permission of the administrator or the court.

A limited 28-day moratorium is available in a CVA but only for "small companies".

Subject to certain conditions, the enforcement of financial collateral security is exempt from the security enforcement moratorium.

A scheme of arrangement does not impose a moratorium on creditor action but may cram down dissenting secured creditors who will be bound by the scheme if approved by the requisite statutory majorities.

Special insolvency measures apply to credit institutions and investment firms under the Banking Act 2009, pursuant to which the resolution authorities have wide powers to impose a variety of stays.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The award of an English seated arbitration tribunal may be enforced, with the permission of the English court, in the same manner as a judgment or order of the court to the same effect without any re-examination of the merits. This is subject to a challenge as to the substantive jurisdiction of the tribunal, on grounds of a serious procedural irregularity or an appeal on a question of law (the latter may be excluded by the parties in their agreement to arbitrate).

The grounds for refusing an award of a tribunal seated in a jurisdiction which has ratified the New York Convention are limited. They are: (a) that a party to the arbitration agreement was (under the law applicable to it) under some incapacity; (b) that the arbitration agreement was not valid under the law to which the parties subjected it or, failing any indication thereon, under the law of the country where the award was made; (c) that it was not given proper notice of the appointment of the arbitrator or the arbitration proceedings or was otherwise unable to present its case; (d) that the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration or contains decisions on matters beyond the scope of the submission to arbitration; (e) that the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties or, failing such agreement, with the law of the country in which the arbitration took place; and (f) that the award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, it was made.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

A statutory moratorium may restrict a creditor from enforcing its security rights by, for example, appointing a receiver (see question 7.6 above).

However, if a secured creditor appoints an administrative receiver first, it will not be possible for an administrator to be appointed (and the moratorium on enforcement of security will not apply). This 'trumping' of appointments only applies where the receiver appointed is an administrative receiver. Where a non-administrative receiver is appointed, an administrator can still be appointed and the administrator can require the receiver to vacate office even though the receivership enforcement process has commenced, although there are certain protections for secured creditors.

The ability to appoint an administrative receiver is only available in limited circumstances. For this reason, a secured creditor who is a 'qualifying floating charge holder' (a holder of a floating charge over the whole or substantially the whole of the company's assets) may instead be able to appoint an administrator out of court as a means of enforcing its security. Unlike a receiver, an administrator is required to act in the interests of all creditors.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Liquidators and administrators are granted wide anti-avoidance powers to challenge certain types of transactions entered into by a company before insolvency. Clawback could be available in relation to certain transactions, such as transactions at an undervalue, preferences or floating charges.

Certain conditions must be met for clawback to be available including:

- the company must be either in liquidation or administration;
- the company must have been unable to pay its debts when the transaction was entered into or as a result of entering into the transaction;
- an unfair advantage was gained by the party contracting with the company, or there is an absence of adequate consideration flowing to the company, as a result of the transaction; and
- the transaction was entered into during the relevant look-back period which varies (generally ranges from six months to two years).

Certain claims are treated as preferential, hence the order of priority in which a company's assets will be distributed is broadly: (i) fixed-charge holders' claims; (ii) insolvency expenses; (iii) preferential claims (primarily employee and certain pension contribution claims, but not tax claims); (iv) prescribed part fund (paid *pro rata* to unsecured claimants out of floating charge assets ahead of floating charge creditors – up to a maximum of £600,000 per company); (v) floating charge claims; and (vi) unsecured claims.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The starting position is that the corporate insolvency regimes under the Insolvency Act 1986 apply to companies registered under the Companies Act 2006.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

However, by virtue of EC Regulation, insolvency proceedings can only be opened as main proceedings in the place where the debtor has its "centre of main interests" (COMI). The Insolvency Act 1986 therefore provides that insolvency proceedings are available to a company which is incorporated in an EEA State other than the UK and a company not incorporated in an EEA State but having its COMI in a Member State (other than Denmark), subject to the overriding requirement that the COMI must be in the UK. Secondary proceedings can be opened in a Member State where the debtor has an "establishment" but these are limited to local assets in the jurisdiction.

Modified versions of the Insolvency Act regimes also apply to certain types of debtors/businesses, such as partnerships.

Special legislation and special insolvency regimes may apply to certain businesses (e.g. banks/credit institutions and investment firms).

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The five main (out-of-court) remedies generally available to a creditor to enforce its security are:

1. going into possession;
2. exercising the power of sale;
3. appointment of a receiver;
4. appointment of an administrator; and
5. appropriation of financial collateral.

Foreclosure is also an enforcement process but requires a court order. Appropriation of an asset does not require a court order but can only be used to enforce financial collateral and is subject to certain conditions.

The preferred method for enforcing security is usually the appointment of a receiver or administration (in circumstances were any receiver would be an administrative receiver and such an appointment would be prohibited).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The English courts will usually decline jurisdiction if the parties have agreed that a foreign court is to have exclusive jurisdiction. However, the English courts may assume jurisdiction in special cases, for example: (i) if they have exclusive jurisdiction, such as in a dispute relating to rights *in rem* in land or corporate constitutional issues; (ii) in relation to certain insurance, consumer and employment contracts; (iii) if the defendant has taken steps in the proceedings in the English courts; and (iv) in certain narrow circumstances, if the court considers that it is the appropriate forum to hear the dispute. This principle is rarely applied where exclusive jurisdiction has been conferred on a foreign court. It is not applied where the chosen court is that of an EU Member State.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The English courts will normally give effect to a clause in an agreement that provides for (i) the submission by a foreign state to what the courts describe as their "adjudicative jurisdiction" (i.e. the courts' power to adjudicate upon claims against foreign states, which includes recognising a foreign judgment or arbitral award), and (ii) the consent in writing of a foreign state to: (a) relief against the foreign state by way of injunction or order for specific performance or for the recovery of land or other property; and (b) the property of the foreign state being subject to any process for the enforcement of a judgment or arbitration award or, in an action *in rem*, for its arrest, detention or sale, provided, in the case of both (i) and (ii) that the agreement is sufficiently clear and the agreement is within the scope of and is permitted by the State Immunity Act 1978.

Central banks are afforded greater protection than foreign states under the 1978 Act. Different considerations apply to the immunity of international organisations, as well as to diplomatic or consular immunity.

The common law has a concept of "non-justiciability" or "act of state doctrine" which means that certain matters are not capable of being adjudicated by the English courts.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are generally no eligibility requirements, although certain types of lending are regulated in England (e.g. consumer credit).

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Article 55 of the European Union's Bank Recovery and Resolution Directive (2014/59/EU) requires a wide range of non-EU law governed contracts entered into by certain EU financial institutions, investment firms and their related entities to include wording by which the counterparty recognises that the in-scope entity's liabilities may be subject to bail-in by relevant EU authorities (broadly, the counterparty's claims may be written down or converted to equity).

Acknowledgment

The authors would like to acknowledge the assistance of Temi Esho in the preparation of this chapter.

Philip Bowden
Allen & Overy LLP
One Bishops Square
London E1 6AD
United Kingdom

Tel: +44 203 088 2511
Fax: +44 203 088 0088
Email: philip.bowden@allenovery.com
URL: www.allenovery.com

Philip is co-head of Allen & Overy's global leveraged finance practice. Philip advises banks and borrowers on a range of debt products, specialising in corporate and financial sponsor leveraged acquisition financing, as well as structured finance and investment grade acquisition financing. He also has broad experience across a range of transactions in the growth markets with a particular focus on Africa.

Darren Hanwell
Allen & Overy LLP
One Bishops Square
London E1 6AD
United Kingdom

Tel: +44 203 088 2257
Fax: +44 203 088 0088
Email: darren.hanwell@allenovery.com
URL: www.allenovery.com

Darren is a London-based senior associate specialising in leveraged finance and event driven transactions and margin lending. He has an extensive knowledge of the syndicated and leveraged loan markets and regularly advises lenders on deals involving complex capital structures, often including a high yield element. Darren has also worked on a number of bespoke structured financings, particularly in developing markets, including the FESCO transaction for which A&O won Finance Team of the Year at the Legal Business Awards in 2014. Darren joined A&O as a trainee in 2002 and has spent time on secondment with Goldman Sachs and Barclays Capital.

ALLEN & OVERY

With over 1,000 specialist lawyers worldwide, Allen & Overy has one of the largest and most international teams of banking and finance lawyers of any global law firm. Few practices can match our top-tier position across the full range of financial products. With such a deep team and global reach, international and industry-leading 'first-of-a-kind' transactions are our hallmark. We have been instrumental in nearly all the major developments in the modern financial markets. Renowned for our intellectual rigour, our banking and finance lawyers draw on deep product expertise and regularly work alongside our regulatory, litigation, restructuring and other specialists – particularly important in light of recent market conditions – to develop innovative solutions for our clients, often incorporating complex financing techniques that lead the industry. That is why over 800 corporate and financial institution participants in the financial markets entrust us with the full range of their domestic and cross-border transactions.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

France

Emmanuel Ringeval

Freshfields Bruckhaus Deringer LLP

Cristina Radu

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The number of financing transactions in France has decreased in 2015 compared to 2014. Although there is still a high level of liquidity in the market, the macroeconomic uncertainty led to high volatility which itself led to a sharp decrease of high-yield financings, in particular in the second semester of 2015.

The year 2015 also saw debt funds continuing to be more and more active in France, with "ticket" size becoming larger.

Bond terms continue to penetrate the loan market, emphasising the convergence between loans and bonds, although the uncertain environment of end of 2015 led to the use of flex provisions on certain of these terms in several transactions.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The French financing market saw several financing transactions exceeding one billion euros, such as the acquisition of Verallia by Apollo Global Management for €3 billion and the acquisition of Bostik by Arkema for €1.75 billion.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, subject to certain conditions, restrictions and limitations relating in particular to the French law requirement of corporate benefit and the prohibition of financial assistance – see questions 2.2, 2.3, 2.4, 2.5 and section 4 below for details.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

All guarantees and security interests granted by a French company must be in that company's corporate benefit. If only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown, the guarantee/security may be deemed as not being in the corporate benefit of the guaranteeing/securing company and may trigger the criminal liability of the managers/directors of the company (for misuse of corporate assets). Some French courts have also declared void guarantees/security interests which were not in the corporate benefit of the guaranteeing/securing company on the ground that such guarantees/security interests had been granted for an illicit cause.

In case of a group of companies, French courts assess such corporate interest at the group level, but some strict criteria must be met, among which: (i) the guarantee/security interest must be granted in the common interest of the group within the framework of a common policy defined for the group as a whole; (ii) there must be some consideration for the guarantee/security interest; and (iii) the guarantee/security interest must not exceed the financial capabilities of the grantor.

A guarantee/security interest granted in order to guarantee the obligations of a subsidiary is usually unlimited as it is generally admitted that a holding company has a corporate interest in guaranteeing its subsidiary's obligations. As for upstream and cross-stream guarantees/security interests, the most commonly accepted corporate benefit justification is the granting of an intercompany loan by the guaranteed company to the guarantor out of loan proceeds made available to the guaranteed company (the guaranteed amount under the guarantee/security interest being in such case limited to the amount of such intercompany loan).

2.3 Is lack of corporate power an issue?

Guarantees granted by the legal representatives of a company are deemed to be validly granted and enforceable (as long as the granting of such guarantees does not fall outside the corporate object of the company, save for the case where (i) it has been authorised by a unanimous shareholders' resolution, or (ii) it was granted by a joint stock company (i.e., a *société anonyme,* a *société par actions simplifiée* or a *société européenne*) or by a limited liability company (i.e., a *société à responsabilité limitée*)). This rule does not, however, cover (i) guarantees which are prohibited by law, or (ii) guarantees which are subject to prior authorisation by the board of directors or by the shareholders (see question 2.4 below).

If a guarantee agreement is signed by a person who is not the legal representative of the company (and if such person does not act under a power of attorney granted by a legal representative of the company) such guarantee may be voided, save for cases where the company has confirmed the guarantee either explicitly or implicitly by performing its obligations thereunder.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental consents or filings are required. Shareholder approval is not required by law (save for the case of a *société civile* offering securities to the public), but the by-laws of a company may contain clauses pursuant to which shareholder approval is required with respect to the granting of guarantees. Also, guarantees granted by a *société anonyme* are subject to authorisation by the board of directors.

If the guarantee is granted by an individual, the signature of such person must be preceded by a specific handwritten statement specifying the maximum guaranteed amount and the duration of the guarantee. A similar requirement is provided by French law with respect to guarantees granted by non-commercial companies.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

See the answer to question 2.2 above with respect to upstream and cross-stream guarantees granted in the context of a group of companies.

Guarantees granted by a French company which is insolvent (*en état de cessation des paiements*) may be declared null and void by a French court – see question 8.2 below for more details.

A guarantee granted by an individual must be proportionate to its income and assets (otherwise, a court may declare that such guarantee is not enforceable).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control or similar obstacles to enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Collateral security can be taken over tangible or intangible assets, among which are: real property; shares; financial securities; bank accounts; receivables; intellectual property rights; business as a going concern; equipment and machinery; inventory; cash, etc. Security interests may be granted in the form of a pledge, a mortgage (real property), a lien (real property), a transfer by way of security (receivables, cash), a delegation (receivables) or a security trust (*fiducie*).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A separate agreement must be entered into in relation to each type of asset. There are, however, some types of security interest agreements which encompass several types of assets: (i) a pledge over business as a going concern, which includes security over assets such as the company's logo and commercial name, goodwill (customer relationship) and lease rights and may also include intellectual property rights, equipment and machinery; and (ii) a securities account pledge which includes a pledge over shares or other financial securities and a pledge over the bank account on which cash proceeds relating to such shares/financial securities are credited (such as dividends).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral security can be taken over real property (land or buildings) by way of a mortgage (*hypothèque*), a lender's lien (*privilege du prêteur de deniers*) or a *gage immobilier*. These security interests must be entered into by way of a notarised deed and must be registered with the relevant land registry.

Collateral can also be taken over machinery and equipment by way of a pledge, but (if not included in a pledge over business as a going concern) only in favour of certain beneficiaries, among them the vendor of the machinery and equipment, and the lender having made available the facilities used to finance the acquisition of the machinery and equipment. The pledge agreement relating to machinery and equipment must be entered into within a maximum period of two months following the delivery of the machinery and equipment to the pledgor and must be registered with the relevant commercial registry within 15 days from its execution for validity purposes.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, collateral can be taken over receivables by way of: (i) a pledge over receivables; (ii) an assignment of receivables by way of security (*Dailly* assignment); or (iii) a delegation (*délégation*).

A pledge over receivables may be granted by an obligor in favour of any type of beneficiaries (as opposed to a *Dailly* assignment of receivables – see the paragraph below). The notification of the pledge to the debtor(s) is not required for validity purposes but in order to render the pledge enforceable against the debtor(s). As from such notification, the debtor(s) must make payments directly to the secured creditor, unless otherwise agreed in the pledge agreement.

A *Dailly* assignment of receivables by way of security may only be granted by a borrower (and not by a guarantor or a third party security grantor) and only in favour of a French licensed credit institution (*établissement de credit)* (or a foreign credit institution which is licensed to carry out bank activities in France under the 2000/12 directive under a so-called "European passport"). The notification of the assignment to the debtor(s) is not required for validity purposes but in order to render such assignment enforceable against the debtor(s).

A delegation of receivables is generally used to take security over receivables under insurance policies or vendor warranties. The parties to the delegation agreement are not only the delegating obligor (*délégant*) and the secured creditor (*délégataire*), but also the debtor (*délégué*) and therefore no notification of the latter is required. Under a delegation agreement, the debtor agrees to make direct payments to the secured creditor.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A pledge over the balance of a bank account is possible under French law. No particular formalities are required in connection therewith, although the bank account holder is usually notified of the pledge so

© Published and reproduced with kind permission by Global Legal Group Ltd, London

as to render such pledge enforceable against such person. A pledge may also be granted over cash (*gage-espèces*) by transferring the ownership of such cash to the secured creditor who may then freely dispose of it, subject to returning the same amount of cash to the pledgor upon discharge of all the secured liabilities.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Collateral security can be taken over shares in companies incorporated in France either by way of a securities account pledge with respect to shares of a joint stock company (a *société anonyme*, a *société par actions simplifiée* or a *société européenne*) or by way of a share pledge with respect to other type of companies (such as a *société à responsabilité limitée*, a *société en nom collectif* or a *société civile*, etc.).

A securities account pledge is a pledge over a securities account in which shares (and/or other securities) are credited and over a cash proceeds account in which dividends or other cash proceeds relating to such shares (and/or other securities) are credited. The securities account is either held by the company whose shares are pledged or by a financial institution. Such security interest automatically extends to any additional shares and any additional cash proceeds which are credited to the pledged accounts during the life of the pledge. In order for such pledge agreement to be valid under French law, a mandatory form of statement of pledge (*déclaration de nantissement*) must be signed by the pledgor. It is also customary for the securities account holder and the cash proceeds account holder to sign confirmations of the pledge.

A share pledge actually pledges the shares (as opposed to the pledge of a securities account in which such shares are credited, as explained above with respect to securities account pledges) and therefore new additional shares are not included automatically in the scope of the pledge. It may also cover cash proceeds related to the pledged shares, but only if this is expressly specified in the pledge agreement. In addition to the registration of such pledge with the clerk of the relevant commercial court as mentioned below, other perfection formalities may be required depending on the type of company whose shares are pledged. For instance, a pledge over the shares of a *société civile* must be notified by bailiff (*signifiée par huissier*) to the company whose shares are pledged.

Shares of French companies are not in certificated form, but in dematerialised form. The pledge must be registered (i) with respect to shares of joint stock companies, in the share transfer registry (*registre des mouvements de titres*) and the shareholders' accounts (*comptes d'actionnaires*) of the company whose shares are pledged, and (ii) with respect to shares of other type of companies, in a special register held by the clerk of the relevant commercial court where the company whose shares are pledged is registered.

It is not recommended to have a securities account pledge or a share pledge governed by New York or English law because of difficulties, both practical and legal, which would arise with respect to the perfection and the enforcement of such security interests.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, security can be taken over inventory. A recent reform has introduced more flexibility for this type of security interest. Starting from 1 April 2016, the parties may choose between a pledge over inventory governed by the provisions of the French commercial code or a pledge over inventory governed by the provisions of the French Civil Code.

As opposed to a pledge over inventory governed by the provisions of the French Civil Code, the pledge over inventory governed by the provisions of the French commercial code may only be granted by a borrower (and not by a guarantor or a third party security grantor) and only in favour of French licensed credit institutions (*établissements de crédit*) (or foreign credit institutions which are licensed to carry out bank activities in France under the 2000/12 directive establishing the so-called "European passport").

Both types of pledge (i) may be enforced through private foreclosure (*pacte commissoire*), and (ii) must be registered for enforceability against third parties (*opposabilité aux tiers*) purposes with the French commercial registry.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to corporate benefit and financial assistance rules and save for the lenders' lien (*privilège du prêteur de deniers*), the pledge over machinery and equipment, the pledge over inventory governed by the provisions of the French commercial code or the *Dailly* assignment of receivables by way of security, which may only be granted in order to secure the grantor's obligations as borrower.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The most expensive fees are those relating to security interests over real estate properties. Registration costs and notary fees with respect to a mortgage are calculated as a percentage of the secured amounts and are therefore expensive (as at 1 March 2016, these costs include land registry tax fees (*taxe de publicité foncière*) of 0.715% of the secured amount, plus land registrar's fees (*contribution de sécurité immobilière*) of 0.05% of the secured amount, plus statutory notary fees of 0.447% of the secured amount, plus a fee of €125 for the registration of the mortgage with the French tax authorities). The costs relating to a lenders' lien (*privilège du prêteur de deniers*) are also based on the secured amount but are not as high as the registration costs of a mortgage, as they do not include the 0.715% mandatory fees corresponding to the land tax (*taxe de publicité foncière*).

Registration fees with respect to a pledge over intellectual property rights are not expensive unless the pledge covers an important number of intellectual property rights and the accelerated registration procedure is chosen, as opposed to the ordinary registration procedure (the ordinary registration procedure may take up to two months while the accelerated registration procedure takes up to five days). The cost for the registration under the ordinary procedure is €27 per intellectual property right, with a maximum amount of €270, and the cost for the registration under the accelerated procedure is an additional €52 per intellectual property right with no maximum amount.

The registration fees with respect to other types of security interests are not significant: e.g., registration costs with the commercial court of Paris of a pledge over business as a going concern, a pledge over inventory, a pledge over machinery and equipment or a pledge over shares (other than shares of a joint-stock company which do not

© Published and reproduced with kind permission by Global Legal Group Ltd, London

require registration with a public register) amount to approximately €160 for each pledge (for an amount of the secured obligations exceeding €41,600). The commercial courts may require, prior to the registration of the above-mentioned security interests with the relevant commercial registry, a registration of such security interest agreements with the tax authorities – the cost of such registration is not significant (€125 for each security interest agreement).

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Generally no, save for (i) security over real estate properties with respect to which registration requirements involve a significant amount of expense (see above), and (ii) pledge over intellectual property rights, which may take up to two months if the ordinary procedure is chosen or may be expensive if the accelerated procedure is chosen (please see question 3.9 above).

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No, but it should be noted that the granting of a share pledge or a securities account pledge may require the prior consultation of the works council of the company whose shares are pledged (if such works council exists and if the pledge is over 50% of the shares of such company). The opinion of the works council is not binding, but its consultation is mandatory and may take from 15 days to four months depending on the complexity of the contemplated transaction.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

A security interest agreement over real estate property requires notarisation. If such agreement is signed under a power of attorney, such power of attorney agreement must also be notarised.

French law agreements may not be signed in counterparts.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Yes, a French joint stock company (a *société anonyme*, a *société par actions simplifiée* or a *société euopéenne*) may not provide any financial assistance in the form of a loan, guarantee or security interest for the acquisition of its own shares. The violation of this prohibition may lead to the criminal liability of the managers/directors of such company and to the voidability of such loan, guarantee or security interest agreement.

(b) Shares of any company which directly or indirectly owns shares in the company

The prohibition of financial assistance would also apply in case of the acquisition of shares in a company which directly or indirectly holds shares in the company.

(c) Shares in a sister subsidiary

There is no financial assistance prohibition as such, but this type of transaction remains subject to the corporate benefit rules described above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

France has not ratified the Hague Convention on the Law Applicable to Trusts and on their Recognition. However, in a 2011 case law, the French Supreme Court recognised the filing of claims in a bankruptcy proceeding by a New York law security trustee, but there is no case law yet with respect to the enforcement of the loan documentation and related collateral security by a trustee.

The role of an agent in a parallel debt mechanism, as well as the parallel debt mechanism itself, has also been recognised by the above-mentioned case law of the French Supreme Court and may therefore be an alternative to the trust mechanism in credit agreements.

The agent concept is very largely used in French syndicated loans and is based on a power of attorney granted by lenders. The security interests are generally granted in favour of each lender and not only in favour of the security agent, and each lender may act individually in enforcing its rights under the collateral security, save for the case where it is contractually prohibited from doing so by the finance documents. If enforcement of security interests is implemented through judicial proceedings, an agent may only act before a French court if it is granted a special power of attorney (*mandat ad litem*) by each lender.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

See the answer to question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

A transfer is usually made in France by way of assignment rather than by way of novation.

A transfer made by way of assignment must be notified to all French borrowers by bailiff (*signification par huissier*) or each French borrower must sign the transfer agreement in a notarised form.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

If the transfer is made by way of novation, the consent of the guarantor (as well as the consent of the security provider) is required in order for Lender B to be able to enforce its rights under the guarantee (or under the security interest). Such consent may be granted concomitantly with the transfer or prior to such transfer (such prior consent may also be provided in the guarantee/security interest agreement itself).

6 Withholding, Stamp and other Taxes; Notarial and other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) Interest payable on loans made to domestic or foreign lenders

Interest paid to French tax resident individuals: As of 1 January 2013, such payments are subject to personal income tax in the hands of the individuals under the progressive tax schedule. However, when the paying establishment is located in France, it has an obligation to declare the gross amount of interest paid and withhold a compulsory tax advance at a rate of 24%, which is later offset against the definitive income tax charge due by the lender.

Interest paid to French tax resident companies: As a matter of principle, such payments are not subject to any withholding tax (***WHT***).

Interest paid to foreign lenders (individuals or companies): Such payments do not give rise to any French WHT.

Interest paid to a Non Cooperative State or Territory (***NCST***): As a general rule, a 75% WHT applies in cases where interest is paid to an account located in a NCST (notwithstanding the tax residency of the corporate/individual lender), unless the French debtor can demonstrate that the operations in respect of which the interest is paid have a main purpose and effect other than allowing their localisation in a NCST. However, please note that if the lender is tax resident of a country that has entered into a double tax treaty with France, the provisions of that treaty (if available) may permit the reduction of the rate (down to nil) of such WHT. The list of NCSTs, as updated annually by the French government, currently comprises the following jurisdictions (as of 1 January 2015): Botswana; Brunei; Guatemala; the Marshall Islands; Nauru; and Niue.

(b) Proceeds of a claim under a guarantee or the proceeds of enforcing security

As a matter of principle, proceeds deriving from a claim under a guarantee or as a result of enforcing security are not subject to WHT in France (irrespective of the tax residence of the beneficiary).

However, it should be noted that:

- Proceeds resulting from the enforcement of a security, in cases where the security grantor is not a French tax resident, may be subject to capital gains WHT (provided that a capital gain is realised upon the sale of the asset on which the security is taken) at rates that vary depending on the nature of the asset. However, if the security grantor is a tax resident of a country that has entered into a double tax treaty with France, the provisions of that treaty (if available) may permit the avoidance of (or at least, reduce the cost of) the WHT.
- When the proceeds deriving from enforcing a security are used to pay interest accrued under a loan agreement, the rules indicated in question 6.1 (a) above are applicable.
- Proceeds resulting from a claim under a guarantee are of a *sui generis* nature, but in the case where the purpose of the guarantee is to ensure (in part or in total) the payment of interest accrued under a loan agreement entered into between a French debtor and a foreign beneficiary, it cannot be totally excluded that such guarantee payments would be viewed (at least in part) as interest payments and accordingly be subject to French interest WHT (under the rules summarised in question 6.1 (a) above). There is, however, no firm position of the French tax authorities in this respect, nor relevant case law on the matter.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

(a) Incentives attributed to foreign lenders

The absence of WHT on interest (subject to the NCST exception) is very attractive for foreign lenders.

In addition, it is worth mentioning that interest payments made to an account located in a NCST or to a beneficiary residing or located in a NCST as remuneration of a loan agreement entered into outside of France either (i) before 1 March 2010 provided that the expiry date has not since been extended, or (ii) as of 1 March 2010 if said agreement is assimilated to an agreement entered into before that date, are also exempt from WHT in France.

(b) Taxes applicable to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration

The same taxes apply to all lenders irrespective of whether they are French or foreign with respect to their loans, mortgages or other security documents for the purposes of effectiveness or registration – see the answer to question 3.9 above for details with respect to taxes in relation to registration with the tax authorities (if required).

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

No, it will not.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No other significant costs would be incurred by foreign lenders in the grant of such loan/guarantee/security (other than those mentioned above which apply to all lenders, irrespective of whether they are French or foreign). However, translation costs may be incurred with respect to security interests which require registration in a public register, if the security agreements are not already drafted in the French language.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No: thin capitalisation rules and other rules limiting tax deductibility of interest expenses apply irrespective of the lender's place of residence.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Convention on the law applicable to contractual obligations of 19 June 1980 (the "**Rome Convention**") in relation to contracts entered into before 17 December 2009 and Regulation 593/2008 of 17 June 2008 on the law applicable to contractual obligations (the "**Rome I Regulation**") in relation to contracts entered into after 17 December 2009, are applicable in France.

(a) Contracts entered into before 17 December 2009

French courts will enforce the foreign law chosen by the parties to contracts entered into before 17 December 2009 in accordance with the Rome Convention, subject to:

- the overriding mandatory rules (*lois de police*) of the law of another country with which the situation has a close connection, if, and insofar as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract; and
- overriding mandatory provisions applicable in France irrespective of the law otherwise applicable to the contract.

In addition, notwithstanding any choice of law clause, in purely domestic contracts, i.e., where all the elements relevant to the situation (apart from the chosen law) are connected with one country only, the mandatory rules of said country shall be applicable.

(b) Contracts entered into after 17 December 2009

French courts will enforce the foreign law chosen by the parties to contracts entered into after 17 December 2009 in accordance with the Rome I Regulation, subject to:

- French overriding mandatory provisions (*lois de police*); and
- the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful.

In addition, notwithstanding any choice of law clause, in purely domestic contracts, i.e., where all the elements relevant to the situation (apart from the chosen law) are connected to one country only, the mandatory rules of said country shall be applicable.

7.2 Will the courts in France recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The criteria relating to the recognition and enforcement in France of judgments rendered by foreign courts vary depending on (i) the country where such judgments were rendered, and (ii) the time when they were rendered:

- judgments rendered within one of the Member States of the European Union **before 10 January 2015** are enforced in France in accordance with the Council Regulation 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters ("**EC Regulation 44/2001**");
- judgments rendered within one of the Member States of the European Union **after 10 January 2015** are enforced in France in accordance with the Council Regulation 1215/2012 of 12 December 2012 ("**EC Regulation 1215/2012**");
- judgments rendered in countries with which France has signed a bilateral treaty are recognised and enforced in France in accordance with the provisions of the relevant treaty; and
- judgments rendered in countries with which France has not signed bilateral treaties, which is the case for the United States, require a specific procedure for their recognition and enforcement, namely the exequatur decision.

(a) Recognition and enforcement of a judgment given against a company in English courts

Judgments rendered <u>before</u> 10 January 2015

Under EC Regulation 44/2001, a simplified procedure, known as 'declaration of enforceability', is used to enforce judgments rendered by the EU Member States' courts. As a matter of principle, judgments rendered by the courts of a given Member State should circulate freely in other Member States. Accordingly, judgments made by the courts of a Member State shall be declared enforceable in another Member State, immediately upon production of certain documents.

The declaration of enforceability is granted in summary *ex parte* proceedings (*sur requête*) before the clerk (*greffier en chef*) of the relevant *Tribunal de grande instance* (article 509–2 paragraph 1 of the French Civil Procedure Code). The clerk does not check the validity of the judgment and must declare the judgment enforceable when provided with a request to that end as well as with (i) a copy of the judgment which satisfies the conditions necessary to establish its authenticity, and (ii) a certificate made by the competent authority certifying that the judgment is enforceable in its country of origin. Also, certain clerks (for instance, the clerk of the *Tribunal de grande instance de Paris*) must be provided with a certified translation of these documents.

An appeal may be lodged before the relevant *Cour d'appel* within one month as from the notification of the declaration of enforceability. At this stage, the appellant will be able to argue that the judgment should not be granted leave to enforce based on one or more of the limited grounds set out under Articles 34 and 35 of EC Regulation 44/2001. These grounds are more restrictive than those applicable to the standard exequatur procedure.

Judgments rendered <u>after</u> 10 January 2015

Under EC Regulation 1215/2012, judgments rendered in civil and commercial matters by the courts of a given Member State are directly enforceable in France (Article 39 of Regulation 1215/2012), provided that two conditions are met, namely: (i) that a French bailiff is provided with a copy of the original decision and a certificate filled by the jurisdiction having rendered the decision (found under Appendix I to Regulation 1215/2012); and (ii) that this certificate is duly served upon the person against whom enforcement is sought, together with the decision (if not already served). This second criterion is not applicable to conservatory measures, except where the measure was ordered by a court without the defendant being summoned to appear.

An application for the refusal of enforcement may be lodged before the enforcement judge ("*juge de l'exécution*"). Please note that for the seizure of salaries, however, the competent court is the first instance court. At this stage, the appellant will be able to argue that the judgment should not be enforced based on one or more of the limited grounds set out under Articles 45 of EC Regulation 1215/2012 (relating to due process, public policy, and the incompatibility with earlier decisions).

(b) Recognition and enforcement of a judgment given against a company in New York courts

In the absence of a treaty signed between France and the United States, the procedure for the enforcement of judgments rendered by New York courts requires a formal writ of summons. Foreign judgments may be enforced in France only once exequatur (also known as the *formule exécutoire*) is granted by the *Tribunal de grande instance* of the defendant's residence (or, if the debtor is not resident in France, the place where his assets are located).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

The following tests must be met in order for a French court to grant an exequatur order with respect to a foreign judgment:

- the court rendering the judgment had jurisdiction over the defendant;
- the foreign court had not been used fraudulently to escape the jurisdiction of a court more closely related to the dispute (i.e., for forum shopping); and
- the foreign judgment was consistent with French international public policy, including due process.

If the French court is satisfied as to the above, the judgment given against a company in New York courts will be granted exequatur without any review of the facts or legal merits.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

If a company is in payment default, a lender may use the fast-track procedure known as *référé-provision* available for the recovery of debts which are not challengeable on serious grounds.

If the amounts are found to be indisputably due, the president of the *Tribunal de Commerce* orders the payment of the debt by an order (*ordonnance de référé*) which has the advantage of being immediately enforceable, notwithstanding an appeal that may be lodged. *Ordonnances de référé* may indeed be appealed within 15 days. Such appeals are heard relatively rapidly by the *Cour d'appel*. There may be a further challenge by a *pourvoi* before the *Cour de cassation* and in such case the decision of the *Cour de cassation* may take up to one year.

Notwithstanding the above, lenders can always go through normal proceedings to obtain payments due under a loan agreement or a guarantee agreement, which may last between 12 and 18 months. The enforcement of non-European judgments may also be of the same duration.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

French law security interests may only be enforced upon the occurrence of a payment default (either resulting from a non-payment of interest, fees or principal or following an acceleration of the secured facilities) and not upon the occurrence of any event of default.

Enforcement of a pledge may be carried out under French law either through judicial foreclosure or public auction or by way of private foreclosure. Enforcement through judicial proceedings (i.e., judicial foreclosure or public auction) may take a significant amount of time (12–18 months with respect to a mortgage or up to 12 months for other type of security interests) whereas enforcement through private foreclosure may take up to two weeks.

The enforcement of a securities account pledge granted over the shares of a listed company may require a regulatory consent from the French stock exchange regulator (*Autorité des Marchés Financiers*) if the pledge is enforced through private foreclosure over more than 30% of the shares of the listed company. Under French takeover rules, where a person, acting alone or in concert, comes to hold directly or indirectly more than 30% of a company's equity securities or voting rights, such person is required, on its own initiative, to inform the French stock exchange regulator immediately and to file an offer for all the company's equity securities. In order to avoid the obligation to file a mandatory bid, an authorisation may be requested from the French stock exchange regulator to temporarily cross the 30% threshold upwards. Such an authorisation may be granted provided that the lenders undertake to sell the shares held in excess of the 30% threshold within a six-month period.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

There are no specific restrictions applying to foreign lenders in the event of filing suit against a company in France or foreclosure on collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, the opening of certain bankruptcy proceedings – safeguard proceedings (*sauvegarde*), accelerated safeguard proceedings (*sauvegarde accélérée*), accelerated financial safeguard proceedings (*sauvegarde financière accelérée*), judicial administration proceedings (*redressement judiciaire*) or liquidation proceedings (*liquidation judiciaire*) – provide for a moratorium of enforcement with respect to lender claims and collateral security (save for collateral security created under a *Dailly* assignment of receivables, a cash collateral agreement (*gage-espèces*), a receivables delegation agreement (*délégation de créances*) or a *fiducie* agreement (but only in the case of a so-called possessory *fiducie* (*fiducie avec dépossession*) whereby the assets are effectively transferred to the *fiduciaire*)).

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

French courts do not carry out a judicial review of the merits of arbitral awards. They only play a supervision function regarding the validity of arbitral awards for which recognition and enforcement are sought in France. According to the French Civil Procedure Code, a French court can set aside an arbitral award only if:

- the arbitral tribunal wrongly upheld or declined jurisdiction;
- the arbitral tribunal was not properly constituted (i.e. it was irregularly composed or the sole arbitrator was irregularly appointed);
- the arbitral tribunal ruled without complying with the mandate conferred upon it;
- due process (*principe du contradictoire*) was not respected; or
- recognition or enforcement of the award would be contrary to international public policy (*ordre public international*).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

See the answer to question 7.6 above.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

If a security interest is granted by a French company during a so-called hardening period (*période suspecte*), such security interest may be declared null and void if (i) it has been granted in order to secure a previously incurred debt, or (ii) it has been granted in order to secure a current or future debt, but the beneficiary of the security had knowledge of the insolvency of the grantor. The hardening period is a period set by the bankruptcy court during which the guarantor/pledgor is deemed to be insolvent. According to the French law insolvency test (*cessation des paiements*), a company is insolvent if it is unable to pay its liabilities as they fall due with its immediately available assets (cash or other liquidity assets). A French bankruptcy court may set the insolvency date of a company as far as 18 months prior to the date on which the company has filed for insolvency.

French law provides for preferential creditor rights with respect to: employees' claims; legal expenses; new loans made available during a court-approved conciliation proceeding; security interests over real estate property; and security interests benefiting from a retention right (such as a share pledge, a securities account pledge or a bank account pledge).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Entities regulated by public law (*personnes morales de droit public*) (such as *collectivités territoriales* or *établissements publics*) are excluded from bankruptcy proceedings.

Entities which are not registered with the commercial register and do not have a legal personality (such as *sociétés en participation*, *sociétés de fait*, *sociétés en formation*) are also excluded from bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes, private foreclosure (*pacte commissoire*) is permitted under French law with respect to almost all types of security interests, save for certain exceptions such as a pledge over business as a going concern.

However, enforcement by private foreclosure is prohibited during certain insolvency and pre-insolvency proceedings such as safeguard proceedings, accelerated safeguard proceedings, accelerated financial safeguard proceedings, judicial administration proceedings and judicial liquidation proceedings.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

French law allows considerable freedom to the parties to a contract in selecting a jurisdiction for their disputes, with the notable exception of disputes relating to real property, which must be resolved by the appropriate court at the place where the property is located.

The choice of a foreign jurisdiction is valid provided that:

- the dispute is international, it being specified that French courts do not require that the dispute has a material link to the foreign jurisdiction chosen by the parties;
- the jurisdiction choice clause does not preclude the mandatory exclusive jurisdiction of a French court in relation to certain aspects (e.g. in relation to employment contracts); and
- the clause is not a unilateral dispute resolution clause giving only one party the choice between several jurisdictions, while the other party is bound to bring actions before one jurisdiction only (this principle has recently been confirmed by a decision rendered by the French Supreme Court on 26 September 2012).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Waivers of sovereign immunity from jurisdiction are legally binding and enforceable under the laws of France.

But a waiver of sovereign immunity from jurisdiction does not entail a waiver of immunity from execution, which must be separately expressed in order for it to be equally binding and enforceable. A recent decision of the French supreme court (*Cour de cassation*) dated 13 May 2015 is seen as having overturned the previous requirement for the waiver of immunity from execution to specifically identify the assets or the category of assets in respect of which such waiver is granted.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Pursuant to French banking monopoly rules, an entity which carries out banking activities on a regular basis in France must either be (i) duly licensed as a credit institution (*établissement de crédit*) or as a financing company (*société de financement*) in France, or (ii) duly "passported" under the European Directive 2000/12 to provide such services in France. Non-compliance with such banking monopoly rules may lead to criminal liability, but according to French Supreme Court case law, a banking transaction carried out in violation of the banking monopoly rules remains valid (however, it should be noted that French courts are not bound by precedent).

A recent law (the so-called "Macron Law") has introduced an important exception to the French banking monopoly rules mentioned above by providing that a company may, as an ancillary activity to its main business, grant loans to another company with which it has economic ties justifying the granting of such loans. The entry into effect of this provision is subject to the publication of a decree expected to be issued in 2016 which will list all the conditions to be met for such loans to not fall foul of the French banking monopoly rules. Some of these conditions are already listed in the Macron Law and include the following:

(a) the maturity of the loan must not exceed two years;

(b) the lender must be a joint stock company (a *société anonyme* or a *société par actions simplifiée*) or a limited liability company (*société à responsabilité limite*) whose accounts, in each case, are certified by an auditor;

© Published and reproduced with kind permission by Global Legal Group Ltd, London

(c) the borrower must be a small or medium-size company;

(d) the entry into the loan agreement is subject to a specific corporate approval process;

(e) the amount of the loan must be specified in the management report and included in an auditor's certificate; and

(f) the receivables under such loan may not be assigned to securitisation vehicles or to specialised funds or be subject to forward contracts (*instruments financiers à terme*) or instruments used to transfer insurance risks to such securitisation vehicles or specialised funds.

It should also be noted that there are some other limited exceptions to the banking monopoly rules which apply to specific entities (such as the European long-term investment funds, which can grant certain loans to qualifying portfolio companies) or specific types of loans (such as participating loans (*prêts participatifs*) – long-term subordinated loans with a low fixed interest rate which can be granted by a commercial company to another commercial, agricultural or industrial company).

With respect to licensing requirements for agents, if such agents provide services which are regulated in France such as payment services, these entities are required to be licensed in order to carry out such services in France.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Among the other specificities with respect to French law financing transactions, the following should be taken into account: (1) interest under a French law loan agreement may only be compounded if it has accrued for a period of at least one year; and (2) a special effective global rate (TEG) notice must be sent to French borrowers no later than the day of entering into of the credit agreement.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Emmanuel Ringeval
Freshfields Bruckhaus Deringer LLP
2 rue Paul Cézanne
75008 Paris
France

Tel: +33 1 44 56 4416
Fax: +33 1 70 39 4416
Email: Emmanuel.Ringeval@freshfields.com
URL: www.freshfields.com

Emmanuel Ringeval is a partner in the Finance department of Freshfields Bruckhaus Deringer LLP in Paris. He is specialised in acquisition finance and corporate finance, acting for lenders and borrowers as well as in restructuring. Emmanuel has over twenty years of experience on domestic and cross-border transactions. He graduated from the University of Montpellier (DESS-DJCE, 1990) and the University of Lyon (*Certificat de Spécialisation, Droit des sociétés, 1990*). Prior to joining Freshfields in 2012, Emmanuel Ringeval was head of the banking and finance department of the Paris office of a major US law firm for eight years.

Cristina Radu
Freshfields Bruckhaus Deringer LLP
2 rue Paul Cézanne
75008 Paris
France

Tel: +33 1 44 56 4456
Fax: +33 1 70 39 4420
Email: Cristina.Radu@freshfields.com
URL: www.freshfields.com

Cristina Radu is an associate in the Finance department of the Paris office of Freshfields Bruckhaus Deringer LLP. She graduated from the University of Paris 1 Panthéon-Sorbonne (*Maîtrise*) and from the University of Bucharest (*Licenta*) in 2004 and she has obtained two post-graduate degrees from the University of Paris 1 Panthéon Sorbonne (a *DESS* in International Commercial Law in 2005 and a *Master 2 Professionnel* in Banking and Finance Law in 2007). She was admitted to the Paris Bar in 2009. Her practice focuses on acquisition finance, corporate finance and restructuring in domestic and cross-border transactions.

Freshfields Bruckhaus Deringer

Freshfields Bruckhaus Deringer is widely regarded as having one of the best international finance practices available. Through its international network, it handles a significant proportion of the largest and most complex transactions, including those with a large cross-border element, in both civil law and common law jurisdictions.

We award great importance to the quality of the advice we give to our clients. We strive to understand their legal, economic and commercial environment in order to anticipate their needs and assist in their strategic decision-making process. We deliver creative, pragmatic advice adapted to our clients' circumstances.

The flexibility and resourcefulness of our lawyers enables our practice to accompany our clients in their most varied projects.

The Finance Group in Paris currently consists of 16 lawyers, including four partners and two counsels.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Germany

Dr. Werner Meier

King & Spalding LLP

Dr. Axel J. Schilder

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

While elsewhere in Europe significant market uncertainties persisted, lending markets in Germany continued to improve in 2015. The current outlook for the country's economic development and, consequently, for its lending markets, is generally viewed as positive. Unlike in some of the European jurisdictions, there is currently no credit crunch in Germany. Apart from distressed situations, German borrowers operate in a market environment in which ample financing sources continue to be available. Germany has, besides the United Kingdom, one of the strongest leveraged buy-out markets in Europe. There has been a solid flow of high-volume deals since 2013. New lenders such as debt funds and insurance companies are increasingly active. At the same time, in spite of the health of the German bank lending market, borrowers increasingly make use of alternative financing means, such as bonds. Also, regulatory requirements continue to force banks to de-leverage, and many have done so in 2015.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The acquisition of Autobahn Tank & Rast Holding (valued at €3.5 billion) by a consortium of investors including Allianz Capital Investors and Infinity Investments from Terra Firma and Deutsche Asset Wealth and Management, as well as the acquisition of Douglas Holding AG (valued at €2.8 billion) by CVC Capital Partners from Advent International and the Kreke family, constituted the largest debt-financed private equity transactions in Germany in 2015. Another example of the strong leveraged buy-out market in Germany was the acquisition of Synlab Services GmbH (valued at €1.7 billion) by Cinven Partners from BC Partners. Overall, there were five buy-out transactions valued at over €1.0 billion in Germany in 2015. The market was also characterised by a strong increase in secondary transactions.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (*see* below for questions relating to fraudulent transfer/financial assistance)?

The three most commonly used German corporate forms are those of (i) a limited liability company (*Gesellschaft mit beschränkter Haftung* – "**GmbH**"), (ii) a limited partnership (*Kommanditgesellschaft*) with a GmbH as the sole general partner ("**GmbH & Co. KG**"), and (iii) a stock corporation (*Aktiengesellschaft* – "**AG**").

GmbHs. Under the capital maintenance rules applicable to GmbHs pursuant to the German Limited Liability Companies Act (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung* – "**GmbHG**"), assets that are required for the maintenance of a GmbH's registered share capital must not be distributed to its shareholders (or to any third party, if such a distribution would benefit the GmbH's shareholders). Any distribution to shareholders that results in the GmbH's net assets at book value falling below its registered share capital is prohibited. Downstream guarantees for loans of a GmbH's direct or indirect subsidiaries do not violate these rules. However, upstream and cross-stream guarantees granted by a GmbH may violate the capital maintenance rules, depending on the GmbH's balance sheet ratios at the relevant point in time. Certain exceptions to these rules apply. Distributions are permissible if they are made against "full value" and arm's length consideration (including a "full-value", *i.e.*, fully enforceable, counter-claim or re-transfer claim). The same applies if and to the extent that the borrower has passed on loan proceeds to the subsidiary GmbH. Furthermore, an exception applies where the GmbH's shareholder and the GmbH have entered into a statutory domination and control agreement (*Beherrschungsvertrag*) or profit and loss transfer agreement (*Gewinnabführungsvertrag*). However, some legal commentators have taken the view that the latter exception should apply only where the subsidiary GmbH's statutory claims against its shareholder under such intercompany agreement(s) have "full value".

As a legal matter, these statutory rules apply only as between a GmbH (and its management) and its shareholders. *See* question 2.2 below as regards the customary incorporation of these restrictions into contractual relationships with lenders and other third parties.

GmbH & Co. KGs. The capital maintenance rules for GmbHs are also applicable to the general partner GmbH of the limited partnership.

AGs. The German Stock Corporation Act (*Aktiengesetz* – "**AktG**") provides for stricter capital maintenance rules as compared to the rules applicable to GmbHs. Any payments or the extension of any

© Published and reproduced with kind permission by Global Legal Group Ltd, London

other benefit by an AG to or for the benefit of its shareholders is prohibited, except in the form of a dividend distribution pursuant to a shareholders' resolution. These restrictions are subject to the same exceptions as described above for GmbHs (*i.e.*, situations in which the AG receives arms' length consideration, or has "full-value" statutory claims against its shareholders under a statutory domination and control or profit and loss transfer agreement, or has received loan amounts on-lent to it by the shareholder/borrower).

The above-described rules with regard to downstream, upstream or cross-stream guarantees apply correspondingly to the extension of downstream, upstream or cross-stream security.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

GmbHs. Shareholders and managing directors of a GmbH may be personally liable to the GmbH for damages in case of a violation of the capital maintenance rules described in question 2.1 above. Furthermore, in case of payments made to a shareholder resulting in a cash flow insolvency (*Zahlungsunfähigkeit*) of a GmbH, managing directors may incur personal liability to the GmbH, unless such payments were made in line with the standard of care of a prudent businessman (*Sorgfalt eines ordentlichen Geschäftsmanns)*.

It is standard market practice in Germany to include enforcement limitation language in the documentation of upstream or cross-stream guarantees or security extended by subsidiary GmbHs for the direct or indirect benefit of a shareholder, in order to shield the GmbH's managing directors from such personal liability risks. Under such limitation language, the secured borrower is generally limited in its enforcement of the guarantee or security to the amount of any free reserves of the GmbH. Accordingly, depending on the GmbH's balance sheet ratios from time to time, the limitation language may have a significant impact on the value of the guarantee or security. Exceptions are typically agreed in respect of loan amounts that were passed on by the borrower to the subsidiary GmbH. *See* question 2.4 below regarding the impact of shareholders' approvals on the liability of a GmbH's managing directors.

AGs. An AG's shareholders and management board members are subject to stricter rules and increased liability exposure *vis-à-vis* the AG as described in question 2.1 above, in case none of the above-described exceptions apply to payments or the extension of other benefits to or for the benefit of the AG's shareholders. In order to avoid personal liability, management board members should only allow such payments or extension of other benefits if the AG has entered into a statutory domination and control agreement with its shareholders.

In addition to the above-described enforcement limitations for GmbHs and AGs, and as a response to case law developed by the German Federal Court of Justice (*Bundesgerichtshof* – "**BGH**"), some legal commentators believe that the extension of upstream or cross-stream guarantees or security may also incur liability on the part of shareholders and management based on the legal doctrine of "destructive interference" (*existenzvernichtender Eingriff*), in cases where such extension impairs the company's continued existence. This doctrine applies to the intentional interference of damages on a company in violation of public policy (*vorsätzliche sittenwidrige Schädigung*), causing or further increasing the company's insolvency. On this basis, additional enforcement limitation language, by which any enforcement of the guarantee or security in question is subject to the company's continued ability to satisfy third-party debt, has been suggested and/or agreed to in some secured lending transactions in the past. However, due to the significant impact of any such additional enforcement limitation on the value of such guarantees or other collateral (whereby a secured creditor effectively subordinates itself to any unsecured third-party creditors), the inclusion of such language is considered unacceptable by many lenders.

2.3 Is lack of corporate power an issue?

With the exception of certain types of insurance companies, German companies are not subject to any *ultra vires* doctrine. Any limitations of management of a GmbH or an AG to represent the company with regard to certain transactions have generally no effect on the validity of agreements with third parties. Certain exceptions apply, in particular for scenarios in which it is obvious to the third party that management exceeds its corporate powers or in which management and the third party collude to the company's detriment.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

The German Banking Act (*Kreditwesengesetz* – "**KWG**") provides that the granting of guarantees in a commercial manner, or to an extent that requires a commercially organised business, requires the authorisation by the German bank regulator (*Bundesanstalt für Finanzdienstleistungsaufsicht* – "**BaFin**"). An exception applies to entities that only engage in any such transactions with their subsidiaries, parent companies or other affiliates (*see* question 10.1 below with regard to additional exceptions to authorisation requirements).

Notwithstanding compliance with internal procedures as set out in the by-laws of the company or its management, it is standard market practice to also require shareholders' approval with regard to the extension of guarantees or security. For GmbHs, such approvals generally include an instruction to the managing directors to enter into the transaction agreements. Under German law, a GmbH's managing director acting on the basis a valid shareholders' approval (or instruction) can generally not incur liability to the GmbH, even if the execution of the instruction is detrimental to the GmbH.

The legal situation is different in the case of an AG, where management is not permitted to follow a shareholder instruction to take an act that is detrimental to the AG, except where a statutory domination and control agreement is in place.

Even in the case of a GmbH, shareholders' approvals are not valid where such approvals violate applicable law, *e.g.*, if an approval is in violation of statutory capital maintenance rules. Accordingly, in the case of upstream or cross-stream guarantees or security, a managing director may not rely on such a shareholders' approval, and should review the validity of such an approval carefully. The corresponding uncertainties related to this, and the lack of case law on point, confirm the importance of the contractual enforcement limitation language, as described in question 2.2 above.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

See questions 2.1 and 2.2 above regarding the limitations imposed by German capital maintenance rules and customary contractual enforcement limitations.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Under German law, there are no exchange controls that would pose an obstacle to enforcement of a guarantee or other collateral.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

For lending obligations, the most common types of available security used in Germany are the following:

Share collateral:

- share pledge; and
- security assignment of title.

Receivables collateral:

- security assignment; and
- pledge.

Cash account collateral:

- account pledge.

Movables and equipment collateral:

- security transfer of title; and
- pledge.

Intellectual property collateral:

- security assignment; and
- pledge.

Real estate collateral:

- mortgage (*Hypothek*); and
- land charge (*Grundschuld*).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Under German law, there is no concept of a floating charge over all assets of the chargor. Accordingly, assets have to be charged on an individual basis. One could legally combine the creation of security over various types of assets in a single document, but standard market practice is to have one security agreement for each asset class, due to the differences in the creation and enforcement procedures applicable to the various types of collateral.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

German law provides for two types of security over real property: (i) "accessory" mortgages; and (ii) "non-accessory" land charges. Land charges are the most common form of security over real estate in Germany, as they offer several advantages as compared to mortgages. Due to the "accessory" nature of a mortgage, the mortgage and the underlying secured receivable are inseparably linked. Accordingly, a mortgage can only secure a specific receivable, it can only be transferred where the underlying receivable is transferred and, by operation of law, if an underlying receivable is transferred, the mortgage is also deemed to be transferred. Land charges are not "accessory" and can therefore be created and transferred independently of the receivables which they secure. The security over real estate created by mortgages and land charges extends generally also to the fixtures, accessories, related products and other components of the real estate.

Both mortgages and land charges are created by way of a security agreement. Generally, such an agreement takes the form of a notarial deed, to enable the parties to effect a registration in the land register (*Grundbuch*), and to facilitate a possible enforcement. Both mortgages and land charges can be in the form of a certified security interest (*Briefhypothek* or *Briefgrundschuld*) or an uncertified security interest (*Buchhypothek* or *Buchgrundschuld*). Where a certificate was issued, such a certificate has to be handed over to the secured party; where no certificate was issued, the exclusion of the certification must (in addition to the above-described general requirements) also be registered in the land register to perfect the security interest.

For equipment that does not constitute a fixture, *see* question 3.1 above in respect of the possible types of security. Typically, this takes the form of a security transfer of title, given that the only alternative (a formal pledge) would require the surrender of actual possession in the equipment to become effective.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables is generally created by way of a security assignment of legal ownership. A security assignment may apply to a single, multiple, all existing and/or future receivables. From a legal perspective, a security assignment can be agreed in oral form, but it is standard market practice to assign receivables in writing. The receivables to be assigned must be sufficiently identifiable (*bestimmbar*). However, it is not required that each single receivable be specifically identified.

Where the underlying receivables contract contains a non-assignment clause, the general rule is that any assignment (including a security assignment) of such receivables that is purported to be made in violation of such a clause does not result in an effective transfer of legal ownership of such receivables. However, as an exception, where both the assignor and the obligor are either (i) corporate entities, (ii) partnerships, or (iii) individual merchants, and (x) the underlying receivables contract constitutes a commercial transaction, or (y) the obligor of the receivable is a governmental agency, an assignment (including a security assignment) does in fact transfer legal ownership of the relevant receivables in spite of the non-assignment clause. This does not, however, apply to loan receivables of a bank.

To perfect the security, obligors are not required to be notified of a security assignment (and as a practical matter, absent an event of default, generally no notification is done), except where otherwise provided in the underlying receivables. Where the obligor was not notified (and is not otherwise aware of the assignment), it retains *vis-à-vis* the assignee certain set-off rights and other objections it might have against the assignor, *e.g.*, it may validly discharge its obligations under the receivables agreement by making payment to the assignor.

A security assignee can enforce the receivables directly against the obligor by presenting evidence of the assignment.

Security over receivables may also be created by way of a formal pledge. However, to perfect a pledge of a receivable, the obligor must be notified. As the assignors generally tend to avoid such notification, security assignments over receivables are far more customary than formal pledges.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

The most common form of security over cash deposited in bank accounts is an account pledge. As cash in bank accounts constitutes, from a legal perspective, a receivable against the account bank, a security assignment could be used as an alternative to a pledge, but this is far less common. Although not legally required, pledge agreements are generally entered into in written form. In order for

© Published and reproduced with kind permission by Global Legal Group Ltd, London

the pledge to be perfected, the account bank as obligor must be notified about the pledge. It should be noted that German banks, pursuant to their standard business terms, already have pledge over all accounts that are maintained with them. Such pledges are generally waived or subordinated by the account bank in case of a new contractual pledge with regard to the cash in bank accounts.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

GmbHs. Shares in a GmbH are not certificated and, from a legal perspective, do not constitute securities. The most common form of security over GmbH shares is a formal pledge. Such pledges must be notarised to be perfected. It is not necessary to notify the pledge to the GmbH. However, sometimes the by-laws of a GmbH require the prior consent of the GmbH or of the remaining shareholders for a share pledge to become effective. Furthermore, a notification to the GmbH may be advisable for purposes of an enforcement of certain rights of the pledgee *vis-à-vis* the GmbH. Under German conflict of laws rules, the perfection of a pledge over a GmbH is generally governed by German law, irrespective of any conflicting choice of law clauses in the corresponding security agreements. Pledges over shares generally do not extend to claims with regard to profits of the GmbH, unless otherwise stipulated by the parties. Unless the by-laws of the GmbH provide otherwise, certain rights associated with holdings in GmbH shares, such as profit claims (but not voting rights), may be pledged separately and without notarisation, but this requires a notification to the GmbH.

Security over GmbH shares can also be created by way of a security transfer of title. However, this form of security is not very common, as the transfer of title may raise potential lender liability issues for the secured party.

AGs. Shares in AGs are generally issued in bearer form and certificated in one global certificate, and such a global certificate is deposited with a clearing system. Security over such shares is generally created by way of a formal pledge, requiring the transfer of direct or indirect possession (*Besitz*) of the securities. This is generally achieved by transferring the securities to a securities account maintained in the name of the secured party, or by blocking the securities account of the pledgor in the books of the account bank. Under German conflict of laws rules, the perfection of a pledge over shares in an AG is generally governed by the laws of the jurisdiction in which the certificate is situated (*lex cartae sitae*). Accordingly, German law will apply where the certificate representing the AG shares is located in Germany.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over inventory and other movable property can be taken by way of a security transfer or a formal pledge. However, pledges over inventory are not common in Germany, as these require the surrender of direct possession of the assets to the pledgee.

Accordingly, security over inventory is generally created by way of security transfer of title. There is no specific form requirement for security transfer agreements, but as a practical matter, these are generally entered into in writing. To perfect the security transfer, the assets to be transferred must be identified (including by reference to any and all assets that are located from time to time at a specified security location), and possession of such assets has to be transferred. Unlike in the case of a pledge, however, it is sufficient that the transferor agree to hold possession on behalf of the transferee, thereby extending indirect possession to the transferee.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (*see* below for questions relating to the giving of guarantees and financial assistance)?

Subject to the limitations described in questions 2.1 and 2.2 above, a company can extend security to secure both its own obligations as a borrower under a credit facility and as a guarantor of the obligations of other borrowers/guarantors under a credit facility.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Germany does not provide for stamp duties and other taxes levied on documents. In particular, no German real estate transfer tax is triggered by the granting of security; however, such tax can be triggered in connection with the enforcement of real estate security. Notary fees are incurred for the creation of pledges in GmbH shares, mortgages and land charges. The amount of the notary fees depends upon the market value of the charged assets and is based on a statutory fee schedule, not any fixed percentages. The same applies with regard to the court fees incurred for the registration of mortgages and land charges in the land register. Notary fees can be significant and often prompted parties in the past to notarise pledges in GmbH shares in Switzerland, where the parties have more flexibility in agreeing on the amount of notary fees. However, law reforms in Germany and Switzerland have raised legal uncertainties for notarisations in Switzerland with regard to the perfection of pledges of GmbH shares. A ruling of the German Federal Court of Justice at the end of 2013 addressed some, but failed to clarify all issues with regard to notarisations in Switzerland.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

See question 3.9 above with regard to expenses. Depending on the court handling the registration of land charges and/or mortgages, the registration might take several weeks or even longer. However, this does not generally result in any delay of the closing of a secured lending transaction, as it is standard market practice for the facility agreement to provide that the mere filing for registration of land charges or mortgages satisfies the corresponding closing condition.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Pursuant to German law, generally, no such consents are required with respect to the creation of security.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are generally no special priorities or other concerns with regard to a revolving credit facility. Security can even be created

© Published and reproduced with kind permission by Global Legal Group Ltd, London

with regard to future receivables, provided that such receivables are identifiable (*see* question 3.4 above).

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

See questions 3.3 and 3.6 above regarding notarisations. Where a security agreement is executed on the basis of a power of attorney, the parties typically require the authorisation pursuant to the power of attorney to be evidenced on the basis of a complete chain of corresponding powers certified by notaries or corresponding entries in commercial registers (*Handelsregister*). In the case of powers of attorney executed by foreign companies, foreign notaries may certify the identity of signatories and the content of the respective foreign register (if any). For some foreign countries, the certifications by the foreign notaries must be accompanied by an apostille.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

AGs. The financial assistance rules for German stock corporations provide for an explicit ban on the extension of loans to third parties and the extension of collateral to secure loans of third parties in order for such third parties to acquire shares in the AG. Any agreements entered into in violation of such rules are invalid. Exceptions to these rules apply (i) where a statutory domination and control or profit and loss transfer agreement exists, (ii) where financial assistance is granted in the course of the regular business of banks or financial services institutions, and (iii) in connection with an equity participation of employees.

GmbHs. GmbHs are not subject to comparable financial assistance rules. However, the capital maintenance rules and the legal doctrine on “destructive interference” described in questions 2.1 and 2.2 above applicable to GmbHs result in comparable limitations. In particular, in a standard leveraged buy-out scenario with a GmbH as the target, financial assistance requested by the purchaser from the GmbH may be considered “destructive interference”. The capital maintenance rules apply not only to payments or the extension of other benefits by a GmbH to its shareholders, but also to future shareholders, if the extension of payments or other benefits to those are closely related to the acquisition of shares in the GmbH.

(b) Shares of any company which directly or indirectly owns shares in the company

In this context, no clear guidance is available from German case law and legal scholars.

AGs. It seems fair to assume that the financial assistance rules described above should apply where such a company can exercise controlling influence over an AG that extended security.

GmbHs. It seems fair to assume that payments or the extension of other benefits by a GmbH to such a company which can exercise influence over the GmbH should be, subject to the limitations described in questions 2.1 and 2.2 above, prohibited pursuant to the capital maintenance rules as applicable to GmbHs. As German courts tend to apply such rules rather broadly, it also seems fair to assume that it does not matter whether such a company is already part of the GmbH’s group when the payment or other benefit is extended. Also, the legal doctrine on “destructive interference” raises additional limitations for the extension of a payment or other benefit in such a scenario.

(c) Shares in a sister subsidiary

As in the scenario under (b) above, there is no clear guidance by German case law and legal scholars. Financial assistance rules applicable to AGs as described in (a) above would not apply. However, the capital maintenance rules and the legal doctrine on “destructive interference” applicable to GmbHs as described in questions 2.1 and 2.2 above apply and might impose limitations that are comparable to financial assistance rules. Furthermore, depending on the facts at hand, such rules may also be applicable in case payments or benefits are extended to an affiliate of the shareholder, if such a shareholder can exercise controlling influence over the provider of the payments or benefits and such affiliate. It also seems fair to assume that such limitations should apply whether or not such an affiliate is already part of the group when the payment or other benefit is extended.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

This is generally recognised by German law, with an exception for “accessory” security interests (*see* question 3.3. above) such as pledges and mortgages (*see* question 5.2 below regarding the parallel debt concept).

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

As described above in question 5.1, this only arises with regard to “accessory” security interests. Due to the fact that the secured claim and an “accessory” security interest for such a claim are legally inseparable, a security agent or trustee can only hold such security where it is also a creditor of the secured claim. As an alternative mechanism to achieve the effect referred to in question 5.1, and to avoid requiring all lenders to become parties to the security agreement, parallel debt structures are frequently used in Germany. In such structures, the parties create an additional obligation of the borrower to the security agent or trustee which is in the same amount as the aggregate outstanding claims under the finance documents. This allows the creation of both “accessory” and “non-accessory” security for the benefit of the security agent or trustee for the full amount of what is outstanding from time to time. Such security can then be enforced by the security agent or trustee, and the enforcement proceeds can be applied to the claims of all lenders. However, although the general view is that these should be recognised under German law, the validity of parallel debt structures has not yet been tested in German courts.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

German law distinguishes between a guarantee (*Garantie*) and a surety (*Bürgschaft*).

Guarantees. German law considers a guarantee to create a separate, "non-accessory" claim against the guarantor. Consequently, the guarantee must be assigned to Lender B. (However, except where expressly permitted by the terms of the guarantee agreement, the assignability of "first demand" guarantees is unclear.) The guarantor retains *vis-à-vis* Lender B any objections resulting from the guarantee agreement upon a transfer of the loan and assignment of the guarantee. However, it may generally not raise any objections resulting from the contractual relationship between the obligor and Lender B under the loan agreement.

In any event, it is general market practice that guarantees are extended for the benefit of all parties to the facility agreement, and that the security agent will hold such guarantees for the benefit of those parties. In these cases, the guarantee need not be transferred to a new lender.

Sureties. German law considers a surety (which must be in writing) to create an "accessory" claim. Consequently, it is automatically transferred upon an assignment of the loan. In contrast to a guarantor, the grantor of a surety is not only entitled to raise objections resulting from the surety upon a transfer of the loan, but also objections resulting from the relationship between the obligor and creditor under the loan agreement.

6 Withholding, Stamp and other Taxes; Notarial and other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Generally, there is no requirement under German tax law to deduct or withhold tax from (i) interest payable on loans made to domestic or foreign lenders, (ii) the proceeds of a claim under a guarantee, or (iii) the proceeds of an enforcement of security. However, the German tax authorities are entitled to assess on an obligor an obligation to withhold tax at a rate of 26.375 per cent (or 15.825 per cent in case of a corporate taxpayer) on interest payments to a foreign lender, if such interest payments are subject to tax in Germany and such withholding appears to be required for safeguarding Germany's taxation right (and is not excluded under any applicable tax treaty). Interest payments may be considered German source income if a particular link to German sources exists. According to German local tax provisions, this link exists, *e.g.*, in the case of interest payments made on loans that are secured by German *situs* real estate. Where an applicable tax treaty also permits Germany to tax such income from interest payments, tax withheld might be credited or refunded upon tax assessment on the foreign lender, which requires a tax filing of the lender as well.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No other German tax incentives are provided preferentially to foreign lenders. No taxes (such as stamp, issue, registration or similar taxes or duties) apply with respect to loans, mortgages or other security documents for the purpose of effectiveness or registration.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Income of a foreign lender will not become taxable in Germany solely because of a loan to or guarantee and/or, generally, the grant of security from a company in Germany.

Notwithstanding the foregoing, income of a foreign lender may become taxable in Germany where a loan is secured by German *situs* real estate or comparable rights or ships registered in Germany. This, however, generally does not apply in case of the existence of tax treaties between Germany and the country of residence of the foreign lender (*see* question 6.1 above). However, income of a foreign lender may become taxable in Germany (i) in cases where such income is attributable to the business property of a permanent establishment of such a lender, including a permanent representative, or a fixed base maintained in Germany by the foreign lender, or (ii) such income is otherwise considered as German-source income (*e.g.*, rental income from German real estate).

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

See question 3.9 above.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

German law does generally not provide for any such consequences.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Regulation (EC) 593/2008 on the Law applicable to Contractual Obligations (Rome I) is applicable in Germany. Accordingly, subject to the requirements set out below, courts in Germany will generally recognise the contractual choice of a foreign law, and enforce such a contract, to the extent that they have jurisdiction for claims under such a contract. Choice of law clauses in contracts are recognised where there is an actual conflict of laws and the contract relates to civil or commercial matters. Choice of law clauses can

© Published and reproduced with kind permission by Global Legal Group Ltd, London

also be added or modified after the relevant contract was executed. However, where there is no actual conflict of laws and the contract is exclusively connected to EU Member State(s), the parties cannot choose the law of a non-EU Member State. If they were to do so, German courts would not recognise such a choice of law and would apply the law of the EU Member State that the contract is connected to. In addition, German courts may apply mandatory provisions of the jurisdictions where the contractual obligations have to be fulfilled. A contractual choice of law will not be recognised, however, where it violates the German *ordre public*.

On 1 October 2015, the Hague Convention on Choice of Court Agreements entered into force, introducing a potential worldwide agreement on jurisdiction clauses and cross-border enforcement. However, as yet, only the EU Member States (excluding Denmark) and Mexico have ratified this convention, so that it has only limited applicability at this point in time.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

In this respect, one has to distinguish between judgments rendered in another EU Member State and judgments rendered elsewhere.

EU Member State Judgments. The enforcement of judgments rendered in another EU Member State is governed by Council Regulation (EC) No. 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters (the "Brussels I Regulation"). Pursuant to Article 33 of the Brussels I Regulation, any such judgments will be recognised and enforced without any special procedure being required or any re-examination of the merits of the case. Certain exceptions apply (*e.g.*, in respect of judgments that are manifestly contrary to the German *ordre public*). Such judgments will be declared enforceable upon application to a presiding judge of a chamber of a German regional court (*Landgericht*).

Non-EU Member State Judgments. Judgments rendered outside the EU will generally be recognised, unless the recognition is explicitly excluded under the German Code of Civil Procedure (*Zivilprozessordnung*). Certain exceptions apply (*e.g.*, in respect of judgments that are contrary to the German *ordre public*, or where the foreign court did not have jurisdiction according to German law). To become enforceable in Germany, such judgments have to be declared enforceable by a German court pursuant to the German Code of Civil Procedure. However, in any such proceeding, the German court does not review the merits of the case.

It is standard market practice in Germany for a party that wishes to rely on a foreign judgment to obtain a declaratory judgment which recognises the foreign judgment.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

There are different factors that impact the timing for obtaining a decision of a German court or enforcing a foreign judgment, including, *inter alia*, the complexity of the case and the workload of the court. In a best-case scenario, with regard to (a) above, a first-instance court judgment might be obtained within one year. With regard to (b) above, in a best-case scenario, the enforcement of a judgment from an EU Member State should general be recognised and enforceable within a few days, while this might take a couple of months in the case of a judgment from a non-EU Member State. However, in both cases this might also take significantly more time, and the time required for the actual enforcement will vary from case to case. Additional time may be added by appeals (most of the first-instance judgments can be appealed, but preliminary enforcement is generally available upon extending collateral).

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Land charges/mortgages. Land charges and mortgages have to be enforced in formal enforcement proceedings, frequently by way of a public auction conducted by the enforcement court (*Vollstreckungsgericht*). The timing of such enforcement is generally impacted by the workload of such court. In addition, the obligor may apply for a suspension of enforcement for a period of six months. This requires, however, that there is a certain likelihood that the suspension will render the auction unnecessary and that the suspension is justified on equitable grounds.

Movables/inventory. Security over movables/inventory that is in the form of a pledge is generally enforced outside of formal enforcement proceedings (*Zwangsvollstreckungsverfahren*) by way of a public auction. Alternatively, where there is an exchange price for the relevant asset, a discretionary sale may be undertaken. Public auctions have a significant impact on timing and require a notification to the security provider with a mandatory waiting period of one month before the auction can be performed.

German law does not provide for any regulatory consents for the enforcement of security. However, the Legal Services Act (*Rechtsdienstleistungsgesetz*) requires express permission for rendering debt collection services (*Inkassodienstleistungen*) (subject to certain exceptions, *e.g.*, for attorneys). Debt collection services are permitted under the Legal Services Act if the debt collection agency is registered in the legal services register and commands over certain legal expertise (in particular civil law, commercial law and insolvency law).

In addition, any factoring services conducted in a commercial manner, and any factorings services requiring a commercially organised business, are subject to licensing rules under the KWG. *See* question 2.4 above and question 10.1 below with regard to exceptions to such licensing requirement.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

The only additional restriction for foreign lenders is that these may be required to post collateral for court costs before any proceedings will begin. However, this is not applicable where such a requirement is waived by a corresponding treaty between Germany and the jurisdiction in which such a lender has its domicile or residence. Lenders from EU Member States or states that are party to the Hague Convention on Civil Procedure of 1 March 1954 are generally not required to post collateral for court costs.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Preliminary insolvency proceedings. Initially, upon an insolvency filing, the insolvency court will generally appoint a so-called "preliminary insolvency administrator" and open "preliminary insolvency proceedings". Such proceedings usually take up to three months, during which it is determined whether (i) an insolvency ground exists, and (ii) the company's assets are sufficient to cover the expected costs of the proceedings. The insolvency court may (and often does) impose a prohibition on claims and security enforcement measures against the debtor during this period by way of a court order. This does not apply to the enforcement of security over real estate; however, the "preliminary insolvency administrator" may apply for suspension of the enforcement of such security by way of public auction where he or she can demonstrate a certain likelihood that the suspension is necessary to avoid an adverse impact on the debtor's financial situation. Furthermore, German insolvency courts may issue an order entitling a "preliminary insolvency administrator" to collect receivables over which security was granted by way of a security assignment.

Insolvency Proceedings. The opening of (actual) insolvency proceedings creates a moratorium on all individual claims enforcement measures against the insolvent debtor. *See* question 8.1 below on creditors with a right to preferential treatment. As regards the impact of insolvency proceedings on the enforcement of security, *see* question 8.1 below.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

German law provides only for very limited review of arbitral awards. The recognition and enforcement of arbitral awards is governed by the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958. Accordingly, a court will generally not re-examine the merits of the case. Certain exceptions apply (*e.g.*, invalidity of the arbitration agreement and corresponding lack of jurisdiction of the arbitral tribunal).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In insolvency proceedings, secured lenders generally have a right to preferential treatment (*Absonderung*) in the form of a preferred distribution from the proceeds of the enforced security, whereas unsecured creditors only participate in the remainder of the proceeds (if any) from the bankruptcy proceedings on a *pro rata* basis. The latter also applies to secured creditors in respect of any deficiency claims they may have after the enforcement of their security.

Certain forms of security can be enforced only by the insolvency administrator. This applies generally to security over (i) inventory/movables in the insolvency administrator's possession, and (ii) receivables, even where the receivables obligor has been notified of the security assignment. The secured party itself may enforce security over receivables or movables only in those rare cases where such security was created by way of a pledge. With regard to land charges and mortgages, both the insolvency administrator and the secured party are entitled to enforce the security by way of public auction or sequestration. In addition, the insolvency administrator may enforce land charges and mortgages by way of a discretionary sale. Even where a secured party is entitled to enforce the security itself, this is subject to possible legal actions by the insolvency administrator, *e.g.*, the insolvency administrator is entitled to file for the suspension of an enforcement by way of public auction, especially where the auction would have a significant adverse impact on the amount to be realised for the insolvency estate.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The insolvency administrator may challenge (clawback) legal actions by the insolvent party that impaired third-party creditors during applicable preference periods if certain additional statutory requirements are satisfied. Applicable preference periods run from one month to 10 years prior to the insolvency filing. Any clawback under these rules is governed by statutory rules and (unlike in many other jurisdictions) not in the discretion of the insolvency court.

One of the most commonly used challenges applied by insolvency administrators relates to the grant of security or satisfaction of a claim by the (now insolvent) debtor, provided that such action was performed (i) during the last three months prior to the insolvency filing, where at such time the debtor was unable to pay its debts as they came due (illiquid) and the creditor knew of such inability, or (ii) after the insolvency filing, provided that at such time the creditor was aware of the debtor's inability to pay its debts or of the filing.

In addition, the insolvency administrator may challenge actions of the debtor that extended security to a creditor or satisfaction of a claim to which such creditor was not entitled (or was not entitled to in such a way or at such time), if such action was taken (i) during the last month prior to the insolvency filing or after such filing, (ii) during the second or third last month prior to such filing, if the debtor was unable to pay its debts at such time, or (iii) during the second or third last month prior to such filing, if the creditor was aware at the time when such action was taken that it was detrimental to the debtor's third-party creditors.

Furthermore, transactions (*Rechtsgeschäfte*) entered into by the debtor may be challenged by the insolvency administrator if they directly impaired the debtor's third-party creditors and the transaction was done (i) during the last three months prior to the insolvency filing, if at such time the debtor was unable to pay its debts and the creditor was aware of that, or (ii) after the insolvency filing, if at such time the creditor was aware of the debtor's inability to pay its debts or of the filing.

Any action performed without any consideration may also be challenged by the insolvency administrator, unless it was performed more than four years prior to the insolvency filing.

In addition, an insolvency administrator is entitled to challenge actions that were taken with the intent to impair the debtor's third-party creditors, provided that the creditor was aware of such intent and the action was taken within 10 years prior to the insolvency filing or after such filing.

In respect of shareholder loans and similar transactions, the insolvency administrator may challenge:

(i) an action taken without any consideration, except where this occurred more than four years prior to the insolvency filing;

(ii) an action by which security was provided for a shareholder loan or similar shareholder's claim, if this occurred within 10 years prior to the insolvency filing or after such filing;

© Published and reproduced with kind permission by Global Legal Group Ltd, London

(iii) an action by which a shareholder loan or similar shareholder's claim was satisfied, if this occurred within one year prior to the insolvency filing or after such filing; and

(iv) an action by which a third party's claim for the repayment of a loan or payment of a similar claim was satisfied, if such claim was secured by security granted by the debtor's shareholder and the action was taken within one year prior to the insolvency filing or after such filing.

An insolvency administrator's clawback rights are more restricted in the case of actions taken by the debtor for which there was immediate and equivalent consideration (*e.g.*, with regard to the extension of security, if such security constituted equivalent (*gleichwertig*) security and there was a direct nexus (*unmittelbarer Zusammenhang*) of the extension of security with the extension of a credit). Any such action is considered a "cash transaction" (*Bargeschäft*) and may be challenged by the insolvency administrator only where the debtor had the intent to impair its third-party creditors. "Equivalence" may also exist if there is a certain level of over-collaterisation. A "direct nexus" requires that there be no significant time difference between the extension of the credit and the extension of security. However, no "cash transaction" exists where the debtor extended security with regard to a pre-existing claim without any explicit contractual obligation to do so; this also applies to the extension of a new credit where the parties agree that that the security granted for the new credit will also secure a pre-existing debt for which previously no security was granted.

In addition, German law provides certain rebuttable presumptions that facilitate the challenge by an insolvency administrator of transactions between the debtor and its related parties (affiliates). *Inter alia*, the insolvency administrator is entitled to challenge any such transaction if it was (i) entered into for consideration during the last two years preceding the insolvency filing, (ii) directly detrimental to the debtor's third-party creditors, or (iii) performed by the debtor with the intent to impair its third-party creditors, unless the related party can prove that it was not aware of such intent.

In October 2015, the German Government issued a draft bill with amendments to the clawback regime described above, with the goal to increase legal certainty, in particular in relation to the challenge of transactions taken with the intent to impair the debtor's third-party creditors. In the latter respect, the draft amendments provide, *inter alia*, that (i) accommodations (*e.g.*, deferrals, waivers or instalments) discussed with or granted by a creditor shall no longer be considered to constitute a strong indication that such creditor knew of the debtor's illiquidity at that point in time, and (ii) the preference period for such transactions shall be decreased from 10 to four years. Furthermore, under the draft bill an additional requirement for any challenge of "cash transactions", besides the existence of intent to impair the debtor's third parties, would be the other party's awareness that the debtor acted with such intent. Other proposed amendments relate, *inter alia*, to the clawback of payments of wages to employees, the clawback of claims resulting from enforcement measures, and interest rates for clawback claims. Most recently, in a meeting of the Legal Committee of the German Parliament at the end of February 2016, it was also discussed whether besides employees other stakeholders such as craftsmen, manufacturers, vendors and suppliers should also benefit from additional protection from clawback rights.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Certain entities governed by public law are, due to public policy considerations, excluded from bankruptcy proceedings pursuant to German insolvency laws.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Creditors principally use court proceedings to seize the assets of a company in enforcement. Private remedies such as "self-help" are typically only permissible as a last resort, *i.e.*, where there is a present danger to suffer irreparable harm.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

In cross-border scenarios, the submission of a party to a foreign jurisdiction is generally governed by Article 23 of the Brussels I Regulation, which provides that a contractual choice of forum is generally permissible and legally binding. Certain form requirements may apply. If expressly agreed, a clause giving only one party the right to choose the forum is permissible. However, if other courts have exclusive jurisdiction pursuant to Article 22 of the Brussels I Regulation, no choice of forum is permissible. This relates in particular to proceedings regarding *in rem* rights in immovable properties or tenancies of immovable properties.

However, there is currently no clear guidance as to where the Brussels I Regulation will apply, unless a cross-border scenario exists where both parties have their domicile in different EU Member States. Where only one party has its domicile in an EU Member State and the other party has its domicile in the same EU Member State or in a non-EU Member State, it cannot be excluded that a court may find that the Brussels I Regulation would not be applicable, so that the choice of jurisdiction clause would be governed by domestic (*e.g.*, German) law. However, it should be noted that German domestic rules correspond largely to the Brussels I Regulation.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A waiver of sovereign immunity is generally legally binding, unless (i) it conflicts with public international law, or (ii) covers areas that are specifically protected by international law, *e.g.*, diplomatic immunity. The enforcement into assets protected by diplomatic immunity, *e.g.*, embassy buildings, is permissible only with a corresponding express waiver of diplomatic immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that it is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing requirements and other eligibility requirements for an agent under a syndicated facility for lenders to a company in your jurisdiction?

The KWG provides that the extension of cash loans in a commercial

© Published and reproduced with kind permission by Global Legal Group Ltd, London

manner, or to an extent that requires a commercially organised business, requires a banking licence. Various exceptions to this rule apply (*e.g.*, for insurance companies; *see* also question 2.4 above regarding a further exception applicable to banking business with certain affiliates).

In addition, according to guidance by BaFin, the licensing requirement does not apply to pre-existing client relationships or to the extension of loans at the borrower's own solicitation. According to BaFin, the latter exception typically applies in the case of large corporate clients and institutional investors.

Furthermore, BaFin may exempt lenders from the licensing requirement where the lender does not require supervision based on the nature of its business. With regard to foreign lenders, such exemption typically applies where these are effectively supervised in their home countries by competent authorities in accordance with internationally recognised standards and the competent home country authorities cooperate with BaFin in a satisfactory manner.

In May of 2015, BaFin announced that German debt funds regulated under the AIFM-Directive may with immediate effect extend and restructure loans in Germany without the need of a banking licence under the KWG. Subsequently, this new administrative practice was implemented into law with the Implementation Act for the UCITS-V in Germany, which will become effective on March 18, 2016. Under this Act, non-German EU funds will also benefit from the new rules (this was not clear under the BaFin announcement in 2015). However, third-country funds benefit from the new rules only if they are admitted for marketing to semi-professional investors in Germany, which requires, *inter alia*, such funds to comply with all requirements under the AIFM-Directive.

To the extent that a lender does not comply with the aforementioned licensing requirements, it may be subject to fines, and the lender's management may be subject to criminal prosecution.

The role of an agent under a syndicated credit facility itself does generally not trigger any licence requirements under the KWG. However, where the agent is also a lender under the syndicated credit facility, the above-described licence requirements apply.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

A material consideration to be taken into account relates to the legal concept of lender liability resulting from the so-called "tortuous grant of a restructuring loan" (*Sanierungskredit*). This legal concept is based on German case law that is not fully clear and consistent. The initial test is whether a lender has extended a loan to a distressed company that is not economically viable, and the loan would actually not result in a restructuring of the company but only delay its insolvency in order for the lender to obtain certain benefits, *e.g.*, the expiration of preference periods. Where such a lender acted with a certain degree of intent and/or recklessness, German courts may consider such extension of credit to be an unfair impairment of other creditors of the distressed borrower, and hold such a lender liable to such other creditors for any losses such creditors suffered from the delay of insolvency caused by such a lender. Such liability can be significant and especially relates to future creditors of the distressed borrower that are not (or not fully) secured. This liability can also be incurred *vis-à-vis* existing creditors of the borrower, amounting to the difference by which the insolvency ratio applicable to their claims against the distressed borrower is reduced as a consequence of the delay of insolvency to the ratio that they would have received if the insolvency filing would have been made earlier. Furthermore, subject to certain requirements, security extended by the distressed borrower to such a lender can be void or challengeable by the insolvency administrator (*see* question 8.2 above). However, German courts acknowledge that restructuring efforts generally involve the extension of new loans and, necessarily, a certain degree of risk that the distressed borrower may eventually become insolvent in spite of the restructuring efforts. Accordingly, it seems fair to assume that lenders should not incur lender liability if they act in good faith when participating in the restructuring of a distressed borrower. In these situations lenders generally obtain restructuring opinions (*Sanierungsgutachten*) from, *e.g.*, auditing firms, confirming on the basis of a thorough due diligence review that, upon the grant of the new loan, the borrower will be viable going forward. Such opinions can be used as a defence if the borrower subsequently falls into insolvency and litigation is initiated against the new lender.

Another material consideration to be taken into account relates to persons who represent lenders in the context of restructuring loans. Such a person can potentially qualify as a *de facto* managing director (*faktischer Geschäftsführer*) of the borrower. This legal concept applies where a person acts *vis-à-vis* third parties as if he or she were appointed as a managing director of the borrower, and effectively manages the borrower in a way a validly appointed managing director would (including by influencing the activities of the actual managing director), but without an actual, legally valid appointment. *De facto* managing directors can incur liability to third parties for any delay of an insolvency filing. There is no clear guidance as to where a person representing lenders may have to be considered a *de facto* managing director of the borrower. All facts at hand have to be taken into account, including in particular the duration and the kind of influence taken by such a person on the actual management of the borrower.

A further material consideration relates to the subordination of shareholder loans. In insolvency proceedings, shareholder loans are subordinated to claims of other creditors of the insolvent party. Such subordination applies as a matter of statutory law, not in the discretion of the court. Exceptions apply where a shareholder either (i) has acquired its shares in an attempt to effect a restructuring (restructuring exemption), which is again typically evidenced by way of a third-party restructuring opinion, or (ii) holds 10 per cent or less of the borrower's registered share capital (small shareholder exemption). In addition to the subordination, an insolvency administrator may be entitled to challenge certain acts of the insolvent party, as described in question 8.2 above.

In a decision rendered in March 2015, the BGH significantly limited the common practice of portfolio company sponsors to subordinate shareholder loans only upon the subsequent commencement of insolvency proceedings in respect of the portfolio company and only for the purposes of such proceedings. Under the new case law, even the receipt of payments of principal and interest on shareholder loans prior to an insolvency filing is restricted. Effectively, the court required a deep subordination of shareholder loans to apply prior to insolvency where the loan's purpose is to relieve the company and its directors from insolvency filing obligations.

The subordination of shareholder loans can pose an additional risk for lenders where these qualify as *de facto* shareholders. This legal concept is based on case law of the German Federal Court of Justice. It generally requires that the lender received a pledge over a company's shares and qualifies as a so-called "irregular pledgee" (*irregulärer Pfandgläubiger*), meaning a pledge that has been put in a position to be able to exert influence over the borrower's management, including by way of overly restrictive covenants and consent requirements in the underlying loan documentation.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Dr. Werner Meier

King & Spalding LLP
TaunusTurm, Taunustor 1
60310 Frankfurt am Main
Germany

Tel: +49 69 257 811 420
Fax: +49 69 257 811 100
Email: wmeier@kslaw.com
URL: www.kslaw.com

Dr. Werner Meier is a finance and restructuring partner and King & Spalding's Head of Restructuring Europe, based in the firm's Frankfurt and London offices. He has 25 years of experience in European debt and corporate restructurings as well as syndicated loans, high-yield bonds, securitisations and other finance transactions. In recent years, he advised The Hellenic Republic in its €206 billion sovereign debt restructuring, the largest restructuring transaction in history, and has won numerous transaction awards. Dr. Meier holds a German doctorate degree in law (*Dr. iur.*) and obtained an LL.M. degree from Columbia University Law School/Columbia University Business School in 1991 and an MBA (*Diplom-Kaufmann*) from University of Bielefeld Business School in 1990. He completed his German legal education and practical training at University of Bielefeld Law School in 1989. Dr. Meier is a member of the Bar in New York and admitted to practise in Germany. He is widely published on German and U.S. finance, capital markets, corporate law and insolvency law issues. *Chambers Global*, *Chambers Europe*, *The Legal 500 EMEA*, *The Legal 500 Deutschland*, *IFLR1000* and *JUVE* all distinguish him as a leading finance and restructuring lawyer.

Dr. Meier is also based in King & Spalding's London office, which is located at 125 Old Broad Street, London EC2N 1AR, United Kingdom. Tel: +44 20 7551 7540 / Fax: +44 20 7551 7575.

Dr. Axel J. Schilder

King & Spalding LLP
TaunusTurm, Taunustor 1
60310 Frankfurt am Main
Germany

Tel: +49 69 257 811 300
Fax: +49 69 257 811 100
Email: aschilder@kslaw.com
URL: www.kslaw.com

Dr. Axel J. Schilder is a tax partner in King & Spalding's Frankfurt office and a member of the firm's global tax group. He has over 15 years of experience in German and international tax structuring, covering all aspects of finance, real estate and investment tax law, including in securitisations and non-performing loan transactions. In 2014 he was part of King & Spalding's team advising a private equity investor on the acquisition of a €800 million loan and distressed assets portfolio. Dr. Schilder started his legal career as a tax officer with the German tax authorities and obtained a diploma for financial administration (*Diplom-Finanzwirt*). He holds a German doctorate degree in law (*Dr. iur.*) and is qualified both as a German lawyer and German tax advisor. He is admitted to practise in Germany, and is a member of the German Tax Advisors Association. He completed his German legal education and practical training at University of Marburg in 1996. He is widely published on German and international tax issues, and regularly acts as a lecturer at the Academy for the German Real Estate Industry, as well as the University of Applied Sciences in Worms for German and International Tax Law.

KING & SPALDING

Celebrating more than 130 years of service, King & Spalding is an international law firm that represents a broad array of clients, with more than 900 lawyers in 18 offices in the United States, Europe, the Middle East and Asia. The firm has handled matters in over 160 countries on six continents and is consistently recognised for the results it obtains, uncompromising commitment to quality and dedication to understanding the business and culture of its clients.

King & Spalding is recognised by *IFLR1000* and other directories as one of the world's leading law firms advising on financial and corporate matters. The firm's global finance practice brings together more than 100 finance lawyers to represent lenders, arrangers, investors, funds and borrowers in the full range of secured and unsecured financings. The firm provides clients worldwide with expertise in leveraged finance, capital markets, securitisations and other structured finance, project finance, Islamic finance, real estate capital markets, financial restructuring, and tax and regulatory matters.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Greece

George N. Kerameus

KPP Law Offices

Pinelopi N. Tsagkari

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The year just gone, 2015, has proven to be another year of extreme challenges for the Greek banking sector. Greek systemic banks concluded, by the end of the year, another recapitalisation, while the market has been operating since mid-2015 under a capital controls regime. The major current challenge is addressing non-performing loans ("**NPLs**"), through the creation of a secondary market in Greece.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

In 2015, Greek banks continued refinancing existing loans on a syndicated basis. Within such a framework, no significant lending transactions (of a value of more than €200 million) took place in 2015.

In this chapter and unless otherwise indicated, any reference to:

- "lenders" means credit institutions, and "borrowers" or "obligors" means companies; whereas
- "companies" means Greek corporations which are regulated by codifying Law 2190/1920 on *sociétés anonymes*, as amended and currently in force (the "**Greek Company Law**"). This chapter does not cover the issues arising from financing received by Greek credit institutions.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Article 23a of the Greek Company Law provides that a company is prohibited from guaranteeing the borrowings of associated legal entities, unless the following (quite strict) conditions are cumulatively met: (i) the guarantee serves the company's interests; (ii) the company has a right of recourse against the principal debtor (i.e. the associated enterprise in favour of which the guarantee is provided); (iii) the general meeting of shareholders (the "**GM**") approves the transaction by an increased special quorum and majority; and (iv) the claims of the lender, in favour of which the guarantee is provided, are subordinated to the claims of the company's existing creditors. In any case, the guarantor's Articles of Association (the "**AoA**") may extend the said prohibitions to other persons, such as to the company's directors or general directors. Greek financial institutions are not subject to the above regime and may freely guarantee borrowings of members of their groups. In addition, a company may guarantee borrowings of one or more other legal entities, whose financial statements are subject to consolidation pursuant to articles 31 *et seq*. of Law 4308/2014 on Greek Accounting Principles, again provided that the GM approves the transaction by an increased special majority.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In principle, the provision of guarantee shall serve the guarantor company's interests, an issue which is a factual and multidimensional one and therefore has to be examined on a case-by-case basis. If such a condition is not met, then the guarantee is considered null and void, and directors' liability (including penal) may arise.

2.3 Is lack of corporate power an issue?

Lack of corporate power (i.e. total absence of the relevant scope in the company's Articles of Association) is an issue only to the extent that a guarantee is considered as not serving the attainment of the company's business scope, in which case it is null and void, as per our response under question 2.2. On such a basis, lenders usually require the provision of guarantee to be included in the business scope of guaranteeing companies.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In principle, no. As aforementioned under question 2.1, an approval by the GM, to which shareholders representing 1/10 of the paid-up share capital (1/20 in the case of listed companies) shall not oppose, is required. The Board of Directors (the "**BoD**") shall submit to the GM a report confirming satisfaction of the conditions for the lawful granting of the guarantee, whereas the GM resolution shall be registered with the Companies' Registrar and meet the statutory publication requirements. In case of companies whose financial statements are subject to consolidation, pursuant to articles 31 *et seq*. of Law 4308/2014 on Greek Accounting Principles, the GM approval shall be resolved by a 2/3 majority (increased to 19/20, if provided on a post-transaction basis).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

In general, no (except for guarantees raising financial assistance issues, in respect of which refer to section 4).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

The capital controls regime still applicable as at the time of printing this Guide may create obstacles to the enforcement and cashing out of a guarantee in the case of a foreign lender.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are two (2) basic categories of security rights under Greek law: collateral *in personam*; and collateral *in rem*. The main personal security rights are guarantees, whereas the main real security rights are (prenotation of) mortgages (over immovable assets) and pledges (over movable assets and rights). Non-attachable assets and/or claims are not available to secure lending obligations.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Given that specific establishment, publication and registration requirements may apply depending on the type of either the security or the asset on which such security is granted, a separate agreement in relation to each type of asset is commonly used. The procedure depends on whether a court decision, notarial deed or private agreement is statutorily required for the establishment of the security, as well as whether such decision, agreement or deed has to be registered with a specific authority and meet any publication requirement. See below for more details.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral, in the form of either a mortgage or a prenotation of mortgage, may be taken over real property (land) and plant, as well as all component parts and accessories of the immovable (i.e. machinery and equipment), which are owned by the security provider and are fixed (or exist) thereto.

Pursuant to the provisions of the Greek Civil Code (the "**GCC**"), a mortgage is the right *in rem* established in favour of a creditor over a person's full ownership (or usufruct) rights on immovable property (land and buildings) to secure an obligation by means of the creditor's preferential satisfaction. A prenotation is a type of temporary mortgage, which may be rendered final provided that: (a) a final court decision orders payment of the due and payable claim, which is secured by the prenotation; and (b) the prenotation is converted to a mortgage within a period of 90 days from the issuance of such a court decision. Once converted into mortgage, the order of priority is set according to the time of registration of the prenotation of mortgage and not to the conversion date. Pursuant to the principle of priority of mortgages, in the event that multiple mortgages are registered against the same property, priority is determined according to their registration dates. Mortgages registered on the same day are satisfied pro rata. Given their equal treatment as to enforceability and ranking, prenotation is usually preferred due to the lower costs involved.

As to the procedure, a mortgage may be established bilaterally, by virtue of a notarial deed, or unilaterally, by virtue of a court decision; a prenotation of mortgage is always established by virtue of a court decision (either on a bilateral or a unilateral basis). For the perfection of both types of securities, the court decision or the notarial deed shall be registered with the competent Land Registry or Cadastre, where the property is situated. Under both types of security, possession of the real property is not conveyed to the creditor. Pursuant to special statutory provisions applicable to (prenotations of) mortgages securing claims of credit institutions: the said securities are protected from clawback in case of bankruptcy of the collateral provider; such securities extend to any machinery and equipment that enters the mortgaged plant even after the establishment of the security; the collateral provider is prohibited from removing and/or transferring the machinery and equipment, without the prior consent of the creditor; and enforcement procedures are facilitated.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Receivables (present or future) may be pledged or assigned under the provisions of the GCC on the basis of a written agreement, which shall take the form of a notarial deed or a private agreement bearing a certain date (the latter is preferred due to its minimal costs). The agreement is executed between the creditor and the collateral provider and must be notified to the debtors of the pledged receivables in order to be perfected. Pledge or assignment of current or future business receivables may also be established under the provisions of articles 11–15 of Law 2844/2000; in addition, collateral security over business receivables may take the form of a floating charge under the provisions of articles 16–18 of Law 2844/2000, which is established on a group of claims/rights. Such pledge of or floating charge over business receivables, under the provisions of Law 2844/2000, is registered in the public books kept by the competent public registry (a special public registry called "*enechyrofylakio*") where the debtor has its registered seat. Such claims/rights are freely collected/disposed by the security provider, who is, however, obliged to substitute them with similar claims/rights. Finally, claims may be pledged in favour of credit institutions licensed in Greece pursuant to the beneficial provisions of legislative decree ("**l.d.**") 17.7.1923.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A pledge over cash deposited in bank accounts is commonly realised in favour of credit institutions under the provisions of either l.d. 17.7.1923 and/or Law 3301/2004, transposing into Greek law EU Directive 2002/47/EC on financial collateral arrangements (the "**collateral law**"). The procedure involves in this case, too, a pledge agreement in the form of a notarial deed or a private agreement bearing a certain date, which is notified to the bank maintaining the accounts.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Shares in companies incorporated in Greece may be pledged as security of claims arising from lending transactions, unless otherwise

© Published and reproduced with kind permission by Global Legal Group Ltd, London

provided by the respective provisions of the AoA of the issuing company. The pledge is extended to dividends and other monetary or personal rights deriving from the shares, unless otherwise agreed.

A pledge of either bearer or registered shares is realised in accordance with the aforementioned (under question 3.4) GCC procedure, with the additional requirement of delivery of the share certificates to the pledgee, whose details shall be noted on the share certificates, as well as into the shareholders' book, in the case of registered shares. In the case of dematerialised listed shares, the pledge needs to be registered with the Dematerialised Securities System, pursuant to article 49 of Law 2396/1996 and the Regulation of the Hellenic Exchanges. Finally, a pledge of listed shares may also be effectuated pursuant to the provisions of the collateral law.

In principle, security over shares in companies incorporated in Greece may validly be granted under a New York or English law governed document; rights *in rem* over the shares, however, will be governed by the *lex rei sitae*, i.e. the law of the place where either the respective account or registry is maintained, in the case of dematerialised shares, or the person – normally the security holder – holding the shares is located, in the case of securities in paper form. Finally, such choice of law will be subject to Greek public order and overriding mandatory provisions, to the extent applicable.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Given its purpose (i.e. to be sold by the security provider), inventory (products) is commonly pledged, under the provisions of articles 16–18 of Law 2844/2000, in the form of a floating charge over a group of assets (the inventory), (see our answer to question 3.4 above).

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company may grant a security interest in order to secure its obligations under a credit facility both as a borrower and as a guarantor of the obligations of other borrowers and/or guarantors of obligations.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Costs vary depending on the type of security.

In the case of mortgage, notarial fees range from 0.2% to 1% of the security value plus VAT (currently amounting to 23%), whereas legal fees are also payable if lawyers are involved. In the case of prenotation of mortgage, court fees do not exceed €500. Registration fees for both securities amount to 0.775% of the security value in case of land registries, or 0.875% in case of Cadastres.

Registration of pledge or floating charge falling within the provisions of Law 2844/2000 in the public books kept with the competent Pledge Registry is burdened with fees equal to 0.775% of the security value.

The above security charges are significantly reduced in case of bond loans issued by Greek companies under the provisions of law 3156/2003 (the "**bond loans law**").

Registration of the pledge of dematerialised listed shares to the Dematerialised Securities System costs €120 (per issuer and type of share). The fees of court bailiffs for the notification of a security document amounts to €35–€95 per service.

Finally, loans granted by Greek or foreign banks to Greek companies and bond loans in general, as well as securities granted in their context, are exempted from Greek stamp duties.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

In principle, notification or registration of securities does not involve a significant amount of time. Limited Land Registries are slow in processing registrations of deeds or court decisions to their public books, but this does not affect the order of priority of said registration, which is determined according to the time of submission of the relevant application before the competent Land Registry (see our answer in question 3.3. above). In terms of expenses, please refer to our answer to question 3.9.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In principle, no consents are required. The only related requirements are provided by the provisions of:

(a) Law 1892/1990, pursuant to which consents shall be obtained as to agreements involving the acquisition, establishment of security and/or lease by individuals or legal entities that are not nationals of an EU/EFTA of rights *in rem* on real property within Greek border areas (as well as shares in companies with such real rights); and

(b) Law 3310/2005, pursuant to which any agreement (including a security document) in respect of rights in shares representing at least 1% of the share capital of a media company or a company taking part in a public tender is null and void unless such agreement is executed before a notary public and notified to the Greek National Council for Radio and Television.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No. Any type of collateral secures the obligations arising from the balance of the respective accounts, after closing thereof.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

See our answers as above.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Pursuant to article 16a of the Greek Company Law, a company (other than a credit institution) is prohibited from providing

© Published and reproduced with kind permission by Global Legal Group Ltd, London

guarantees and/or giving security to support borrowings incurred to finance the direct or indirect acquisition of shares of the same by any third party (other than the employees of either the company or of an associated thereof company) unless:

(i) the GM provides its prior consent to the guarantee and/or security by an increased quorum and majority, on the basis of a BoD report on the reasons and the company's interest for the transaction to be approved – as well as an auditor's report, in case members of the BoD of the issuing or the parent company are directly or indirectly contracting parties to the respective transactions; and

(ii) the secured amount, which shall appear in a non-distributable reserve as long as the security is outstanding, does not cause the company's own funds to fall below the aggregate amount of share capital and non-distributable reserves.

(b) Shares of any company which directly or indirectly owns shares in the company

As long as the company, whose shares are being acquired, is considered to be the parent company of the company which is providing the guarantee or other security, then the restrictions referred to under question 4.1(a) apply.

(c) Shares in a sister subsidiary

This case is not covered by the provisions of the Greek Company Law.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

In principle, no. Such a notion may be found in (a) the bond loans law, which provides for the role of a bondholders' representative, acting also as a security agent in the framework of bond loans issued by Greek companies, as well as of securitisation transactions. Under such provisions, securities *in rem* are granted and registered in the name of the security (bondholder) agent but on behalf of the bondholder; such agent shall be either a credit institution or an investment firm, licensed to operate in Greece and is appointed by the issuer of the bonds (i.e. borrower), and (b) in Law 3389/2005 on Public Private Partnerships (the "**PPP Law**") pursuant to which a security trustee is appointed in order to receive and manage any rights *in rem* provided as security for loans granted (for the realisation of the projects falling within the scope of PPP Law) by credit or financial institutions, which should be jointly and severally entitled to claim full or partial payment of such loans as per the provisions of article 489 GCC.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Other than the security agent and trustee provided by the bond loans law and PPP Law, respectively, as above, there is no alternative mechanism (including the parallel debt clause) to achieve the intended effect without any legal risk.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The transfer of a lender's rights and obligations arising from a loan (and a guarantee) agreement is allowed, unless otherwise provided by the respective contractual provisions and may be effectuated either pursuant to the general provisions of the GCC, or as a securitisation transaction or finally under the newly introduced regime for NPLs secondary market. Except for the case of a securitisation transaction, in order to be perfected, the transfer shall be notified to the debtors (borrower and guarantor). In the framework of both a securitisation transaction and NPLs, registration with the public registry is required.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest payable on credit facilities is not subject to withholding tax; it has been clarified that, under the provisions of the new Greek Income Tax Code (the "**ITC**"), applicable as of 01.01.2014, such exemption also applies to foreign lenders (see our answer to question 6.2 for applicable DTT rates). A 15% withholding tax is levied on interest from bond loans issued by resident companies (see our answer to question 6.2 for foreign investors). The above tax treatment should not alter due to the fact that interest has been paid in the form of proceeds from a guarantee claim or from enforcement of security.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

In cases where, under the ITC provisions, interest payable to foreign lenders is subject to withholding tax, the lower rate among the following shall apply:

(a) 15%, as provided by the ITC;

(b) the rate provided by the tax treaty (if any), signed by Greece, with the State of which the foreign lender is a tax resident; and

(c) the zero rate provided by the EU Interest and Royalties Directive, if the relevant statutory conditions are met.

Under the ITC provisions, the exemption of non-resident companies without a permanent establishment in Greece from any withholding tax on interest from bond loans issued by resident companies no longer applies (it applied until 31.12.2013).

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Foreign banks do not acquire a permanent establishment in Greece solely because of the granting of a loan to a Greek company or a guarantee and/or grant of security therefrom.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

An annual contribution at the rate of 0.6% is imposed on the average outstanding monthly balance of each loan granted by a Greek or foreign bank to a Greek resident. Loans between banks, loans to the Greek State, loans funded by the EIB, as well as bond loans, are exempt from such contribution. As to guarantees, no additional cost arises. For costs and fees in respect of securities, kindly refer to our answer to question 3.9 above.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are, in principle, no adverse legal consequences to a borrower due to the fact that some or all of the lenders are organised under the laws of a jurisdiction other than Greece. Thin capitalisation rules exist in Greece, but their application is not affected by the residence of the lenders. Deductibility of interest may be disallowed under special tax anti-avoidance provisions.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Greek courts do recognise and enforce contracts that have a foreign governing law on the basis of the provisions of the Rome Convention on the law applicable to contractual obligations and Regulation EC 593/2008, whichever is applicable, subject to: rights *in rem*, which are governed by the law applicable as per the conflict of law rules; Greek public order; and overriding mandatory provisions.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes, Greek courts will recognise and enforce a foreign judgment without re-examination of the case, pursuant to the applicable provisions of: EU Regulations, in case of judgments from other EU Member States (e.g. Regulations 805/2004 and/or 1215/2012, which has replaced Regulation EC 44/2001); bilateral international conventions; and the respective provisions of the Greek Code of Civil Procedure (the "**GCCP**").

However, Greek courts may deny recognition in case: the foreign judgment is not an enforceable title or *res judicata* in the foreign country; it is issued by a foreign court not having jurisdiction as per Greek law; it violates Greek public order; the defendant was deprived of its rights to a fair trial; or the foreign judgment is contrary to a Greek judgment, which is *res judicata* for the same issue and parties.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The period required for a foreign lender to obtain a judgment (of first degree, i.e. appealable) over a Greek law governed contract starts from six months, in case of a payment order, and goes as far as two to four years, in case of a law suit. In the case of foreign governing law, such periods are expected to be significantly extended. The period required for the recognition of a foreign judgment may also prove considerable. Such periods are intended to be shortened further to significant changes introduced to the GCCP, effective as of 1.1.2016.

In any case, enforcement of a Greek or foreign judgment and actual satisfaction of a lender is usually lengthy, especially when auctions are involved (see below, question 7.4), given that legal defences (other than to claim payment) are available to the obligor(s) during the enforcement procedure as a consequence of the typically excessive requirements of the latter. The length of the process is also heavily dependent on if there are claims of other creditors participating in the enforcement and auction proceedings with general and/or special privileges, as per the GCCP provisions.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Under the GCCP's general rules of enforcement of security, the mortgagee/pledgee of mortgaged/pledged immovable/movable assets may seek satisfaction through the issuance of an enforceable title (in principle, either non-appealable court decisions, including payment orders, or notarial deeds), which is followed by seizure of the property for auction. The GCCP includes specific rules as to the actions and periods within which enforcement proceedings shall be effectuated.

As to the allocation of proceeds from the auction of a specific asset, in case of multiple creditors participating in the respective proceedings with claims higher than the auction proceeds, the following priority of payments apply: where creditors holding a general privilege (such as State claims from VAT due (including surcharges), as well as from unpaid taxes and increments thereof, employees' and lawyers' claims arising from employment relationships of the two years prior to the declaration of bankruptcy, including employment termination compensation and social security claims, etc.) coincide with secured (i.e. security on the specific asset on which enforcement takes place) and unsecured creditors then secured creditors shall be satisfied up to 65% from the auction proceeds, whereas general privileged claims shall be satisfied up to 25%, and finally the rest 10% of the auction proceeds shall satisfy the unsecured claims. If there are no unsecured creditors then creditors holding general privileged claims shall receive 1/3 of the auction proceeds, whereas the rest 2/3 shall be distributed to the secured creditors. If again, secured and unsecured claims coincide, the latter creditors shall receive 10%

© Published and reproduced with kind permission by Global Legal Group Ltd, London

of the auction proceeds and 90% shall be allocated to the secured creditors. Finally, if there are no secured creditors, then unsecured creditors shall be satisfied from the 30% of the auction proceeds and creditors holding a general privileged claim from the remaining 70% of the auction proceeds. The above mandatory auction is avoided in case of: a pledge of claims under the provisions of l.d. 17.7.1923, where the credit institution arguably acquires full ownership thereof and is entitled to liquidate the claim, with the obligation to refund to the borrower any amount exceeding its secured claim; and financial collateral arrangements under the provisions of the collateral law, which provide for the satisfaction of the creditor through sale, set off or application of the financial instruments and/or cash in discharge of the relevant obligations.

No regulatory consents are required.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

No restrictions apply. However, it has been argued that foreign lenders do not enjoy the benefits of l.d. 17.7.1923.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Bankruptcy or reorganisation (reconciliation) proceedings involve suspension of enforcement proceedings, which, however, apply for a limited period of time (usually not more than one year). In the case of reconciliation, collateral security rights may be amended, as provided by the reconciliation agreement reached between the debtor and its creditors.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. An arbitral award will be recognised by Greek courts under the provisions of the New York Convention for its contracting states and under the provisions of the GCCP for any other case.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

As already mentioned, in case of bankruptcy the court usually imposes a temporary moratorium on individual prosecutions (i.e. prohibiting the lender from commencing or continuing enforcement procedures against the debtor who has been declared bankrupt). In addition, a security agreement is subject to the clawback provisions of the Greek Bankruptcy Code (the "**GBC**"), i.e. Law 3588/2007 as amended and currently in force (security agreements are in principle protected from clawback if established by virtue of the provisions of the collateral law or Law 4112/1929, as well as if carried out in the framework of a reconciliation plan). Finally, the GBC provides that creditors with a real security on an asset of the bankruptcy estate are satisfied solely by the liquidation of such asset, with an option however to waive their security and be satisfied by the whole bankruptcy estate, in which case their claims are subordinated as per the GBC provisions. Securities under the collateral law are in principle not affected by the bankruptcy proceeding.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

According to the GBC, transactions (in the form of donations or other transactions with disproportionately small consideration, payments of non-outstanding debts, establishment of *in rem* securities, etc.), which take place during the suspect period are subject to clawback, upon request of the bankruptcy administrator or a creditor. The suspect (preference) period is determined by the bankruptcy court and may not start earlier than two years from the date of issuance of the court decision declaring bankruptcy. Furthermore, transactions carried out within a period of five years preceding the declaration of bankruptcy are conditionally subject to clawback.

During bankruptcy proceedings the enforcement agent distributes the liquidation proceeds, following the system of privileges, pursuant to the provisions of articles 975 *et seq*. of the GCCP (with regards to priority of payments kindly refer to our answer to question 7.4 above).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The GBC is applicable to all types of companies, except for the following legal entities which are subject to special liquidation provisions: credit institutions as provided by Law 4261/2014; insurance undertakings as provided by Law 4364/2016; and investment firms, as provided by article 22 of Law 3606/2007 as amended by Laws 3756/2009 and 4099/2012.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

As aforementioned, the only enforcement processes that do not involve court proceedings are those provided by (a) l.d. 17.7.1923, and (b) the collateral law.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, it is legally binding and enforceable.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

An obligor's waiver of sovereign immunity is legally binding and enforceable under the laws of Greece, subject to any overriding mandatory provision establishing an immunity right in favour of that obligor.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

In principle, loans to a Greek company may be granted either by: credit institutions (an authorisation by the Bank of Greece is required in case of a non-EU bank); other entities licensed (i.e. investment firms) by the Bank of Greece to carry out lending business; or members of the same corporate group. In addition, as aforementioned, the security agent under the bond loans law shall be a credit institution or an investment firm licensed to operate in Greece.

At this point, it should be stressed that in accordance with Law 4354/2015, which entered into force on 1.1.2016, a legal regime regarding the management and transfer of claims arising out of non-performing loans granted by credit institutions, has been introduced in Greece. For that purpose, the Bank of Greece recently issued the relevant licensing framework and specified the minimum requirements, with regards to the establishment and operation of NPLs (management and/or acquiring companies), in Greece, which companies may under certain conditions provide new loans to the debtors of such NPLs.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

In any case, lenders and equity investors need to obtain special legal and tax advice when participating in financings in Greece.

George N. Kerameus
KPP Law Offices
10 Paradissou str.
GR 151 25 Maroussi, Athens
Greece

Tel: +30 210 3390 723
Fax: +30 210 3390 342
Email: g.kerameus@kpplaw.eu
URL: www.kpplaw.eu

George is a member of the Athens Bar Association and has been admitted before the Supreme Court and the Council of State. After commencing his career within the tax department of one of the "big four" multi-disciplinary firms, he joined a prominent Greek law firm, which he left, having been its tax partner, to found KPP Law.

George advises Greek and foreign banks in their capacity as creditors in the framework of all types of lending and other financial transactions, but also Greek banks when receiving financing or protection by, as well as granting security to, foreign banks and international organisations. He has been recommended in *Chambers & Partners* in the practice area of Banking & Finance for Greece.

George is also a tax expert, focusing on corporate tax advice, both on a day-to-day and transactional basis, with great experience in all direct and indirect tax issues, while he has also acted on behalf of corporate clients as the lawyer in charge of legal due diligence within the framework of M&A transactions.

Pinelopi N. Tsagkari
KPP Law Offices
10 Paradissou str.
GR 151 25 Maroussi, Athens
Greece

Tel: +30 210 3390 723
Fax: +30 210 3390 342
Email: p.tsagkari@kpplaw.eu
URL: www.kpplaw.eu

Pinelopi N. Tsagkari has been a member of the Athens Bar Association since 2011. In February 2016, she joined KPP Law as an associate. Pinelopi holds an LL.B. from the Aristotle University of Thessaloniki, and an LL.M. in International Banking and Finance Law from Leeds University of the United Kingdom. Pinelopi practises in the areas of corporate law, civil law, banking law and litigation and is fluent in Greek and English.

KPP Law (Kerameus, Papademetriou, Papadopoulos Law Offices) consists of Greek and foreign lawyers with advanced levels of education and considerable professional experience.

We are highly specialised in the fields of banking & finance, competition and tax law, with clients from various business sectors, such as banking, insurance, retail, real estate, energy, telecommunications, real property, audit & business consultancy and transportation. We also have strong Corporate, M&A, Restructuring and Litigation practices.

Our aim is to provide our clients with valuable and practicable legal services of the highest level, striking the right balance between protecting and promoting their wider business and/or personal interests.

Our lawyers are proficient in Greek, English, French, German, Italian, Danish and Spanish.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Hong Kong

Richard Mazzochi

David Lam

King & Wood Mallesons

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Syndicated lending volumes in Asia Pacific (excluding Japan) for 2015 amounted to approximately US$495.2 billion, some 14% down on the previous year. The number of deals (1,366) was also down significantly. To some extent, these declines came about due to the high water mark set in 2014, a bumper year for syndicated loans. Bucking the trend were Hong Kong and China, where both jurisdictions posted significant gains in volume. This is notwithstanding the fact that Chinese real estate companies, major borrowers in previous years, were quieter in 2015.

The outlook for 2016 is uncertain. China, a key driver for Asian growth in recent years, continues to slow its pace of growth, with official growth targets now set to a range of 6.5 to 7%. Although major banks remain flush with liquidity, macro-economic shifts may reduce demand from borrowers.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Major transactions include CK Property Finance's $5.2bn dual-tranche three-year term loan, which was the one of the largest real estate acquisition-related facilities out of the region on record. In South East Asia, Charoen Pokphand Group's $2.4bn multi-tranche facility was closed mid-year, and was the largest loan from a Southeast Asia borrower in 2015 and the fourth largest deal from a Thai borrower on record. Notably, Ford Motor Company, in an amendment to its long-standing US$13.4 billion (equivalent) syndicated loan facility, added a substantial CNH tranche, which may pave the way for more major league US corporates to tap the Asian markets for this currency.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company can give a guarantee or grant security over its assets in respect of the borrowings of another member of its corporate group.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

A director has a fiduciary duty towards the company and must act in its best interests. This applies when considering the giving of a guarantee or other security. If a director breaches its duty, then it may be personally liable towards the company.

The directors of the company will have to consider whether the giving of the guarantee will be in the best interests of the company and whether the company will benefit from the giving of such guarantee. It is important that the company itself, not only the group as a whole, will derive benefit from the giving of the guarantee. It is generally easier to establish that there is corporate benefit for a guarantor giving a downstream guarantee than a guarantor giving an upstream guarantee or a cross-stream guarantee.

2.3 Is lack of corporate power an issue?

Section 115 of the Companies Ordinance provides that a company has the capacity, rights, powers and privileges of a natural person of full age. If, however, the objects of a company are stated in its articles of association, the company must not do any act that it is not authorised to do by its articles of association. Also, if any power of a company is expressly modified or excluded by its articles of association, the company must not exercise any power contrary to such modification or exclusion.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental approval, consent or registration is required.

In view of the issues raised in question 2.2 above, it is recommended that shareholder resolutions approving the giving of the guarantee are obtained where it secures the obligations of a parent or sister company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

These matters would not affect any limit on the amount of a guarantee. However, if a company is experiencing solvency issues, the matters referred to in question 8.2 should be borne in mind.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, there are not.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

It is possible to take security over almost any type of asset in Hong Kong, whether tangible or intangible. This includes real estate, contractual rights and other receivables, securities, bank accounts, intellectual property, ships, aircraft and inventory.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A company can execute a debenture (i.e. a single document containing a range of fixed and floating charges over all assets). However, it is also possible to provide individual security agreements over particular assets. Generally, the procedure would involve the due execution of the relevant document by the security provider, registration of the document where applicable, and other perfection steps that may be required depending on the type of security. For example, for an assignment of a contract it is required to provide notice to the assignor's counterparty to perfect the security.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

It is possible to take security over land, and this is most commonly done by taking a legal charge over the property (commonly referred to as a mortgage). The mortgage should be in written form, executed as a deed and specified to be a statutory legal charge. On or before the execution of the mortgage, the mortgagor would have provided title deeds of the property to the mortgagee to facilitate the title investigation. Original title deeds will be retained by the mortgagee until the mortgage is released.

After the mortgage deed is executed, it should be registered with the Land Registry within one month of its execution in order to preserve the priority of the mortgagee against any interests in the land that may be registered thereafter.

If the mortgagor/chargor is a Hong Kong incorporated company, or if it is a foreign company registered with the Companies Registry, then it would also be necessary to register the mortgage deed with the Companies Registry within one month of its execution in order to perfect the security.

It is possible to take security over plant, machinery and equipment in Hong Kong, and this would typically done by a chargor granting a fixed or floating charge over those assets. A charge is a security interest over an asset that does not involve the transfer of ownership to the chargee. Generally speaking, a creditor will prefer to have a fixed charge because this will have a higher priority in the insolvency of the chargor as compared with a floating charge.

However, the nature of a fixed charge requires that the creditor maintain a high degree of control, and the courts may, regardless of whether the deed of charge describes a charge as a fixed charge, recharacterise such charge as a floating charge if it considers that this degree of control is not maintained.

Where a floating charge is used, the chargor is free to deal with the assets. If the chargor parts with ownership, then it will no longer be subject to the charge. The floating charge can crystallise and become a fixed charge if a specified crystallisation event (which would normally include an event of default) occurs.

For an effective charge over plant, machinery or equipment, there is no need to obtain any title documents, or notify any third party of the charge. Where the chargor is a company, it may be necessary to register the deed of charge with the Companies Registry, as in the case of a mortgage deed (please see above).

It is also possible to take a pledge or a lien over plant, machinery or equipment, but because these require physical possession this is rarely done in a syndicated loan context.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security can be taken over receivables, and this is usually done by way of an assignment. However, a charge can also be used, in which case the same considerations referred to in question 3.3 above apply.

Where an assignment is taken, to be a legal assignment, it must comply with the requirements of the Law Amendment and Reform (Consolidation) Ordinance (Cap. 23), including that the assignment is absolute and over the assignor's entire legal interest, the assignment is in writing, the assignment is of a legal debt, and notice of the assignment is given to the contract counterparty. Where one or more of the above criteria is not met, the assignment may be an equitable assignment. This can still be effective security, and could be desirable where it is not practical to serve notice on each of the counterparties (which may be the case where there is a large number). On enforcement of the security, the creditor may wish to perfect the assignment by giving the notice, which will facilitate the collection of any claim, or the enforcement of the assigned rights by the creditor.

It is prudent for the creditor to have the underlying contract giving rise to the receivables reviewed to ensure that there is no prohibition on the assignment of the receivables. If so then the assignment may not be effective, and it could cause the assignor to be in breach of its obligations under the contract, which could in turn create liabilities for the assignor or render the contract voidable.

If the assignor is a company, the deed of assignment may be registrable with the Companies Registry (see question 3.3).

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

It is possible to take a fixed or floating charge over a bank account in Hong Kong. Please see above for relevant considerations for fixed and floating charges.

It is also possible to take an assignment of the account. Procedurally, this is broadly similar to an assignment of receivables as outlined above. Typically, the notice of assignment to the relevant bank is given at the outset, and have the account bank required to acknowledge the notice. In addition to perfecting the assignment, this would enhance the control of the assignee creditor. For example, it may require the account bank to waive any rights of set-off that it may have, or instruct the account bank that after it is served with an enforcement notice, it should only follow the instructions of the assignee creditor and not those of the assigning debtor.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

It is possible to take security over shares. Where the shares are certificated, it is common to take a fixed charge over the shares. The chargee would normally require the delivery of the original share certificates, as well as various ancillary documents (such as share transfer forms, directors' resignation letters and written resolutions) to be executed in blank to facilitate enforcement. Otherwise, the procedural requirements are similar to those of other fixed charges.

It is possible for a creditor to take a legal mortgage. This would involve the shares being transferred to the creditor, who is then registered as the owner of the shares. This can be considered the strongest form of share security as it would be very difficult for the mortgagor to arrange to sell the shares to a third party without the consent of the creditor. However, this is not a common form of security as the creditor may not want to deal with any consolidation issues that arise if the company whose shares are charged becomes a subsidiary, and there may be stamping costs involved in the transfer.

For scripless shares, these are generally held in the clearing system, CCASS. In addition to taking a fixed charge over those shares, it would be possible to take an assignment in respect of the account at the broker in which such shares are held. The procedural requirements are substantially similar to those of taking security over a normal bank account. Where a significant proportion of shares in a listed company are the subject of the security, it may be necessary to make a notification to the stock exchange.

It is possible in principle to take security over shares with a New York or English law governed document, but where the shares are located in Hong Kong it is generally advisable to use a Hong Kong law governed security document.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

The forms of security that are available for the taking of security over inventory are broadly the same as those for taking security over plant, machinery and equipment as set out in question 3.3 above. Generally a floating charge would be most appropriate as the chargor would expect to be able to freely sell the inventory without first having to obtain the consent of the chargee.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Generally speaking, a Hong Kong company can do all of the above.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notarisation is not required for the creation of security.

A registration fee of HK$340 is payable for each security agreement registered in the Companies Registry. Other registrations may be required against particular assets. Security over land should be registered in the Land Registry (which normally costs HK$210 to HK$450). Security over IP may be registrable in certain IP registers (for example, patents (costing HK$325) and registered trademarks (costing HK$800).

Stamp duty is generally not payable on the creation of security, though it may be payable on the enforcement security. For example, on the transfer of land, and on the transfer of shares, stamp duty may be payable, with the rate depending on the consideration provided.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The above matters are not normally onerous, and should be straightforward provided they are commenced in good time. Notification requirements in respect of an assignment of contracts can be onerous when there are a large number of contracts being assigned.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No governmental approvals or consents are required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, though it is common practice for security documents to contain clauses to clarify that the security applies to any further advances granted under a loan facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Security over certain asset types are required to be documented in writing (see the above questions with respect to assignments, and mortgages over land). Furthermore, documents contain a power of attorney should also be executed by deed.

As a matter of common practice, security documents are executed as deeds to prevent the document from being invalid due to lack of consideration.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

If a person is acquiring or proposing to acquire shares in a company incorporated in Hong Kong, the company and any Hong Kong incorporated subsidiaries must not give any financial assistance directly or indirectly for the purpose of the acquisition before or at the same time as the acquisition takes place. Also, if a person has acquired shares in a company incorporated in Hong Kong, and any person has incurred a liability for the purpose of the acquisition, the company or any of its subsidiaries must not give financial assistance directly or indirectly for the purpose of reducing or discharging the liability. In other words, refinancing of loans made available for financing the acquisition is likely to be caught by this prohibition as well.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

"Financial assistance" may take many forms and section 274 of the Companies Ordinance (Cap. 622) provides that it includes financial assistance given by way of "guarantee, security or indemnity". This usually prohibits the target company and its Hong Kong incorporated subsidiaries in an acquisition financing from giving guarantees and/or security to secure the facility financing the acquisition that is made available to the purchaser. Certain exceptions apply to this prohibition. This prohibition may also not apply if the company follows one of the three sets of relaxation procedures. These so-called "whitewash" procedures can be quite complex, and the choice of which one to follow depends on the structure of the relevant transaction and timing requirements.

If a company unlawfully gives financial assistance, the validity of the financial assistance and of any transaction connected with it is not affected solely by reason of the contravention of the prohibition of the giving of the financial assistance. However, the company and its responsible persons may be the subject of criminal sanctions if it is found that the restrictions have been breached.

(b) Shares of any company which directly or indirectly owns shares in the company

Please see above.

(c) Shares in a sister subsidiary

The financial assistance prohibition does not apply where the shares acquired are only of a sister company.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Security agency and trust arrangements are recognised. In syndicated lending, security will typically be granted in favour of a bank acting as security trustee on behalf of all syndicate members from time to time. The existence of the trust means there is no need to grant separate security to each lender or to grant new security or make new security registrations each time there is a change in syndicate membership. The security trust provisions will provide that the security trustee (or a receiver appointed by it) is the only party entitled to enforce the security (acting on the instructions of the lenders).

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Hong Kong.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The use of a security trustee to hold the benefit of the security and guarantee package on behalf of the syndicate (as described above) means that there are no notification or perfection requirements if membership of the syndicate changes from time to time. The security and guarantee package will continue to benefit the lenders, including new lenders joining the syndicate.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

These are not applicable in Hong Kong.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No tax incentives exist that provide preferential treatment to foreign lenders, and no special taxes apply to foreign lenders in relating to the effectiveness or registration of security documents.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

A foreign lender would not be subject Hong Kong tax solely due to a single loan made to a Hong Kong company. However, if it is required to pay profits tax in Hong Kong by reason of its business generally then it may be taxed on the profit made on the loan. Likewise, a foreign lender would not be subject to Hong Kong tax solely because its benefits from a guarantee or security from a Hong Kong grantor.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please see section 3 above.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Generally speaking, the Hong Kong courts will recognise the choice of a foreign law provided this would not be contrary to public policy

© Published and reproduced with kind permission by Global Legal Group Ltd, London

in Hong Kong. The courts may apply Hong Kong law mandatorily in some circumstances, such as where the subject matter of dispute relates to real property located in Hong Kong.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The Hong Kong courts will generally enforce a final and conclusive foreign judgment without re-examination of the merits, subject to certain exceptions. These include where it would be contrary to public policy, where the foreign judgment was obtained by fraud, and where the judgment relates to foreign penal or revenue laws.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

This will depend on the relative complexity of the facts of the case. If it is straightforward and the defendant does not mount a defence then the creditor may be able to get default judgment within one month of the initiation of proceedings. If there the defendant does mount a defence, then the creditor may be able to get summary judgment within three to six months. Failing this, the time to get a judgment will depend very much on the facts of the case.

The time to complete an enforcement procedure depends on the procedure chosen, but it can be done in under two months. For foreign judgments, the enforcement process can be completed within four to six months, but it can be considerably longer depending on the circumstances.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

In general there are no strict requirements with respect to the timing or value of the enforcement procedure. Public auctions and (except for in the case of very limited classes of assets) regulatory consents would not be required. However, the creditor does have certain duties towards the provider of the security to obtain a reasonable price. In an enforcement situation, the creditor would generally appoint a receiver, have the asset valued independently, and consider holding an auction if appropriate.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

No, they do not.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

In a compulsory winding-up of the security provider, once a liquidator is appointed, no proceeding may be commenced against the company or its assets without the leave of the court. However, a creditor may appoint a receiver over the relevant assets, and the court would be expected to grant leave for such receiver to take possession of the assets.

Although rarely seen, where a scheme of arrangement in respect of a company has been agreed by the relevant classes of creditors, and been sanctioned by the court, a moratorium may be put into place in respect of such company's debts in accordance with the terms of the scheme of arrangement. Generally though, no moratorium will come into place until the scheme is effective.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

As Hong Kong is considered a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (through the accession by China), the Hong Kong courts would enforce an arbitral award without re-examination of the merits, assuming that the award was made in a country that was also party to the New York convention. In such a case, the defendant would not be able to challenge the award on its merits.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

See question 7.6 above, and question 8.2 below.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Sections 266 and 266B of the Companies (Winding Up and Miscellaneous Provisions) Ordinance may invalidate transactions relating to a company's property if they are deemed to be "unfair preferences" for the purposes of section 50 of the Bankruptcy Ordinance and if the company is ultimately wound up. A company will be regarded as having given an unfair preference if the company does anything or suffers anything to be done which has the effect of putting its creditor (or surety or guarantor for any of its debts) into a position which will be better than the position such creditor (or surety or guarantor) would have been in if nothing had been done.

This applies where:

(a) the preference is given by the company to a creditor within six months (generally) or two years (when granted to an associate) before the winding-up petition, and at the time of the giving of the preference, the company is insolvent or becomes insolvent in consequence of the transaction or preference; and

(b) the company is influenced by a desire to prefer that creditor.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Also, subject to certain exceptions, section 267 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance invalidates any floating charge over a company's property or undertaking granted within 12 months of the commencement of its winding-up, unless it can be shown that the company was solvent immediately after that security was created.

In terms of order of payment upon insolvency, generally, creditors having the benefit of fixed charges and mortgages rank at the top, followed by the payment of liquidation costs (including realisation costs). Liquidation costs are followed by payments owed to preferential creditors. Payments to preferential creditors include wages, contributions to a mandatory provident fund, the return of deposits where the insolvent company is a bank and payments on insurance claims where the insolvent company is an insurance company. Only after all these payments have been discharged will creditors secured by floating charges be paid.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Unregistered companies (which includes foreign companies registered with the Companies Registry) may not be the subject of a voluntary liquidation procedure.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

This can be possible, but only in very limited circumstances. A creditor or receiver would not generally be able take possession of an asset without a court procedure, especially where the asset is a physical one. However, there may be circumstances where the security arrangement was established in such a way that the involvement of a court is not required. For example, where a creditor has the benefit of the assignment of a bank account, the creditor may instruct the account bank to make payments to the order of the creditor instead of the assignor.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Where the relevant contract provides that a foreign court will have exclusive jurisdiction, the Hong Courts will generally give effect to such choice. However, there may be exceptions, for example where the Hong Kong court found that the choice of jurisdiction was illegal, not made in good faith, or contrary to public policy.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The doctrine of absolute sovereign immunity applies in Hong Kong.

Waiver of sovereign immunity was considered in the recent cases of *Hua Tian Long (No 2)* and *FG Hemisphere Associates LLC v Democratic Republic of the Congo*. These cases suggest that if an obligor can establish to the satisfaction of the courts of Hong Kong that it is entitled to sovereign immunity then any waiver of that immunity (from jurisdiction, proceedings or execution) given by it in the relevant agreement may not be enforceable.

It may be possible to waive immunity before the courts (e.g. at the onset of proceedings), but this waiver must be express and unequivocal. It is also possible for a relevant state or state-owned entity to waive its immunity by conduct, as it may do by participating in the proceedings instead of claiming immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Lending business in Hong Kong is governed by the Money Lenders Ordinance. This Ordinance requires every person who carries on business as a money lender to hold a money lender's licence. However, this Ordinance does not apply to authorised institutions (i.e. licensed banks, restricted licence banks and deposit taking companies approved by the Hong Kong Monetary Authority) nor to loans made to such institutions, and in each such case no licensing under the Ordinance is required. The licensing requirement in this Ordinance does not apply to certain categories of loans (referred to in the Ordinance as "exempted loans", which include without limitation certain secured loans, intra-group lending and loans to employees) and certain categories of persons (referred to in the Ordinance as "exempted persons", which include without limitation certain types of financial institutions and insurance companies) making loans.

Any person who carries on a business as a money lender in contravention of the Money Lenders Ordinance is liable for a fine of up to HK$100,000 and imprisonment for up to two years. The lender may also be unable to enforce any relevant loan agreement.

There are no special licensing or eligibility requirements to become a facility agent in Hong Kong, though often a facility agent will be a bank that is an authorised institution.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

In a recent Hong Kong case (*Charmway v Fortunesea*), it was held that lenders under a syndicated loan facility (documented using the LMA standard template) would not be able enforce their rights against the borrower to recover their portion of a loan without the consent of a specified majority of lenders. Although the LMA and APLMA loan templates have been updated with a view to allowing individual lenders to enforce such rights without majority lender consent, the new drafting has not been tested in court, and any loan facilities documented using the old form of template will, in principle, be subject to the ruling in that case.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Richard Mazzochi
King & Wood Mallesons
13/F Gloucester Tower, The Landmark
15 Queen's Road Central
Hong Kong

Tel: *+852 3443 1046*
Fax: *+852 3443 1299*
Email: *richard.mazzochi@hk.kwm.com*
URL: *www.kwm.com/en*

Richard Mazzochi is a partner in the Hong Kong office of King & Wood Mallesons where he specialises in banking and finance. He has previously worked in Sydney, Singapore and London.

Richard has extensive experience in a broad range of significant matters including capital markets financing in the European, American and Asian markets; securitisation, repackagings and other structured finance; structured products (including funds); derivatives; market regulation (including clearing and settlement systems).

He acts for leading arrangers, sponsors, issuers, borrowers, lenders and dealers.

Richard is qualified in Hong Kong, England & Wales and Australia (NSW).

David Lam
King & Wood Mallesons
13/F Gloucester Tower, The Landmark
15 Queen's Road Central
Hong Kong

Tel: *+852 3443 8314*
Fax: *+852 3443 1299*
Email: *david.lam@hk.kwm.com*
URL: *www.kwm.com/en*

David Lam is a partner in the banking and finance department of King & Wood Mallesons, Hong Kong office. He has extensive experience in a wide range of lending transactions including acquisition financing, pre-IPO financing, real estate financing, privatisation financing and general syndicated lending.

He advises lead arrangers, lenders, sponsors and corporate borrowers.

David is qualified in Hong Kong, England & Wales and the People's Republic of China.

David is fluent in English, Mandarin and Cantonese.

KING&WOOD
MALLESONS
金杜律师事务所

King & Wood Mallesons (**KWM**) is a unique leading global firm headquartered in Asia, with 2,700 lawyers across 30 offices around the world.

Specifically, our Global Banking & Finance team offers depth and breadth across acquisition and corporate finance, asset finance, property finance, project finance, capital markets, derivatives, structured products, financial services regulation and restructuring & insolvency.

Our clients include top commercial and investment banks, large listed and unlisted corporates, private equity and other financial sponsors, market infrastructure participants, regulators and industry bodies.

Recent industry recognition include *International Financial Law Review*'s 2016 Regional Law Firm of the Year and National Firm of the Year – China (for the 6th year), *Asia Legal* Awards' 2016 Finance Team of the Year, *Financial Times* Asia Innovative Lawyer Awards' 2014 Most Innovative Law Firm Asia Pacific, *FinanceAsia*'s 2015 Best Financial Law Firm (Australia/NZ) and Australian Banking & Finance Awards 2015 Law Firm of the Year.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Indonesia

Theodoor Bakker

Ali Budiardjo, Nugroho, Reksodiputro

Ayik Candrawulan Gunadi

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Prudential Principles for Non-Banks

Recently, Bank Indonesia ("**BI**") enacted BI Regulation No. 16/21/PBI/2014 dated 28 October 2014 concerning the Implementation of Prudential Principles for the Management of Offshore Loans of Non-Bank Corporations ("**NBCs**") ("**Regulation 16**"), which replaces BI Regulation No. 16/20/PBI/2014 with the same subject. Regulation 16, which came into force as of 1 January 2015, aims to mitigate various risks inherent to private external debt, specifically for non-bank corporations. In principle, Regulation 16 requires NBCs with offshore loans (except for trade credit) to implement prudential principles by satisfying certain obligations to meet prescribed hedging ratios, liquidity ratios, and credit ratings, as follows:

- Hedging Requirement. Each NBC must effectuate a minimum hedging ratio of 25% of the combined negative spread between its Foreign Exchange Assets and its Foreign Exchange Liabilities which will be due (i) within three months after the end of the relevant quarter, and (ii) between the fourth and the sixth month after the end of the relevant quarter. The hedging ratio must be realised by hedging the foreign exchange against the Rupiah by taking out derivative coverage in the form of a forward, a swap and/or an option. During the first year after effectiveness (until 31 December 2016), a reduced minimum hedging ratio of 20% would apply.
- Liquidity Ratio. The NBC must meet a minimum liquidity ratio of 70%, calculated by dividing the total value of Foreign Exchange Assets that is available up to three months after the end of the last quarter by the amount of Foreign Exchange Liabilities that are due up to three months after the end of the most recent quarter. Receivables derived from forwards, swaps, and/or options which will be closed up to three months after the end of the most recent quarter may be included in the calculation. During the first year after effectiveness (until 31 December 2015), a reduced minimum liquidity ratio of 50% would apply.
- Credit Rating. The NBC must have a credit rating (either an issuer credit rating or a debt credit rating) of at least BB- (or equivalent) issued by an authorised Rating Agency (including, amongst others, Fitch Ratings, Moody's Investor Service and Standard and Poor's). The rating may not be older than two years. The rating must be a long-term debt rating if the NBC wishes to issue long-term bonds. The credit rating requirement is not applicable to offshore debt in foreign exchange ("**FX Offshore Loan**") obtained (i) for the purposes of refinancing (i.e. without increase of principal), or (ii) from international institutional credit providers (bilateral or multilateral) in relation to infrastructure projects (including infrastructure in the fields of transportation, roads, irrigation, drinking water, sanitation, telecommunication and informatics, electricity, and oil and gas). Institutions that are specifically mentioned in Regulation 16 are International Finance Corporation (IFC), Japan Bank for International Cooperation (JBIC), Japan International Cooperation Agency (JICA), Asian Development Bank (ADB) and Islamic Development Bank (IDB). The Credit Rating requirement would be applicable on the FX Offshore Loan that is signed or issued as of 1 January 2016.

On 6 March 2015, Bank Indonesia issued Bank Indonesia Circular Letters No. 17/3/DSta on the Reporting of Prudential Principles Implementation Activities in Managing Foreign Debt of Non-Bank Corporations to implement Regulation 16 ("**Circular 17**"); Circular 17 was further amended by Bank Indonesia Circular Letters No. 17/24/DSta dated 12 October 2015.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

As the largest issuer of bonds, the Government of Indonesia regularly taps the local market to finance the state budget. The Indonesian Government bond forms vary from conventional and retail government bonds to government *sukuk* in several tenors. Municipal bonds are issued by the province or district government for financing public utilities projects.

Although both government and corporate bonds are listed on the Indonesia Stock Exchange ("**IDX**"), they are mostly traded over-the-counter ("**OTC**"). BI also issues short-term bank certificates known as Certificates of the Central Bank.

The last issuance of Indonesian government bonds was in 2015, amounting to USD 30,000,000,000. The global medium-term notes were priced at 99.393% with a coupon and yield of 4.125% and 4.200% respectively for the 10-year tranche, and at 98.867% with a coupon and yield of 5.125% and 5.200% respectively for the 30-year tranche. The maturity dates are 15 January 2025 and 15 January 2045, respectively. There continues to be a trend of high demand for the offering among investors for the short-term international market.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, a company guarantee is commonly acceptable in financing practice.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Under Indonesian law, the validity of a legal act performed by an Indonesian company may be contested for want of a corporate benefit. Furthermore, under Indonesian law, there is uncertainty as to whether the issuance of a guarantee or a third party security or a stipulation in an agreement for the benefit of third parties by a company in order to secure the fulfilment of obligations of a third party is or can be regarded to be in the furtherance of the objects of that company (the "*Ultra Vires* Doctrine"), and consequently, whether such guarantee or third party security may be voidable or unenforceable under the laws of the Republic of Indonesia. In determining whether the issuance of a guarantee and third party security is in furtherance of the objects of a company, it is important to take into account the provisions of the articles of association of that company and whether that company derives certain commercial benefit from the transaction in respect of which the guarantee and third party security is issued.

Based on the *Ultra Vires* Doctrine, validity or enforceability can in principle only be challenged by that company itself, i.e. arguably through (a) the shareholders of that company, (b) the board of directors of that company, (c) the board of commissioners of that company, or (d) by a receiver in the event of bankruptcy. By obtaining the written consent of all of the shareholders, board of directors and board of commissioners of the relevant company authorising that company to enter into a guarantee and third party security for the benefit of the company for whose benefit it creates such guarantee or third party security and confirming that such transaction is in the interests of that company, those parties should not be able to successfully challenge the validity or enforceability of that guarantee on the basis of the *Ultra Vires* Doctrine.

2.3 Is lack of corporate power an issue?

Yes, the Indonesian Company Law and the articles of association of an Indonesian company normally stipulate certain requirements to obtain a corporate power (approval) from the organs of the company i.e. board of commissioners' approval and/or shareholders' approval. Lack of corporate approval would legally affect the validity of the corporate guarantee and cause the board of directors to be held liable against any loss in relation to such provision of corporate guarantee/security.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Please refer to our explanation in question 2.3 above.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

On the amount of guarantee, it is not specifically stipulated in the regulations. Please note, however, that Indonesian Company Law stipulates that the board of directors must request shareholders' approval to encumber the assets of the company having a value that exceeds 50% of the net assets in 1 (one) transaction or more, whether or not related to each other. Thus, it could somehow be interpreted that a guarantee needs to also consider the assets of the company.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control obstacles for the enforcement of a guarantee. The enforcement of a guarantee will be done through a court order. Please note, however, that the Indonesian court system recognises three levels of courts, namely the district court, court of appeal and Supreme Court. This means that if a borrower still challenges a decision from the judges of a district court and files an appeal to the court of appeal, the guarantee cannot be enforced by the lender pending the decision of the judges of court of appeal. This process would continue up to the Supreme Court, which can take years for enforcement.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

To secure the lending obligations, we can classify the common types of security as follows:

- Immovable assets – i.e. land, buildings, fixtures and vessels with gross weight of 20 cubic metres or more and aircraft – form of security: **mortgage**.
- Movable assets – i.e. machinery, inventory, raw material and vehicles – form of security: **fiduciary transfer**.
- Intangible assets – i.e. shares, intellectual property rights, etc. – form of security: **pledge**.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A special agreement is required to create security over each type of assets. The procedure for each type of security is as follows:

- Mortgage

  A mortgage deed must be signed before the Land Officer with jurisdiction over the land to be mortgaged. This deed must be in Bahasa Indonesia (the official language of Indonesia) and in the prescribed official form. The signed mortgage deed must be then registered at the relevant land offices. The mortgage is established at the moment it is entered in the land book located at the relevant land offices.
- Fiduciary security

  A fiduciary security deed must be signed before the notary. This deed must be in Bahasa Indonesia (the official language of Indonesia) and in the prescribed official form. Based on this deed, the transferor (borrower) transfers its legal title to the transferred assets to the transferee (lender) for the period during which the debt remains outstanding. The fiduciary security is effective when the fiduciary security office issues a fiduciary certificate.
- Pledge

  A pledge agreement can be executed in a notarial deed or executed privately, setting out the pledge's particulars. The pledge is effective when the pledge is recorded in the shareholders' register of the relevant company.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Please refer to questions 3.1 and 3.2.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, the proper form of security over receivables is fiduciary transfer. Please refer to question 3.2 above.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, the most common form of security over a cash deposit is a pledge over the bank account. However, the fiduciary registration office has expressed the view that a bank account cannot be the subject of an Indonesian security interest and the enforceability of a pledge over a bank account is yet to be tested in court. Although its enforceability is doubtful, it is common practice to secure cash deposits with a pledge over a bank account.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, collateral security over shares in companies incorporated in Indonesia can be taken. A pledge of Indonesian shares can be enforced provided that the governing law is Indonesian law. See the procedure discussed above.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over the movable property can be taken by way of fiduciary transfer.

The fiduciary security must be made by a notarial deed and in the Indonesian language. The debt so secured can be in the form of:

- existing debts;
- future debts already agreed upon in a certain amount; or
- debts the amount of which can be determined at the time of execution based on the principal agreement.

The goods encumbered by a fiduciary security must be registered, including goods located outside Indonesian territory.

The fiduciary transferee shall apply for the registration of the fiduciary security and attach to the application a registration statement with the stipulated data. Upon registration on the date of receipt of the registration application, the applicant will obtain a Fiduciary Security Certificate stating the date of the application. The fiduciary security is created on the date of registration it in the Fiduciary Register Book (*Buku Daftar Fidusia*). The Fiduciary Security Certificate has force of execution equal to a final court verdict.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, it can.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Registration fees for mortgages are normally based on the value of the secured amount under the mortgage (the lender has a choice whether to use the actual value of the assets or the principal amount of the loan), and can be costly. There is also a registration fee for fiduciary transfers. However, the amount is nominal. Notary fees concerning fiduciary transfers and pledges of shares vary and are at the notary's discretion. Stamp duty of IDR 6,000 (less than US$ 0.50) is payable on any agreement signed by the parties.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Please refer to question 3.9 above, particularly on the registration fee for mortgages. With regard to the estimated time for filing and registering a mortgage or fiduciary security, it would approximately take one month, while for the shares pledge it can be done once the pledge agreement has been executed.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Normally, creditor consent is required (unless the relevant security provider does not have any debt). Shareholder approval is also required in this situation as we have described in our response to question 2.5.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

If it is a revolving credit facility and the initial loan has been repaid, the security needs to be re-created every time the facility is given. However, we understand, in practice, some creditors have different views. They are of the view that no re-creation of security is required since the initial security covers the entire facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Yes, please refer to question 3.9 above.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Financial assistance is not an issue: there are no such prohibitions or restrictions other than those that may be set out in the Articles of Association of the company concerned. In addition, a company guaranteeing and/or giving security to support borrowings incurred

© Published and reproduced with kind permission by Global Legal Group Ltd, London

to finance or refinance the direct or indirect acquisition of such shares may be deemed *ultra vires* unless there is direct commercial benefit. See also question 2.5 above.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Indonesia does indeed recognise the role of an agent for the above purpose. They are known as a "security agent". The security agent is appointed by the lenders in a separate agreement. This agreement, among others, stipulates the period of appointment, rights and obligations of the security agent, termination, etc.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Yes, Lender A may use a "cessie mechanism", commonly known as an "assignment of claim receivables", and assign its rights to Lender B by executing the "Cessie Deed". Regarding the guarantee, all related guarantee deeds must be re-executed in favour of Lender B.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Yes, there are requirements to deduct or withhold tax from interest payable on loans made to domestic or foreign lenders, as stipulated in the Income Tax Law. For cross-border loans, the withholding tax rate can usually be reduced if the lender resides in a jurisdiction which has a tax treaty with Indonesia.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No tax incentives would be given to a foreign creditor. However, foreign creditors may enjoy a certain tax rate to the extent its country has a treaty with Indonesia.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

No, unless, under the "force of attraction" rule, such loan or guarantee or grant generates income for the foreign lender attributable to its Indonesian business, if any.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please refer to question 3.9 above, particularly on the registration fee for mortgages.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, but recurring administrative requirements relating to the reporting of payment of interest and principal apply, and foreign loans received by certain categories of Indonesian borrowers require prior governmental approval.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Indonesian law recognises a choice of foreign law as the governing law of a loan agreement except to the extent that: (i) a loan term or a provision of that law is clearly incompatible with Indonesian public policy; and (ii) the Indonesian court must give effect to mandatory rules of the law of another jurisdiction with which the situation has a close connection.

Theoretically, courts in Indonesia can enforce a contract that has a foreign governing law. In practice, however, there have been cases where Indonesian courts have refused to give effect to choice of foreign law clauses for other specified or unspecified reasons. A foreign choice of law is not permitted for security agreements or guarantees, and these agreements must be governed by Indonesian law.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Indonesian courts will not recognise judgments of foreign courts. Accordingly it will be necessary for any matter in which a judgment has been obtained in a foreign court to be re-litigated in the Indonesian courts in order to enforce in Indonesia, the cause of action giving rise to the foreign judgment. Such Indonesian courts may attribute such importance to the foreign judgment as they may deem appropriate.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) It would take approximately six months to obtain a judgment in the district court. However, if the counter party (defendant) appeals to the higher courts (court of appeal and Supreme Court), it may take years.

(b) Foreign court judgments cannot be enforced in Indonesia.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

On default, a security interest can be enforced through a public auction or private sale.

Public sale or auction

In theory, a public auction can be conducted without a court judgment or order if the owner of the assets is co-operative. In practice, however, a court order is required.

In the case of listed shares, however, the Indonesian Civil Code clearly specifies that an auction held by two brokers can be conducted in the market. In this case, no court order is required so long as a power of attorney to dispose of the shares has been given (usually at the time the pledge is created).

Private sale

A private sale is permitted if this means that a higher sale price can be achieved for the parties. Private sale requires consent from the owner of the assets, which is normally included in the relevant security documents.

For mortgage and fiduciary transfer, private sale can only be conducted:

- After the expiry of one month from written notification of the intended sale to interested parties and publication of this notice in at least two daily newspapers with circulation in the area where the asset is located.
- Where no third party has voiced an objection against the private sale. The law is unclear as to who these third parties may be, although it is safe to assume that they include, at least, the borrower's other creditors.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

The above enforcement method as explained in question 7.4 also applies to foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, it is known as Suspension of Payments (moratorium). The procedure is started by the debtor or its creditor petitioning the Commercial Court for a suspension of payments. The Commercial Court must then grant a provisional moratorium, and appoint a supervisory judge and an administrator or receiver to assist the debtor in managing its estate. The debtor will be entitled to manage and dispose of its assets jointly with the administrator. During this suspension period, the debtor does not have to make payments to its unsecured creditors and secured creditors cannot enforce their security without the court's consent. The purpose of a suspension of payments is to enable the debtor to propose a composition plan.

For creditors holding a mortgage, a pledge, a fiduciary security or any other *in rem* security right may enforce its right against the secured assets as if there were no bankruptcy. However, the aforesaid right is limited by the so-called "stay period". A stay is a restriction on the right of secured creditors and third parties to exercise their right. This stay applies for a time period of at most 90 (ninety) days as of the date of the bankruptcy judgment. The stay does not apply to claims of creditors whose rights are secured by cash deposits and the rights of creditors to set-off debts. By law, the 90-day stay will expire on an earlier date in case of an early termination of the bankruptcy or upon the commencement of the state of insolvency.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

A foreign or international arbitral award can be recognised and enforced in Indonesia as Indonesia has ratified the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards through Presidential Decision No. 34 of 1981. The procedures for recognition and enforcement of foreign arbitral awards are further regulated by Law No. 30 of 1999 on Arbitration and Alternative Dispute Resolutions. However, before the enforcement, the award needs to be registered at the District Court of Central Jakarta. Please note, however, that the Chairman of the District Court of Central Jakarta may refuse to issue the writ of execution if it views that the award violates public order. The decision rejecting the enforcement can be appealed at the Supreme Court and must be decided by the Supreme Court within 90 (ninety) days as of the registration of the appeal. A decision approving the enforcement of the award cannot be appealed.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The mortgage, the pledge and the fiduciary transfer are "*in rem rights*" which are "*absolute*" and "*exclusive*", and create preferential

© Published and reproduced with kind permission by Global Legal Group Ltd, London

rights to the holder of the security even in bankruptcy. Bankruptcy of the mortgagor, the pledgor and the fiduciary transferor does not, in principle, affect the security right of the mortgagee, pledgee and transferee in that the assets in question are not regarded as being part of the bankruptcy assets. However, the creditors should note the "stay" period as we have elaborated in response to question 7.6, which restricts the ability of the creditors to enforce its rights.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes, there are.

On the preference period with respect to the security, we believe that there should be no preference period, except that: once the bankruptcy estate is declared in the state of insolvency, the secured creditors must exercise their privileged right over the collateral within 2 (two) months as of the point the bankruptcy estate is declared to be in the state of insolvency. Otherwise, the appointed receiver is required to request the delivery of the collateral to be sold by the receiver. If the receiver has enforced the collateral, the proceeds that will be distributed to the secured creditors need first to be deducted by not only the amount of the mandatory preferred claims (which will also apply if the secured creditors enforced the collateral by themselves), but also the bankruptcy costs.

On the clawback rights, under Articles 41 and 42 of the Indonesian Bankruptcy Law, for the interest of the bankruptcy assets, only the receiver could request the nullification of a preferential transfer transaction conducted by the debtor before its bankruptcy, if such transaction was considered detrimental to the creditors ("**Bankruptcy Preferential Transfer**"). To nullify a Bankruptcy Preferential Transfer the receiver must prove the following requirements:

(i) the preferential transfer was performed by the debtor before it was declared bankrupt;

(ii) the debtor was not obligated by contract (existing obligation) or by law to perform the preferential transfer;

(iii) the preferential transfer was prejudiced the creditors' interests; and

(iv) the debtor and such third party had or should have had knowledge that the preferential transfer would prejudice the creditors' interests.

If the preferential transfer transaction was conducted within a period of 1 (one) year before the company's bankruptcy, provided that the transaction was not mandatory for the debtor and unless it could be proven otherwise, both the debtor and the third party with whom the said act was performed were deemed to know that such transaction was detrimental to the creditors when such transaction belongs to one of the following three categories:

(i) a transaction in which the consideration that the debtor received was substantially less than the estimated value of the consideration given;

(ii) a payment or granting of security for debts which are not yet due; or

(iii) a transaction entered into by the debtor with a certain relative or related parties.

There is no provision under the Bankruptcy Law which stipulates a specific period when the Bankruptcy Preferential Transfer claim can be made. However, request for the nullification of a Bankruptcy Preferential Transfer shall be made by the receiver. The claim can be made only if the debtor has a receiver.

If the underlying security documents are nullified due to the Bankruptcy Preferential Transfer, then the security will also become invalid.

On other preferential creditors' rights, there are several kinds of creditors, generally regulated in the Indonesian Civil Code ("**ICC**"), Indonesian Bankruptcy Law, and Law No. 6 of 1983 which was lastly amended by Law No. 16 of 2009 regarding the General Provision of Taxation ("**Tax Law**"), which have preferential rights with respect to the *in rem* security as follows:

(a) Specific expenses stipulated by the Tax Law:
- legal expenses arising solely from a court order to auction movable and or immovable goods;
- expenses incurred for securing the goods; and
- legal expenses, arising solely from the auction and settlement of inheritance.

(b) Preferred creditors ranked above the secured creditors:

Tax claims and court charges which specifically result from the disposal of a movable or immovable asset (these must be paid from the proceeds of the sale of the assets over all other priority debts, and even over a pledge or mortgage), the legal charges, exclusively caused by sale and saving of the estate (these will have priority over pledges and mortgages).

(c) The receiver's fee.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

No, there are no entities which are excluded from bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No, there are no processes other than the court proceedings which are available to a creditor to seize the assets of the company in enforcement.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, a submission to a foreign jurisdiction should be binding and enforceable.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Sovereign immunity has not been explicitly legislated in Indonesia. The Republic of Indonesia has subscribed to the doctrine of restrictive sovereign immunity by its entry into the Convention on the Settlement of Investment Disputes between States and Nationals of other States of 1965. However, if a party is a state-owned company and enters into a commercial contract, it can be argued that such state-owned company has waived its entitlement (if any) to sovereign immunity.

In practice, the Government of Indonesia ("**GOI**") does not use sovereign immunity as the basis of defence in a dispute which relates to its obligation under a commercial agreement.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Nevertheless, the GOI specifically does not waive any immunity in respect of:

- actions brought against the Republic arising out of or based upon U.S. federal or state securities laws;
- attachments under Indonesian law;
- present or future "premises of the mission" as defined in the Vienna Convention on Diplomatic Relations signed in 1961;
- "consular premises" as defined in the Vienna Convention on Consular Relations signed in 1963;
- any other property or assets used solely or mainly for Government or public purposes in the Republic or elsewhere; and
- military property or military assets or property or assets of the Republic related thereto.

The GOI is subject to suit in competent courts in Indonesia. However, Law No. 1 of 2004 on State Treasury prohibits the seizure or attachment of property or assets owned by the GOI.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are not necessarily any eligibility requirements for a lender be a bank. Lenders to a company in Indonesia do not need to be licensed in Indonesia as long as the loan is not given in a manner that causes the lenders to be engaged in the banking business in Indonesia. There is no distinction between a lender that is a bank and a non-bank. Similarly with lenders, there is no specific licence for an agent in Indonesia. However, we normally assume that the lenders and agents have proper licences under its jurisdiction.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Bank Indonesia has recently issued Regulation No. 17/3/PBI/2015 concerning Mandatory Use of the Rupiah in the Territory of Indonesia ("**Regulation No. 17**"), which became effective for cash transactions as of 31 March 2015, and for non-cash transactions, 1 July 2015. It is intended to implement Law No. 7 of 2011 concerning Currency.

Under Regulation No. 17, individuals or corporations must use the Rupiah in all cash and non-cash transactions in Indonesia. Transactions extend to the use of cheques, giro slips, credit cards, debit cards, ATM cards, and electronic money, which include:

(a) payment transactions;

(b) other settlement of obligations that must be fulfilled on money terms; and/or

(c) other financial transactions.

There are some specific exemptions to this mandatory use of the Rupiah that are stipulated in Regulation No. 17 (including its exemptions and formality to obtain those exemptions).

Other than the above, we believe there are no matters that need to be considered when participating in financings.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Theodoor Bakker
Ali Budiardjo, Nugroho, Reksodiputro
Graha CIMB Niaga, 24th Floor
Jalan Jend. Sudirman Kav. 58
Jakarta 12190
Indonesia

Tel: +62 21 250 5125
Fax: +62 21 250 5001
Email: tbakker@abnrlaw.com
URL: www.abnrlaw.com

Mr. Theodoor Bakker graduated from Leiden University in the Netherlands, is admitted to the Amsterdam Bar and is a registered Foreign Lawyer under the Indonesian Advocates Law. He has worked in Southeast Asia since 1984, over time building up extensive experience in: direct foreign investment; project finance work, including private power and petrochemical projects; aircraft finance; infrastructure development; and general manufacturing investment. During the Asian financial crisis, he was involved in many aspects of restructuring and insolvency, and has advised on foreign law issues of bankruptcy reform in Indonesia. His practice now also encompasses capital market transactions, structured finance, and mergers and acquisitions. He has published various articles on insolvency and cross-border investment issues and teaches at the Faculty of Law of University of Indonesia and at the Ministry of Law and Human Rights.

Ayik Candrawulan Gunadi
Ali Budiardjo, Nugroho, Reksodiputro
Graha CIMB Niaga, 24th Floor
Jalan Jend. Sudirman Kav. 58
Jakarta 12190
Indonesia

Tel: +62 21 250 5125
Fax: +62 21 250 5001
Email: agunadi@abnrlaw.com
URL: www.abnrlaw.com

Mr. Ayik Candrawulan Gunadi joined ABNR as an associate in September 2001 and became a Partner on 1 October 2013. He graduated in 1997 from the Faculty of Law, Parahyangan Catholic University, majoring in Economic and Business Law, and in 2000 completed his LL.M. programme at the Erasmus University Rotterdam, the Netherlands, majoring in Business and Trade Law. Before joining ABNR, he worked for a law firm and for PT Asuransi Winterthur Life Indonesia (or now known as PT Asuransi Aviva Indonesia) in Indonesia. He also worked in the Netherlands, as a foreign trainee with Loyens & Loeff, an international legal and tax consultants in Rotterdam, and thereafter with a Dutch Bank in Amsterdam. He has extensive experience in matters involving corporate law, foreign investment, intellectual property and project finance, and has been actively involved in infrastructure projects in Indonesia.

He returned to ABNR after a few months with a major Indonesian power company as its senior legal manager, and currently heads the ABNR team which monitors regulations in connection with energy and mineral resources projects.

Ali Budiardjo, Nugroho, Reksodiputro, usually abbreviated to ABNR, was established in Jakarta in 1967 as a partnership of legal consultants in Indonesian business law. The firm is one of Indonesia's largest independent full-service law firms. The commitment we make to clients is to provide broad-based, personalised service from top quality teams of lawyers with international experience that includes groundbreaking deals and projects. ABNR's reputation has been recognised around the world by independent industry surveys and law firm guides. ABNR was selected, based on its high level of integrity and professionalism, to be the sole Indonesian member of the world's largest law firm association Lex Mundi and of the prestigious Pacific Rim Advisory Council (PRAC).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Ireland

Fergus Gillen

McCann FitzGerald

Martin O'Neill

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Robust conditions returned to the Irish lending market as the domestic banks emerged from a period of economic and institutional fragility to take a significant share in the senior debt market. The competition between these lenders for transactions in the commercial real estate, construction and SME sectors has led to relatively favourable conditions, both in relation to pricing and covenant levels, for borrowers in 2015/2016. A notable feature has been the continued growth of the direct lending market, as new non-bank lenders continue to emerge in a manner reflective of trends in the US and the UK. The deleveraging process undertaken by domestic and non-domestic banks in relation to their non-performing and non-core loan books in Ireland continued in 2015, and secondary transactions arising from these loan sales, continue to bring a large volume of transactions to the market. Borrowers have taken advantage of the benefits of the newly available Irish Collective Asset-management Vehicle (known as an ICAV), a corporate fund introduced under legislation in Ireland in 2015, which is attractive when borrowing against commercial real estate as ICAVs are exempt from Irish tax on their income and profits. Irish company law was also overhauled, with a view to making it more efficient and business-friendly, by the commencement of the Companies Act 2014 on 1 June 2015.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Loan sales have continued to feature strongly, including Project Poseidon in which Lloyds Banking Group sold a portfolio of loans with a nominal value of €3.6 billion and Project Jewel in which the National Asset Management Agency sold loans secured on the principal retail shopping centres in Ireland for approximately €1.8 billion. Ireland also continued in its role as one of the world's key aviation finance jurisdictions with some major transactions e.g. Aercap's acquisition of International Lease Finance Corporation for USD$3 billion plus shares in Aercap (funded through debt and cash) to create the leading global franchise in the aircraft leasing industry. The re-emergence of confidence in the real estate sector has brought with it numerous significant financing transactions including the €68 million acquisition of the Frascati shopping centre in Dublin.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, in principle, provided the company has the capacity to do so and there is sufficient corporate benefit. There are a limited number of instances where there are statutory prohibitions (e.g. see the financial assistance section below) but there are often also applicable exceptions or "whitewash" procedures.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

A third party without notice dealing with a company in good faith should not be prejudiced by a lack of corporate benefit for a company in entering into a transaction. The company's directors, however, have fiduciary duties and could be found in breach of these if they caused the company to enter into a transaction without benefit. It is sensible for directors to document in board minutes the reasons (including benefit) for the company's entry into material contracts.

2.3 Is lack of corporate power an issue?

Under the new Companies Act 2014 (in force since June 2015) there are a number of different types of company and the issue of corporate capacity or power is relevant to differing extents dependent on the type of company. Regardless of the company type, the directors have an obligation to ensure that they do not procure entry by the company into a contract which is outside the objects of the company (where relevant) or the powers given to the directors. Lack of corporate capacity or power should not, however, generally render a guarantee void against a third party acting in good faith.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Generally a resolution of the board of directors, evidenced by board minutes, is all that is required. A guarantee must be in writing, signed by the guarantor and for good consideration. Guarantees are usually executed as deeds to avoid the risk of an argument based on a lack of consideration.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Not as a matter of law; however, a guarantee given where a company is insolvent or close to becoming insolvent is capable of being set aside. Please refer to section 8 below.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No; however, international controls or sanctions (e.g. in connection with terrorist financing) could apply in Ireland and it is prudent for a lender to ensure that none are relevant to the particular guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In principle, a lender can take security over any Irish assets belonging to an Irish company.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A secured financing will often involve an obligor company granting an "all assets" debenture, which is expressed to create (i) a floating charge over all present and future assets, and (ii) fixed charges and specific security assignments over certain classes of assets (e.g. real estate, receivables, intellectual property, shares and material contracts). Where details of specific assets are available these should be included in schedules to the debenture, where they are to be subject to a fixed charge.

A prescribed form security document is also required where a company creates security over real estate registered in the Land Registry.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Such security can be created by a charge executed as a deed. Assuming the assets are already owned by the company and identifiable, the charge should be a legal charge. It is also possible to create security over future land, plant, machinery and equipment; however, such security is equitable (rather than legal) in nature. To obtain a legal charge over such future property a supplemental charge should be executed once it has been acquired. As noted in question 3.2 above, where title to the real estate being charged is registered in the Land Registry, a prescribed form security document must also be executed. Other forms of security (e.g. mortgage, pledge, lien and hypothecation) are also possible in respect of plant, machinery and equipment.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security can be taken over receivables by way of security assignment and/or by way of charge (fixed or floating). A security assignment can be legal or equitable. For an assignment to be legal, it must be in writing, absolute, for the entire debt and notice must be served on the debtor. Where these criteria are not met, the assignment is equitable. A legal assignment has a number of advantages over an equitable assignment, e.g. the assignee can sue the debtor directly, it has a higher priority and the debtor cannot discharge the debt by set-off against the assignor.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes; security can be created over the rights of an account-holder to the debt represented by the account. Where the account is held with a third party bank, security is created by way of assignment. Notice is usually served on the account bank to effect a legal (rather than equitable) assignment and certain acknowledgments are requested from the account bank. It is not unusual for the account bank to ignore such a request unless specifically negotiated in advance. In certain transactions, lenders will also require an account control agreement though these are not typical in the Irish market. Where the account is held with the lender, security is created by way of a charge, which can be either fixed or floating. For a charge to be categorised as fixed (regardless of how it is described), the lender needs to exercise a significant level of control over the account.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Collateral security can be taken over shares in an Irish company. Shares in an Irish company can be either certificated or uncertificated. Following the principles of *lex situs*, it would be very unusual to seek to create security over shares in an Irish company by means of a New York or English law governed document, but it is not, in theory, impossible to do so. Security over shares in an Irish company is generally effected by a deed of charge, which is accompanied by a number of ancillary documents to assist enforcement, e.g. stock transfer forms and original share certificates. It is also possible to take a legal mortgage of shares but this is less common.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes; as inventory is revolving by nature, security is generally effected by way of a floating charge.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, provided the transaction itself does not give rise to a restriction (e.g. see section 4 below).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Security created over certain categories of assets by an Irish company or by a non-Irish "relevant external" company must be

© Published and reproduced with permission by Global Legal Group Ltd, London

registered in the Irish Companies Registration Office (the "**CRO**"). The registration can only be effected through the CRO's online system and the registration must be made within 21 days, otherwise the security is void against a liquidator and other creditors.

Where a fixed charge is created over book debts a notification should also be made to the Irish Revenue, as failure to do so may impact on the secured party's level of recovery.

Security created over real estate in Ireland should be registered with the Irish Property Registration Authority. The procedure differs depending on where title to the property is registered (Land Registry or Registry of Deeds).

Depending on the circumstances, other registrations may also be required e.g. at the Irish Patents Office or relevant Circuit Courts (for "agricultural chattels"). In addition, registration in non-Irish registers may also be needed e.g. the European Patents Office and the International (Cape Town) Registry (for aircraft).

Irish stamp duty is not payable on the execution of security documents and security documents are not required to be notarised under Irish law. Stamp duty is payable in connection with the realisation of certain assets, including real property and shares.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Assuming title to the secured assets is in order, the time and cost involved in making such filings is not significant. It is worth noting, however, that a transfer of real property will require a "first registration" application if title is registered in the Registry of Deeds and this can take a significant period of time to be processed.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally speaking, no; however, where a security assignment is being taken in respect of a contract it may be necessary to get the prior consent of the counterparty to the contract. If regulated persons or assets are involved, additional consents may be required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No; the approach to security for a revolving facility and other types of facilities should not be different.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

While only a limited number of assets require a security document to be executed as a deed, it is standard practice in Ireland for all security documents to be executed as deeds. The formalities for execution of deeds are set out in legislation (and in a company's constitution) and typically involve application of a company's corporate seal.

A lender will generally expect to receive a director's certificate which will include, amongst other matters, certified copies of the company's constitution and board minutes approving execution of the relevant documents.

Unlike certain other jurisdictions, signature pages should not be signed in advance of security documents being finalised.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Yes; the Companies Act 2014 prohibits a company giving "financial assistance" (which includes guarantees and security) for the purpose of an acquisition made or to be made by a person of shares in the company (or where the company is a subsidiary, in its holding company).

In the case of a private company, certain exceptions apply (including a refinancing exception) and it is also possible to "whitewash" the financial assistance through the summary approval procedure set out in the Act. The summary approval procedure requires, amongst other matters, shareholder approval and a declaration of solvency by the directors.

In the case of a public company, while certain exceptions apply, the whitewash procedure is not available.

(b) Shares of any company which directly or indirectly owns shares in the company

As noted above, the prohibition on financial assistance also applies to the giving of financial assistance for the purchase of shares in a company's holding company (direct or indirect). The position regarding exceptions and availability of a whitewash procedure is as summarised at paragraph (a) above. In addition, a private company cannot whitewash financial assistance for the purpose of an acquisition of shares in its holding company if the holding company is a public company.

(c) Shares in a sister subsidiary

There is no statutory prohibition on the giving of guarantees and/or security in connection with financing provided for the acquisition of shares in a sister subsidiary. As usual, the directors of the company giving the guarantees and/or security need to be comfortable that there is adequate corporate benefit.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes; the use of facility agents and security trustees for syndicated lending transactions is well established in the Irish market. The loan (and, where relevant, intercreditor) documentation should outline the roles of the agent and trustee and how enforcement proceeds are distributed.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Ireland.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Provided the transfer is a valid one, Lender B should be able to enforce the loan and guarantee documentation directly against the relevant obligors. Lender B may be required to provide evidence to a court of the validity of the transfer and should also ensure that related security registrations are updated to refer to Lender B.

If the "transfer" is an assignment of the benefit of Lender A's rights (rather than a transfer of the rights and obligations which would require borrower and guarantor approval), then the assignment will need to meet the criteria of a legal assignment (see question 3.4 above), including service of notice on the borrower and guarantor, to enable Lender B to enforce the rights directly. In the case of a regulated loan and/or guarantee, compliance with regulatory requirements would also be necessary.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) Unless an exemption is available, Irish withholding tax applies to payments of Irish source yearly interest made by a company, currently at a rate of 20 per cent.

Yearly interest means interest other than short interest, while short means interest that is not capable of arising for a period of more than one year. Accordingly unless a facility has a scheduled maturity of one year or less, interest arising thereon would be yearly interest.

Separately, interest paid by a borrower that is resident in Ireland or operating in Ireland through a branch or agency with which the relevant facility is connected or that is paid on borrowings secured on Irish land or buildings would typically be regarded as having an Irish source.

There are, however, numerous exemptions from this obligation to withhold an amount for, or on account of, Irish tax from a payment of Irish source yearly interest arising on a loan and these are regularly availed of by both domestic and foreign lenders in financing transactions following careful analysis of their availability.

(b) In relation to the proceeds of a claim under a guarantee, should the payments be regarded *sui generis*, then no Irish withholding tax should apply as Irish withholding tax does not apply to guarantee payments *per se*. However, should a guarantor step into the shoes of the borrower, the ensuing guarantee payments may be regarded as payments of interest whereby the analysis outlined at (a) should be relevant.

In relation to the proceeds of enforcing security:

(i) should any such proceeds comprise interest, the analysis at (a) above would apply;

(ii) in general, in connection with a sale of land or certain mineral or exploration rights in Ireland or unquoted shares in a company where those shares derive their value wholly or mainly from those assets, if the consideration is in excess of €500,000, the purchaser is obliged to withhold an amount on account of Irish tax from the purchase proceeds, currently at a rate of 15 per cent. This is unless that purchaser is provided with a Tax Certificate issued by the Revenue Commissioners (to the seller upon application by the seller provided that certain conditions are met) relieving that obligation; and

(iii) where enforcement includes the sale of property by or on behalf of the holder or beneficiary of security, in relation to capital gains tax or corporation tax on chargeable gains the seller must account for any such taxes that would otherwise be due from the security-provider out of the proceeds realised before they are applied for any other purpose. Accordingly such tax liability, if arising, must be settled in priority to any secured liability, regardless of the security provided.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No tax incentives are provided preferentially to foreign lenders. No taxes generally apply to foreign lenders with respect to their loans, mortgages or other security documents for the purposes of effectiveness or registration. In limited circumstances, where a loan is not vanilla, stamp duty might arise on the acquisition of a loan by way of assignment (rather than origination or novation).

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Pursuant to general Irish tax rules, unless otherwise exempt, any person in receipt of Irish source interest income would be technically liable to Irish income tax. This would include a company that is not tax resident in Ireland or operating in Ireland through a branch or agency with which the loan is connected. There are, however, exemptions from such income tax in Irish law, available in certain circumstances to lenders resident in an EU Member State or in a territory that has signed a double taxation agreement with Ireland. Separately, exemption may be available under a double taxation agreement itself.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No; see question 3.9 above.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Ireland does not have thin capitalisation rules *per se*. However, in relation to the tax-deductibility of interest paid by a company to lenders outside Ireland specifically, where that interest is paid to a company with which the Irish payer of interest has more than a 75 per cent shareholding relationship, that interest may be regarded as a distribution and not tax-deductible in certain cases. These rules are, however, dis-applied in numerous circumstances including where the lender is resident in an EU Member State or pursuant to the provisions of a double taxation agreement.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Ireland is bound by Regulation (EC) No. 593/2008 on the law applicable to contractual obligations (the "**Rome I Regulation**"). Article 3 of the Rome I Regulation provides that a contract shall be governed by the law chosen by the parties. Accordingly, if a contract specifies that the laws of any EU Member State (or any other country) shall apply, the Irish court shall be bound to apply the parties' choice.

However, pursuant to Article 3(3), where mandatory rights or protections afforded under Irish law do not exist under the law chosen by the contracting parties, the Irish court will afford those rights and protections to the relevant contracting party, notwithstanding the governing law chosen by the parties.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Judgments granted by the Courts of an EU Member State (e.g. England)

Ireland is bound by Regulation (EU) No. 1215/2012 (the "**Recast Brussels Regulation**"). Chapter III provides that a judgment made by the courts of one Member State can be enforced in another Member State as if it had been delivered in that Member State itself.

Certain safeguards are provided for judgment debtors, including if:

- it would be manifestly contrary to public policy in the enforcing state;
- the defendant was not properly served with the proceedings in sufficient time to arrange for his defence; or
- the judgment is irreconcilable with a judgment given between the same parties in the enforcing state.

Judgments granted outside the EU (e.g. New York)

In order to be enforceable, a foreign judgment must, amongst other matters, (a) be for a definite sum of money, (b) be final and conclusive, and (c) have been given by a court of "competent jurisdiction" (a concept recently considered by the Supreme Court). The Irish courts will be particularly concerned that the foreign proceedings were properly served on the judgment debtor in accordance with Irish service requirements, such that the judgment debtor had an adequate opportunity to defend the proceedings.

To enforce a judgment originating outside the EU, the procedure is to issue and serve a summary summons with a modified special endorsement of claim referring to the foreign judgment, and then bring a motion for liberty to enter final judgment grounded on affidavit.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The period of time in which a judgment can be obtained and enforced against assets can vary significantly from case to case, depending on whether the defendant defends the proceedings, whether the plaintiff can obtain judgment summarily (i.e. without the need for a full oral hearing), whether the case meets one of the criteria for entry into the Commercial Division of the High Court and how busy the Court lists are during any particular period.

If the proceedings seek to enforce an Irish law governed contract, one might expect to obtain judgment within the following periods:

- if the defendant does not enter an appearance, within 6–10 weeks from the date of demand;
- if the proceedings are contested but the court awards summary judgment, within 9–12 months in the High Court and within 3–4 months in the Commercial Court; and
- if the proceedings are fully contested and remitted for a full oral hearing, within 9–18 months in the Commercial Court, though it could take up to two years in the ordinary High Court. The timeframe for obtaining judgment will often depend on the scope and extent of discovery.

If the proceedings seek to enforce a foreign law governed contract, these periods could increase somewhat, as the parties will be required to produce to the court expert evidence of the particular governing law.

The period of time required to enforce a judgment against assets once obtained depends entirely on the nature of the asset. For example, judgments can be secured against real property within a matter of weeks but it can take considerably longer to actually realise value from the property once secured.

Judgments obtained in an EU Member State can be enforced very quickly in Ireland under the Recast Brussels Regulation, provided the judgment debtor does not contest the enforceability of the judgment in Ireland. Proceedings for the recognition of judgments obtained outside the EU can take a number of months, as described above, before the judgment creditor is in a position to enforce the judgment against assets.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

A well-drafted security document should provide the security-holder with sufficient powers to enable it to enforce and realise security with relative ease, though the need for regulatory consents will depend on the nature of the secured assets.

Where a receiver is appointed to realise secured assets, the receiver is under an obligation to obtain the best price reasonably possible for the relevant assets. To ensure that the receiver complies with this obligation he will typically obtain independent valuations of the assets and/or undertake an open marketing process. This process can impact on both the timing and value of realisation.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

Foreign lenders are not under any restrictions which do not apply to domestic lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

In corporate insolvency, most procedures in Ireland do not provide for a moratorium on the enforcement of security. However, Irish law provides for a corporate rescue procedure called "examinership" by which an insolvent company can apply for the protection of the court for a period of up to 100 days, to allow it time to formulate a Scheme of Arrangement designed to facilitate the survival of the company. During the period of court protection, creditors may not take any enforcement action against the company.

Where the Scheme of Arrangement is approved by the court, creditors' claims can be unilaterally written down in accordance with the terms of the Scheme. However, in order to approve a Scheme, the court must be satisfied that the company has a reasonable prospect of survival as a going concern, and must consider objections raised by creditors to ensure that the Scheme is not "unfairly prejudicial" to their interests.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Ireland is a contracting state to the New York Arbitration Convention, which provides for the recognition and enforcement of arbitral awards, subject to the exceptions provided for in the Convention. The New York Convention has force of law in Ireland under section 24 of the Arbitration Act 2010, and under section 23 of that Act, an arbitral award may be enforced by action or, by leave of the High Court, in the same manner as a judgment or order of the High Court with the same effect; where leave of the High Court is given, judgment may be entered in terms of the award.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Note for section 8: as a general comment, the term "bankruptcy" in Ireland relates solely to a procedure for personal insolvency and does not relate to companies. The equivalent corporate procedure in Ireland is known as "liquidation" and the information provided herein relates solely to corporate insolvency.

The liquidation of a company in Ireland does not affect the ability of a secured lender to enforce security granted by that company. An examinership, however, does create a moratorium on enforcement; please see question 7.6.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Preference periods

A floating charge on the undertaking or assets of a company created within 12 months (or two years in the case of "connected persons", which can include related companies) before the commencement of the winding-up of that company shall be invalid:

- unless it can be shown that the company was solvent immediately after the creation of the floating charge; and
- except as to money actually advanced or paid in consideration for the charge.

Clawback rights

(i) Unfair preference: Any payment or other transfer of property (including security) by a company within six months of its being wound up insolvent in favour of any creditor with a view to giving such a creditor a preference over other creditors, shall be deemed an unfair preference. The six-month period extends to two years where the creditor is a "connected person".

If a transaction is held to be an unfair preference, a liquidator or receiver of the company may recover the money paid or property transferred to the creditor, or may have the security set aside.

(ii) Improper transfers: where a company is being wound up, a liquidator, creditor or contributory of a company can apply to court to have a disposition (including security) set aside, and for the return of the assets the subject of the disposal, where such disposition had the effect of perpetrating a fraud on the company, its creditors or members. There is no time limit within which an improper transfer can be challenged.

Preferential creditors

(i) Priority over fixed charges: except for the expenses of an unsuccessful examinership and the possible capital/corporate gains taxes referred to in question 6.1, a fixed charge security-holder has priority to the proceeds of realisation of fixed charge assets.

(ii) Priority over floating charges: the expenses of an examinership, the costs and expenses of liquidation, certain taxes, rates and employee claims have priority over the claims of creditors holding security in the form of a floating charge.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Insurance companies are not excluded from the usual procedures for liquidating insolvent companies in Ireland. However, an additional procedure exists for dealing with insolvent insurance companies known as "administration", which is provided for under the Insurance (No. 2) Act 1983.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

A secured creditor can enforce its security without recourse to court proceedings. An unsecured creditor cannot seize assets of a debtor without obtaining and enforcing a judgment through court proceedings.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, in principle. The precise rules governing recognition of submission to a foreign jurisdiction depend on the jurisdiction chosen.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The Irish courts will in principle give effect to a contractually agreed waiver of state immunity from jurisdiction and enforcement.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Generally it is not necessary for a lender to be licensed before lending to a company in Ireland. Regulated lenders (such as banks) are subject to the codes of conduct and regulations issued by the Central Bank of Ireland when lending to certain persons. It should be noted, however, that by lending to a company in Ireland or purchasing a loan originally made by a regulated lender, an unregulated lender may also incur obligations in respect of their conduct (for example under the Credit Reporting Act 2013 and the Consumer Protection (Regulation of Credit Servicing Firms) Act 2015). Ireland does not have particular statutory licensing or eligibility requirements for an agent under a syndicated facility agreement.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

As a general comment, please note that the above responses relate to Irish companies. Additional material considerations apply when dealing with other counterparties such as natural persons or regulated funds (whether constituted as an "investment company" or otherwise). Specific advice will always be needed on the terms of the particular transaction being entered into.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Fergus Gillen
McCann FitzGerald
Riverside One, Sir John Rogerson's Quay
Dublin 2
Ireland

Tel: +353 1 611 9146
Fax: +353 1 829 0010
Email: fergus.gillen@mccannfitzgerald.com
URL: www.mccannfitzgerald.com

Fergus is Head of McCann FitzGerald's Finance Group. He focuses on a wide range of debt finance work, with a particular emphasis on corporate lending transactions, debt capital markets (public and private), restructuring, securitisation and structured finance. Fergus advises many financial institutions (Irish and international), non-financial corporates and state-owned entities.

Martin O'Neill
McCann FitzGerald
Riverside One, Sir John Rogerson's Quay
Dublin 2
Ireland

Tel: +353 1 607 1786
Fax: +353 1 829 0010
Email: martin.oneill@mccannfitzgerald.com
URL: www.mccannfitzgerald.com

Martin is a Senior Associate and works as a professional support lawyer in the firm's Finance Group, having previously worked in the corporate banking team. Martin's experience covers a broad range of banking and finance work with a focus on acquisition finance and corporate banking. Martin has advised on a large number of syndicated and bilateral financing transactions, security reviews, enforcement strategies and bespoke remediations as well as loan portfolio sales.

McCann FitzGerald

McCann FitzGerald is one of Ireland's premier law firms, with 68 partners and over 350 lawyers and professional staff.

The firm is consistently recognised as being the market leader in many practice areas and its pre-eminence is endorsed by clients and market commentators alike. Our principal office is located in Dublin and we have overseas offices in London, New York and Brussels.

The firm is divided broadly into four main groupings of corporate, banking & financial services, dispute resolution and litigation and real estate (including construction). We also operate industry sector and specialist practice groups which comprise professionals from different groupings. In this way, we provide advice and representation on the basis of what is best for clients and their requirements.

Our clients include international corporations, major domestic businesses and emerging Irish companies. We also have many clients in the State and semi-State sector.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Japan

Taro Awataguchi

Anderson Mori & Tomotsune

Yuki Kohmaru

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Japanese lending has traditionally relied upon mortgages over real estate to secure loans. In the case of small and medium-sized entities, personal guarantees by representative directors of the borrowers have also been common (a guideline called "*keieisha-hosho* guideline" on this type of guarantee became effective on February 1, 2014). While new types of asset backed or cash flow financing such as (i) asset-based lending (ABL), (ii) debtor-in-possession (DIP) financing, and (iii) project financing are developing in Japan, the traditional practice of lending against real estate collateral remains one of the preferred methods among Japanese banks.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Since the great earthquake and tsunami of March 11, 2011, there has been growing anti-nuclear sentiment in Japan and intensified analysis by policymakers regarding Japan's energy demands. Financing the costs of alternative clean energy solutions (such as solar, wind, hydro-power and geothermal) through project financing structures is one of the key focuses in Japan now and for the next decade.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, guarantees from related companies are permissible in Japan.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In general, there are no enforceability concerns, although directors may be personally in breach of their duty of care under the Companies Act (Act No. 86 of July 26, 2005, as amended) in such situations. That said, if only a disproportionately small benefit or no benefit at all is received by the guarantor, in a bankruptcy proceeding of the guarantor, the guarantee may be subject to avoidance by the bankruptcy trustee.

2.3 Is lack of corporate power an issue?

Corporate power is necessary for a guarantor to grant guarantees.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

The Civil Code (Act No. 89 of April 27, 1896, as amended) requires that any guarantee agreement must be in writing. Shareholder approval is not required. Depending upon the materiality of the amount guaranteed, the board of directors' approval may be required. In practice, the loan and/or guarantee agreement will contain a representation and warranty as to the board of directors' approval, and such approval will often be a condition precedent to funding a loan.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Japanese law does not provide net worth, solvency or similar limitations on the amount of a guarantee. (Please note that, where an obligor has the obligation to furnish a guarantor, such guarantor must be a person with capacity to act, and have sufficient financial resources to pay the obligation. This does not apply in cases where the creditor designated the guarantor.)

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No. However, please note that a payment exceeding JPY 30,000,000 from a resident in Japan to overseas by way of bank remittance may be subject to reporting requirements.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In Japan, many types of property may be pledged to secure debt obligations, including real property (buildings and land), plant, machinery, equipment, receivables, accounts, shares and inventory.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Different types of security interests may be created by one security agreement; however, as discussed in questions 3.3 to 3.8 below, the security interest in each type of asset must be perfected separately.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

(1) Real property (land)

Under Japanese law, a typical security interest upon real property is a mortgage (*teito-ken*). For a revolving facility with a maximum claim amount (*kyokudo-gaku*), a revolving mortgage (*ne-teito-ken*) is applicable.

A mortgage on land or a building is created by an agreement between a mortgagor and a mortgagee. In order to perfect the mortgage against a third party, the mortgage must be registered with the Legal Affairs Bureau ("LAB") having jurisdiction over the property. There are approximately 500 LABs throughout Japan.

Under Japanese law, the land and any building on the land are treated independently. Therefore, the mortgagor of the land and the mortgagor of any building on the land could be different entities. It is, therefore, important to separately create and perfect the mortgage as a first lien upon both the land and the building. In Japan, almost all land (by parcel) and buildings (by building, upon completion) are already registered with the LAB. The registration of the mortgage is made as an addition to such existing registration. Therefore, it is necessary to investigate the title and confirm whether the property is already encumbered by an existing mortgage. Typically, a mortgage registration includes (i) the name and address of the debtor and mortgagor, (ii) the origin and date of the mortgage, (iii) the priority, and (iv) the claim amount (in the case of a revolving mortgage, the maximum claim amount). Though various covenants and other provisions may be included in the mortgage agreement, the full mortgage agreement is not recorded in the registration. Only the registrable items including those enumerated above will appear in a registration.

(2) Plant

A typical "plant" consists of land, a building, machinery and equipment. As mentioned above, land and a building can be collateralised by a mortgage (*teito-ken* or *ne-teito-ken*). Machinery and equipment are classified as movables, and can be collateralised by a security interest (*joto-tanpo)* (discussed below).

In addition, Japanese law provides for two comprehensive security interests for property located in a factory. One is a factory mortgage (*kojo-teito-ken*), and the other is a factory estate mortgage (*kojo-zaidan-teito-ken*). A factory mortgage over the land covers all machinery and equipment located in the factory. A factory estate mortgage is a very strong security interest that can actually eliminate pre-existing security interests over movables in the factory estate. Notice regarding the factory estate is published in the Japanese official gazette and if an existing security interest holder fails to object within a certain period (specified from one to three months), the existing security interest is extinguished. Both a factory mortgage and a factory estate mortgage require identification of each piece of machinery and equipment, and therefore require more burdensome procedures and costs than normal types of mortgages. The factory mortgage and factory estate mortgage are not very common and are used mostly for large factories.

(3) Machinery and equipment

Machinery and equipment are movables. Movables can be collateralised by way of assignment as security (*joto-tanpo*). This security interest can be created by a security agreement between an assignor and an assignee. In order to perfect this security interest, the target movable must be "delivered" from the assignor to the assignee. Delivery can be made by (i) physical delivery, (ii) constructive delivery, or (iii) (where the assignor is a legal entity (including a company)) if a movable assignment registration (*dosan-joto-toki*) is filed with the LAB, the registration itself is deemed delivery from the assignor to the assignee. The LAB located in the Nakano Ward of Tokyo is the exclusive designated LAB for any movable assignment registration.

In creation of *joto-tanpo*, it is necessary to identify the target movable by whatever means is enough to specify it, such as kind, location, number and so forth. This identification rule is also applicable in perfection of *joto-tanpo* by way of physical or constructive delivery. In perfection by movable assignment registration, there are two statutory ways to identify the target movable: (i) specification by kind and a definitive way to specify the target (such as a serial number); and (ii) specification by kind and location. The former is usually used for a fixed asset, and the latter is usually used for inventory (aggregate movables).

Note that the movable assignment registration is compiled by the assignor (not by the target movable). Therefore, unlike a real estate registration which can be searched by the property, a movable assignment registration cannot be searched by the target movable, and priority cannot be registered because there is no statutory registration system to reflect the priority in the movable assignment registration. There is continued debate as to whether a second lien (*joto-tanpo*) is valid. Anyone can search whether an assignor has already filed a movable assignment registration and obtain an outline certificate of the registration for a fee of JPY 500. If there is no existing movable assignment registration filed with the LAB, a certificate of non-existence of movable assignment registration will be issued. However, this does not mean there is no physical or constructive delivery. Therefore, it is necessary to perform due diligence with respect to possible physical or constructive delivery by an assignor. If a movable assignment registration has been filed with the LAB, the outline certificate describes (i) the existence of such registration, (ii) the timing of the assignment, and (iii) the name and address of the assignee, but it does not provide detailed information regarding the target movable. A comprehensive registration certificate is only accessible to limited persons, and in practice, a lender will ask the debtor to obtain the latest comprehensive certificate.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

A security interest in receivables (claim) may be taken by a pledge (*shichi-ken*) or assignment as security (*joto-tanpo*). These security interests can be created by a security agreement between the pledgor/assignor and pledgee/assignee.

In creation of the security interest, it is necessary to identify the target receivable enough to specify it (such as kind, date of origination and other items to the extent applicable). If the target is a claim to be generated in the future (*shorai-saiken*, "future claim"), the period (beginning and end dates of the period during which the claim will be generated) must be specified in the security agreement and in connection with perfection. If there is an agreement made between the debtor and the obligor of the target receivable which prohibits pledge/assignment of the target receivable, the pledge/assignment is basically invalid, with two exceptions: (i) if the pledgee/assignee is unaware of the prohibition agreement without gross negligence, the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

pledge/assignment shall be valid; and (ii) the pledge/assignment will become valid retroactively from the time of the pledge/assignment (to the extent not harmful to a third party) if the obligor of the target receivable consents to the pledge/assignment, even if there has been a prohibition agreement.

The pledgee/assignee can assert the security interest ***against the obligor of the target receivable*** upon (i) notice to the obligor from the pledgor/assignor, or (ii) acknowledgment of the obligor. The pledgee/assignee can assert the security interest ***against a third party*** (such as a double pledgee/assignee or bankruptcy trustee of the pledgor/assignor) upon (i) notice to the obligor of the target receivable from the pledgor/assignor by a certificate with (a stamp of) a fixed date, (ii) an acknowledgment of the obligor of the target receivable by a certificate with (a stamp of) a fixed date, or (iii) (only where the pledger/assignor is a legal entity (including a company)) a claim pledge/assignment registration with the special LAB located in Nakano Ward of Tokyo. The registration can be made with the LAB upon creation of the security interest without notice to the obligor. In such a case, practically, the notice to the obligor of the target receivable will be sent upon the event of default of the pledgor/assignor, and the notice must be accompanied by a registration certificate (this notice can be sent by the pledgee/assignee).

The claim assignment registration is not compiled based upon the target receivable, but by the assignor. Therefore, unlike the real estate registration, the claim assignment registration cannot be searched by the target receivables, and, as with movables, priority cannot be registered.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

There are various types of bank deposits in Japan. We will discuss two typical deposit claims used for a pledge: (i) a term deposit (*teiki-yokin*); and (ii) an ordinary deposit (*futsu-yokin*). Validity of a pledge over a term deposit is well established; however, there has been debate as to the validity of a pledge over an ordinary deposit because there is no Supreme Court decision addressing this issue. Nevertheless, a pledge over an ordinary deposit is often used for structured financing. As a pledge or assignment of a deposit is usually prohibited by the deposit agreement, a pledge without the bank's consent is invalid. A pledge over deposits is usually created by a standard form of pledge agreement created by the depository bank, including consent by such bank. If the bank's consent is made with a fixed date stamp, that consent constitutes perfection against a third party. If the lender is itself the depository bank, the bank can either set off or exercise the pledge over the deposit claim.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Under Japanese law, shares of stock companies (*kabushiki-kaisha*) incorporated in Japan can be pledged or assigned as security (*joto-tanpo*). The articles of incorporation of a Japanese stock company will specify whether the shares are represented by physical certificates. If the shares are "certificated" (i.e., if physical certificates representing the shares are issued or will be issued), then a pledge can be created by physical delivery of the certificates to the pledgee, and perfected against the issuing company and any third party by continuous possession of the certificates by the pledgee. As this type of pledge is usually unregistered and thus unknown to the issuer (*ryaku-shiki-shichi*), any dividend will be paid to the pledgor, and upon an event of default, the pledgee has to seize the dividend before it is paid to the pledgor. In contrast, if the name and address of the pledgee and target shares are registered on the shareholders' list at the request of the pledgor (*toroku-shichi*), the dividend can be paid directly to the registered pledgee.

If the shares are not and will not be certificated, a pledge may be created by a security agreement between the pledgor and pledgee, and perfected against the issuer and any third party by registration of the pledge on the issuer's shareholders' list.

After January 5, 2009, all share certificates of all listed stock companies incorporated in Japan became null and void. The shares and shareholders of all listed companies are now subject to the book-entry system controlled by the Japan Securities Depositary Center, Inc. (JASDEC). A pledge over listed shares is created and perfected by registering the pledge with the pledgor's account established at the applicable institution under the book-entry system.

Please note that a company which is not listed may, in its articles of incorporation, restrict the transfer of shares and make any transfer subject to the approval of the issuer (such as consent by the board of directors).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, inventory is usually treated as an aggregate movable. Creation and perfection are as discussed in question 3.3 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to the other items discussed within this chapter regarding guarantees and security interests.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Registration taxes are imposed on (i) mortgage registration (0.4% of the claim amount (as for revolving mortgage, 0.4% of the maximum claim amount)), (ii) movable assignment registration (JPY 7,500 per filing (up to 1,000 movables)), and (iii) claim assignment registration (JPY 7,500 per filing (up to 5,000 claims) and JPY 15,000 per filing (exceeding 5,000 claims)). Creation of assignment as security (*joto-tanpo*) over claims may be subject to a fixed stamp duty of JPY 200 as discussed in question 6.2.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No, except for the factory estate mortgage which requires the procedures discussed in question 3.3 above.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory consents are required to grant security, except for general consents for transfers required by the terms of the asset itself (such as licences).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Taking an example of a revolving mortgage over real property, loans up to the registered maximum amount will be secured by the mortgage in accordance with the priority of the original registration filing.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In general, most of the official documents are executed with a registered seal. The seal registration certificate is also necessary (for example, for filing an official registration). In many cases, there are alternative ways available to foreign lenders.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company: no.

(b) Shares of any company which directly or indirectly owns shares in the company: no.

(c) Shares in a sister subsidiary: no.

Apart from financial assistance restrictions, the directors of a company may be deemed in breach of their fiduciary duty of care if the company provides a guarantee or security to secure the borrowings of its shareholder without gaining any benefit in return (as discussed in question 2.2 above).

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

In the practice of Japanese syndicated loans, an agent usually exists for the syndicated group. However, even if one of the syndicated secured lenders serves as such an agent, it cannot enforce the security interest held by other creditors. In addition, enforcement on behalf of other creditors may be prohibited by the Attorney Act (Act No. 205 of June 10, 1949).

Under the general rule of the Civil Code and other related laws, it is generally understood that the "secured creditor" and the "security holder" must be the same person/entity ("Same Person/Entity Principle"). However, under a security trust system, separation between the "secured creditor" and the "security holder" can be achieved. Until 2007, based on the Secured Bonds Trust Act (Act No. 52 of March 13, 1905), such security trust system only applied to bonds. In 2007, a new Trust Act (Act No. 108 of December 15, 2006) provided for a more general security trust system. Under the new system, if a trust is created with a security interest as the trust property and the terms of the trust provide that the beneficiary is the creditor whose claim is secured, the trustee can be a security trustee ("Security Trust"). As the holder of the security interest, the security trustee may, within the scope of affairs of the Security Trust (subject to instruction by trust beneficiaries in many cases), file petitions for enforcement and take other actions necessary, including distribution of proceeds.

One of the benefits of using a Security Trust is that no individual transfer and perfection procedures are necessary when a secured creditor assigns its secured claims because the security holder does not change under the Security Trust.

However, this new Security Trust system is not used often. While the Trust Act was amended to provide for the Security Trust system, other Japanese laws have not been amended to conform and retain features of the Same Person/Entity Principle. This lack of harmonisation creates practical enforcement risks that have yet to be tested in Japanese courts.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Under Japanese practice, when a Security Trust is not used, secured creditors (such as syndicated loan lenders) elect a "security agent" for administrative purposes only ("Security Administrative Agent").

The basic difference between the security trustee and the Security Administrative Agent is that the Security Administrative Agent is not a holder of all collateral security for all secured creditors. As a result, with respect to the Security Administrative Agent, (i) perfection must be obtained individually for each secured creditor, (ii) when a secured creditor assigns its secured claim and its collateral security, individual perfection procedures to transfer the collateral security are required, and (iii) each secured creditor has to take enforcement actions under its own name notwithstanding that syndicated secured creditors act in concert (subject to the majority approval of the syndication group).

Under Japanese law, when several secured creditors share the single/same collateral in the same ranking, there are two possible legal structures (where applicable): (i) "independent and in the same ranking security" ("Same Rank Security") where each secured creditor owns independent security of the same ranking; and (ii) "joint share security" where all secured creditors share one security ("Joint Security"). The basic difference is that each secured creditor may enforce its security in the Same Rank Security, while unanimous consent of all secured creditors is required to enforce security in the Joint Security. However, secured creditors in a Same Rank Security often enter into an inter-creditor agreement prohibiting individual secured creditors from enforcing the collateral security without majority consent; and, in the case of a syndicated loan, such inter-creditor arrangement is usually provided for in the collateral agreements to which all secured creditors each having a Same Rank Security are parties. Violation of the inter-creditor agreement does not invalidate the enforcement, but only constitutes a damage claim of the other secured creditors.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

If the loan transfer is not prohibited by the terms of the loan documents, the loan can be transferred by agreement between

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Lenders A and B, and the guarantee is automatically transferred to the same assignee (Lender B). In order to perfect the loan transfer against the guarantor, according to a prevalent theory, either (i) a notice to the borrower, or (ii) consent by the borrower is sufficient. However, practically, it is sometimes prudent to send a certified notice to both the borrower and guarantor. In practice, however, instead of providing notice to both the borrower and guarantor, Japanese lenders often require certified written consents from both of them to be obtained in order to avoid any dispute regarding the transfer.

6 Withholding, Stamp and other Taxes; Notarial and other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Yes. Under the Income Tax Act of Japan (Act No. 33 of March 31, 1965) ("Income Tax Act"), a 20.42% withholding tax (including Special Reconstruction Income Tax, which is imposed until December 2037) is levied on the interest paid to foreign lenders where such foreign lender is a corporation having neither a head office nor main office in Japan under a loan.

However, if Japan and the country where the foreign lender resides are parties to a tax treaty (such as the United States or the United Kingdom), the withholding tax rate may be lowered or the obligation to withhold tax may be relieved entirely. For example, (i) no withholding tax is levied on interest paid to all UK lenders, and (ii) no more than 10% withholding tax is levied on interest paid to US lenders under the tax treaty effective as of March 11, 2015. Under the tax treaty between the US and Japan, if a lender is a bank, insurance company or registered securities dealer, the obligation to withhold tax in Japan is relieved entirely. As of February 27, 2016, the tax treaty between the US and Japan is scheduled to be amended, subject to the US ratifying the amendment. After the amendment, all US lenders (including other lenders which are not listed above) are to be exempted from the withholding tax in Japan.

Withholding tax is not levied on interest paid to domestic lenders because that interest is taxed under the Corporation Tax Act of Japan (Act No. 34 of March 31, 1965) ("Corporation Tax Act").

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Under the Corporation Tax Act and other local government tax laws, foreign creditors making loans to Japanese domestic borrowers, but not otherwise having a "permanent establishment" in Japan, are not required to pay (i) the national corporation income tax, (ii) the prefectural and municipal inhabitants' tax, or (iii) the prefectural enterprise tax. Under the applicable tax laws, the effective tax rate on corporations (based on the standard tax rate, including local tax) in Japan is 32.11%. The effective corporate tax rate for the fiscal years commencing on or after April 1, 2016 until March 31, 2018 is scheduled to be 29.97% and the effective corporate tax rate for the fiscal year commencing on or after April 1, 2018 is scheduled to be 29.74%. Activities in Japan such as (i) having a branch office, (ii) performing operating construction work for more than one year, or (iii) having independent agent(s), may constitute having a "permanent establishment" in Japan. If a tax treaty exists between Japan and the country where the foreign lender resides (such as the United States and the United Kingdom), special preferential tax treatment may be applicable to interest income.

A stamp tax is imposed based on the amount of indebtedness evidenced by a loan agreement and can range from JPY 200 to JPY 600,000. A flat fee stamp tax of JPY 200 is required for a guarantee. Collateral agreements such as mortgages and pledge agreements are in general not subject to additional stamp tax. However, certain types of collateral agreements collateralising claims (such as trade receivables) by way of assignment as security (*joto-tanpo*), as opposed to a pledge (*shichi-ken*), may be subject to a fixed stamp duty of JPY 200 applicable to claim assignment agreements.

Registration tax is discussed in question 3.9.

Stamp tax and registration tax apply without regard to the foreign or domestic status of a lender.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

No. There is no corporation income tax or individual income tax under the Corporation Tax Act or the Income Tax Act specifically applicable to foreign lenders solely due to the fact they are lending to Japanese borrowers (or accepting a guarantee or security in connection with a loan to a Japanese borrower).

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No. Documents can be notarised to facilitate compulsory execution in the future. If documents are notarised, a creditor does not need to obtain a court judgment when filing an attachment.

Possible additional fees include (i) process fees based on the Foreign Exchange and Foreign Trade Control Act (Act No. 228 of December 1, 1949) ("Foreign Exchange Act") (mainly attorneys' fees), (ii) attorneys' fees and other fees required to draft contracts and process various registrations, and (iii) tax accountant fees.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

As a basic rule, before starting to lend in Japan, foreign lenders must acquire a licence as a "branch office of a foreign bank" residing in Japan under the Banking Act (Act No. 59 of 1981) or register as a "money lender" under the Money Lending Business Act (Act No. 32 of May 13, 1983).

Based on the Foreign Exchange Act, a foreign lender (including both individuals and corporations) which lends money to a Japanese corporation is required to report to a government authority (such as the Ministry of Finance) if certain conditions are met. In most cases, only *post facto* reporting is applicable, and it is usually not burdensome. Also, there are wide exemptions from the reporting requirement (including, but not limited to, such cases: (i) if the lender of loans is a bank or other financial institutions specified in a Cabinet Order; (ii) if the term of loans does not exceed one year; or (iii) if the amount of loans does not exceed JPY 100 million).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, in principle, they will.

Article 7 of the Act on General Rules for Application of Laws (Act No. 78 of June 21, 2006) adopts a "party autonomy rule" whereby the formation and effect of a juridical act shall be governed by the law of the place chosen by the parties at the time of the act.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Generally, courts in Japan will enforce a New York or English court judgment without re-examination of the merits; however, courts in Japan may evaluate the merits to the extent necessary to determine that the judgment satisfies the criteria for recognition.

Article 118 of the Code of Civil Procedure (Act No. 109 of June 26, 1996, as amended) ("Code of Civil Procedure") and Article 24 of the Civil Execution Act (Act No. 4 of March 30, 1979, as amended) ("Civil Execution Act") establish the mechanism for recognition and enforcement of foreign judgments.

The Civil Execution Act specifically provides that "the judgment granting execution shall be rendered without reviewing the substance of the judgment of a foreign court"; however, it also provides that (i) the foreign judgment must be final and non-appealable, and (ii) the judgment must fulfil the four conditions set out in Article 118 of the Code of Civil Procedure, as follows:

(i) The foreign court must have had jurisdiction over the defendant.

(ii) The defendant must have received adequate service of process.

(iii) The foreign judgment must not violate the public policy of Japan. Particular types of awards, such as punitive damages, may violate this requirement. When a public policy defence is raised, a Japanese court will look beyond the judgment to the underlying transaction. A defendant can also raise a public policy defence if the procedures through which the judgment was rendered were not consistent with Japanese public policy.

(iv) Reciprocity is assured. Japan has reciprocity with both the US and England.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

It differs depending upon the circumstances, but generally it would take approximately six months to one year to complete such proceedings.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

If a secured lender intends to foreclose the secured assets non-consensually, it may file a petition for a public auction of the collateral with the court, if applicable (typically, real estate). Before payment is made by the winning bidder at the real estate auction, a private sale would take place if there is a consensual arrangement with the debtor.

Other than regulatory consents that may be specific to the nature of the collateral as a regulated asset, no general regulatory consents are required to enforce collateral.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

In general, there are no restrictions on foreign lenders seeking to file suits against a company in Japan or to foreclosure on collateral.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, the in-court insolvency proceedings described below provide a stay against the enforcement of certain claims.

Japanese law provides for two types of restructuring proceedings (Corporate Reorganisation and Civil Rehabilitation) and two types of liquidation proceedings (Bankruptcy and Special Liquidation).

In Corporate Reorganisation proceedings, unsecured and secured creditors are stayed from exercising their rights (security interests) outside of the proceedings.

In Civil Rehabilitation proceedings, unsecured creditors are stayed from exercising their rights outside of the proceedings, but secured creditors are not stayed from exercising their security interests (although secured creditors may become subject to a suspension order by the court having the effect of a temporary stay).

In Bankruptcy and Special Liquidation proceedings, unsecured creditors are stayed from exercising their rights outside of the proceedings, but secured creditors are not stayed from exercising their security interests (although secured creditors may become subject to a suspension order by the court in Special Liquidation proceedings).

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. The Code of Civil Procedure does not specifically discuss the enforcement of a foreign arbitral award. However, Article 45 of the Arbitration Law (Act No. 138 of August 1, 2003) discusses recognition of arbitral awards generally, providing that "an arbitral award (irrespective of whether or not the place of arbitration is in the territory of Japan; this shall apply throughout this chapter) shall have the same effect as a final and conclusive judgment". The Arbitration Law is based upon the UNCITRAL Model Law on International Commercial Arbitration. Japan is also party to various international protocols and bilateral treaties, such as the New York Convention

© Published and reproduced with kind permission by Global Legal Group Ltd, London

that addresses recognition and enforcement of foreign arbitral awards. Japan acceded to the New York Convention on June 20, 1961 and the Convention entered into force on September 18, 1961.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

As stated in question 7.6 above, in Corporate Reorganisation proceedings, secured creditors are stayed from enforcing their security interests. The claims of secured creditors will be treated as secured claims up to the value of the collateral as of the date of the commencement of the Corporate Reorganisation proceedings. Such value will be determined by way of an amicable settlement between the parties, a valuation order or a judgment by the court. Secured creditors will receive repayment in accordance with the reorganisation plan as approved by the borrower's creditors and confirmed by the court. In proceedings other than Corporate Reorganisation, secured creditors may enforce their security interests outside of the relevant proceedings. In practice, however, secured creditors sometimes refrain from exercising their security interests in exchange for settlements where the value of the relevant collaterals are agreed upon and repaid.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In a Corporate Reorganisation proceeding, the Trustee exercises the right of avoidance. In the case of a Civil Rehabilitation proceeding, the Supervisor exercises the right of avoidance.

If a loan is "new money" and the collateral is fair equivalent value, the secured transaction (collateralisation) is, as a basic rule, not subject to avoidance. However, if the change of the type of the property (e.g. from real property to cash) gives rise to an actual risk of the debtor's disposition prejudicial to the unsecured ordinary creditors (in a Corporate Reorganisation, secured and unsecured creditors), and the debtor had such intention and the lender was aware of the debtor's intention as of the time of the transaction, such transaction may be subject to avoidance.

If a secured creditor obtained security for an existing debt knowing that the debtor became "unable to pay debts", the lien could be avoided. If collateralisation for an existing debt was carried out within 30 days prior to the debtor becoming "unable to pay debts" in the event where the debtor did not owe any duty to provide such security, it could also be avoided.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Among the four insolvency proceedings stated in question 7.6 above, Civil Rehabilitation and Bankruptcy are available for both legal entities (including companies) and individuals, while Corporate Reorganisation and Special Liquidation are limited to stock companies (*kabushiki-kaisha*). Note that there is a special legislation that applies to Corporate Reorganisation, Civil Rehabilitation and Bankruptcy proceedings of financial institutions (including banks).

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

A secured creditor may exercise its rights independently from the Civil Rehabilitation, Special Liquidation or Bankruptcy (however, in the Civil Rehabilitation and Special Liquidation, such exercise may be subject to a suspension order by the court).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Under the Code of Civil Procedure, the amendment of which has been effective since April 1, 2012, the parties' agreement on the foreign (non-Japanese) jurisdiction is, as a basic rule, legally valid and enforceable if:

(i) it is made with respect to an action based on certain legal relationships and made in writing;

(ii) the designated foreign court is able to exercise its jurisdiction over the case by the foreign law and in fact; and

(iii) the exclusive jurisdiction of a court of Japan over an action in question is not provided for in laws or regulations.

Please note that jurisdiction over actions relating to (i) consumer contracts, or (ii) labour relationships are subject to the independent rule specified under the amended Code of Civil Procedure.

See question 7.2 regarding recognition of foreign judgments.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A waiver of sovereign immunity is legally valid and enforceable subject to the conditions in the Act on the Civil Jurisdiction of Japan with respect to a Foreign State, etc. (Act No. 24 of April 24, 2009) (the "Immunity Act").

The Immunity Act is based on the United Nations Convention on Jurisdictional Immunities of States and Their Property (2004) and is effective from April 1, 2010.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

See questions 5.1, 5.2 and 6.5.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

No; however, foreign lenders should note that court dockets in Japan are not available online and are not accessible to the general public. In general, there is also less transparency in court proceedings in Japan than in some jurisdictions, fewer hearings and *ex parte* communications are permitted. In particular, this lack of publicly available information can pose concerns for distressed debt investors regarding trading restrictions and non-public information.

Taro Awataguchi
Anderson Mori & Tomotsune
Akasaka K-Tower, 2-7
Motoakasaka 1-chome
Minato-ku, Tokyo 107-0051
Japan

Tel: *+81 3 6894 1073*
Fax: *+81 3 6894 1074*
Email: *taro.awataguchi@amt-law.com*
URL: *www.amt-law.com*

Taro Awataguchi focuses his practice on secured financing transactions (including asset-based lending transactions), complex debt restructurings and cross-border insolvency cases (including successful representation (full recovery plus award) of the first statutory secured creditors committee in the history of Japanese corporate reorganisation proceedings). He also has experience in complex litigations pertaining to finance and insolvency.

Yuki Kohmaru
Anderson Mori & Tomotsune
Akasaka K-Tower, 2-7
Motoakasaka 1-chome
Minato-ku, Tokyo 107-0051
Japan

Tel: *+81 3 6888 5838*
Fax: *+81 3 6888 6838*
Email: *yuki.kohmaru@amt-law.com*
URL: *www.amt-law.com*

Yuki Kohmaru is well versed in acquisition finance and other secured financing transactions. He also has extensive experience in M&A transactions, venture capital investments, joint ventures and corporate reorganisations. He regularly advises banks and financial institutions, private equity funds, institutional investors and business corporations on a broad range of domestic and cross-border transactional matters.

ANDERSON
MŌRI &
TOMOTSUNE

Anderson Mori & Tomotsune is among the largest and most diversified law firms in Japan offering full corporate services. Our flexible operational structure enables us to provide our corporate clients with effective and time-sensitive solutions to legal issues of any kind. We are pleased to serve Japanese companies as well as foreign companies doing business in Japan. In response to the increasingly complex and varied legal needs of our clients, we have grown significantly, augmenting both the breadth and depth of expertise of our practice. Our principal areas of practice consist of Corporate, M&A, Capital Market, Finance and Financial Institutions, Real Estate, Labour and Employment, Intellectual Property/Life Sciences/TMT, Competition/Antitrust, Tax, Energy and Natural Resources, Litigation/Arbitration/Dispute Resolution, Bankruptcy and Insolvency/Restructuring, International Trade and International Practice (China, India, Asia, US, EU and Others).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Mexico

José Ignacio Rivero Andere

Gonzalez Calvillo, S.C.

Samuel Campos Leal

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

In the last three years Mexico was able to conclude several structural reforms considered essential for the development of the Mexican economy.

One of these reforms was the Financial Reform, which had the main purposes of (i) guaranteeing access to credit to the Mexican people, (ii) creating a reliable banking and financial system, and (iii) eliminating financial transactions with unlawful money.

Also, as a result of these reforms, Mexico has tendered an important number of infrastructure projects that have required all types of financial structures and innovation.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The most significant project financings in Mexico in recent years are generally related to the construction, operation and maintenance of: power plants; oil and gas projects, including pipelines and storage facilities; dams; water treatment plants; and transportation infrastructure such as highways and toll roads.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, so long as the by-laws of the Mexican guarantor permit the guarantee of obligations of third parties. These guarantees can be created either under Mexican or foreign law, provided that when created under foreign law, certain provisions are included in the foreign documents to ensure enforceability of a judgment of the foreign law guarantee in Mexico against the Mexican guarantor (e.g. limitations on guarantee language, appointment of a process agent and provisions for submission in the jurisdiction).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

No, guarantees are enforceable regardless of the benefit obtained by the Mexican guarantor.

2.3 Is lack of corporate power an issue?

Yes, for the validity of the guarantee, the Mexican guarantor (i) should be authorised under its by-laws to act as guarantor, (ii) if applicable under its by-laws, corporate approvals have to be obtained, and (iii) a duly appointed representative of the Mexican guarantor should execute the guarantee.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Subject to the by-laws of the Mexican guarantor, corporate approvals (e.g. shareholders, board of directors, etc.) may be required.

Subject to contractual provisions applicable to the Mexican guarantor, contractual consents may also be required.

Except for regulated entities, no governmental consents are required.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No; however, the enforceability of the guarantee may be limited or affected by statutory priorities or provisions established by: (i) laws imposing federal, state or municipal taxes, including taxes or amounts payable by Worldwide Mexico that are considered as such under Mexican law, such as social security and payments of similar import owed to, or collectible by, a governmental authority with the power to collect fiscal contributions; (ii) Mexican federal labour laws regarding compensation of any kind owed by Worldwide Mexico to persons covered by such laws; and (iii) reorganisation, insolvency, fraudulent transfer, bankruptcy, moratorium or other laws affecting creditors' rights generally.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No. On enforcement, see question 2.1 regarding the enforceability of foreign law guarantees.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

(i) Equity (shares, quotas, etc.), (ii) rights and/or any type of movable assets (receivables, cash deposited in bank accounts, inventory, IP, etc.), and (iii) real estate (land and buildings).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

(i) Collateral over Equity: To perfect collateral in Mexico over equity issued by a Mexican company, a Mexican equity quotas pledge agreement would have to be implemented, jointly with the delivery of (a) if applicable, equity certificates duly endorsed, (b) evidence of the entry of the pledge in the partners registry book, and (c) equity quota powers to be exercised by the lender upon the occurrence of an enforcement event.

(ii) Collateral over Movable Assets: To perfect collateral in Mexico over machinery, equipment, or any other type of movable assets located in Mexico, including trademarks registered in Mexico (either owned by the Mexican entity or by its affiliates), a Mexican floating lien pledge would have to be implemented. This type of security will provide for the creation of collateral without interfering with the operations of the Mexican entity as the possession of the pledged assets will remain with the pledgor.

In connection with the equity pledge and the floating lien pledge, please note the following:

(a) The signatures of the parties to the equity pledge (to ensure priority over tax credits) and the floating lien pledge (to comply with perfection requirements under Mexican law) would need to be ratified before a notary public in Mexico. To accomplish this, representatives of such parties would need to be available at closing to execute these documents in front of a notary public. In case the collateral agent or the foreign grantors do not have representatives in Mexico, a PoA in terms of Mexican law would have to be granted for such purposes; if granted outside of Mexico, such PoA would need to be notarised, and, as applicable, apostilled or legalised, and sent to Mexico for further notarisation.

(b) The equity pledge (to ensure priority over tax credits) and the floating lien pledge (to comply with perfection requirements under Mexican law and produce effects *vis-à-vis* third parties), would need to be registered in the Sole Registry of Movable Security. In addition, in case the floating lien pledge covers any trademarks registered in Mexico, such pledge would also have to be registered at the Mexican Institute of Intellectual Property (IMPI).

(c) If granted outside of Mexico, the equity/stock powers to be delivered in terms of the equity quotas pledge would have to comply with the same formalities as a PoA described in (a) above.

(iii) Trust: As an alternative to the mentioned pledges, a Mexican guarantee trust structure, whereby the collateral assets are transferred to a trustee to guarantee the secured obligations, could be implemented.

A trust is generally used when it is intended to create a general security agreement encompassing all or a substantial part of the relevant project assets. Generally speaking, under a trust, the project's companies, sponsors or security providers will transfer title of assets to a trustee, who is a Mexican bank or financial entity authorised to act as trustee, with the purpose of securing payment and performance obligations of the project companies, sponsors and/or obligors towards the banks or entities granting the relevant financing, who will be principal beneficiaries of the trust. Depending on the type of trust and the assets involved, certain formalities for incorporating, operating and transferring assets to the trust may apply.

The primary advantage of the trust structure is that it makes all collateral remote to the bankruptcy of the grantors, as there is a "true sale" of the assets to the trustee, and it gives more control over the assets to the bank in the event of a default. The primary disadvantage of the trust structure is that it may interfere with the operations of the grantors (as the possession of the assets would need to be transferred to the trustee), and that its implementation could represent material costs (including trustee fees and costs, and tax implications).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

(i) Collateral over Real Estate Assets (land and buildings): To perfect collateral in Mexico over Mexican land and/or buildings, a Mexican mortgage agreement would have to be implemented.

In terms of Mexican law this mortgage would need to be granted through a notarial deed and thus, as in the case of the stock pledge and the floating lien pledge, representatives of the parties thereto would need to be available at closing in Mexico to execute this document before a notary public.

In addition and in terms of Mexican law, for this mortgage to produce effects *vis-à-vis* third parties, it will need to be registered in the public registry of property of the place where the assets are located.

In connection with security over machinery and equipment, please refer to question 3.2, points (ii) and (iii).

(ii) Trust: As an alternative to the mortgage, a Mexican guarantee trust structure, whereby the mortgaged assets are transferred to a trustee to guarantee the secured obligations, could be implemented. Please refer to question 3.2, point (iii).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. See question 3.2, points (ii) and (iii).

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. See question 3.2, points (ii) and (iii).

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes. See question 3.2, points (ii) and (iii).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. See question 3.2, points (ii) and (iii).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, so long as the by-laws of the Mexican guarantor permit the granting of security interests. These guarantees have to be created under Mexican law when the subject matter thereof are assets located in Mexico or governed by Mexican laws.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

In most cases where security is granted, the participation of a notary public is required in order to perfect the security interests being created (i.e. security over real estate, guarantee trusts and floating lien pledges). In other cases, although not legally required for perfection, it may be advisable to ratify security documents with a notary public. Notarial fees are variable and will depend on the type of document or security interest being notarised; these fees are topped out in most cases but can be high (although, in large transactions or when topped fees are high, notaries can and will typically grant fee discounts).

Registration fees are associated with security registration at public registries for security over real estate assets. All security over real estate assets must be registered at the local public registry of property for the security to be perfected and opposable to third parties, and fees will also greatly vary from state to state. In most cases, registration fees are also topped out by local authorities, but in some cases special discounts may apply when the security is associated with benefits for the locality or state (i.e., infrastructure, investment, etc.).

While registration of security over assets other than real estate, such as receivables, cash deposited in bank accounts, inventory and similar assets will typically be required (depending on the type of security being created), documents evidencing security over these movable assets are, as of recently, electronically registered at the Sole Registry of Movable Security, and there is no fee payable for such registration (although associated notarial costs may apply).

Please note that, in addition to the above, in some other cases and in certain local jurisdictions, additional taxes or fees may apply on perfection and/or registration of security.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The time and/or expenses associated with creating, perfecting and registering security in Mexico vary on a case-by-case basis. The number of secured assets, type and extent of security, nature of the assets in security (i.e. real estate, receivables, etc.) all play a role in determining the amount of time and expense.

Registration of real estate-backed security can take anywhere from a few days to a couple of months, depending on the locality where it needs to take place. Registration of security over movable assets was, until recently, also subject to time considerations but with the advent of electronic registration, it can now be done in a matter of days and at marginal cost. As for costs associated with creation, notarisation and perfection, please refer to the foregoing answers.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

There can be, if the project involves a regulated activity. Security over permits, concessions, procurement contracts, licences and other regulated assets (such as pipelines, water treatment plants, energy plants, mining properties), or over companies or entities that use, procure, manage and/or operate such assets, will typically require prior governmental approval to create security over them (or, at best, prior notice to the relevant authorities).

In addition, subject to the by-laws of the Mexican grantor, corporate approvals (e.g. shareholders, BOD, etc.) may be required. Also, subject to contractual provisions applicable to the Mexican grantor, contractual consents may also be required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

See questions 3.2, 3.9 and 3.10.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

No, so long as the by-laws of the Mexican guarantor permit it. Note that related party transactions derived from the financing will have to be executed on an arm's length basis and may require governmental, corporate and contractual approvals.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. Mexico would recognise the role of security agents and it is valid to appoint such agents to act on behalf of financing parties, provided such appointment is done in writing and contains the specific authorisation and role of the agent by and on behalf of the relevant financing parties.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Mexico. See question 5.1.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Specific contractual requirements under the loan documents should be complied with. Also, in terms of Mexican law, unless the Mexican borrower and guarantor are notified of the assignment, they will be released of their obligations by paying to Lender A.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Yes. Withholding taxes do generally apply to interest payable to foreign lenders, as well as to the proceeds of a claim or an enforcement of security that are destined for payment of interests, commissions or fees (and not principal). The withholding rate will depend on the underlying transaction, the characteristics and nature of the relevant lender, the applicability of international taxation treaties and other related factors, and the rates can vary from 4.9% to 40%, depending on different factors.

Please note that withholding requirements do not apply to Mexican banks and financial entities, which will calculate and pay their taxes in accordance with applicable Mexican tax laws.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Mexico has entered into many treaties to avoid double taxation with different countries, and each treaty or agreement provides for distinct types of privileges, restrictions, fees, and, in some cases, exemptions thereof. They tend to reduce taxes of one treaty country for residents of the other treaty country in order to reduce double taxation of the same income, reducing the amount of tax withheld from interest.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Foreign lenders are required to pay income tax if they have a permanent establishment within Mexican territory, or when the income comes from sources within the Mexican territory. A foreign lender will be considered to have a permanent establishment in Mexico if (a) any of its activities or services are performed in a place of business within the Mexican territory (e.g. branches, offices, facilities, or similar), or (b) it acts within the Mexican territory through a person or entity, other than an independent agent.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

In most cases where security is granted, the participation of a notary public is required in order to perfect the security interests being created (i.e. security over real estate, guarantee trusts and floating lien pledges). In other cases, although not legally required for perfection, it may be advisable to ratify security documents with a notary public. Notarial fees are variable and will depend on the type of document or security interest being notarised; these fees are topped out in most cases but can be high (although, in large transactions or when topped fees are high, notaries can and will typically grant fee discounts).

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No. There are no adverse consequences for a Mexican borrower if some or all of the lenders are foreign entities.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes. Mexican law generally allows the parties freedom in the choice of law applicable to agreements and contracts, and Mexican courts will recognise a contract governed by a foreign law and will construe and solve any dispute applying such foreign law within the Mexican territory, provided such laws do not contravene Mexican law principles.

That said, creation of collateral over assets located in Mexico or governed by Mexican law can only be created and enforced through Mexican law-governed documents.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes. Loan documents and offshore security documents in which the lender or main group of lenders are offshore entities or are funded through foreign resources will typically be governed and construed under foreign law (such as, in many cases, New York or UK law). Mexican courts will recognise a foreign judgment and will enforce it in Mexico, provided such judgment does not contravene Mexican law principles, including if service of process is not correctly and legally completed.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Enforcement and foreclosure procedures will depend on the type of security interest and the collateral being enforced. In most of these procedures, there can be special and other blocking procedures that can directly impact the timing and cost of enforcement.

Note that enforcement in Mexican Courts of a foreign judgment under a foreign law finance document will be much more efficient than trying to enforce the foreign law finance document itself.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Yes. Foreclosure of a mortgage or a regular pledge will typically require a summary judicial procedure that would ultimately result in public auctions to sell (or transfer) the collateral as payment to the lenders. For non-possessory pledges and guarantee trusts, it is possible to elect between a judicial or a non-judicial procedure.

As for regulatory consents, typically the same consents required, if applicable, for the creation of security will apply to its foreclosure (especially if the receiver or buyer of the assets is not the same entity as that which requested the original consent), but in many cases the original consent would cover the ability to foreclose on the assets, subject in some cases to prior notice to the relevant authorities. Also, enforcement can be significantly affected or impacted in case of reorganisations or bankruptcy under applicable law.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

Generally no; however restrictions applicable to foreign investors or creditors to own or operate certain assets (restrictions on foreign investment) will apply to foreign investors or creditors in the event of a foreclosure.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. From the date of the bankruptcy judgment to the end of the reorganisation stage, no claim or foreclosure will be enforceable against the company pursuant to the Federal Bankruptcy Law.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Mexican courts have the legal obligation to recognise contractual submission of disputes to international arbitration, as well as international arbitral awards, subject to compliance with procedural and formal requirements under the Mexican Commerce Code and applicable international treaties. Please note that enforcement of an arbitral award could be denied, among other applicable matters: if one of the parties to the arbitration agreement did not have adequate or sufficient legal capacity to enter into such arrangement or such arrangement is not valid under the laws chosen by the parties; if service of process is not correctly and legally completed; if the award refers to a controversy which, under the terms of the arbitration agreement, was not subject to arbitration or contains a decision that exceeds the terms of such arbitration agreement; if the subject matter of the arbitration procedure cannot be arbitrated or the enforcement of the award is contrary to Mexican law, public policy of Mexico, international treaties or agreements binding upon Mexico; or if the award is not final in the jurisdiction where it was obtained.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Mexico's Federal Bankruptcy Law is the general statute governing reorganisation and bankruptcy proceedings throughout Mexico. Reorganisation and/or bankruptcy proceedings will directly affect enforcement of a security for a lender, but the impact will greatly vary depending on the legal robustness of the security received by such lender.

In general terms, and subject to exemptions and rights, the Federal Bankruptcy Law treats a lender secured under a security structure created under a pledge or a mortgage as a secured creditor. Important benefits afforded to a secured creditor are priority ranking, continued ordinary interest accrual, loan currency protection and (subject to some exemptions) ability to participate or not in the eventual creditor agreement that concludes the reorganisation proceeding; in the event no agreement is reached and the relevant company becomes bankrupt, secured creditors have the right to foreclose on their security, and they have the same right if such an agreement is validly reached but not signed by the relevant creditor.

Because, as explained above, under a trust title to the assets that form the trust estate is transferred to the relevant trustee and therefore subtracted from the patrimony of the relevant company, lenders secured by or through a trust have, through this agreement, a bankruptcy remote vehicle under applicable law. Please note, however, that in recent cases, while this remoteness has been generally accepted by Mexican courts, precautionary measures issued by Mexican courts have temporarily frozen enforcement and foreclosure of assets under trusts on the basis, among others, of the need for the company subject to the reorganisation procedure to use such assets for its survival.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes. The Federal Bankruptcy Law and its associated regulations establish clawback rights (general 270 clawback period for fraudulent conveyance) and also sets forth a list which, subject to exemptions and interpretation, sets forth the following ranking priorities for creditors: (i) singularly privileged creditors (i.e. burial and sickness expenses); (ii) secured creditors (those secured with an *in rem* guarantee, such as the pledges and mortgage agreements); (iii) specially privileged creditors; and (iv) common (typically

© Published and reproduced with kind permission by Global Legal Group Ltd, London

unsecured) creditors. However, please note that credits against the asset mass, such as certain tax or labour credits, debts incurred while at the reorganisation process, asset maintenance and other similar costs, may actually have higher ranking than secured credits and will typically be paid first.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes. Governmental entities (i.e., states, municipalities, and certain government entities) are not subject to the Federal Bankruptcy Law. However, they can (and have) implemented trust structures to guarantee debt instrument offerings and other forms of financing, even governmental procurement, and ascertain that assets transferred to such trust are considered to be isolated from the reach of said governmental entity and may be subject to the Federal Bankruptcy Law.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes. The trust structure offers the alternative of contractually agreeing to extrajudicial out-of-court proceedings for foreclosure of the secured assets. The floating lien pledge also offers an out-of-court procedure to the parties, subject to certain prior agreements. However, please note that Mexican law does not allow the actual seizing or taking possession of assets through out-of-court proceedings; therefore, any actual seizure or taking possession of project assets prior to the conclusion of an out-of-court proceeding of foreclosure must be undertaken and approved by the applicable courts.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes. Submission to a foreign jurisdiction is legally binding and enforceable, so long as certain requirements are met when submitting to foreign jurisdiction (i.e., that the matter subject to jurisdiction is not exclusive of the Mexican courts – such as in real estate matters, that the choice of jurisdiction is solely for the benefit of one of the parties but not all of the parties, and that the parties have unequivocally waived their corresponding jurisdiction).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Sovereign immunity is not recognised in Mexico and, therefore waiver of immunity is generally valid in Mexico. However, please note that even though the entities of the Mexican federal and local government are not immune to resolutions and awards against them, they can have immunity against attachments (including in aid of execution) and foreclosure of certain assets or services of governmental property.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Generally speaking, no legal restrictions exist for any person within the Mexican territory to grant a loan to a company. The difference between banking institutions and unauthorised entities is that banking institutions are the only entities authorised to obtain funds from the general public.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The Federal Public Private Partnership Act intends to regulate the legal structure of public-private partnerships to enable the provision of a wide array of services, including those that require the construction and financing of infrastructure, in order for the private sector to become a supplier for the Federal Public Administration by acquiring the obligation to build the infrastructure required to provide such services and proportionally assuming the risk of developing a project. This intends for new and more attractive projects to be tendered under a more secure scheme for project developers; therefore, it is intended to substantially increase the possibility of obtaining or providing improved financing deals for such projects.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

José Ignacio Rivero Andere
Gonzalez Calvillo, S.C.
Montes Urales 632, 3rd Floor
Lomas de Chapultepec
11000 Mexico City
Mexico

Tel: +52 55 5202 7622
Email: jrivero@gcsc.com.mx
URL: www.gcsc.com.mx

José Ignacio Rivero Andere is partner of Gonzalez Calvillo, S.C. and has over 15 years' experience providing legal and business advice to clients from diverse sectors, in multimillion domestic and cross-border transactions in: banking and finance; capital markets; corporate law; M&A; real estate; and private equity. Mr. Rivero serves as member of the board of several companies and has been recognised in his areas of practice by important publications such as *Latin Lawyer* and *Chambers and Partners Global* and *Latin America*.

Mr Rivero has international experience both professionally and academically. He worked as an international associate for the firm Proskauer Rose LLP in New York, and obtained degrees in business administration, Class of 2008, Northwestern University, Kellogg School of Management; Master of Laws (LL.M.), Class of 2008, Northwestern University, School of Law; and attorney at law (JD Equivalent), Escuela Libre de Derecho with honours (2005).

Samuel Campos Leal
Gonzalez Calvillo, S.C.
Montes Urales 632, 3rd Floor
Lomas de Chapultepec
11000 Mexico City
Mexico

Tel: +52 55 5202 7622
Email: scampos@gcsc.com.mx
URL: www.gcsc.com.mx

Samuel Campos is an associate at Gonzalez Calvillo, S.C. with a focus on banking, finance and capital markets as well as corporate in general. He pursued studies from Escuela Libre de Derecho (law degree) and Penn State University.

GONZALEZ CALVILLO, S.C.
ABOGADOS

Founded in 1987, Gonzalez Calvillo, S.C. is a leading Mexican law firm based in Mexico City. The firm has rewritten the model of the full-service law firm by blending it with the transactional/deal-making core of the firm.

For almost 30 years, it has grown steadily while very selectively. It currently has a broad, solid and energetic partnership base of 20 and close to 80 dedicated lawyers comprising the legal team.

The firm is known for its ability to build cross-disciplinary teams in the most challenging and sophisticated transactions and environments. Most of the firm's lawyers have international legal studies in the United States or Europe and experience as foreign associates in highly prestigious global law firms.

Areas of practice: banking and finance; M&A; joint ventures and strategic alliances; private equity; capital markets; corporate; infrastructure; real estate; licensing and franchising; IP; litigation; arbitration; bankruptcy and restructuring; antitrust; government procurement; telecommunications; labour; environmental; energy; oil and gas; and power generation.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Norway

Marit E. Kirkhusmo

Kyrre W. Kielland

Advokatfirma Ræder DA

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Benefitting from high energy prices, the Norwegian economy survived the financial crisis and later the European debt crisis and maintained stable growth contrary to many of its European neighbours. Until mid-2014 the Norwegian high yield bond market was booming, attracting national and international lenders.

During the summer of 2014, oil prices plunged and are at present (January 2016) a third of earlier levels. Needless to say, investments in the offshore industry which has driven the economic growth in Norway for years has dropped significantly, and many suppliers to the Norwegian offshore industry are struggling. Almost two thirds of its outstanding debt in the bond market are related to the oil and gas sector, and the borrowers' distress causes turmoil in the Norwegian high yield market. Similarly, banks have been forced to take losses even on secured loans. On the positive side, the Norwegian market for real estate transactions continues to be very attractive to international investors, and 2015 was by far the best year ever for real estate transactions, including lending transactions.

Consequently, the main trends in the Norwegian lending market for 2016 are less new loans and more restructurings and even bankruptcies. For new projects or financings we expect that the banks' and bondholders' requirements for security will be stricter, with a continuous decrease in "bankable" leverage. These trends apply in particular to the offshore and energy sector but are expected to influence other sectors as well.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Financed by UBS, Credit Suisse and Barclays, Nomad Foods successfully closed the purchase of Norway's leading producer of frozen food, Findus Group, for a purchase price of approximately GBP 500.

During 2015, Songa Offshore successfully took delivery of "Songa Equinox" and "Songa Endurance", two category D rigs, each with a financing need in excess of USD 500 million. Songa Endurance was financed through a loan syndicate including, *inter alia*, Eksportkreditt Norge AS, with an export credit facility in the amount of USD 132 million. Similarly, Eksportkreditt Norge and GIEK had a USD 190 million share of the USD 950 million facility arranged by Nordea Bank Norge ASA for the financing of Seadrill's drill ship "West Carina", delivered in January 2015.

We might also mention that the European Investment Bank ("**EIB**") in October 2015 announced a EUR 200 million long-term loan facility to Norwegian airport operator Avinor AS for the expansion and upgrading of Bergen airport.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Pursuant to the Norwegian Limited Liability Companies Act (the "**LLCA**") section 8-7, private limited liability companies (No: *aksjeselskap* or *AS*) may in most instances guarantee borrowings of one or more other members of its corporate group (No: *konsern*). The same applies to public liability companies (No: *allmennaksjeselskap* or *ASA*) pursuant to section 8-7 of the Norwegian Public Limited Liability Company Act (the "**PLLCA**", and together with the LLCA, the "**LLC Acts**").

The term "corporate group" is, however, quite narrowly defined in relation to limited liability companies. Pursuant to the LLC Acts, the term only includes groups whose holding company is a Norwegian limited liability company ("**AS/ASA**"). Where the holding company is not a Norwegian limited liability company, e.g. a Norwegian general or limited liability partnership or a foreign holding company of any kind, the company can only guarantee if such guarantee serves for the economic benefit of the group, i.e. for the benefit of at least one or more of the company's affiliates.

Should a company be required to guarantee for affiliates in other scenarios than the above, then the guarantee amount cannot exceed the distributable equity of the company and the company must receive adequate counter-security.

Similar restrictions as mentioned above apply to companies organised as limited liability partnerships (No: *Kommandittselskap*) pursuant to the Norwegian Partnership Act section 3-17. Other partnerships, such as general partnerships (No: *Ansvarlig selskap*), are free to guarantee borrowings of one or more members of its corporate group without any such restrictions.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Unenforceability might be an issue if the guarantee/security has been issued by a limited liability company contrary to the provisions

© Published and reproduced with kind permission by Global Legal Group Ltd, London

of the LLC Acts Chapter 3, whose provisions serve for the protection of the equity of the company. Chapter 3 imposes, *inter alia*, statutory obligations on the company to maintain its equity at a prudent level relative to its activities, to avoid exposing the company to unreasonable financial risks, and to enter into any intra-group transactions on an arm's length basis, in addition to prohibiting distributions from the company in excess of distributable equity.

Except in cases where the guarantee obligation is deemed a direct distribution of equity, there is a condition for unenforceability that the guarantee beneficiary knew, or ought to have known, that the guarantee was provided contrary to the above mentioned provisions and that enforceability would be contrary to good faith. If the company has provided the lender with a copy of minutes from a BOD meeting or general meeting (as appropriate) approving the guarantee/security and expressly stating that it is in the best interests of the company, the lender will normally be deemed to have acted in good faith.

Directors negligently approving or issuing a guarantee contrary to the LLC Acts Chapter 3, run the risk of liability towards the company, its shareholders or its bankruptcy estate if the guarantee is held to be enforceable against the company in accordance with the above. Negligent Directors of a general or limited liability partnership run the same risk of liability, although the Directors of a partnership do not have the same express statutory obligations to preserve the equity of the company.

2.3 Is lack of corporate power an issue?

Yes. Lack of corporate power might cause guarantees/securities to be held unenforceable. As mentioned in question 2.2 above, however, there is a condition for unenforceability that the guarantee beneficiary knew, or ought to have known, that the guarantee was issued by (a) person(s) lacking corporate power and that enforcement of the guarantee would be contrary to good faith.

The LLC Acts Chapter 6 contain strict provisions regarding corporate power to enter into any agreements or guarantees on behalf of a limited liability company. In addition to the Board of Directors (acting jointly), the general manager has corporate powers in matters of day-to-day character (except in matters of unusual character or of great importance). The by-laws of the company may authorise one or several Directors and/or the general manager to act singly or jointly on behalf of the company. The Board of Directors may also by board resolution issue "permanent" or *ad hoc* proxy or power of attorney.

Similar provisions apply to general and limited liability partnerships, *cf.* the Partnerships Act Chapters 2 and 3, however, so that each partner would have corporate power unless the company is formally registered with Board of Directors.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental filings or formalities are required in connection with guarantee/security.

For most limited liability companies, the issuing of a guarantee would be deemed a matter of unusual character or of great importance. Thus, the matter must be approved by the Board of Directors and a BOD resolution should be obtained for the sake of good order.

Further, pursuant to the LLC Acts section 3-8, a shareholder approval might be required for certain transactions with related parties, *inter alia*, a guarantee/security in favour of or for the benefit of a shareholder or its affiliates where the consideration from the company exceeds 10% (in case of AS) or 5% (in case of ASA) of the share capital of the company. For limited liability companies there are several exceptions to this requirement, e.g. where (i) the guarantee beneficiary owns 100% of the shares of the company, or (ii) the guarantee has been entered into as part of the company's regular business and on commercial terms.

For companies organised as limited liability partnerships (No: *kommandittselskap* or *KS*), the approval of the partnership meeting is required for any matter of unusual character or of great importance, such as issuing of guarantees in higher amounts or providing security over assets of material importance to the business of the company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no such limitations imposed on the amount of the guarantee under Norwegian law. However, unlimited guarantees may be held unenforceable under Norwegian law, at least when issued in favour of a financial institution, *cf.* the Financial Agreements Act section 61. Guarantees issued in favour of financial institutions should therefore expressly state the maximum amount secured or to be secured by the guarantee.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

As long as payment under the guarantee is made through a licensed bank or payment institution, there are no obstacles affecting the enforceability of the guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The different collaterals that are available to secure lending obligations under Norwegian law are set out in the Mortgages and Pledges Act of 1980 (the "**MPA**"). According to the MPA section 1-2, paragraph 2, collateral security can only be validly agreed upon for assets which are specifically permitted by law. A general pledge of all assets would not be enforceable under Norwegian law.

The MPA permits that collateral security is agreed in, *inter alia*, real property, movable property, machinery and plant, inventory, vendor's lien, securities, financial instruments registered in a securities registry, shares and receivables. Assignment of contracts by way of security would not be enforceable under Norwegian law, as opposed to, e.g., English law; however, earnings and other receivables under a specified contract may be pledged.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

There is no concept under Norwegian law to give security by means of a floating mortgage over all the assets of a person or entity. The main rule under Norwegian law is that only individualised assets or assets which can be individualised may constitute collateral security. Some important exceptions are, however, recognised from this rule as the MPA opens up for the possibility to mortgage groups of certain specified assets, such as receivables (factoring), machinery and plant, inventory, farming products and fishing tools and thereby create a floating mortgage over such groups of assets.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

The MPA section 2-1 provides that collateral security can be taken over real property, registered rights in real property and undivided interests in real property. Leasing and owner-occupied units fall within this category. Unless otherwise agreed, the security encompasses the land (ground) and houses, buildings, plants, etc. on the ground. The mortgage is perfected by the registration of standard mortgage documents with the Norwegian Land Registry (No: *Statens Kartverk*).

Motor vehicles used in or determined for use in business activity, movable production machinery which is used or determined for use in construction business, and railway material used in or determined for use in railway traffic can be pledged as separate categories. The pledge can cover each vehicle or machine separately or be a fleet mortgage. The pledge is perfected by registration in the Register of Mortgaged Movable Property (No: *Løsøreregisteret*). Furthermore, there are some special provisions in the MPA sections 3-9 and 3-10 that certain assets related to farming and fishing equipment used in fishing industries may serve as collateral security. Perfection is obtained by registration in the Register of Mortgaged Movable Property (No: *Løsøreregisteret*).

A floating charge can also be established over an entity's operating assets, *cf*. the MPA section 3-4 (No: *driftstilbehørspant*) (e.g. machinery, plant and other equipment, certain intellectual property rights, such as rights in trademarks, patents and designs, acquired copyrights, plant breeders' rights and certain mineral exploitation rights, etc.). Perfection is obtained by registration in the Register of Mortgaged Movable Property (No: *Løsøreregisteret*).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Receivables which the mortgagor (i) has on a named debtor, and (ii) which the mortgagor will obtain against a named debtor in a specified legal matter, *cf*. section 4-4, paragraph 1 can be mortgaged. Legal protection is obtained through notification of the debtor that the receivable is pledged. It is not a requirement under Norwegian law that the debtor has accepted the notice but in practice banks often require such acceptance from the debtor to obtain evidence that the notification has been sent and that legal protection is obtained.

Pursuant to the MPA section 4-10, a business person or entity can pledge receivables which it has or will obtain in the future from sale of goods or services in its business or in a separate part of its business ("factoring"). This is done in a standard mortgage document. Legal protection is created by registration in the Registry of Mortgaged Movable Properties.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Cash deposited in bank accounts is considered receivables and can be pledged the same way as receivables on named debtors. Legal protection is established by way of notification to the debtor, in this case the bank.

There is a special regulation in the MPA section 4-4, paragraph 2 that cash on accounts in a credit institution can be pledged in favour of the credit institution. As regards consumers, such a pledge must be established through written agreement and the pledge can only comprise cash on a specified bank account which has been set up in connection with the agreement.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Shares in limited liability companies, which are not registered in a securities register, can be pledged/mortgaged unless otherwise set out in the articles of association of the company, *cf*. the MPA section 4-2 a. Perfection is created by notification to the company that the share(s) is pledged.

If the company's shares are registered in a securities register, perfection is created by registration of the pledge in the securities register, *cf*. the MPA section 4-1, paragraph 3.

Partnership shares in Norwegian limited liability partnerships can also be pledged. Perfection is obtained by a transfer of the possession of the partnership shares to the pledgee and thus it is required that the partnership agreement allows for physical partnership shares to be issued.

Share certificates are no longer issued. Security over shares in Norwegian companies can validly be agreed regardless of whether the agreement is governed by New York or English law as long as the Norwegian law requirements for legal perfection are complied with.

When the company is notified that a share is pledged, this information shall without undue delay be recorded in the register of shareholders with a note of the day the information was added to the shareholders' register, the name, address and organisation number (if applicable) of the pledgee. The registration of the pledge in the shareholders' register does not in itself create legal protection for the pledge, as this is created already by notification of the pledge to the company. If the company's shares are registered in a securities register the shareholders' register is replaced by the registration in the securities register.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Business companies or persons can pledge their inventory pursuant to the MPA section 3-11. The security must either encompass the entire inventory of the pledger or a certain specified part of the inventory which operationally is separated from the other inventory and appears to be an independent unit. The pledge is a floating security and covers the inventory or parts of the inventory from time to time. Legal protection of the mortgage is created by way of registration on the name of the owner in the Register of Mortgaged Movable Property (No: *Løsøreregisteret*), *cf*. the MPA section 3-12, paragraph 1.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, a company can grant security in order to secure its obligations as (i) a borrower under a credit facility, and (ii) a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility, subject, however, to the limitations which apply to intra-group guarantees and financial assistance, as further described under question 4.1, being complied with.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Except for nominal fees for registration in applicable registries, which are limited, no stamp duty or similar fees or taxes are or will become payable in connection with execution of the pledge.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No, the time or expense required for the filing, notification or registration required to create legal protection of security is limited.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No, this is not applicable.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No. Collateral security will be provided as security for any and all amounts from time to time outstanding under the revolving credit facility, and the lender's priority in and to the security will depend on the time and date of legal perfection, unless otherwise agreed to in the facility agreement. Time and date of drawdown of the secured loan(s) currently outstanding is not relevant in this respect.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

If the pledgor is a company or entity, the declaration of pledge must be signed in accordance with the signatory provisions of the company/entity or pursuant to a power of attorney which is executed in accordance with the signatory provision. Further, most standard mortgage documents provide that the signatures of the pledgor must be confirmed either by two witnesses or a notary, a lawyer, an auditor and certain other professionals. The same requirements as to form which apply to the execution of a declaration of pledge, will also apply to the execution of any power of attorney relating to the same document, meaning that the signatures on the power of attorney must be confirmed as well. If the pledgor is a foreign person or legal entity it is required that the signature on the declaration of pledge or power of attorney be notarised and legalised.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Yes, the LLC Acts section 8-10 contains strict restrictions on a limited liability company's ability to give financial assistance in relation to the acquisition of shares in the company. Firstly, the company may not provide financial assistance in excess of the distributable equity of the company. Secondly, the guarantee or security can only be provided on commercial terms and against satisfactory counter-security. Thirdly, the Board's resolution to provide such financial assistance has to be approved by a shareholders' meeting with a qualified majority. Fourthly, the Board has to provide the shareholders' meeting with a report of its considerations. Fifthly, and only in case of public limited liability companies, the Board's report has to be filed in the Norwegian Business Register prior to such financial assistance being provided.

Thus, in relation to financial assistance by way of guarantees or security, the statutory restrictions on financial assistance are in practice a prohibition.

For limited liability partnerships (No: *Kommandittselskap* or *KS*) the Partnership Act imposes a prohibition against financial assistance. Such prohibition does not, however, apply if the acquiring company is already, prior to such acquisition, within the same company group as the company. For general partnerships there are no prohibitions or restrictions on financial assistance in respect of acquisition of shares of the company.

(b) Shares of any company which directly or indirectly owns shares in the company

Yes, the same restrictions as outlined in (a) above would be applicable if the target owns sufficient shares/parts to be deemed a holding company of the company.

(c) Shares in a sister subsidiary

For limited liability companies there are no prohibitions or restrictions on a company's ability to financially support the acquisition of sister companies.

For limited liability partnerships, however, the same prohibitions and restrictions, as outlined above, apply.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Although Norwegian law does not recognise the concept of a security trustee as such, the role of a security agent and/or facility agent acting on behalf of the lenders will be recognised. As long as enforcement does not involve legal proceedings, the agent will be able to act on behalf of the secured parties (from time to time) in relation to enforcement of security and application of proceeds against the claims of the secured parties.

A facility agent or security agent will normally not be entitled to initiate legal proceedings on behalf of the lenders. In relation to bond trustees acting on behalf of the bond holders, the Norwegian Supreme Court recently confirmed that the bond trustee was entitled to initiate legal proceedings in its own name. Whether this in certain circumstances might also be the case for agents acting on behalf of a large syndicate of lenders remains unprecedented. To avoid risk of dismissal we regularly advise that agents formally include the secured parties as claimants in any legal proceedings to the extent this is feasible.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

See question 5.1 above. Alternative mechanisms such as joint and several creditor status are theoretically available, but such alternatives are less practical than the appointment of a facility agent or a security agent to act on behalf of the lenders.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The answer to this question will in most cases depend on the wording of the facility agreement and the guarantee. The wording which is often used is that the loan is outstanding, and guarantee is issued in favour of the Finance Parties or Lenders, which is defined as the lender(s) from time to time. In these cases the loan and guarantee would be enforceable by Lender B without further notice or other actions.

In other cases it follows from the guarantee that the guarantee is issued in favour of a named lender and that a transfer of the guarantee to another lender requires the prior approval of the debtor/guarantor.

If the facility agreement and guarantee has no wording indicating that the guarantee is issued in favour of an individual lender or that any lender would be covered, one would have to fall back on the background rules of law. According to Norwegian background law the loan and guarantee can be enforced by Lender B if the debtor and the guarantor have been notified of the transfer. It is not required that the debtor and/or the guarantor approves the transfer.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

There are no such requirements to deduct or withhold tax under Norwegian law.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives to foreign lenders. No taxes apply to foreign lenders with respect to loans, mortgages or other security documents for the purpose of effectiveness or registration.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

There are no tax incentives to foreign lenders. No taxes apply to foreign lenders with respect to loans, mortgages or other security documents for the purpose of effectiveness or registration.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

A foreign lender will not become taxable in Norway solely because of a loan to or guarantee and/or grant of security from a company in Norway. In order to become taxable in Norway the foreign lender must be considered tax resident in Norway and would in such case be subject to normal tax on income or gains.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are no adverse consequences to a borrower if some or all of the lenders are organised under foreign jurisdictions.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, Norwegian courts will generally recognise and apply foreign governing laws to the extent the parties have agreed to such governing law in the contract or such governing law is otherwise applicable. The enforcement of a contract with foreign governing law is subject only to: (i) such choice of law being agreed to for *bona fide* purposes; (ii) the application of overriding mandatory provisions in Norwegian law; and (iii) the application of such law would not be manifestly incompatible with the public policy (*ordre public*) of Norway.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The courts of Norway will recognise and enforce, without re-examination of the merits of the case, any final judgment against a company obtained in England and any other court of a country party to the Lugano Convention on jurisdiction and the enforcement of judgment in civil and commercial matters concluded on 30 October 2007 (the "**Lugano Convention**"), which is parallel to the European Union's Brussels Regulations 44/2001. Such recognition and enforcement would, however, be subject to Norwegian rules of public policy (*ordre public*) and certain circumstances where the judgment is given in default of appearance.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Further, the courts of Norway will recognise and enforce, without re-examination of the merits of the case, any final judgment against a company obtained in the state of New York or another state or country not being party to the Lugano Convention, if the relevant parties have agreed to such court's jurisdiction in writing and for a specific legal action or for legal actions that arise out of a particular legal relationship, in accordance with the Dispute Act section 19-16, *cf.* section 4-6, and if not in conflict with Norwegian public policy rules (*ordre public*) or internationally mandatory provisions.

As mentioned under question 7.7 below, Norwegian courts will also recognise and enforce arbitral awards given in England or New York (or any other jurisdiction).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) The time frame for obtaining a decision of a Norwegian court depends on the complexity of the case and the workload of the court. In most cases, a judgment in the first instance can be obtained within six months, and the recognition and enforcement proceedings may then be initiated when the ruling has become legally binding, which is a month after the ruling, unless the case is appealed. Enforcement is initiated by a petition to the Enforcement and Execution Commissioner (No: *Namsfogden*). The process of establishing distress over the company's assets should take approximately 2–4 months, and the realisation process has approximately the same time frame. If real estate is subject to a forced sale, special requirements apply; see question 7.4 below.

According to the Enforcement Act section 7-2 (f) a written claim against the defaulting party is considered a basis for enforcement of debt and the claim can be enforced directly by a petition to the Execution and Enforcement Commissioner without first obtaining a court judgment. If the company raises objections to the claim, however, the case will be referred to the Conciliation Board and/or the District court for judgment. If no objections are made, the Commissioner will establish distress on one or more of the company's assets, and the lender may then file a petition for a forced sale.

(b) The time frame for enforcing a foreign judgment which is recognised in Norwegian courts as more particularly described under question 7.2 above, would be approximately the same as for enforcing a Norwegian judgment. The enforcement of the claim will then be carried out by the Commissioner in accordance with the Enforcement Act, *cf.* the Enforcement Act section 4-1 (f) or (g).

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Depending on the collateral, different assets have different time frames with regards to realisation. Forced sale of real estate has to be approved by the district court and this might take up to six months. The Enforcement and Execution Commissioner will then administrate the sale. Moreover, depending on the nature of the real estate, licensing requirements may impact timing and value of enforcements. For other assets, the Commissioner may initiate a forced sale without a judgment of a Norwegian Court if the requirements set out in question 7.2 above are met.

The Financial Collateral Act section 7 provides an exemption from the rules in the Enforcement Act and enables the parties to enter into an agreement that entitles the mortgagee to redeem the pledge immediately at market value.

According to the Enforcement Act the forced sale of an asset is to be carried through in the way that provides the best possible economic outcome. It is generally up to the Commissioner to decide how the asset should be realised. Public auctions are an alternative if the asset is suitable for this. However, the Act also has provisions regarding handing over the asset to the secured creditor, which may be a good option if the market demand is lower than usual, and it is assumed that a sale will not achieve a reasonable price. In general, a forced sale will not result in a selling price in accordance with market value due to the circumstance that it is a forced sale.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

According to the Dispute Act section 20-11, a party that does not have residence/registered office in Norway may under certain conditions be required to put up collateral for costs incurred in a court case. However, collateral cannot be required if it would be contrary to obligations to treat all parties residing abroad and parties resident in Norway that follows from international law, or if it would be disproportionate with regard to the nature of the case, the relationship between the parties or other circumstances. The EEA Agreement and the European Human Rights Convention has provisions that limit the range of this provision.

If such requirement is imposed, the case will not be heard until the requirement is met. This provision will also apply if the foreign lender has to bring the case before the court in order to foreclose on collateral security. However, there is no such requirement for initiating enforcement proceedings before the Enforcement and Execution Commissioner; please see question 7.2 above.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The main rule is that the mortgagee's rights, if established in accordance with the legal provisions applicable, are valid even if the company is taken under bankruptcy proceedings. However, the Debt Reorganization and Bankruptcy Act of 1984 have provisions regarding voluntary debt settlement and compulsory composition which may influence the mortgagee's security. The voluntary debt settlement requires acceptance from all creditors. Such proceedings require that the debtor files a petition to the District Court for debt settlement proceedings. The debt negotiations committee will submit a proposal for a composition. If the proposal entails that the creditors get more than 50% of their claims, such proposal requires that 3/5 of the creditors accept the proposal, and if the proposal is less than 50%, 3/4 of the creditors' votes are required. A compulsory composition also entails that mortgages or liens that are beyond the estimated value of the collateral will be annulled.

If the company has been taken under bankruptcy proceedings, claims can no longer be enforced by creditors unless the proceedings were initiated before the bankruptcy. However, if a creditor that

© Published and reproduced with kind permission by Global Legal Group Ltd, London

has initiated enforcement proceedings that has resulted in distress over company assets within three months of the filing of bankruptcy, such distrains on assets will not be legally binding for the bankrupt estate according to the Act section 5-8.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Norway has ratified the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards of 1958 (the "**New York Convention**"). Thus, arbitral awards obtained in any jurisdiction whether party to the New York Convention or not, will be recognised and enforced without re-examination of the merits of the case. However, recognition and enforcement of arbitral awards will be subject to, *inter alia*, arbitrability, Norwegian public policy rules (*ordre public*), internationally mandatory provisions and certain circumstances where the judgment is given in default of appearance.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

When insolvency proceedings have been initiated, secured creditors generally have a right to preferential treatment (No: *separatistrett*), i.e., the right to get coverage from the realisation of the asset in which the creditor has collateral, which leaves only a possible surplus of the realisation to be divided among other creditors. In general, only the appointed administrator may realise the company's assets, and the bankrupt estate also has a secured right to obtain 5% of the proceeds if this is necessary for the processing of the bankrupt estate, according to the MPA.

The Bankruptcy Act section 117 states that the realisation of assets shall be carried out in the manner that is expected to provide the best price for the asset. However, according to the Bankruptcy Act section 117 a, the administrator may sell the asset even if the value of the asset is less than the secured claim, if the asset is sold along with other assets, and the combined sale is expected to provide a better price than by selling each asset separately, or if the sale is part of a transfer of the entire business. Further, the Act section 117 b states that the administrator may decide that the asset has less value than the secured claim, and therefore revoke the seizure in the asset to the company. The asset is then placed at the debtor's disposal. However, the administrator may also revoke the seizure and by agreement transfer the asset to the mortgagee according to the Bankruptcy Act section 117 c. Such agreement shall be entered into based on the market value of the asset, and the mortgagee may then realise the asset.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The Creditors Recovery Act of 1984 has provisions regarding both the priority of claims and clawback rights. In general, claims against the estate will be covered first according to section 9-2. The rank is then the preferential debts of first and second priority, according to section 9-3 and 9-4. Thus, most employees' claims and tax debts will be covered first, in that order. However, some parts of the employee claims, and tax debts may be considered without priority according to section 9-6 and 9-7.

As a main rule, the priority provisions will not affect a claim that is secure; in which case the mortgagees claim has the best priority in the collateral. However, security can under certain circumstances be set aside. The administrator may challenge a company act that has granted a creditor payment or security within a defined time period prior to the bankruptcy. The provisions are objective, in the sense that a creditor's good faith is irrelevant, and the time frame is then three months prior to the filing of the bankruptcy, unless the beneficiaries creditor is considered closely related to the company in which case transactions made up to two years prior to the bankruptcy can be set aside. According to section 5-7, security granted in order to secure existing debt ("old debt") and security for existing debt which has not received legal protection without undue delay, which took place later than three months prior to the bankruptcy, may be set aside. There is also a subjective provision in section 5-9 that applies to dispositions which are considered unfair if the creditor knew or should have known that the debtor was in a difficult financial situation, and the circumstances that made the disposition unfair. This provision is applicable to dispositions which took place up to 10 years prior to the bankruptcy.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

A municipal entity (No: *kommunalt foretak*) cannot be taken under bankruptcy proceedings as such enterprise is not considered to be an independent legal entity. Further, a Norwegian Foreign Enterprise (No: *NUF*) is not considered an independent legal entity, but rather a branch of a foreign limited company, and does not normally have legal venue in Norway. A court may, however, commence bankruptcy proceedings against a company that has its principal place of business in Norway. Thus, if the foreign limited company is declared bankrupt based on the fact that its place of business is in Norway, the NUF will be processed as part of the bankruptcy proceedings.

The Bank Guarantee Act chapter 4 has provisions entailing that financial institution and insurance companies cannot be declared bankrupt. Such enterprises will be subject to administration by the authorities.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No. A creditor has to resort to legal proceedings in order to seize an asset of a company in an enforcement if rights are infringed or otherwise impaired. As stated above, there are different legal proceedings that may be initiated to enforce a claim, either by a petition to the Court to obtain a judgment or recognition of a foreign judgment, or a petition to the Execution and Enforcement Commissioner. Reference is also made to the provisions regarding debt settlement and compulsory composition in question 7.6 above.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, as long as such submission to a foreign jurisdiction has been made in writing and for a specific legal relationship, the party's submission to jurisdiction will normally be legally binding and enforceable. Please note, however, that certain statutory limitations

© Published and reproduced with kind permission by Global Legal Group Ltd, London

to the parties' choice of jurisdiction might apply to, *inter alia*, consumer contracts.

Further, unbalanced jurisdiction clauses, e.g. jurisdiction clauses which are exclusive for one party (typically the borrower) and non-exclusive for the other party (typically the lender(s)), run the risk of being held unenforceable under Norwegian law.

If and to the extent that proceedings has already been instituted or are pending in a foreign jurisdiction at the time a matter is brought before a court in Norway, the courts of Norway shall stay or dismiss the Norwegian proceedings in accordance with the rules of the Lugano Convention and the Dispute Act section 18-1.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Norwegian courts are bound by international law regarding sovereign immunity, and a party's waiver of sovereign immunity will be legally binding and enforceable to the extent permissible under applicable international law.

A general waiver of sovereign immunity might be held contrary to international law, for instance in respect of diplomatic immunity. Enforcement of assets protected by diplomatic immunity for instance, might require an express waiver of immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Effective as of 1 January 2016, the Norwegian licensing requirements will follow the new Norwegian Financial Institutions Act of 2014. As a general rule, a licence is required for credit or financing services within the Norwegian territory. The granting of a licence would be subject to eligibility requirements relating to capitalisation, financial position, organisation and management. The eligibility requirements would be stricter for a lender seeking banking licence rather than seeking licence only for specific financing activities.

A lender would not be deemed to provide financing services in Norway (and require a licence) solely by its participation in a single loan to a Norwegian company. However, for lenders with an active approach to the Norwegian market and not only isolated Norwegian financings, the lender may be considered to provide financial services in Norway, which is subject to licensing requirements.

Many foreign banks and financiers are licensed to provide cross-border services in the lending market or to operate in Norway through a branch office. Normally, these are financial institutions which are subject to supervision by another EEA state and have permission to operate as financial institution in or from another EEA state, and thereby are allowed to offer loans in Norway. The Financial Institutions Act also permits easier access to licences for branch offices of foreign lenders outside of the EEA area, subject to satisfactory financial supervision in its state of incorporation.

Breach of licencing requirements will not cause the facility agreement to be unenforceable, but wilful or negligent breaches may be punishable by fines or, in exceptional circumstances, up to one year in prison.

There are no particular licensing requirements for agents of syndicated loans as such, but normally the agent will also be one of the lenders and the same licensing and eligibility requirements will apply to the agent as to the other lenders.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

No, there are no other material considerations which should be taken into account.

Acknowledgment

We would like to gratefully acknowledge Ingrid Birgitte Lund, associate at Advokatfirma Ræder, for her valuable contributions to this chapter.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Marit E. Kirkhusmo

Advokatfirma Ræder DA
P.O. Box 2944 Solli
N-0230 Oslo
Norway

Tel: +47 23 27 27 00 / +47 995 23 534
Fax: +47 23 27 27 01
Email: mek@raeder.no
URL: https://en.raeder.no

Marit E. Kirkhusmo has a long and broad experience as a lawyer within financing transactions, primarily within the shipping and offshore sectors. Her experience extends from traditional bank financing to bond deals, leasing transactions and more transactional work such as private placements. Over previous years she has assisted clients in several complex financial transactions, such as sale lease backs, structuring of ship and rig financings and in a number of export financing transactions. She assists companies, managers and lenders with negotiations and closings.

During one of her previous positions as general counsel for a large shipping group over many years, she has gained considerable commercial knowledge and experience which adds value when advising clients. She is a member of the board of directors of GIEK – the Norwegian Export Credit Guarantee Agency.

Kyrre W. Kielland

Advokatfirma Ræder DA
P.O. Box 2944 Solli
N-0230 Oslo
Norway

Tel: +47 23 27 27 00 / +47 450 22 056
Fax: +47 23 27 27 01
Email: kwk@raeder.no
URL: https://en.raeder.no

Kyrre W. Kielland holds broad experience with financing and other transactions within shipping, aviation and real estate. He advises banking institutions/lenders, companies and others with negotiations and closing of financial transactions and complex loan and leasing structures.

In addition to traditional bank financing, Kyrre advises clients on leasing transactions and bond deals in the Norwegian and European market (Euro Medium Term Notes). He holds precious experience with export financing to the benefit of our many clients from his secondment with Eksportkreditt Norge AS, the Norwegian export financing scheme.

Further, Kyrre is regularly appointed as an external examiner at the faculty of Law, University of Oslo and Lillehammer University College, within fields such as private international law, international commercial law and law of contracts.

Advokatfirma Ræder DA is a leading Norwegian law firm with more than 65 experienced lawyers, of which eight are dedicated to our department for Shipping, Offshore and Financing. We provide advice within most areas of commercial law and are centrally located at Solli Plass in Oslo.

The majority of our clients are national and international companies, organisations and government authorities. We focus on offering tailor-made, cross-disciplinary advice that suits the needs of each client.

We have an international focus and have built an extensive network of cooperative partners across national borders. Our international network and experience mean that we can provide prompt assistance to all our clients, including those situated outside of Norway.

We focus on each client and concentrate on building trust by providing good advice based on solid, specialist legal knowledge and commercial understanding. Our organisation is built on a foundation that is characterised by orderliness, commitment, quality and respect.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Peru

Juan Luis Avendaño C.

Miranda & Amado Abogados

Jose Miguel Puiggros O.

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The Peruvian economy has grown significantly in the last 10 years, so financing needs have grown exponentially. Peruvian companies can obtain bank financing on a cross-border basis without restriction so the market has seen a great deal of competition between domestic banks and foreign banks. Banks have been active in trade finance, acquisition finance and project finance, participating individually and in syndicates.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

One of the largest bank financings ever to take place in Peru was undertaken in 2014 by a consortium of Chinese banks led by China Development Bank and including the Bank of China and Industrial and Commercial Bank of China, for the financing of the acquisition and development by subsidiaries of China Minmetals Corporation (MMG) of the copper mining project "Las Bambas" (formerly of Glencore-Xstrata) in southern Peru, for a total amount of approximately USD 8 billion (in which our firm advised the lender party). Likewise, another significant lending transaction was the USD 2.3 billion syndicated loan for the construction of the Peru LNG project, which included a 400km natural gas pipeline, a liquefaction plan and a seaport. The whole project required an investment of more than USD 4 billion. Peru LNG is a limited liability company indirectly owned by Hunt Oil, SK, Repsol and Marubeni. The bank syndicate was led by Societé Generale and included K-Exim, SACE, US-Exim and the IDB, among others. The deal was completed by June 2008.

In the past two years we worked on, among others, three important financial operations. We advised Abengoa Transmisión Sur S.A., a leading engineering and clean-technology company, in the issuance of senior secured notes due 2043 for the amount of USD 432 million. Also, we advised Cassa Depositi e Prestiti s.p.a., Kfw IPEX-Bank GmbH, Societé Générale and Banco Santander S.A. (Milan Branch) in connection with the granting of a loan for an amount of up to USD 800 million to Lima Metro Loan RPI-CAO Purchase LLC in order for the latter to purchase from Metro de Lima Línea 2 S.A. the quarterly collection rights named "RPI-CAOs" which will be issued under the Concession Agreement for the underground railway project "*Línea 2 del Metro de Lima y Callao*". In connection to that same project, we advised Credicorp Capital Servicios Financieros S.A. and Banco de Crédito del Perú in connection with the granting of a revolving credit facility of up to PEN 100 million in favour of Metro de Lima Linea 2 S.A. for the payment of Value Added Tax (VAT) within the context of the construction and development of the project, to be repaid and backed with the cash flows derived from Metro de Lima Linea 2 S.A.'s participation in the Tax Refund Regime for VAT ("*Regimen de Reintegro Tributario del IGV*").

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Under Peruvian law, there are certain circumstances that restrict the ability of a company to guarantee borrowings of one or more other members of its corporate group. Article 106 of the Peruvian Corporate Act (*Ley General de Sociedades*) prohibits Peruvian corporations from making loans, granting guarantees or creating security interests on their assets to back the acquisition of their own shares (please refer to our answer to question 4.1 below regarding financial assistance). In this regard, a Peruvian company is prohibited from granting any guarantee in connection with the acquisition of its own shares.

There are no restrictions in other scenarios. However, the granting of a guarantee to secure obligations of a related company could be declared void by a court if is not within the corporate purpose of the company (i.e. as an "*ultra vires*" act) or has no economic benefit for the company.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

There are no enforceability concerns if a disproportionately small (or no) benefit to the guaranteeing/securing company is shown. On the other hand, director or officer liability claims could be initiated only in the event their actions in connection with the granting of the guarantee have been made exceeding their faculties, with malicious intent (*dolo*) or gross negligence (*negligencia grave*). Liability claims may be initiated by (a) minority shareholders, or (b) creditors. Creditors will only have a valid action against directors or officers who entered into a certain transaction if the following requirements are met: (i) the claim is intended to reconstitute the company's equity; (ii) the claim has not been filed by the company or its shareholders; and (iii) the collection risk is substantially increased. The statute

© Published and reproduced with kind permission by Global Legal Group Ltd, London

of limitations to file claims against directors and officers is two (2) years as from the date of execution of the relevant guarantee.

2.3 Is lack of corporate power an issue?

Yes. In accordance with article 13 of the Peruvian Corporate Act, in order for a guarantee to be binding and enforceable against a company, the officers executing such guarantee must be duly authorised to do so.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No. Generally, having a guarantee executed in writing by duly authorised representatives of the company with sufficient powers is enough for the guarantee to be valid and enforceable. Specific consents could apply when dealing with certain types of counterparties such as banks, insurance companies, pension funds and governmental agencies (which should be answered on a case-by-case basis). Shareholder approval will not be necessary unless the company bylaws expressly require such approval for the granting of a guarantee or it is outside of the corporate purpose of the company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no provisions under Peruvian law that limit the amount of a guarantee over the basis of net worth or solvency because, in any event, the guarantor company shall only respond up to the amount of its equity. However, in the case of bonds (*fianza*), the Peruvian Civil Code (*Código Civil*) establishes that the guarantee may not exceed the amount of the secured obligation after including all applicable interest, expenses, fees and enforcement costs. Hence, the guarantee may not exceed the amount finally owed by the debtor.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, there is no foreign exchange control applicable in Peru.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under Peruvian law, in addition to personal guarantees (*fianzas* or *avales*) the following types of collateral may be mainly used to secure lending obligations:

(i) Pledges: over movable property such as inventories, vehicles, ships, shares, credits, accounts, rights and, generally, all movable assets (except for specific exceptions).

(ii) Mortgages: over immovable property such as real estate, as well as exploitation concessions (mining, transportation, electric and public utility concessions).

(iii) Guaranty Trust: through which assets and rights are transferred to a trust, *in dominio fiduciario*, which created an autonomous and independent patrimony that is managed by a trustee (*fiduciario*) for the benefit of creditors in the terms and conditions established in the corresponding trust agreement.

Additionally, warrants are available to creditors and, in the financial sector, either guarantees such as stand-by letters of credit and credit derivatives are also acknowledged by the local regulation.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Yes, as long as the security agreement complies with all the formalities required for granting a security for each type of asset as described in our answer to question 3.1 above. Also, in Peru we have several alternatives when it comes to determining the composition of a security package. In the case of assets comprising a production unit, the obligor may grant a special type of mortgage known as "production unit mortgage", which enables the grantor to include under a single mortgage (and through the execution of a single mortgage agreement), a group of assets of different nature, both movable property and real estate property (i.e. buildings, *in rem* rights, equipment, machinery) as long as they all pertain to a single production unit. In case a collateral package is structured to include a production unit mortgage, the parties can still agree to have separate security documents (i.e. pledges and mortgages) over all the assets that, for some reason, were not included under the relevant production unit. Please refer to our answer to question 3.3 below with regards to the applicable procedure.

Likewise, a single guaranty trust agreement may be executed in order to create a guarantee trust that includes all types of the relevant assets and rights of the borrower, to the extent permitted by law (i.e. real property, accounts, movable assets, contracts, concessions, shares, etc.). This mechanism could be combined with the execution, in parallel, independent security agreements over other assets not comprised in the trust, taking into account each asset's nature. All assets and rights subject to security would be part of the trust and administered by a designated trustee on behalf and for the benefit of the secured creditors.

A guaranty trust is created through the execution of a trust agreement (*contrato de fideicomiso*) between the guarantor (*fideicomitente*), the relevant creditor (*fideicomisario*) and the trustee (*fiduciario*). Please note that, in accordance with the General Banking Law (*Ley General del Sistema Financiero*), only entities that are duly authorised to act as trustees by the Superintendence of Banking and Insurance (*SBS*) may act as such (in addition to authorised trustee entities, banks may also perform such function). Although the guaranty trust will be created upon the execution of the trust agreement, in order to obtain enforceability against third parties the agreement must be executed as a public deed and registered in the Contracts Public Registry (*Registro Mobiliario de Contratos*) and, in case the assets comprised in the trust are registered assets (i.e. real estate and certain movable assets such as vehicles, aircraft, etc.), it must also be registered in the relevant registry (please refer to our answers below for details regarding the relevant registries).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Mortgages are created by means of the execution of a private document and a public deed between the Obligor and the Lender (or the corresponding security agent or trustee, as applicable) and will be valid and perfected once registered before the public registries (please note that, as opposed to pledges where registration is only needed for perfection/enforceability as explained below, in the case of mortgages registration is required for validity). Security interests over land and buildings must be registered in the file of the relevant asset in the Immovable Property Registry (*Registro de Propiedad Inmueble*). Security interests over concessions must be

© Published and reproduced with kind permission by Global Legal Group Ltd, London

registered in the Public Registry of Concessions for the Exploitation of Public Services (*Registro de Concesiones para la Explotación de los Servicios Públicos*) or, in the case of mining concessions, in the Mining Rights Registry (*Registro de Derechos Mineros*).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. The Peruvian Pledge Law (*Ley de Garantía Mobiliaria*) expressly allows for pledges to be created over receivables. A pledge is created by means of the execution of a private agreement between the Obligor and the Lender (or the corresponding security agent). However, in order to file the agreement for registration before the public registries, a public deed must previously be granted before a Notary Public. The perfection of the pledge (to achieve enforceability against third parties) and a stronger level of publicity against third parties will be obtained by registering the pledge in the Contracts Public Registry (*Registro Mobiliario de Contratos*).

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. The Peruvian Pledge Law expressly allows for pledges to be created over cash deposited in bank accounts. Please refer to our answer to question 3.4 above for the applicable procedure.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes. The Peruvian Pledge Law does not require the shares subject to pledge to be issued by a company incorporated in a particular country. A share pledge is created by means of the execution of a private agreement between the Obligor and the Lender (or the corresponding security agent). However, in order to file the agreement for registration before the public registries, a public deed must previously be granted before a Notary Public. The perfection of the pledge (to achieve enforceability against third parties) is obtained once the security interest is registered in the relevant stock ledger of the respective Obligor. In order to give the security a stronger level of publicity against third parties, share pledges are usually registered in the Contracts Public Registry (*Registro Mobiliario de Contratos*) as well. Share of companies in Peru may be in certificated form or in account entry form, in accordance with the Peruvian Corporate Act.

Peruvian law allows contracting parties to freely choose the governing law, dispute resolution venue and language used in all private agreements, including security documents. In that regard, a share pledge agreement may be granted under New York or English Law and the validity and enforceability of such agreement will be determined by such foreign law and not by Peruvian law. Thus, to the extent that the share pledge agreement is valid and enforceable under New York or English law, Peruvian law and courts will recognise such share pledge agreement. However, please note that, in case such agreements need to be filed as evidence or otherwise before Peruvian courts, they need to be officially translated into Spanish by a translator registered in Peru. When filed before government agencies (i.e. insolvency authority), translations do not need to be official.

The shares can also be transferred in *dominio fiduciario* to a guarantee trust. Please see the responses above regarding procedure for establishment of the trust, validity and enforceability.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. The Peruvian Pledge Law expressly allows for pledges to be created over inventory. Please refer to our answer to question 3.4 above for the applicable procedure. In case the assets comprising the inventory are assets registered in the Public Registry, the pledge must also be registered in the Movable Assets Registry (*Registro Jurídico de Bienes Muebles*) in connection with such assets.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

To the extent that the financial assistance restrictions (as explained in our answer to question 4.1 below) are not violated, a company may validly grant a security interest in order to secure its obligations both as a borrower under a credit facility and as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

(i) Mortgages (immovable assets):

The costs involved in the registration of mortgages are comprised of notary fees (required for execution of agreement as a public deed), which will vary depending on the designated Notary Public and are customarily calculated taking into consideration the secured amount (in a range between USD 500 and USD 5,000), and public registry fees. As of the date of this document, registry fees are set at 0.75/1,000 over the total secured amount (when less or equal than approximately USD 10,000) or 1.5/1,000 if the secured amount exceeds such amount, with a limit of one Referential Tax Unit ("UIT") (currently S/. 3,950.00, which is equivalent to approximately USD 1,128), with an additional S/. 31 (equivalent to approximately USD 9) qualification fee.

(ii) Pledges (movable assets and rights):

The costs involved in the registration of pledges are comprised of notary fees (required for execution of agreement as a public deed), which will vary depending on the designated Notary Public and are customarily calculated taking into consideration the secured amount (in a range between USD 500 and USD 5,000), and public registry fees. The costs of registering a pledge over movable assets in the public registries depend on the secured amount (*monto del gravamen*). As of the date of this document, registry fees are set at 1.5/1,000 of the total secured amount (expressed in Nuevos Soles) with a limit of one UIT, and an additional S/. 10.00 (equivalent to approximately USD 3) qualification fee.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Please refer to our answer to question 3.9 above regarding the applicable expense. Regarding the duration of the applicable procedures, general timing for registration of pledges and/or

© Published and reproduced with kind permission by Global Legal Group Ltd, London

mortgages in the relevant public registries is sixty (60) business days. Please bear in mind that, as mentioned above, in the case of mortgages, registration is necessary for creation of the security interest, while in the case of pledges registration is advisable in order to obtain publicity and enforceability of the security interest against third parties.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Not generally (except, as mentioned, in the case of mortgages, for which registration is required for creation of the security interest). Specific consents could apply when dealing with certain types of counterparties such as banks, insurance companies, pension funds, governmental agencies and concessionaires of infrastructure concessions (which should be answered on a case-by-case basis).

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no special priority or specific concerns associated with granting security for borrowings under a revolving credit facility. In such case, priority shall be governed by the terms and conditions of the relevant facility agreement. However, please bear in mind that in case the borrower is subject to an insolvency procedure under the Peruvian Insolvency Act (*Ley General del Sistema Concursal*), the priority rights of secured creditors shall be subordinated to the rights of workers (in connection with their compensation and benefits) and the payment of contributions to social security programmes.

Nevertheless, secured creditors have priority over (x) tax claims (including fines, interest and penalty fees owed to the Peruvian State), and (y) unsecured creditors.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

As mentioned above, security documents must be executed as public deeds (through a notary) in order for them to be registered in the relevant Public Registry. Execution under power of attorney shall be necessary in case a special power requires to be granted by the company in favour of the person who shall execute the documents (i.e., in case such person is not a representative or officer of the company already duly authorised to execute the documents on its behalf, in accordance with the company's powers and faculties regime or the applicable Shareholder's Meeting resolution, as the case may be).

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

As mentioned, article 106 of the Peruvian Corporate Act prohibits Peruvian corporations from making loans, granting guarantees or creating security interests on their assets to back the acquisition of their own shares. In this regard, a company is prohibited from guaranteeing or giving security in order to secure borrowings incurred to finance or refinance the direct or indirect acquisition of its shares. The granting of security in breach of this prohibition would be susceptible of being declared null and void (for which any interested party, including the grantor, may file a judicial claim), and the directors approving the transaction would be subject to liability. However, there is no case law on this matter, and there is uncertainty as to how a Peruvian court would rule on such claim.

(b) Shares of any company which directly or indirectly owns shares in the company

In our view, the financial assistance limitation applies only to direct acquisitions (i.e., acquisition of shares of the target company which are financed, guaranteed or secured by the target company), and that, therefore, indirect upstream and/or cross-stream acquisitions are outside the scope of the financial assistance prohibition. In that regard, a company could provide security in order to back borrowings incurred to finance the acquisition of shares of the company that owns its shares (upstream), or those of a sister subsidiary (cross-stream). The reasoning behind this interpretation lies in the fact that, under Peruvian law, prohibitions and provisions that restrict rights in general may not be applied by analogy or by extension: they must be expressly established. However, it is important to note that there are no regulations or case law interpreting the scope of the financial assistance prohibition. Hence, this conclusion represents only our legal judgment based on the laws of Peru and, while we believe that in a properly presented case before a Peruvian court such court would rule in accordance with our position, it is possible that such court could reach an adverse decision.

(c) Shares in a sister subsidiary

Please refer to our answer to question 4.1(b) above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes, it will.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Agents and trustees may enforce claims on behalf of lenders in Peru, without the need to have each lender participating individually on the enforcement actions.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Generally, and notwithstanding any requirements and limitations under the assignment and participation provisions in the relevant loan

© Published and reproduced with kind permission by Global Legal Group Ltd, London

documentation, the assignment of credits shall be communicated to the borrower and guarantor in order to be enforceable against them.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

For purposes of this analysis, we are assuming that the foreign lender does not have a Permanent Establishment ("PE") in Peru. Otherwise, tax consequences may vary.

Interest payments to domestic lenders (domiciled entities or individuals) are not subject to withholding income tax.

Conversely, in the case of loans granted by foreign lenders (non-domiciled entities or individuals) to local borrowers, interest will be subject to a withholding of the Peruvian income tax. In this case, if the Peruvian borrower assumes the economic burden of the withholding tax, such borrower can deduct such amount as an expense for its income tax determination.

Below you will find a brief description of the tax treatment applicable to cross-border lending activities:

(i) Income tax

Interest paid to foreign lenders qualifies as Peruvian-source income and thus is subject to the Peruvian income tax, whenever the loan proceeds are placed or economically used in Peru or if the payer of such interest is domiciled in Peru. With respect to the proceeds of a claim under a guarantee or the proceeds of enforcing security, only the amount exceeding the amount guaranteed or secured paid by a domiciled entity or individual in Peru will qualify as Peruvian-source income.

The withholding tax rate applicable to interest paid to non-domiciled entities is 4.99%, provided that the following conditions are met: (i) in case of loans in cash, the foreign currency proceeds enter into Peru (deposited in a bank account in Peru); (ii) the borrower uses the proceeds of the loan in the ordinary course of its business, or to refinance existing loans; (iii) the debt service does not accrue an annual interest rate exceeding LIBOR +7 (any excess thereof will be subject to the 30% income tax withholding); and (iv) the borrower and lender are not deemed to be related parties (the operation cannot be structured as a back to back loan). For this purpose, the definition of "interest" includes expenses, commissions, premiums and any other additional fee agreed.

If the mentioned conditions are not met, the applicable withholding tax rate will be 30%.

The withholding tax rate applicable to interest paid to non-domiciled individuals is also 4.99%, unless the borrower and the lender qualify as related parties or the loan qualifies as transaction made from or through tax havens. In these latter cases, the rate will be 30%.

If the foreign lender is domiciled in a jurisdiction that is deemed to be a tax haven, the borrower will be required to prepare, for income tax purposes, a transfer pricing analysis on the terms and conditions of the loan in order to determine that the interest meets the arm's length principle, pursuant to transfer pricing rules.

(ii) Value-added tax (VAT)

Interest paid to the lender will be exempted from VAT provided that the lender of the loan is a financial institution (local or foreign bank).

If the lender is not a financial institution, the interest to be paid by the domestic borrower will be subject to an 18% VAT. In such case, if the lender is a domestic entity, the taxpayer of the VAT will be the lender, as the transaction will qualify as a rendering of services in Peru. The VAT paid by the borrower will qualify as a fiscal credit which will offset its debit or output VAT, provided that certain requirements are met.

In turn, if the lender is a foreign entity, the transaction will qualify as a utilisation of services in Peru, and the taxpayer of the VAT will be the domestic borrower, who will be able to use the paid VAT as a credit to be offset with its debit or output VAT once paid, provided that certain requirements are met

(iii) Financial transactions tax

Additionally, in Peru there is a financial transactions tax ("FTT") that taxes at a rate of 0.005% any debit or credit made in an account opened at a Peruvian bank or any other financial institution, either in national or foreign currency. Hence, if the loan is disbursed and deposited in a Peruvian Financial System ("PFS") bank account, such credit will be levied at the corresponding FTT rate. Likewise, interest and principal paid from or deposited in a PFS bank account will also be subject to the FTT. The taxpayer of the FTT is the holder of the Peruvian bank account.

Likewise, please note that the tax treatment applicable to interest included in the proceeds of a claim under a guarantee or of enforcing security, as mentioned in point (b) of this question, will be the same as the one applicable for interest from loans, which has been explained above.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no incentives other than the application of the reduced withholding income tax rate of 4.99% mentioned in our answer to question 6.1.

Additionally, bear in mind that Peru has signed Double Tax Treaties that are currently in force with the following countries: Brazil; Canada; Chile; South Korea; Mexico; Portugal; and Switzerland. Those Tax Treaties follow the OECD Model and, in general, limit the withholding tax rate to 15%. This would be relevant if the mentioned requirements in order to qualify for the reduced rate of 4.99% are not met.

In addition, Decision 578 is applicable to countries of the Andean Community (Peru Colombia, Ecuador and Bolivia). According to this Decision, interest is only taxable in the country in which the expense is registered.

Furthermore, no taxes are levied on foreign lenders with respect to their loans, mortgages or other security documents, for the purposes of effectiveness or registration.

However, notarial and registration fees may be incurred, as mentioned to our answer in question 3.9 above.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Only interest (including expenses, commissions, premiums and any other additional fee agreed) derived from a loan to or guarantee and/or grant of security to a company in Peru will be subject to Peruvian taxes, provided that the foreign lender does not perform any other economic activities within Peru. If that was the case, income derived from such additional activities in Peru will also be subject to Peruvian taxation and 'Permanent Establishment' may arise.

© Published and reproduced with permission by Global Legal Group Ltd, London

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

As mentioned, notarial and registration fees may be incurred for executing security agreements. Please refer to our answer to question 3.9 above.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are no adverse consequences in that case. However, if the lender is domiciled in a tax haven jurisdiction, transfer pricing rules will come into play in order to determine the market value of the interest.

Bear in mind that Peruvian legislation does include a thin capitalisation rule; however its application does not depend on the location of the lender. Pursuant to this rule, interest paid to related companies exceeding the result of applying a coefficient (debt/equity ratio) of "3/1" at the close of the preceding fiscal year, is not deductible for income tax purposes.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, they will.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes. The recognition procedure takes place before the Superior Court. A final, non-appealable foreign judgment against the borrower would be recognised conclusively, and enforceable in the competent courts of Peru without reconsideration of the merits, provided that: (i) there is in effect a treaty between Peru and the relevant country regarding the recognition and enforcement of foreign judgments; or (ii) in the absence of such treaty, the following conditions and requirements are met:

(a) such judgment does not resolve matters under the exclusive jurisdiction of Peruvian courts;

(b) such court has jurisdiction under its own private international law rules and under international rules on jurisdiction;

(c) the defendant was served in accordance with the laws of the place where such court sits, was granted a reasonable opportunity to appear before such foreign court and was guaranteed due process rights;

(d) the judgment has the status of *res judicata* in the jurisdiction of the court rendering such judgment;

(e) there is no pending litigation in Peru between the same parties for the same dispute, which shall have been initiated before the commencement of the proceeding that concluded with the foreign judgment;

(f) such judgment is not incompatible with another enforceable judgment in Peru unless such foreign judgment was rendered first;

(g) the foreign judgment is not contrary to public order or good morals;

(h) the foreign judgment was not rendered by court in a country which denies enforcement of Peruvian judgments or engages in a review of their merits;

(i) the foreign judgment is (i) officially translated into Spanish by a translator registered in Peru, and (ii) certified with an "*Apostille (Convention de La Haye du 5 octobre 1961)*" pursuant to the Hague Convention Abolishing the Requirement of Legalization for Foreign Public Documents, or if it is not party to such Convention, certified by the Peruvian consulate; and

(j) applicable court filing fees are paid.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

It could take between two and four years in each case. Even though a borrower could have no legal basis for opposing enforcement, they could still delay enforcement just by challenging on appeal a decision from the first instance court.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Court proceedings do require a public auction. Even for private foreclosures, we always recommend that the process includes certain minimum protections in favour of the owner of the assets, such as an obligation to obtain an independent appraisal, publicity and minimum bids.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

No, they do not.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. As of the date of the release of the publication with the debtor's insolvency declaration in the Official Gazette (the "Bar Date"), all obligations of the debtor originated until the Bar Date ("pre-publication claims"), including obligations owed to secured creditors, become temporarily unenforceable. The automatic stay suspends enforcement of any pre-publication claim against the debtor's estate until a reorganisation plan or liquidation plan is approved and new conditions are established. In addition, from the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Bar Date, all execution proceedings for collection and injunctions against the debtor's estate are stayed. The automatic stay will suspend the enforcement of any credits against the borrower. It will also suspend the accrual of interest and late charges.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Peru is a member of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. A claim seeking recognition of the foreign award will need to be filed before a competent Superior Court in Peru.

As a general rule, foreign arbitration awards are recognised unless:

(a) the parties to the agreement under the laws applicable to them were under some incapacity, or the agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the laws of the country where the award was granted;

(b) the party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case;

(c) the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognised and enforced;

(d) the composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or

(e) the award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In liquidation scenarios, secured credits shall be paid with the proceeds of the foreclosure of their respective collateral, unless such collateral has been sold and the proceeds have been used to pay labour or alimony claims (the latter only if the insolvency is of an individual). In those cases, all the creditors that hold collateral participate *pari passu* in relation to their contribution for payment of the credits ranked above them. If there should be any unpaid remnant, such amount is paid *pro rata* with non-secured claims. In a reorganisation/restructuring process, although priority is preserved, payments will be realised according to the reorganisation plan provisions (i.e. the priority will not apply). If fixed assets are sold during reorganisation, the priority rules for distribution will apply.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Under the Peruvian Insolvency Law, once the debtor files for its insolvency, or is given notice of an involuntary filing, all actions by management (a) during the prior year ("Suspect Period"), and (b) from that date on and until the date the creditors ratify or replace management ("Avoidance Period"), are put under scrutiny with two different tests. These tests may result in such actions being declared unenforceable.

The first test covers all actions or transactions, whether for consideration or not, performed during the Suspect Period. These will be declared unenforceable if they have a negative impact on the net worth of the debtor and are not related to the normal activities of the debtor (both requirements must be met).

The second test covers the following actions by management if they happen during the Avoidance Period: (1) payment of unmature obligations, under any form; (2) payment of mature obligations not made according to their terms; (3) acts and agreements for consideration that are not in the ordinary course of business of the debtor; (4) set-offs among reciprocal obligations with creditors; (5) liens over, or transfers of, property, whether gratuitous or for consideration; (6) liens created in security of obligations incurred prior to insolvency; (7) judicial or out-of-court foreclosures; and (8) mergers/spin-offs, provided they have a negative impact on the net worth of the debtor.

The priority ranking applicable in Peru is: (i) labour claims (included pension claims); (ii) alimony claims (applicable only when the insolvent is an individual); (iii) secured claims, including attachments and seizures; (iv) tax claims; and (v) non-secured claims.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Banks and insurance companies are subject to a different insolvency regime. Pursuant to the Peruvian Banking Law, the banking regulator ("SBS" – from the Spanish name) has the power to interrupt the operations of a bank in order to prevent it from, or to control and reduce the effects of, a bank failure. Either of these actions, depending on the event, must be taken upon the occurrence of certain events, including: (a) suspension of payments; (b) repeated failure to comply with instructions from the SBS or the Central Bank; (c) repeated violation of the Peruvian Banking Law or the bank's by-laws; (d) unauthorised or unsound management; or (e) deficit of regulatory capital (to the extent that if it is in excess of 50%, then an Intervention is mandatory). Less drastic measures, such as (i) placing additional requirements, (ii) ordering a capital increase or an asset divesture, or (iii) imposing a financial restructuring plan, may be adopted by the SBS when the situation allows it.

An Intervention may halt a bank's operations for up to 45 days, which may be extended for a second period of up to 45 additional days, during which time the SBS may institute measures such as (a) cancelling losses by reducing reserves, capital and subordinated debt, and (b) segregating certain assets and liabilities for transfer to another financial institution. After an intervention, the SBS will proceed to dissolve and liquidate the bank unless the bank merges with another acquiring institution or another recovery measure is adopted.

Beginning on the date on which a resolution of the SBS subjecting a bank to an intervention regime is issued, and continuing until such intervention is concluded (which period ends when the liquidation process begins), the Peruvian Banking Law prevents any creditor of the bank from: (a) initiating any judicial or administrative procedure for the collection of any amount owed by the bank; (b) enforcing any judicial decision rendered against the bank to secure payment of any of its obligations; (c) constituting a lien or attachment over any of the assets of the bank to secure payment of any of its obligations; or (d) making any payment, advance or netting payment obligations

© Published and reproduced with kind permission by Global Legal Group Ltd, London

or assuming any obligation on behalf of the bank, with the funds or assets that may belong to it and are held by third parties, except for: (i) the netting of payment obligations that are made between regulated entities of the Peruvian financial system and insurance systems; and (ii) under certain circumstances, the netting of payment obligations arising from repurchase agreements and derivatives transactions entered into with local or foreign financial and insurance institutions.

During liquidation, claims of bank creditors rank as follows:

First order – Labour claims:

1st Employee remunerations.

2nd Social benefits, contributions to the private and public pension system and other labour claims against the bank accrued until the date when the dissolution is declared, retirement pensions or the capital required to redeem those pensions or to secure them by purchasing annuities.

Second order:

Claims for bank deposits and other types of saving instruments provided under the Peruvian Banking Law, in the portion not covered by the Deposit Insurance Fund.

Third order – Taxes:

1st Claims by the Peruvian social security administration (*EsSalud*) related to health care benefits for which the bank is responsible as employer.

2nd Taxes.

Fourth order – Unsecured and non-privileged credits:

1st All unsecured and non-privileged credits against the bank, ranked on the basis of (i) the date they were assumed or incurred by the bank whereby obligations assumed or incurred on an earlier date shall rank senior in right of payment to obligations assumed or incurred by the bank at a later date, and (ii) obligations assumed or incurred by the bank on a date that cannot be determined shall rank junior in right of payment to all the obligations comprised in (i) above and *pari passu* among themselves.

2nd The legal interests on the bank's obligations that may accrue during the liquidation.

3rd Subordinated debt.

Except for unsecured and non-privileged credits, all claims within an order will be ranked *pari passu* among themselves. Each category of creditors will collect in the order indicated above, whereby distributions in one order will be subject to completing full distribution in the prior order.

Any security interest created before the issuance of the resolution declaring the bank's dissolution and the initiation of the liquidation process shall subsist in order to guarantee the obligations it secures. The secured creditors shall retain the right to collect from the proceeds of the sale of the collateral, on a preferred basis (except with respect to labour claims and savings, which are privileged claims), subject to certain rules established under Article 119 of the Peruvian Banking Law.

Peruvian banks are not subject to the regime of insolvency and bankruptcy otherwise applicable to Peruvian corporations in general.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Different types of securities would be subject to different regimes. Mortgages, which create security over real estate assets only, shall always be enforced through court proceedings, while pledges (which create security over movable assets) may contain an agreement between pledger and beneficiary to have an out-of-court foreclosure process. Usually, an out-of-court foreclosure would be much faster than a court proceeding.

Another mechanism for securing assets under Peruvian law is the guaranty trust. Trusts are bankruptcy remote vehicles and can hold different types of assets such as any kind of movable assets, including flow of funds and bank accounts, and real estate assets as well. A trustee must be responsible for holding and administering the assets in accordance with a trust agreement, which makes this structure more expensive. In this case, the security may also be enforced out-of-court by the trustee, who shall act in accordance with the terms and conditions provided in the relevant trust agreement

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Submission to a foreign court is valid and enforceable under the laws of Peru. In this respect, article 2060 of the Peruvian Civil Code provides that the election of a foreign tribunal under an agreement with respect to patrimonial (monetary) or economic actions will be valid and enforceable under Peruvian law as long as such actions are not referred to matters in which Peruvian Courts have exclusive jurisdiction (i.e. when the dispute refers to real property rights or civil actions resulting from crimes or misdemeanours executed in Peru, or with effects produced in Peruvian territory).

There is no specific prohibition of non-exclusive jurisdiction agreements in Peruvian law. Considering that it is valid to agree an applicable jurisdiction different than the courts of Peru, we understand that parties could agree that jurisdiction (local or foreign) may be defined by the plaintiff. The only limit applicable to this kind of agreement will be the exclusive jurisdiction matters mentioned in the preceding paragraph. However, note that, although there is some experience in the drafting of commercial agreements in this sense, there is no experience regarding the enforceability of that kind of agreements.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

There is no sovereign immunity in Peru.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

In Peru it is not necessary to obtain an authorisation from the SBS or from any governmental entity in order to provide credit in

© Published and reproduced with kind permission by Global Legal Group Ltd, London

favour of Peruvian citizens or residents, individuals or companies. In accordance with article 11 of the Peruvian Banking Law, any person willing to enter into the business of banking in Peru shall hold an authorisation from the SBS; however, the business of banking has been defined as financial intermediation, meaning the activity of receiving funds from the public (i.e. taking deposits) *and* granting loans with such funds. In that regard, any entity (whether a foreign bank or a foreign non-banking entity or individual) may grant loans to Peruvian residents without any licensing or eligibility requirements being applicable.

However, in connection to any distinctions under the laws of Peru between a bank lender and a non-banking lender, it should be noted that non-banking lenders may not charge compensatory or default interest in excess of the maximum rates established by the Peruvian Central Bank (currently 40.7% for compensatory interest and 6.1% for default interest for obligations in PEN, and 15.98% for compensatory interest and 3.2% for default interest for obligations in foreign currency). The consequence of a non-banking lender receiving interest in excess of such maximums will result in the lender having to return the excess amount to the debtor or to apply it to the principal of the loan, at the discretion of the debtor. Also, it should be noted that charging interest in excess of the legal maximums without a banking licence may constitute usury pursuant to the Peruvian Criminal Code, which is a felony punishable with up to three (3) years in prison.

Finally, no licensing or other eligibility requirements apply in order for an agent under a syndicated facility to perform its functions in connection thereto regarding a company in our jurisdiction.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There is nothing that comes to mind that has not already been covered in this chapter.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Juan Luis Avendaño C.

Miranda & Amado Abogados
Av. Larco 1301, Pisa 20
Miraflores, Lima 18
Peru

Tel: +51 1 610 4730
Fax: +51 1 610 4748
Email: jlavendano@mafirma.com.pe
URL: www.mafirma.pe

A partner of Miranda & Amado since 2003, and having graduated from Yale Law School in 1998, he is focused on the financial industry and is involved in regulatory work and all kinds of transactional work. He has participated in almost all cross-border issuances by Peruvian banks, assisting foreign investment banks in structuring the first tier one hybrids, tier two subordinated notes and MT-100 securitisations (for approximately US$ 14 billion) and different structured instruments and derivatives. He regularly assists Peruvian banks, including subsidiaries of global banks and banking regulatory matters, and has counselled Citibank, Morgan Stanley, Bank of America, JP Morgan, Deutsche, Standard Chartered, SMBC, Bank of Tokyo, China Development Bank, Itau, BTG Pactual, BBVA and Credicorp Capital, among others. He has also advised Citibank, Deutsche, HSBC, Celfin, Larrain Vial, Itau, IDBNY, among others, in obtaining their respective licences to operate in Peru, as well as several investment funds managers, traders and issuers in public offerings. Mr. Avendaño has been a co-managing partner of the firm since 2010.

Jose Miguel Puiggros O.

Miranda & Amado Abogados
Av. Larco 1301, Pisa 20
Miraflores, Lima 18
Peru

Tel: +51 1 610 4778
Fax: +51 1 610 4748
Email: jmpuiggros@mafirma.com.pe
URL: www.mafirma.pe

He graduated as a lawyer from the Universidad de Lima, and has a Master's Degree from Northwestern University – Kellogg School of Management, 2004 (LL.M./K). He undertook an internship in the Program for Foreign Lawyers of Holland & Knight LLP – Washington, D.C. (2007). He has been a partner at Miranda & Amado Abogados since 2011, and joined the firm as an associate in 2001. He concentrates his professional practice on giving advice on and structuring different financing operations for lenders as well as for borrowers, including loans, project finance, public and private offerings of debt and equity securities, takeover bids and public exchange offers and asset securitisation, among others.

Miranda & Amado is a full-service Peruvian law firm with an international outlook. A market leader across a range of practice areas, the firm is renowned for its expert handling of highly sophisticated transactions and cross-border deals for a predominantly multinational clientele.

The firm has won Peru Law Firm of the Year and Client Service Award at the Chambers Latin America Awards and is the only Peruvian firm to have ever been nominated for Latin American law firm of the year. Miranda & Amado covers all areas of law while maintaining its boutique approach to highly sophisticated matters in electricity and gas, telecoms, mining, infrastructure, real estate and banking and finance. The firm's expertise in these industries is well supplemented by market-leading practice groups in corporate finance, M&A, litigation, labour, tax and competition.

The firm takes pride in having the right balance of experience and youth. A high proportion of the firm's talented lawyers studied at US and UK law schools and have worked at some of the best law firms in New York, Chicago, Washington D.C. and London.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Puerto Rico

José Fernando Rovira-Rullán

Ferraiuoli LLC

Carlos M. Lamoutte-Navas

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Commercial and consumer lending has seen a reduction in recent years due to the general economic downturn. Activity in the lending markets continues, albeit at lower volumes and somewhat driven by opportunity funds that have acquired loans in bulk from local banks. Local lending alternatives are limited as a result of (A) the assisted closure by the Puerto Rico Office of the Commissioner of Financial Institutions ("PROCFI") and the United States Federal Deposit Insurance Corporation ("FDIC") of three local banks during the second quarter of calendar year 2010, (B) the sale of the Puerto Rico operation of a multinational Spanish banking group during the fourth quarter of calendar year 2012, and (C) the assisted closure by the PROCFI and the FDIC of a fourth local bank during the first quarter of calendar year 2015. It is noteworthy, however, that several well-capitalised opportunity funds and emerging financial institutions have commenced operations in Puerto Rico in recent years.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

On March 21, 2013, the Luis Muñoz Marín International Airport Public-Private Partnership Transaction came to a successful completion with the project's financial closing. The local component of the financial closing took place in Ferraiuoli and secured crucial funding for the Highstar Capital and Grupo Aeroportuario del Sureste-led Aerostar Airport Holdings, LLC. Ferraiuoli's multi-disciplinary practice was involved in all aspects of the financial transaction, which included: (A) the re-financing of a portion of the leasehold fee and certain other costs and expenditures through the issuance and sale of senior secured notes in the aggregate principal amount of $350 million; and (B) the financing of certain other costs and expenditures through a senior secured term loan commitment in the aggregate principal amount $50 million and a revolving facility in the aggregate principal amount of $10 million.

On September 22, 2011, the Abertis and Goldman Sachs Infrastructure-led Autopistas Metropolitanas de Puerto Rico closed a significant financing for the 40-year PR-22 and PR-5 real toll concession. The $1.136 billion financing is split between (A) a $750 million club loan with a seven-year bullet maturity, and (B) $386 million in equity. The aforementioned financing was also conducted within the parameters of the Puerto Rico Public-Private Partnerships Act and benefitted from the active involvement of attorneys currently working for *Ferraiuoli*.

While other significant lending transactions have taken place in Puerto Rico in recent years, the above-referenced transactions are probably the most significant and groundbreaking deals completed to date.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Except otherwise restricted or limited in the company's governance documents, a company can guarantee borrowings of one or more other members of its corporate group. There is no statutory legal restriction or limitation in this respect.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

No. The guarantee will be effective and enforceable against the company if approved by the company in accordance with the company's governance documents.

2.3 Is lack of corporate power an issue?

Yes. The company needs to act and remain in good standing and in compliance with its charter and its internal governance documents. A guarantee authorised with insufficient corporate power could potentially render the same ineffective and unenforceable.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

The effectiveness and enforceability of a guarantee issued by a non-public corporation is generally not contingent to the consent or approval of, or the filing or registration with, any Puerto Rico governmental authority. Note, however, that any requirements of this nature need to be nonetheless examined on a case-by-case basis insofar as the same may vary depending on the type of legal entity issuing the guarantee and its internal governance mechanisms. An opinion is generally obtained at closing from counsel to the loan parties confirming that neither the execution and delivery of the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

guarantee, nor the consummation of the transactions contemplated thereunder, requires the consent or approval of, or any filing or registration with, any governmental authority except for those consents, acknowledgments and approvals which have been obtained and those notices which have been given on or prior to closing.

As stated in question 2.2 above, a guarantee will generally be effective and enforceable against the company if approved in accordance with the company's governance documents.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no statutory limitations imposed on the amount of a guarantee by reason of the net worth, solvency or similar criteria of the guarantor.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no statutory exchange control or similar obstacles to the effectiveness and enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are infinite types of collateral, as virtually anything can be used for such purpose as long as it is acceptable to the secured party. The most common types of collateral include real estate, equipment, inventory, accounts receivable, contracts, general intangibles and fixtures.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

The manner in which to perfect a lien or security interest varies depending on asset type.

Personal property is governed by a modified version of the United States Uniform Commercial Code Revised Article 9. While most personal property collateral could be covered under a single blanket-lien Security Agreement, it is advisable when dealing with certain types of collateral, such as deposit accounts and life insurance, to prepare separate asset-specific Security Agreements.

In the context of real property, the execution of a Deed of Mortgage before a licensed Puerto Rico notary public, together with compliance with numerous substantive and procedural formalities and its recordation in the Puerto Rico Registry of the Property, is mandatory for the creation of a mortgage lien. On December 8, 2015, the Governor of Puerto Rico signed into law Act No. 210 adopting Puerto Rico's new Registry of the Property Act.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

In the context of personal property, such as machinery and equipment, a modified version of United States Uniform Commercial Code Revised Article 9 governs, which generally requires the execution of a Security Agreement and the filing of a UCC-1 Financing Statement at the applicable filing office.

In the context of real property, it is obligatory to create a mortgage lien via the execution of a Deed of Mortgage before a licensed Puerto Rico notary public, together with compliance with numerous substantive and procedural formalities and its recordation in the Puerto Rico Registry of the Property. On December 8, 2015, the Governor of Puerto Rico signed into law Act No. 210 adopting Puerto Rico's new Registry of the Property Act.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Collateral security can be taken over account receivables by the execution of a Security Agreement and the filing of a UCC-1 Financing Statement at the applicable filing office. Account debtors only need to be notified of the granting of the security interest at the time of the enforcement of the same.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Collateral security can be taken over cash deposited in a bank account by the execution of a Security Agreement and an acknowledgment of control of deposit issued by the depositary bank, usually in the form of an Account Control Agreement.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Collateral security can be taken over shares in certificated form in companies incorporated in Puerto Rico by the execution of a Security Agreement and the delivery of control over the pledged shares. A secured party obtains control over a certificated security which is delivered to the secured party in bearer or registered form and, if in registered form, is either endorsed to the secured party or in blank or is registered in the name of the secured party in the books of the issuer.

Collateral security can also be taken over uncertificated shares in companies incorporated in Puerto Rico by the execution of a Security Agreement and (A) the filing of a UCC-1 Financing Statement at the applicable filing office, or (B) by exercising control over the uncertificated shares. The secured party obtains control either by becoming the entitlement holder or, as has increasingly become common practice, by entering into an Account Control Agreement with both the securities intermediary and the debtor pursuant to which the securities intermediary agrees that it will comply with all entitlement orders given to it by the secured party without further consent from or action by the debtor. It is important to reference that control takes precedence over the filing. Thus, if a secured party obtains a perfected security interest in the uncertificated shares by control after the debtor has already granted a security interest which was perfected by filing, the later security interest, perfected by control, will have priority over the earlier (filed) security interest.

Likewise, if any of the above operations are to be governed under foreign law, in such case the parties would need to comply with both the laws applicable to Puerto Rico and the laws of the foreign jurisdiction in question.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Collateral security can be taken over inventory by the execution of a Security Agreement and the filing of a UCC-1 Financing Statement in the applicable filing office.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Subject to proper corporate approval in accordance with the company's governance documents, a company can grant a security interest in order to secure its obligations under the scenarios contemplated above.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The answer to this question varies depending on the type of collateral subject of the security.

In the context of personal property collateral capable of being perfected by the filing of a UCC-1 Financing Statement, the filing of the same with the Commercial Transactions Registry of the Puerto Rico Department of State ("PRDOS") costs at present $25.00 per each registration.

On the other hand, in the context of real property collateral, perfecting a security interest in real property entails the payment of (A) internal revenue and notarial tax stamps, (B) legal assistance stamps, (C) recordation and filing vouchers, and (D) a notarial tariff, all of which are of a statutory nature and calculated based on the value of the transaction.

In general terms, internal revenue and notarial tax stamps, legal assistance stamps and recordation and filing vouchers can be estimated in the aggregate at roughly 0.56% of the value of the transaction. Likewise and subject to certain additional restrictions and thresholds, the notarial tariff can be negotiated by agreement between the parties and the notary public, but the same can never be more than 1% or less than 0.50% of the value of the transaction, and can never be less than $250.00.

Moreover, loan and security documentation notarised by a licensed Puerto Rico notary public also entails the payment of $5.00 internal revenue stamp per document.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

In general terms, the creation of a security interest on personal property does not involve a significant amount of time or expense. The creation of a mortgage on real estate can be more costly, depending on the complexity of the title and the amount of the mortgage. Please refer to our response in question 3.9 above as to the costs and expenses of security over personal property collateral *vis-à-vis* real property collateral.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In general terms, only debtor consent is necessary for the creation of a lien or a security interest. Note, however, that certain types of collateral, such as (A) receivables payable by an agency of the local or federal government, (B) airplanes and vessels, and (C) dairy produce quotas, among a few others, may require compliance with certain specific filing, notice and/or consent requirements.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No special priority or other concerns arise solely by reason of the borrowing to be secured being a revolving credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

All types of documents, both private and public, generally require execution before a licensed Puerto Rico notary public. In the case of mortgages, these need to be executed in deed form before a licensed Puerto Rico notary public and following numerous substantive and procedural formalities, such as the filing in the Registry of the Property, in order for it to be effectively constituted.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Except if the company's organisational and/or governance documents dictate otherwise, there are no statutory prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance the aforementioned acquisitions.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. In syndicated credit facilities, which are fairly common in Puerto Rico in the context of larger credit facilities, an administrative and collateral agent usually acts on behalf and for the benefit of all participating lenders.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

While certain jurisdictions of the United States recognise the concept of a security trust, that is not the case in Puerto Rico.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Puerto Rico loan documentation generally includes specific assignment provisions that enable the original lender to transfer the loan to a third party. Besides compliance with any transfer requirements provided in the applicable loan documentation and the completion of any necessary endorsements, there are no special statutory requirements necessary to make the loan and guarantee enforceable by the transferee.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest payments to domestic lenders are not subject to any Puerto Rico withholding requirements. Interest payments to foreign lenders are not subject to any Puerto Rico withholding requirements unless the borrower and the lender are related parties, in which case the interest payments are subject to a 29% withholding tax.

The above rules would also apply to the portion of a claim under a guarantee or security interest that consists of accrued but unpaid interest. The portion of the claim representing principal would not be subject to any Puerto Rico withholding requirements.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Foreign lenders are not subject to Puerto Rico income taxes on their interest income unless: (A) the loan is attributable to a Puerto Rico office or place of business; or (B) the lender and the borrower are related parties.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Income generated by a foreign lender is not taxable in Puerto Rico solely because of a loan to or guarantee and/or grant of security from a company in Puerto Rico.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No. Please refer to question 3.9 above for an overview of the principal costs and expenses applicable to Puerto Rico loan and security documentation.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no adverse consequences to a borrower company by reason of one or more lenders being organised under the laws of a jurisdiction other than Puerto Rico.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Puerto Rico courts generally find choice of law clauses valid. However, the choice of law clause must meet the following two requirements: (A) the chosen state has a substantial relationship to the parties or the transaction and there is a reasonable basis for the parties' choice; or (B) application of the law of the chosen state would not be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The United States Congress has mandated that federal courts grant full faith and credit to the judgments of all states, territories and possessions of the United States, including Puerto Rico. The method by which a judgment of another state is recognised and enforced, is determined by the local law of the enforcing state. However, foreign or state court judgments do not automatically operate in Puerto Rico. In order to be recognised and enforced, exequatur proceedings are necessary. Under Puerto Rico law, local courts must give full faith and credit to judgments from Courts in the United States when the following standards apply: (A) that the judgment has been issued by a state court with jurisdiction over the person and the subject matter; (B) that the state court that issued the judgment observed due process of law; and (C) that the judgment has not been obtained by fraud. The court must give full faith and credit to state court judgments when the exequatur proceedings factors are met.

In cases involving judgments by non-United States jurisdictions, a more complex test applies. In the absence of treaty or special legislation, foreign judgments may be validated in Puerto Rico only if (A) the foreign judgment was issued by a court with jurisdiction over the person and the subject matter, (B) the judgment was entered by a competent court, (C) due process of law was observed, (D) the justice system under which the judgment was rendered is characterised by its impartiality and absence of prejudice against

© Published and reproduced with kind permission by Global Legal Group Ltd, London

foreigners, (E) the judgment is not contrary to Puerto Rico public policy or of the selected forum, and (F) the judgment was not procured by fraud.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In general terms, a complaint where defendant has no defence (and none are raised) can be resolved, and judgment obtained and enforced, in a period of five to nine months In order for a foreign judgment to be enforced, the interested party must commence exequatur proceedings in a court in Puerto Rico. Such proceedings can take anywhere from four to six months, without taking into account the time to obtain real property through the public sale process (depending the municipality, another two months).

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Real property that is duly registered and serves as collateral security must be sold at a public auction in Puerto Rico, which significantly impacts the timing and value of enforcement. No regulatory consent is needed for enforcing collateral security. However, in cases where the collateral security is a residential property that is the principal dwelling of the debtor, creditor and debtor must participate in mandatory mediation.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

Subject to certain exceptions and in order to file suit in local Puerto Rico courts (non-federal), a foreign corporation or a claimant who does not reside in Puerto Rico must pay a non-resident bond of at least $1,000.00. Court proceedings are stayed until the non-resident bond is submitted.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The United States Bankruptcy Code ("Bankruptcy Code") has full force and effect in Puerto Rico, except for Chapter 9. Puerto Rico is considered a state for all purposes of the Bankruptcy Code, except for who may be a debtor under Chapter 9. The Bankruptcy Code creates a forced moratorium on the creditor's right to enforce and execute his security interest. Upon the filing of a bankruptcy petition, the lender needs to seek authorisation from the bankruptcy court to exercise any right to enforce a collateral security. Please refer to our response in question 8.1 below for further insight as to the ability of a lender to enforce its rights as a secured party over the collateral security.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Puerto Rico courts have adopted the standard of judicial restraint not to interfere with arbitration awards except when the parties agreed that the award must be issued according to law, in which case the court may correct errors of law in regard to the applicable law. In such a case, judicial review of arbitration awards in Puerto Rico is akin to judicial review of administrative decisions. Despite such judicial restraint, a Puerto Rico court may entertain a challenge of the award based on: (A) fraud; (B) misconduct; (C) due process violations; (D) violation of public policy; (E) lack of jurisdiction; and (F) because the award does not resolve all issues submitted for resolution.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The automatic stay contemplated under Section 362 of the Bankruptcy Code prohibits, although not on an absolute basis, any creditor from taking aggressive action against the debtor after the filing of a bankruptcy petition. In order for a secured creditor to enforce its rights, it must file a "motion for relief from the stay" in order to get permission to take various actions against the collateral held by the bankruptcy debtor. In general terms, a secured creditor is entitled to relief from the stay only if it can successfully evidence: (A) good cause, including lack of adequate protection for the secured creditor; or that (B) the debtor does not have equity in the property and it is not necessary for an effective Chapter 11 reorganisation under the Bankruptcy Code.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The power to avoid preferential transfers under section 547 of the Bankruptcy Code serves two broad purposes: (A) it prevents creditors from exerting undue pressure on struggling debtors; and (B) it discourages a debtor from engaging in unusual acts that either favour certain creditors or otherwise hasten the debtor's bankruptcy. To prevent this result, the Bankruptcy Code exempts certain transfers made within the ordinary course of the debtor's and creditor's business.

To prove the "ordinary course of business defence" the creditor must show that the preference payments were made in the "ordinary course of business" between the creditor and the debtor. Typically, this is done by showing that the same were: (A) not the result of any overt collection activity on the part of the creditor; and (B) were made in a similar amount of time and under similar terms and conditions as previous, non-preference period payments made by the debtor to the creditor. Alternatively, if the payments were not made in the ordinary course of business between the parties, the creditor can show that the preference payments were made on terms and conditions prevalent in the respective industry. All payments that are shown to have been made in the ordinary course of business are not avoidable as preferences and need not be repaid.

The Bankruptcy Code establishes a 90-day period prior to the filing of a bankruptcy petitions as a preferential transfer period. In certain cases, such term can be extended to two years under the Bankruptcy Code and further extended according to available remedies in the state law.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

The Bankruptcy Code also establishes different types of priority claims such as: domestic support obligations; extensions of credit in an involuntary bankruptcy case; wages/salaries/commissions; contributions to employee benefit plans; claims of certain farmers and fishermen; deposits by individuals; taxes and debt owed to governments; commitments to maintain capital of an insured depository institution; and claims for death or injury while the debtor was intoxicated. These priority claims are also subject to "the ordinary course of business defence". Therefore, in order to be avoided as preferential transfers, the transactions would have occurred during the preference period and outside the normal relations of the creditor and the debtor.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The Bankruptcy Code precludes certain entities from qualifying as debtors in bankruptcy proceedings. Entities from highly regulated industries such as domestic insurance companies, banks, savings banks, cooperative banks, savings and loan associations, building and loan associations, homestead associations, credit unions, or industrial banks or similar institutions have other federal statutes which control their restructuring; these companies are regulated by the Federal Deposit Insurance Act. It is still uncertain, since neither the Bankruptcy Code nor the Federal Courts have expressly determined so, whether Series LLCs are also excluded from entering any bankruptcy relief proceeding.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

A bankruptcy proceeding with an automatic stay order in effect precludes the creditor from seizing the debtor's assets. However, if the bankruptcy case is dismissed or the stay is lifted, the creditor can pursue the execution of its collateral. If the collateral is abandoned by the bankruptcy trustee, the creditor would also have certain rights over the collateral. It will depend on the chapter in which the bankruptcy case is filed and on the rights of the creditor under other applicable laws.

Moreover, depending upon the nature of the collateral and the provisions of the collateral documents, creditors may be permitted to exercise self-help remedies, some of which are contemplated under Puerto Rico's modified version of the United States Uniform Commercial Code.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

It is well-established that forum selection clauses are *prima facie* valid and should be enforced, unless enforcement is shown by the resisting party to be 'unreasonable' under the circumstances. More specifically, a forum selection clause should be enforced unless the resisting party can show that enforcement would be unreasonable and unjust, or that the clause was invalid for such reasons as fraud or overreaching or that enforcement would contravene a strong public policy of the forum in which suit is brought, whether declared by statute or by judicial decision.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Puerto Rico can waive its immunity in three ways: (A) by a clear declaration that it intends to submit itself to the jurisdiction of a federal court; (B) by consent to or participation in a federal programme for which waiver of immunity is an express condition; or (C) by affirmative conduct in litigation. However, Puerto Rico's waiver of sovereign immunity in its own courts is not a waiver of the 11th Amendment immunity in the federal courts.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

The laws of the Commonwealth of Puerto Rico require that individuals and companies be authorised before engaging in any financial business on its jurisdiction. The licensing requirements will vary depending on the business of each lender. If a lender intends to become involved in any *consumer* lending activities within the jurisdiction of Puerto Rico, such a lender must first obtain an authorisation from the PROCFI. To the extent that such lender is qualified as a national association under a United States federal charter, the process for obtaining such an authorisation from PROCFI should be fairly simple and expedient. As part of the aforementioned process, such a lender will likely be required by PROCFI to become authorised to do business in Puerto Rico at the Corporations Registry of the PRDOS.

If a lender intends to become involved in any *commercial* lending activities within the jurisdiction of the Commonwealth of Puerto Rico, the licensing requirements are more lax. Depending on the nature and volume of the transactions proposed to be transacted within Puerto Rico's territorial boundaries, authorisation from PROCFI and registration with the PRDOS may not be required.

The PROCFI grants licences under the following categories: Credit Repair Agencies; Brokerage Institutions; Commercial Banks; Casinos; Cheque Cashers; Financial Intermediaries; Pawn Shops; Instalment Sales and Credit Cards; International Banking Entities; International Financial Institutions; Investment Advisors; Leasing Companies; Money Transmitters; Mortgage Institutions; Mortgage Brokers; Small Loan Companies; Mortgage Loan Originators; and Trust Companies.

Except for Credit Unions, which are licensed, supervised and insured by the *Corporación Pública para la Supervisión y Seguro de Cooperativas de Puerto Rico* ("COSSEC"), and individuals and companies engaged in the insurance business that fall under the jurisdiction of the Insurance Commissioner of Puerto Rico, the remaining group must either obtain a licence or be registered with the PROCIF.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The answers provided above properly address the main material considerations for lending transactions governed under Puerto Rico law.

José Fernando Rovira-Rullán
Ferraiuoli LLC
221 Ponce de León Avenue, 5th Floor
San Juan, 00917
Puerto Rico

Tel: +1 787 766 7000
Fax: +1 787 766 7001
Email: jrovira@ferraiuoli.com
URL: www.ferraiuoli.com

Mr. Rovira-Rullán is a Capital Member of *Ferraiuoli*, Chair of its Commercial Lending Practice Group and Chair of its Conflict Committee. Prior to joining *Ferraiuoli*, Mr. Rovira-Rullán worked for Puerto Rico's Thirteenth (13th) Legislative Assembly as Special Advisor to the Director of the Office of Legislative Services where he collaborated closely with lawmakers and other executive personnel and was actively involved in the legislative process.

Mr. Rovira-Rullán's principal areas of practice include commercial lending, financial restructuring, real estate, corporate governance and general corporate law. As a transactional attorney, Mr. Rovira-Rullán principally concentrates his practice in the representation of foreign and domestic commercial lenders, real estate developers and other business entities.

Throughout his career, Mr. Rovira-Rullán has been actively involved in all aspects of the commercial lending, real estate and corporate practice. Representative clients include local and cross-border lending institutions, real estate developers, commercial real estate management companies and global commodity trading firms.

Carlos M. Lamoutte-Navas
Ferraiuoli LLC
221 Ponce de León Avenue, 5th Floor
San Juan, 00917
Puerto Rico

Tel: +1 787 766 7000
Fax: +1 787 766 7001
Email: clamoutte@ferraiuoli.com
URL: www.ferraiuoli.com

Mr. Lamoutte-Navas joined *Ferraiuoli* on May 5, 2014 as a Senior Member of the firm's Corporate Department. Mr. Lamoutte's main areas of practice are banking and finance, real estate, mergers and acquisitions, corporate and construction lending, mortgage and registry of property law, and UCC secured transactions.

As a business lawyer, Mr. Lamoutte-Navas principally focuses his transactional practice in the representation of major commercial lenders, real estate developers and business owners, both foreign and domestic, and also advises on business and regulatory matters. He also handles debt restructurings, collections, workouts and foreclosures.

Over the course of his career, Mr. Lamoutte-Navas has conducted hundreds of real estate and commercial financing transactions involving multiple types of collateral.

Ferraiuoli LLC
Looking Forward

From the very beginning, *Ferraiuoli* was founded as an alternative to business as usual. We recognised that in order to become one of Puerto Rico's leading law firms, we had to partner with our clients and provide them with smart, cost-efficient, business-savvy legal advice. Our clients run the gamut from local entrepreneurs to multi-national Fortune 500 companies. They are innovators in technology, energy, finance and healthcare. They are in the business of looking forward. And so are we.

Ferraiuoli has received international recognition in the legal field by Chambers & Partners, a London-based legal directory firm that publishes, on an annual basis, the leading directories of the legal profession identifying the world's top lawyers and law firms. In its 2016 Latin America and Global edition, Chambers ranked *Ferraiuoli* as a leader in Corporate, Environment, Intellectual Property, Labour and Employment, Real Estate, and Tax, and several firm attorneys were named "Leaders in their Fields" by the publication. *Ferraiuoli* has further been honoured as one of Puerto Rico's outstanding firms by Chambers & Partners as it was shortlisted as one of the candidates for Puerto Rico's Law Firm of the Year for the years 2011–2015.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Romania

Andrei Burz-Pinzaru

Reff & Associates SCA

Mihaela Maxim

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Recent developments indicate an increased legislative appetite for increasing borrowers' protection, especially consumers, mainly due to the public attention enjoyed by consumer lawsuits initiated against banks. There are a number of controversial legislative drafts in this respect, aimed, e.g., at repealing the "writ of execution" quality of loans granted by Romanian credit and financial institutions, at allowing consumers the option to "give in" the financed real estate against the debt, etc. Personal insolvency law, which will allow individuals to suspend enforcement and write-off debt under certain circumstances, has been enacted but suspended from application until December 2016.

The process of cleaning balance sheets of non-performing assets has been accelerated in the last year under pressure from regulators. Crediting, both corporate and retail, is somehow stagnant but expected to increase in the near future.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The year 2015 has seen a number of significant transactions on the Romanian corporate lending market, among which we note: the EUR 1 billion revolving facility arranged by BRD Groupe Société Générale and UniCredit Bank Austria AG for OMV Petrom; the USD 137 million revolving facility granted to ALRO S.A., the largest aluminium smelter in Central and Eastern Europe, by a syndicate of local banks; as well as the three facilities amounting to EUR 75 million granted to Mid Europa Partners by a combination of Austrian and Romanian banks, mostly to finance the purchase of Regina Maria, one of the largest Romanian private healthcare providers.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, provided that the guarantor has a certain commercial benefit deriving from the guarantee and such operation does not qualify as a prohibited financial assistance transaction.

Unfortunately, the law does not provide specific criteria for assessing the existence of the commercial benefit; therefore, the directors of the guarantor should make this assessment in each particular case, having in mind the general financial situation of the company, the risks undertaken and the benefits obtained by the guarantor, etc. In order to substantiate the economic interest and to grant additional comfort, in practice, the borrower pays the guarantor a guarantor's fee, established based on arm's length principles. While this is a mitigating factor, its strengths depend on whether such guarantor's fee is reasonably proportionate to the risk undertaken.

Please also note that the Romanian Company Law provides for several restrictions applicable to joint stock companies (Romanian, *societati pe actiuni*) – e.g. companies are prohibited from guaranteeing borrowings of their directors or of companies in which such directors or their immediate family members are directors, or shareholders owning more than 20% of the share capital.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In case the benefit to the guaranteeing/securing company is disproportionate or non-existent, the guarantee may be annulled for lack of cause. Among the most common enforceability concerns related to guarantees granted to corporate affiliates are:

(a) the possibility of third party creditors, through an "*actio pauliana*" action, to challenge guarantees issued to secure a third party's obligations if such creditors can prove that the guarantee is fraudulent to their interests and that the beneficiary of the guarantee was aware of such fraud;

(b) clawback in insolvency, such as the creation of a guarantee relating to a previously unsecured claim during a suspect period of six months, fraudulent operations during a suspect period of two years, etc.; and

(c) as a consequence of the so-called "misuse of corporate assets" criminal offence, i.e. the action of a founding shareholder/director/manager that (i) uses the assets of the relevant company in bad faith against the interests of such company or for its own purpose or for the purpose of favouring another company where it is directly or indirectly interested, or which (ii) takes a loan from or obtains a guarantee, in any form, directly or indirectly, from the managed company, a subsidiary of the latter or from a company that controls the managed company (noting that there are some exceptions in which this offence does not apply, such as treasury operations). A guarantee could be declared as null and void for an illicit cause if the court identifies such a criminal offence in a particular case.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

As a general note, the director(s) approving the relevant guarantee may be held liable towards the relevant company for the damages caused by the "disproportionate" or "no benefit" guarantee, unless such guarantee has been approved through a shareholders' meeting, in which case, however, the shareholders' vote against the best interest of the company may put the validity of the guarantee at risk. Shareholders having a contrary interest to the interest of the company in setting up the particular guarantee should refrain from voting, or face the risk of certain civil and criminal liability.

2.3 Is lack of corporate power an issue?

Romanian Company Law is generally protective of third parties contracting with a company and provides that a company is bound by the acts of its corporate bodies even when such acts exceed the corporate object of such company, unless: (i) the relevant third parties were aware of such breach (mere publication of the articles of association is not enough to prove awareness); or (ii) if the respective acts breach the limitations established by the law for the respective corporate bodies.

Extensive corporate checks prior to the execution of the guarantee are however recommendable and usually taken up in practice.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

As a general rule, under Romanian law there are no special formalities, such as governmental filings, that are required to render a guarantee effective.

Shareholder approval is not required by law, except for joint stock companies and only if the relevant guarantees exceed half of the book value of the assets of the respective company (i.e. 20% of the total immobilised assets, less receivables, in the case of listed companies). In the case where shareholder approval is not required by law, joint stock companies require at the very least an approval from the board of directors.

In practice however, articles of association usually provide for a shareholder or at least board of directors' approval and creditors usually require such an approval in order to avoid corporate abuse claims.

In any situation where a corporate approval is required or recommendable, all the relevant formalities must be complied with accordingly (e.g. convening notice, publication in official journals, etc.).

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Please see our answer under question 2.4 above. In addition, Romanian law provides, as an eligibility condition of the guarantor, that such person has and maintains in Romania sufficient assets to cover the secured liabilities. This requirement does not apply when the creditor has asked for a specific person to act as a personal guarantor, which is the most common situation in practice.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There is no exchange control or similar obstacles to enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Collateral security is generally divided under Romanian law into three large categories: (i) mortgages or immovable assets (e.g. land, constructions, etc.); (ii) mortgages over (tangible and intangible) movable assets (e.g. machinery, inventory, equipment, shares, bank accounts, cash, receivables, IP rights, business as a going concern, etc.); and (iii) pledges with the dispossession of the security provider (Romanian, *gajul cu deposedare*), which is the least used form in practice and assumes that the creditor takes the physical possession of the collateral away from the respective security provider.

Financial collateral under the corresponding EU Directive 2002/47/EC cannot be created in relation to corporate borrowers' lending. Fiduciary arrangements (Romanian, *fiducia*) are regulated by the Romanian Civil Code but not used in practice, due to difficult formalities and an uncertain fiscal regime.

Other forms of quasi-security are available and sometimes used, such as: certain creditors' liens; and assignment of receivables with security title (Romanian, *cesiunea de creanta cu titlu de garantie*), etc.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Yes, it is possible to give an asset security by means of a general security agreement; however, due to different formalities applicable to various types of assets, in practice, parties generally execute one agreement per each group of assets with similar characteristics and similar legal regime (usually one agreement for the immovable assets and one agreement for the movable assets). Please see question 3.3 below for further details on the procedure.

The movable assets which are commonly grouped together are receivables, cash and accounts, while sometimes equipment and IP rights are added, depending on the structure of the transaction. Due to the particularities of registration and the somewhat different legal regime, security over shares is almost always created through a separate agreement as a matter of practice.

Security over business as a going concern includes, by its own nature, security over more than one type of asset (e.g. movable assets, company's logo, commercial name, goodwill, etc.). In addition to registration with the Electronic Archive (please see the sections below for further details), this specific security also has to be registered with the relevant trade register.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes, collateral security can be taken over the above-listed assets.

Security over real property (such as land and plant/factory) is conventionally created through an immovable mortgage agreement, which, for its validity, must be executed in authentic form and, in order to be binding on third parties, must be registered with the relevant land book. Under Romanian law, the lender who has lent an amount of money for the acquisition of an immovable asset has a legal mortgage over such asset (note however that this mechanism is very rarely used in practice, due to the uncertainties of its legal regime).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Security over machinery and equipment is created through a movable mortgage, which can be executed under private signature and, in order to be binding on third parties, must be registered with the electronic archive of movable mortgages ("Electronic Archive").

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, collateral security can be taken over receivables (one or more receivables or over a portfolio of receivables, with some exceptions in the latter case) either through a movable mortgage (Romanian, *ipoteca mobiliara*) or through an assignment of receivables with security title (Romanian, *cesiune de creanta cu titlu de garantie*).

Both agreements can be executed under private signature and have to be registered with the Electronic Archive in order to be binding on third parties. Notification of the (assigned) debtor is not required for the validity of the agreement, but is in the enforcement process. In practice however, bank creditors usually require the notification of the (assigned) debtor shortly after the execution of the security agreement in order to ensure that the relevant receivables are routed through the accounts opened by the borrower with the lender.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, collateral security can be taken over cash deposited in bank accounts (both current accounts and deposit accounts), provided, however, that the relevant bank account is specifically nominated in the movable mortgage agreement.

If the lender is the bank where the bank account is opened, then such lender has control over the accounts. If not, control over such accounts can be achieved through a three-party agreement between the creditor, the borrower and the relevant account bank.

Similarly to the other movable mortgages, this mortgage has to be registered with the Electronic Archive. Subject to such registration being performed, the mortgage created in favour of a creditor who has control over the respective account is preferred to the mortgage created in favour of a non-controlling creditor.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, collateral security can be taken over shares issued by Romanian companies, and this particular type of security has recently benefitted from regulatory clarifications, especially with respect to the enforcement process.

A mortgage on the shares issued by Romanian joint stock companies is created through an agreement under private signature which will include details on the secured amount, as well as on the value and the category of the relevant shares. In case the security has as object bearer's shares or registered shares issued in material form (which would be very rare in practice) the mortgage has to be mentioned on the respective title as well and signed by the relevant mortgagor and mortgagee.

The mortgage must be registered (i) with the shareholders' register of the company that has issued the respective mortgaged shares, and proof in this respect is provided to the mortgagor, and (ii) with the Electronic Archive.

To be valid, a mortgage over shares issued by a Romanian limited liability company requires shareholder approval, adopted with at least 3/4 of the share capital. Same registration requirements as per the above apply.

Starting in July 2015, the Romanian Company Law has stipulated that the directors of the company whose shares are being mortgaged must provide the mortgagor, or the court bailiff, upon request, with the company's financial statements and any other documents or information necessary to establish the value of the shares, as well as to facilitate their take over, which although applicable only to mortgages created after July 2015, should incentivise such directors to cooperate in the enforcement process.

Mortgages over shares issued by listed companies have to indicate the number of shares and the secured obligation as well as the identities of the security provider, the borrower and the secured creditor. The respective shares are evidenced in separate accounts of the owner. These mortgages do not need to be registered with the Electronic Archive (although such registration is usually made in practice) and are binding on third parties through registration with the central depository. The enforcement of a movable mortgage over listed shares is performed through the relevant market's mechanisms.

Romanian law generally recognises the possibility of the parties to choose the governing law of an agreement; however, when regulating movable mortgages over intangible assets (such as shares), the law of the issuer generally prevails. Even if it is possible for you to choose the governing law, we would not recommend such an alternative, given that such a mortgage would no longer enjoy the writ of execution quality and this will create further enforcement issues and open potential grounds for challenges.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, inventory can be mortgaged through a movable mortgage agreement. Given that the inventory is a universality of assets, the agreement has to describe the nature and content of such universality (usually a description of the assets forming the inventory, quantity, location, accounting registration numbers, etc.). Registration with the Electronic Archive is required for opposability purposes.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes; according to Romanian law, a conventional mortgage can be granted either by the debtor of the secured obligation or by a third party. Our notes under questions 2.1 and 2.2 above apply accordingly.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Similar to other jurisdictions, the most expensive type of mortgage is the immovable mortgage, in which case the cost structure is as follows:

(i) a public notary fee, owed for authenticating the immovable mortgage agreement. The law only provides for minimum notarial fees and these can be increased by each notary. The notary fees are charged *pro rata* at the value of the secured amount. E.g. for amounts higher than RON 500,000

© Published and reproduced with kind permission by Global Legal Group Ltd, London

(approximately EUR 110,000), the minimum notary fee amounts to RON 1,285 (approximately EUR 285) plus 0.07% of the amount that exceeds the threshold. From a fee perspective, it would be preferable to execute one mortgage agreement for more immovable assets, as the notary will only charge a fixed fee for each additional immovable asset;

(ii) a fee for registering the mortgage with the land book; respectively RON 100 (approximately EUR 22) per asset, plus 0.1% of the value of the secured amount under the mortgage agreement; and

(iii) a fee for obtaining the land book excerpt for authentication purposes of RON 40 (approx. EUR 9) per asset.

The registration with the Electronic Archive of movable mortgages amounts to RON 30 (approx. EUR 7) per registration form, plus the fees of the Electronic Archive registrar, which may vary depending on the registrar, but are usually around EUR 50.

Registration of a movable mortgage over shares with the shareholders' register should not bear any charges, except when such shareholders' register is kept by an independent company, in which case the fees of such company will apply. The fees charged by the central depository for registering the mortgages over listed shares depend on the value of the mortgaged security (the maximum amount is RON 5,000 – or approx. EUR 1,100).

Other charges may become applicable depending on the nature of the mortgage (e.g. fees applied by the supervisory body in the field of IP rights, the trade register for mortgages on a business as a going concern, specialised registers of ships, planes, etc.)

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The legal term for the land book to register an immovable mortgage is two business days for standard registrations and one business day if an emergency fee is paid. In practice, due to the correspondence involved, it takes around one week to register an immovable mortgage in the land book.

Registration with the Electronic Archive usually takes a couple of hours and proof of registration is usually obtained on the same day.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Please see our notes under question 2.4 above, which also apply in relation to security.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Romanian law does not create special priorities for security granted for revolving credit facilities.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

As mentioned above, mortgages over immovable assets require, as a validity condition, to be executed as authentic deeds, which means that notarisation will be required. If such document is executed based on a power of attorney, this power of attorney has to be issued in authentic form as well.

Romanian law requires that a private signature document is executed in as many originals as there are parties with contrary interests, and each original has to mention the overall number of originals executed by the parties. Romanian law does not expressly regulate the execution in counterparts, but this is generally accepted in practice.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Romanian law strictly prohibits joint stock companies from issuing guarantees or security in relation to the acquisition of its own shares by a third party. Current operations of credit and financial institutions, as well as transactions aimed at acquiring shares by or for the respective company's employees, are exempted, provided however that these transactions do not cause the net assets of the relevant company to fall under the aggregate between the subscribed share capital and the non-distributable reserves.

(b) Shares of any company that directly or indirectly owns shares in the company

Romanian law does not expressly prohibit such guarantee/security. If such a structure is used in order to avoid the above-mentioned legal prohibition, it could also be voided due to illicit cause.

(c) Shares in a sister subsidiary

Under Romanian law there is no express restriction in this respect.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The Romanian Civil Code (in force as of October 2011) has expressly recognised the possibility to have a security agent but only in respect of movable mortgages, in which case such security agent may exercise all the rights of the secured creditors which appointed it, including enforcement rights.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

The following alternative mechanisms have been and continue to be used in practice:

(i) parallel debt structure governed by a foreign law (usually English law); such structure has been recognised during at least one occasion in insolvency proceedings;

(ii) agency agreements under which all creditors empower the security agent to act as their proxy with respect to the security

© Published and reproduced with kind permission by Global Legal Group Ltd, London

(noting, however, that separate PoAs may be required, especially in the enforcement process); and

(iii) active solidarity between lenders, which will allow one lender to enforce the claims on behalf of all lenders (noting, however, that in this particular case, the security agent should also be a lender).

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Under Romanian law, loan transfers are made through one of the following structures:

(i) assignment of rights, by which only the rights under the respective loan agreement together with the collateral pass to the new lender. The assignment has to be notified to the assigned debtor and to its personal guarantors (although in practice the notice is also addressed to security providers) and be registered with the Electronic Archive;

(ii) novation, which requires the consent of the assigned debtor and of its personal guarantors, as well as an express reference to the maintenance of the existing collateral and which leads to a transfer of rights and obligations for the new lender (formally, a new obligation of the debtor is borne towards the new lender); and

(iii) transfer of contract (assuming that the contract has not been entirely performed), which requires the consent of the assigned debtor and, although not entirely clear, of the personal guarantor; this also leads to a transfer of the existing contract to the new lender.

Note that loans granted by Romanian credit and financial institutions are writs of execution. In practice there has been a lot of debate on whether such loans continue to be writs of execution if transferred to lenders who do not fall under these categories; however, there seems to be a growing consensus that such contracts maintain this quality in this scenario.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

a) Interest payable on loans made to domestic or foreign lenders

In the case of interest paid by a Romanian taxpayer to another Romanian taxpayer, no withholding taxes should be withheld by the borrower. The interest will be included in the overall tax base of the lender and taxed at 16%.

As regards interest paid by a Romanian borrower to a non-resident lender, such interest payments shall be subject to a 16% withholding tax rate in Romania. However, the withholding tax rate can be reduced or even eliminated by claiming the provisions of applicable tax treaties or of the EU Interest and Royalties Directive (in the case of related parties).

Lenders from EU/EEA countries may opt to have the withholding tax computed on a net basis instead of a gross basis. The tax is still calculated and withheld by the borrower on a gross basis; however, the lender has the right to file an annual return, claim deduction for certain costs (e.g. refinancing costs, FX losses) and ask for reimbursement of withholding tax paid in excess.

b) Proceeds of a claim under a guarantee or the proceeds of enforcing security

The enforcement of guarantees may be seen as a payment of the underlying receivable (e.g., principal, interest, etc.), which would trigger withholding tax implications in Romania (for the portion covering the interest).

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

From a Romanian tax perspective, loans granted to Romanian taxpayers by foreign lenders may be attractive from a withholding tax perspective given that exemption in Romania may be granted under certain circumstances.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

No, it will not, except for the aspects mentioned at question 6.1 above.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are no specific costs in view of the lender being a foreign entity. Please see question 3.9 above for more details on the costs of executing and registering various securities.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

The deduction of interest by Romanian borrowers is generally restricted by thin capitalisation rules; however, such restrictions do not apply to interest paid to credit institutions and non-banking financial institutions.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, Romanian courts will recognise the choice of a foreign law governing a contract; however this is subject to (i) a valid choice of law being made, and (ii) the concerned parties proving the content of the relevant foreign law. If the court issues a decision regarding a contract governed by a foreign law, the court's decision shall be enforced according to the procedure regulated by Romanian legal provisions.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

As regards EU Member States, including the United Kingdom, the judgments issued in one Member State are recognised in other Member States without any special procedure being required. In case a party invokes in one Member State a judgment issued in another Member State, the respective party has to present a copy of the judgment satisfying the conditions necessary to establish its authenticity as well as a certificate issued by the originating court.

With respect to non-EU Member States, such as the United States, the judgments rendered in such jurisdiction are recognised and enforced in Romania in accordance with the provisions of the relevant bilateral treaties. According to the available public information, it appears that there is no treaty concluded between Romania and the United States regarding mutual recognition of the effects of civil foreign judgments. In this case, the interested party will have to undertake a specific procedure, called exequatur, for obtaining the recognition and enforcement of the decision.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

a) In order to initiate a procedure for recovering the receivable, the following steps must be followed: (i) the claimant must file the claim against its debtor; (ii) the first court issues the judgment; (iii) the judgment of the first court can be appealed; and (iv) the final judgment can be enforced by the court.

Under the above scenario, we estimate a period of three to five years until the effective recovery of the claim. However, the duration of the procedure depends on the complexity of each case and also on the nature of the assets subject to the enforcement procedure.

In case the debt is unchallenged by the debtor, a faster procedure would be available and the creditor can obtain a payment injunction against its debtor (in Romanian "*ordonanta de plata*"). The payment injunction is recognised by the law as writ of execution, and according to Romanian procedural rules it can be enforced as of the date of its issuance. In such cases the above-estimated time period can be reduced to two years.

b) In order to enforce a foreign judgment in a Romanian court: (i) the foreign judgment has to be recognised by the Romanian courts based on the request submitted by the interested party; and (ii) the enforcement of the recognised foreign judgment has to be approved by a Romanian court (in Romanian "*incuviintare*"), provided, however, that the respective foreign judgment is enforceable under the legal provisions of the state where the judgment was issued. In the case of the above scenario, we estimate a period of one to three years until the effective recovery of the claim.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

a) According to Romanian legal provisions, there are three methods for selling movable and immovable assets in an enforcement procedure: (a) mutual sale; (b) direct sale; and (c) enforcement sale through public auction.

If the assets cannot be capitalised through mutual or direct sale, the enforcement officer sells the assets through public auction. This procedure lasts approximatively six months.

Intangible assets, such as movables securities over bank accounts, lease agreements or insurance policies, can be capitalised through the garnishment procedure (Romanian, *poprire*) which is usually a faster procedure.

b) Depending on the nature of the enforced asset, certain regulatory consents from the competent authorities/bodies may be required.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

As a matter of principle, all EU and non-EU citizens/legal entities have the same procedural rights as Romanian citizens/legal entities. Certain restrictions may apply in case the respective foreign lenders seek to enforce the collateral by taking ownership over the respective asset.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Starting with the date when insolvency procedures have been opened against a certain person, all judicial or extrajudicial proceedings as well as enforcement proceedings against such persons' property are suspended by law.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

According to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, each Contracting State, including Romania, recognises the authority of an arbitral award.

If the arbitral award is issued by a state that is not a party to the New York Convention, Romanian law provides that the respective arbitral award shall be recognised and is to be enforced in Romania only if the dispute subject to the arbitral award can be solved in Romania through arbitration, and the arbitral award is not contrary to public order provisions of the Romanian international private law.

As a matter of principle, Romanian courts will not carry out a judicial review on the merits of the arbitral award.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

As mentioned at question 7.6 above, starting with the date when insolvency procedures are opened against a person, all judicial and extra-judicial proceedings against such person, including enforcement proceedings, are suspended by law.

Under these circumstances, enforcement during insolvency procedures is possible only with court approval and only in limited situations (e.g. the claim is equal or less than the value of the asset and the asset is not relevant for the reorganisation of the debtor, the secured claim is not appropriately protected, e.g. because the collateral is not adequately insured, etc.)

In order to receive any payments out of insolvency, the creditor's claim has to be registered with the table of claims. Secured creditors have a higher position in the table of claims and, subject to some exceptions, enjoy priority with respect to the amounts resulting from the sale of their collateral.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

According to the Romanian Insolvency Law, secured creditors registered as such in the final table of claims have priority over fiscal authorities for tax debts and employees with respect to disbursements of amounts obtained from the sale of their collateral.

Yes, Romanian Insolvency Law does provide for suspect periods and clawback rights as protection measures against fraudulent actions of the insolvent company. The suspect periods vary from six months to two years and generally cover actions such as gratuitous transfer deeds, over-valued and fraudulent transactions, preferential payments (such as the ones made prior to their due date, to the extent such date would have fallen after the opening of the insolvency procedures), creating preference rights for previously unsecured claims, etc.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The Insolvency Law does not apply to independent professions, such as lawyers, public notaries, or to pre-university institutions, universities and other similar institutions within the national research/development system.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Romanian law allows creditors secured with movable mortgages to perform the enforcement either under the provisions of the Romanian Civil Code (as a form of a private enforcement process, although court or court-bailiff intervention is still required in certain situations) or under the provisions of the Romanian Civil Procedural Code. However, except for movable mortgages over accounts (which are usually enforced by set-off) and movable mortgages over receivables (which are usually enforced through notifying the assigned debtor to pay directly either to the creditor or to the debtor's account opened with the creditor), the other movable mortgages are usually enforced under the provisions of the Civil Procedural Code, through formal court-approved enforcement proceedings.

Immovable mortgages can be enforced only under the provisions of the Civil Procedural Code.

Note that both movable and immovable mortgages are qualified as writs of execution under Romanian law, which significantly simplifies the enforcement process.

Lenders and debtors can also agree on settling the debt through other means (e.g. debt to assets swap, etc.).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Romanian law allows parties to choose the competent courts in pecuniary matters, where the actual or potential dispute results from a commercial agreement which implies foreign elements. Such agreement has no effect if it leads to the abusive deprivation of one party from the protection ensured by the Romanian laws. Moreover, parties cannot choose a foreign court when a Romanian court has exclusive jurisdiction, such as legal disputes concerning immovable assets located in Romania or consumer agreements where the provider has received the order in Romania or the offer has been made in Romania and the consumer has undergone endeavours to conclude the agreement.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The state and public authorities may conclude arbitration conventions only if they are authorised to do so by Romanian law or by international conventions to which Romania is a signatory party.

Please note that assets that are in the public property cannot be enforced and no waiver from this rule is allowed. Assets which are in the private property of the state or of public authorities can be enforced, but subject to certain restrictions.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Under Romanian law, professional lenders have to be licensed by the National Bank of Romania either as a credit institution or as a non-banking financial institution ("NBFI"). Both are regulated entities (although a stricter regulatory regime applies to credit institutions) and have high minimum share capital requirements. Credit institutions

© Published and reproduced with kind permission by Global Legal Group Ltd, London

established in EU Member States can provide services in Romania if they are duly "passported" in accordance with EU regulations.

Granting loans with professional title without having the necessary licence constitutes a criminal offence. The National Bank of Romania has the authority to decide whether a certain lending activity is carried out with professional title.

In order to act as an agent under syndicated facility, the respective institution has to include this activity in its object of activity and have it authorised with the National Bank of Romania.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are no other material considerations which should be taken into account by lenders when participating in financings in Romania.

Andrei Burz-Pinzaru
Reff & Associates SCA
4–8 Nicolae Titulescu Road
East Entrance, 3rd Floor
Sector 1, Bucharest, 011141
Romania

Tel: +40 21 222 16 61
Email: aburzpinzaru@reff-associates.ro
URL: www.reff-associates.ro

Andrei Burz-Pinzaru is an attorney-at-law, Head of the Banking & Securities practice in Reff & Associates, and also the Global Leader of the Banking & Securities group of the Deloitte Legal network of legal practices. He has 18 years of multidisciplinary advisory experience in Banking, Capital Markets and M&A and holds a Juris Degree and a B.Sc. Degree.

During his career, Andrei advised on loan and security documentation in bilateral/syndicated loans, real estate finance, debt restructuring, NPL deals and securitisation structures in aggregate value of several billion euros. He assisted in multiple M&A deals of acquisitions concerning banks and various financial services industry companies and advised on the cross-border application of banking resolution laws. In the capital markets area, he advised on stock option plans, securities/rights offerings, pre-IPO preparation, insider dealing and market manipulation cases. *IFLR 1000* recognises Andrei as a leading lawyer in Romania for Banking, Capital Markets and M&A.

Mihaela Maxim
Reff & Associates SCA
4–8 Nicolae Titulescu Road
East Entrance, 3rd Floor
Sector 1, Bucharest, 011141
Romania

Tel: +40 21 222 16 61
Email: mmaxim@reff-associates.ro
URL: www.reff-associates.ro

Mihaela Maxim is a Managing Associate with Reff & Associates, and an attorney-at-law with 13 years of professional experience. She focuses on banking and finance, area in which she has acted on numerous occasions for local and international credit institutions and other types of financial services entities. Her experience includes working as an in-house lawyer for two large international banks with a Romanian presence, where she has focused on advising on major debt restructuring and syndication transactions, standstill agreements, insolvency and enforcement issues.

Mihaela has also been actively involved in the drafting and negotiation of complex financing transactions, including on the structuring of the corresponding security packages, especially on the lender's side, as well as on various regulatory matters.

Mihaela is a graduate of the Faculty of Law, University of Bucharest (2002) and has an LL.M. from the London School of Economics and Political Sciences (2009, with Distinction).

Reff | Associates

Reff & Associates SCA is a law firm member of the Bucharest Bar, independent in accordance with the applicable Bar rules. Reff & Associates represents Deloitte Legal in Romania, the network of legal practices present in 57 countries worldwide. The firm has about 50 lawyers, and, during the last five years, has consistently assisted clients in transactions with an aggregate value in excess of EUR 1 bn/year. In each of 2013 and 2014, the firm assisted in four of the top ten largest M&A deals in Romania.

The firm regularly assists in finance deals and portfolio transfers. In loan transfers, the firm assisted last year in more than 10 deals in aggregate of approx. EUR 1bn (including corporate/retail portfolio transfers and individual corporate loan transfers). *The Legal 500 EMEA* ranks Reff & Associates as a leading law firm in Romania for Banking & Capital Markets, Real Estate and M&A. For further information about the practice, please visit www.reff-associates.ro.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Chapter 48

Russia

Oleg Mosgo

Mosgo & Partners

Anton Shamatonov

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The crude oil price crash and EU and US sanctions against Russia related to the situation in Ukraine, both followed by the dramatic depreciation of the Russian rouble (approx. 50% in 2014 and 17% in 2015), have influenced the Russian economy and financial market for the last couple of years. Russian banks were cut off from financial resources outside the country. Many loans nominated in foreign currency became too burdensome for borrowers, which resulted, in some cases, in the restructuring of debts, judicial disputes and bankruptcies. Many projects have been suspended or cancelled. Most banks changed their lending policies; some of them even limited their corporate lending programmes, and therefore corporate lending has never been so sought after by Russian businesses.

From a legal standpoint, recent years have seen major reforms aimed at the improvement of legislation. Some of them are still in progress. The Russian Civil Code was amended in 2014, the new rules on pledge having taken effect in July 2014. Pledge of receivables, pledge of bank account, a pledge register for movable property and many other mechanisms are now described in the text of the Civil Code in detail.

Previously, there was a major issue with pledges: pledged assets had to be described in detail for a pledge to be valid and enforceable. There have been many cases when a pledge was challenged due to the fact that the assets were not determined. The law is now more reasonable and allows for flexibility: all or part of the assets can be collateral and even the future assets of the company can be included into the contract, with reasonable description.

Pledge managers have been introduced into the Civil Code, which is important for syndicated lending.

A *register of notices of pledge of movables* has been created, enabling pledgees to ensure their rights with respect to third parties.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

In September 2015, Uralkalyi, a major Russian company and the world's largest producer of potassium fertilisers, received credit from Sberbank of USD 1.5 billion (previously, in April 2015 it also received syndicated credit from Commerzbank, IKB, Industrial Commercial Bank of China and China Construction Bank of USD 650 million).

In 2014, the mostly state-owned Sberbank organised a bridge loan for a Gazpromneft & Novatek joint venture of approximately USD 3 billion to increase participation in Italian oil company Eni, the final goal being rights to the subsoil use in Yamal-Nenetsk Autonomous Region.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

There are two different types of guarantee in Russia.

The first is a surety, when the guarantor becomes liable together with the party to the contract (borrower); in cases where the borrower fails to perform, the creditor may claim compensation from the guarantor, which must be in writing. The surety depends on the validity of the main obligation (or contract) and usually secures rights of the creditor under a particular transaction, although, since 1st June 2015, if a surety is given by commercial organisation, it can cover all existing and even future debts of the debtor.

The second is a so-called "independent guarantee", which replaced bank guarantees after 1st June 2015 (which could only be issued by a bank). Under an independent guarantee the guarantor (a commercial organisation) shall pay the agreed amount in case the creditor claims for the money. An independent guarantee remains in force even if the main obligation (contract) is void or avoided. It must be in written form.

As a general rule, any company can provide any of the above-mentioned guarantees, including a member of the group.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

There is no special regulation on enforceability or director liability if only a small benefit to the guarantor can be shown.

However, according to the general rules and principles of law, a director of a company is to act in good faith to the benefit of the company; otherwise, the director can be liable for the damages incurred.

If there was no approval by the shareholders of the guarantor (if required) or if the guarantor became bankrupt and the guarantee violates the rights of creditors, surety or independent guarantee can in some cases be challenged in court. In such situations, absence of benefit may help convince the court that the guarantee is voidable.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.3 Is lack of corporate power an issue?

The aspect of lack of corporate power due to the limitations of legal capacity is important only from a strictly formal point of view. The company can limit its legal capacity and its business purposes in the charter. The deal can be challenged in the court if the other party knew or should have known about such limitations.

However, in practice the companies usually do not limit their legal capacity in their charters/by-laws/articles of association. This can be different in companies which are owned by the state: such companies may have special purposes and may have limited powers.

It is much more common for there to be a lack of corporate approvals (please see question 2.4 for details).

One should bear in mind that in September 2014 the *Four-Eyes Principle* became available to companies: now there can be more than one director (CEO) in the company. The charter may provide that the directors act jointly (two or more signatures are required) or separately (only one signature is required). The directors may have different powers that should be set forth in the charter of the company. To check the number of directors and their names, one can address the Unified State Register for Legal Entities, which is also available online at www.egrul.nalog.ru (in Russian). To check their powers, the charter should be analysed.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Yes, corporate approvals may be (and, in large-scale transactions, usually are) necessary. There are generally three types of transaction approvals that may be required:

- for a *large-scale* (major) transaction (a transaction which amounts to **25% or more of the net assets** of the guarantor) the approval of the board of directors or a shareholders' meeting may be necessary;
- for a transaction which may amount to less than 25% of the net assets of the company, but the approval of which is required according to the **charter** of the company, the approval of the board of directors or a shareholders' meeting may be necessary; and
- for *"interested-party" transactions* (a transaction which may result in the benefit of the **affiliates** of the guarantor) the approval of the board of directors or the shareholders which are disinterested in the transaction may be necessary.

To make sure the deal will not be challenged in court, one should check the charter of the company, check the balance sheets and, if necessary, receive the necessary corporate approvals.

There is no special governmental control over guarantees and no consents or filings are required.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There is no *ex ante* control or limitations imposed on the amount of the guarantee. However, *ex post*, the guarantee can be challenged in the bankruptcy proceedings if it violates the rights of creditors.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There is no special regulation on the enforcement of a guarantee with regard to exchange control or similar. However, there are certain bank formalities that a company shall comply with according to the currency control.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

According to the new text of the Russian Civil Code effective from 1 July 2014, any assets, objects and rights can be used as collateral (pledge) with some minor exceptions (e.g. assets which cannot be foreclosed and rights which are inseparably connected with the personality of the creditor, such as alimony and others, cannot be used as collateral).

In fact, movables and immovables, rights to receivables, bank accounts (including deposits), stock, bonds, rights of participants of the companies (shareholders' rights) and exclusive rights to intellectual property can be used as collateral. Pledge of immovable property is also called a "mortgage" and is traditionally regarded as one of the most reliable types of security.

If the pledger is a commercial organisation, the pledge agreement may provide that the pledgee may retain the collateral in his ownership (it is not a general rule).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

From 1st January 2015, the amendments regarding the pledge of all assets (total, or comprehensive, pledge) entered into force, making it possible for entrepreneurs to provide all or part of their assets or certain types of assets (e.g. all vehicles or all equipment) as collateral. However, these provisions are still to be tested in practice and the rules on crystallisation of the assets shall be created through practice.

The above must be in written form. The parties may agree that notarial certification is necessary. If the pledge agreement secures the contract which was notarised, it also needs to be notarised. Defects in such will result in nullity of the pledge.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. The agreement shall be in written form and in some cases may require notarisation. A pledge of real property (land, buildings) shall be registered in the Register for Rights to Real Estate (*Государственный реестр прав на недвижимое имущество и сделок с ним*), otherwise it shall have no legal effect with respect to third parties.

Pledge of machinery and equipment shall usually be deemed as a pledge of movables. The agreement shall be in written form and may require notarisation in some cases. The pledge of movables can be registered in the electronic register for movable property which ensures that third parties are informed about the pledge even if they acquire rights to them. This register was introduced in mid-2014 and is maintained by notaries public.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, pledge of receivables is possible and, after the amendments of mid-2014, more flexible. Generally, this must only be in written form. There are certain limitations when pledge of receivables is impossible (e.g. assignment is impossible under the law).

The debtor shall be notified of the security.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, the text of the Russian Civil Code, updated in 2014, provides for such an instrument.

An agreement between the pledgor and the pledgee is required in written form (and sometimes requires notarisation). A special collateral account in the bank shall be opened. There are generally no restrictions on who can be the pledgee, e.g. the bank where the pledged account is opened. The pledgor may dispose of the money on such account, unless otherwise provided by the agreement. In case the pledgee informs the bank on default of the pledgor, the bank shall not make any transactions with the account which result in a decrease of the sum on it below the pledged amount.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

There are two types of pledge over shares in companies: pledge over shares in joint-stock companies (JSC or, in Russian, *AO*); and pledge of shares (participation interests) in limited liability companies (LLC or, in Russian, *OOO*). The shares are not in certificated form.

Pledge over shares (the agreement must be in written form, though notarisation is usually not required) in a JSC shall be registered by the special company which maintains the register of the JSC. As a general rule, the shareholder reserves the right to vote.

Pledge over shares in an LLC shall be notarised. A simple majority (or even more, if provided by the charter) of votes of other shareholders is necessary for the pledge to be valid. Pledge is registered in the Unified State Register for Legal Entities and the LLC is notified about the pledge by a notary public.

For practical reasons it is not recommended to use foreign law as the governing law of the agreement, but there are such cases (although not common) in practice. Due to the fact that pledge over shares in an LLC is to be notarised and notaries public cannot check the consistency of the pledge agreement under foreign law, such transaction is unlikely to be validated through notarisation.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, it can. A written form of the agreement is necessary (notarisation is usually not required). The value of the pledged inventory shall not be less than that agreed. As a general rule, the pledgor shall maintain the register of such pledged inventory, recording all incoming and outgoing transactions.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Generally, a company can guarantee both its own debt and the debt of other borrowers and/or guarantors, subject to the limitations described in questions 2.3 and 2.4 above.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

There is no stamp duty in Russia.

The registration fees are moderate and can usually be neglected.

The most significant is the notarisation fee which is calculated from the price of the transaction (up to 0.5%). Notarisation is necessary when: i) the secured obligation has been notarised; ii) the pledge over shares in a limited liability company is in question; and/or iii) the parties agreed to use notarisation (e.g. for a non-judicial procedure of foreclosure, if applicable).

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Usually the procedure requires a moderate amount of time and expense. Pledge of movable assets can be done relatively fast and easily. Pledge of immovable assets (and intellectual property), which requires registration in state bodies, may take, approximately, an additional month. Expenses are usually connected with notary fees.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Usually there are no such consents required (see also questions 2.3, 2.4 and 3.6 above), if the rights of third parties are not considered.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There is an issue of describing the secured obligation in Russia, if such description is not concrete enough. However, in 2014 the law was amended, clearly stating that pledge of future debt is also possible, and the wording of the law is now more flexible for entrepreneurs willing to secure future debt (e.g. in cases involving a revolving credit facility). No special priority is provided.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

The agreement must be in written form (in practice this is usually done as a single document, not by means of exchange of the signed copies). Notarisation may be necessary (please see question 3.9 above). An additional copy is necessary if registration is required (for the archives of the registration authority).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Currently, there is no special regulation of "financial assistance" in Russia as there is, for example, in Germany. However, the company's CEO may require approval for the deal. See question 2.4 above for types of approval.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Pledge managers were introduced into legislation in June 2014, enabling creditors to choose one of the creditors or a third party as a person who will sign a pledge agreement with the pledgor and/or exercise all rights and duties of the pledgee under such agreement. The legal provisions governing agency relationships (in Russian – *поручение*) are applicable to the duties of the pledge manager, and the relationships between the creditors are governed by the provisions of simple partnerships – unless otherwise provided by the agreement of the parties – or stems from the essence of the obligation. This is yet to be tested in practice.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Please see question 5.1 above. Major syndicated lending transactions in Russia have usually been governed by foreign law, although there were examples when the same documentation was used under Russian legislation with the arbitration clause providing Russian state arbitrazh courts as a place for dispute resolution. The situation may change in the future when practice finds it reasonable to use pledge managers for these purposes. Hopefully, based on the principle of freedom of contract, set forth in the Civil Code and elaborated in the recent clarifications of the former Supreme Commercial Court, the contract for pledge management will include provisions on monitoring the status of the debt, solvency of the debtor, enforcing loan documentation, etc.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Such transfer is usually done by means of assignment. Generally, the consent of the debtor (guarantor) is not required, unless otherwise provided by the agreement.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Generally, interest payable on loans is regarded as income and is subject to Russian corporate income tax (CIT). Russian borrowers shall be a tax agent for the lender and shall withhold CIT from the interest payable (there are exceptions, *inter alia*, when there is treaty between the countries on avoidance of double taxation). Taxation of the proceeds of a claim under a guarantee or the proceeds of enforcing a security generally follows the rules of the main obligation (i.e. only interest is taxable).

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no special incentives for foreign lenders. No special taxes are provided for purposes of effectiveness or registration.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Generally, if a company has no representative office in Russia from the standpoint of the tax legislation, it shall not become taxable in Russia solely because of the loan/guarantee/security. However, the interest on the loan may be subject to corporate income tax (see also question 6.1 above).

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Generally, notarisation is not necessary. However, the parties may decide otherwise; in this case notary fees may be considerable as they are calculated based on the sum of the transaction. For expenses during pledge agreement execution, please see question 3.9 above.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Generally, there are no such consequences under Russian law.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, generally the courts recognise a foreign governing law and enforce the contract if this does not violate mandatory Russian laws, principles and public order. The court may ask for clarification of the foreign governing law from the party and may ask an expert to prove that the interpretation of the foreign law by the party is correct.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

In principle, judgments of foreign courts can be recognised in Russia. However, there are some requirements for this: presence of an international treaty; or reciprocity principle. There are no such agreements between Russia and the USA or UK. The principle of reciprocity is quite unreliable and means providing evidence of recognition and enforcement of Russian courts' decisions in foreign jurisdictions and may depend on the political situation. However, should the requirements be met, the court will not re-examine the merits of the case unless public order in Russia is violated.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Statutory term (which can be prolonged, e.g. if the case is difficult or the notice of a foreign party is required) for the court of 1st instance to issue a decision is three months after the claim is filed. It takes an additional month for the decision to enter into force. The minimum time for execution of the decision (if executed through the bank, as opposed to the state bailiffs' service) is approximately one week. In practice it takes about six months, if there is no appeal, for both filing a suit in a Russian court and enforcing a foreign judgment. Often, if a foreign company wishes to participate in a Russian court not through a Russian lawyer, there is a significant problem regarding notice: notices are made officially (not by post, but through state authorities of the respective countries) and usually take several months.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

In practice, judicial enforcement is often necessary if the debtor objects to enforcement of security (see question 7.3 above). In most cases the pledged assets are to be sold via an auction (usually takes a couple of months). In 2014, certain amendments have been made to the Civil Code, reducing complexities for the pledgees. According to such amendments, entrepreneurs may agree that the pledged assets will be transferred to the pledgee or sold to a third person, the price being not less than the market price. This may significantly reduce the terms for enforcement of the collateral security.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

Generally, there are no such restrictions.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, there is a moratorium on enforcement of lender claims in bankruptcy. Usually the pledged assets can be sold within the final stage of bankruptcy and the pledgee may receive from 70 to 80% of the sale price.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Russia is party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958); therefore, generally, no re-examination of merits is required and the award can be enforced.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy of the borrower usually means that the collateral security can be enforced when the final stage of bankruptcy commences (receivership). Depending on the type of secured obligation and the type of pledge, the creditor may receive from 70 to 80% of the value of the pledged assets, but in any case not more than the debt.

If the pledge of bank account is considered, there is no need to sell the assets, and therefore no expenses for the auction will be deducted from the final sum.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

As indicated in question 8.1 above, secured creditors can receive only up to 70 or 80% of the value of the pledged assets. The rest of the sum

© Published and reproduced with kind permission by Global Legal Group Ltd, London

is divided between the bankruptcy manager (bankruptcy proceedings expenses, bankruptcy manager fee) and the preferential creditors, such as employees, injured persons (tort claimants), authors, etc.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Legal entities with state participation may be excluded from bankruptcy; special rules apply.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

There is no alternative to judicial enforcement in bankruptcy.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

A Russian court will recognise a choice of foreign law and submission to a foreign jurisdiction provided that it is not illegal or contrary to Russian public policy.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A Federal law on Foreign States Immunities has recently been adopted (Federal law No. 297-FZ dated 3rd November 2015). According to the law, a foreign state may waive its immunity (either in an international treaty or in a contract). Certain procedural actions are also regarded as waiver (e.g. participating in a court dispute on the merits).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Generally, any company may be a lender in Russia. Domestic banks, that is, the organisations whose main purpose is financial services, must have a licence granted by the Central Bank of Russia. Foreign banks must have an equivalent status according to their *lex personalis* (their domestic laws).

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Currently, one of the most important considerations is the legislation which has undergone significant reform. The changes have yet to be put into practice. Moreover, after the 2014 judicial reform in which the Supreme Commercial Court was dismissed and substituted by the Supreme Court with a subdivision for commercial disputes, there is still no understanding as to whether the courts will maintain the recent flexible and active approach or stick to the formal wording of the law and interpret it conservatively.

Currency exchange rates should be taken into account and special provisions may be necessary to guarantee stability under contracts formed in Russia.

Finally, it is necessary to remember the formalities described in the sections above (written form, registration and notarisation, if required, corporate approval in written form), which may seem excessive in a particular situation, but the neglect of which may result in long-term court disputes with high expense.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Oleg Mosgo
Mosgo & Partners
1 Bolshaya Yakimanka
119180 Moscow
Russia

Tel: *+7 495 228 48 78*
Fax: *+7 495 228 48 78*
Email: *oleg.mosgo@mosgolaw.com*
URL: *www.mosgolaw.com*

Oleg is the managing partner at Mosgo & Partners law firm (Russia). He studied law and obtained an LL.M. and a Juris Doctor degree from the Albert-Ludwig University (Freiburg, Germany). Oleg practised law in leading German law firms in Berlin for several years, having become a partner in a Russian law firm in 2003.

Apart from his knowledge of the German and English languages and the European approach to business, Oleg possesses broad experience in virtually every area of law that foreign companies have to deal with when doing business in Russia. He has extensive practical experience in structuring M&A transactions. Oleg has advised clients on German and Russian contractual, corporate and investment law. In addition, Oleg has represented the interests of foreign companies and their affiliates in state courts and has experience in international commercial arbitration.

Oleg is the author of several books and numerous publications on legal issues in Germany and Russia. He is a member of the International Bar Association.

Anton Shamatonov
Mosgo & Partners
1 Bolshaya Yakimanka
119180 Moscow
Russia

Tel: *+7 495 228 48 78*
Fax: *+7 495 228 48 78*
Email: *anton.shamatonov@mosgolaw.com*
URL: *www.mosgolaw.com*

Anton is a partner at Mosgo & Partners law firm (Russia). He holds a Master of Laws degree from the Russian School for Private Law (State Institute, Moscow), speaks fluent English and has good command of German and French.

While working for the Supreme Commercial Court of the Russian Federation, Anton has represented it in disputes with other state authorities and organisations. Anton worked in the sphere of legal consulting and practised commercial law for several years before joining Mosgo & Partners.

Anton's core activity is representing clients in litigation. He represents both Russian and foreign companies in state courts and international commercial arbitration in corporate and contractual disputes and bankruptcy cases. In addition, he advises clients on the issues of Russian contract law, investment law (real estate), M&A transactions and deal structuring and possesses experience in land and subsoil law.

Anton has authored several publications on legal issues in Russian and English. He is a member of the International Bar Association.

MOSGO & PARTNERS LAW FIRM

Mosgo & Partners is a Russian law firm which maintains the highest international standards in providing legal advice and representing the interests of major corporations from Europe, Asia and Russia engaged in machinery-building, packaging, agriculture, consulting services, etc.

The Company's lawyers are proficient in English and German languages, and hold Juris Doctor and LL.M. degrees from German, American and Russian universities. The Company's partners have authored numerous publications on legal issues in English, German and Russian periodicals and books.

The Company's key practices include:

- Commercial & Contract Law;
- Corporate Law;
- Real Estate & Construction;
- Antitrust Law; and
- Labour Law.

The Company has great experience in structuring M&A transactions. Another core practice of the Company is litigation (including bankruptcy cases and disputes with state authorities) and international commercial arbitration.

Mosgo & Partners is a member of the German-Russian Chamber of Commerce (*Deutsch-Russische Auslandshandelskammer*). The Company's partners are members of the International Bar Association.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Singapore

Valerie Kwok

Drew & Napier LLC

Blossom Hing

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

It has been reported that overall loan growth in Singapore has slowed due to an overall decline in loans to China and emerging Asia, which had driven strong credit growth in recent years after the global financial crisis. The demand for credit has also declined as a result of slowdown in regional growth.

On the local property market front, as a result of the introduction of measures in 2013 by the MAS to stabilise and curb speculation in the residential property market, the number of housing transactions remained subdued in 2015 and was accompanied by slowed growth of household debt. The banking sector continues to be challenged as a result of the substantial exposure to the private housing market, although the risks appear limited given that unemployment remains low, most properties are owner-occupied, and the high down payments mandated by tight loan-to-value limits.

Separately, the phase implementation of the long-awaited overhaul of the Companies Act (Cap. 50, 2006 Rev. Ed.) (***CA***) was put in effect. The Companies (Amendment) Bill 2014 (***Amendment Bill***) contains more than 200 amendments to the CA, including some key amendments that will impact financing transactions in Singapore and these will be discussed in greater detail below. Phase 1 of the amendments in the Amendment Bill was implemented on 1 July 2015 and Phase 2 commenced on 3 January 2016.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The takeover battle for Fraser & Neave Ltd. (the largest in history in Singapore and South East Asia), between competing bidders TCC Asset Ltd (***TCCA***) and Overseas Union Enterprise dominated headlines in 2012 and 2013 as the eventual winner, TCCA, completed its takeover bid in early 2013. This transaction involved financing estimated to be around S$13.8 billion, funded by, amongst others, DBS Bank and United Overseas Bank and remains one of the most significant lending transactions in recent years.

Other major transactions in 2013 include the S$2.6 billion syndicated loan facility granted to Senoko Energy – Singapore's largest energy supplier – to refinance its existing debts, in which DBS Bank was coordinating mandated lead arranger; as well as the S$1.2 billion leveraged loan granted to Universal Group Holdings.

Significant lending transactions in 2014 include the S$5.1 billion amendment-and-extension facility for casino operator Marina Bay Sands to, amongst others, extend the maturities of facilities, in which DBS Bank was coordinator and mandated lead arranger and bookrunner, and the US$4.95 billion bridging loan for the Oversea-Chinese Banking Corporation's acquisition of Wing Hang Bank Ltd., underwritten by the Bank of America Merrill Lynch, the Hongkong and Shanghai Banking Corporation Limited and J.P. Morgan.

Significant lending transactions in 2015 include a syndicated refinancing credit facilities of up to S$2.27 billion granted to Resorts World at Sentosa Pte Ltd. The facilities were underwritten by the original mandated lead arrangers and bookrunners, namely, The Bank of Tokyo-Mitsubishi UFJ, DBS Bank Ltd, The Hongkong and Shanghai Banking Corporation, Oversea-Chinese Banking Corporation and Sumitomo Mitsui Banking Corporation.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, subject to there being sufficient corporate benefit and no contravention of specific rules under the CA, for example, relating to guarantee of loans to companies related to directors and provision of financial assistance.

S157 of the CA provides that a director of a company "*shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office*". This statutory statement is in addition to the directors' duty under general law to exercise their discretion *bona fide* in what they consider is in the best interest of the company. The directors of a company have to ensure there is sufficient corporate benefit in giving any guarantee, including a guarantee for the borrowings of one or more members of its group.

A commonly asked question is whether directors can, in giving a guarantee, consider the interests of the corporate group. The theoretical rule is that companies within a group are separate legal entities. However, in practice, companies are often part of larger groups and it is generally accepted that there is corporate benefit on the face of a transaction involving a holding company guaranteeing the obligations of its subsidiary. It would be harder, however, to show corporate benefit in a subsidiary guaranteeing the debts of its holding or sister companies and in such situations, it would be prudent to have the shareholders of the company sanction the giving of the guarantee.

In addition, companies have to be mindful of the prohibition under s163 of the CA relating to the guarantee of loans, quasi-loans or credit transactions to companies related to directors. There are exceptions

© Published and reproduced with kind permission by Global Legal Group Ltd, London

to this prohibition, including where the companies involved are in a subsidiary/holding company relationship or are subsidiaries of the same holding company in the legal sense. Members of a corporate group in the legal sense are therefore generally exempted. They are, however, not exempted if they are non-subsidiary affiliates and directors have to be careful then to conduct the necessary enquiry to ensure there is no contravention of the section. With effect from 3 January 2016, a new exception was introduced to allow for prior approval by the company in general meeting to permit such transactions. It is anticipated that, where practicable (for example when dealing with private companies), lenders are likely to require such prior approval by shareholders to be obtained to do away with the risk of triggering this prohibition.

Regard also has to be given to the prohibition against giving of financial assistance and other considerations where a company is insolvent, as set out in sections 4 and 8 below.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

See question 2.1 above. In giving a guarantee, the directors of the company have to ensure there is sufficient corporate benefit. If the corporate benefit to the guaranteeing company is disproportionately small or there is no corporate benefit, then there may be an issue as to whether the directors in giving the guarantee are in breach of their fiduciary duties.

Where directors have given a guarantee in breach of their fiduciary duties, the guarantee may be set aside if the lender had knowledge of the impropriety and the offending directors may be both civilly and criminally liable for their breach.

Other considerations where a company is insolvent are set out in section 8 below.

2.3 Is lack of corporate power an issue?

Unless otherwise limited or restricted by the provisions of its own constitutive documents, a company has full capacity to perform any act, including enter into guarantees. Caution should be taken as there are, however, companies with old forms of constitutive documents that still contain restrictions and limits on the grant of guarantees and if so, such restrictions will continue to apply.

The effect of the lack of corporate power in the grant of a guarantee, whilst it does not invalidate the guarantee *per se*, may be asserted or relied upon in, amongst others, proceedings against the company by any member of the company or, where the company has issued debentures secured by a floating charge over all or any of the company's property, by the holder of any of those debentures to restrain the doing of any act or transfer of any property by the company. The court may, in such a situation, exercise discretion to set aside and restrain the performance of the guarantee but allow for compensation for loss or damage sustained.

With effect from 3 January 2016, the CA deems the power of the directors to bind the company, or authorise others to do so, to be free of any limitation under the company's constitution, in favour of persons dealing with the company in good faith. It remains to be seen if the Singapore courts will find that knowledge of an act being beyond the powers of the directors under the constitutive documents of the company will, by itself, be sufficient to establish a lack of good faith for purposes of this new provision.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental consents or filings are generally required.

A guarantee will be required to be lodged with the companies' registry in Singapore, the Accounting and Corporate Regulatory Authority of Singapore (***ACRA***), only if by its terms it also seeks to create a charge or agreement to charge within the meaning of s131 of the CA.

In terms of formalities, a contract of guarantee has to be in writing and signed by the person sought to be rendered liable under the guarantee. Board resolutions approving the terms, execution and performance of the guarantee should be passed. Shareholders' approval should also be obtained if there is any potential issue of lack of corporate benefit and breach of directors' duties, or triggering of s163 of the CA or where it is otherwise required by statute (for example, to whitewash the transaction) or the constitutive documents of the company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, unless otherwise restricted by the constitutive documents of the company.

If, however, the amount guaranteed is clearly disproportionate to the corporate benefit received, the issues discussed in question 2.2 above would arise.

Other considerations where a company is insolvent are set out in section 8 below.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange controls in Singapore which would act as an obstacle to the enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under Singapore law, all types of collateral may potentially be available to secure lending obligations, provided the grant thereof is not against public policy.

Common types of collateral that can be used include real property (land and buildings), personal chattels, debts and other receivables, stocks and shares and other choses in action.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is possible to give asset security by means of a general security agreement, for example, by way of a debenture seeking to take security over different classes of assets, save to the extent that a statutorily prescribed form is required (e.g. to effect a legal mortgage over land under the Singapore Land Titles Act (Cap. 157, 2004 Ed.) (***LTA***) or take a legal assignment over book-entry securities).

The main types of security interests that can be created under Singapore law are mortgages, charges, liens and possessory pledges,

© Published and reproduced with kind permission by Global Legal Group Ltd, London

and the appropriate method of taking security would depend on the nature of the asset over which the security is to be taken and the extent of security required.

Different classes of assets will also be subject to different procedures and perfection requirements.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Land

Yes, a legal or equitable mortgage/charge or assignment of sale and purchase/lease/building agreement with mortgage-in-escrow is commonly granted over real property (land and to the extent immovable, plant and buildings thereon). The type of security will depend on, amongst other factors, whether title over the land has been issued, the land type and the type of holding.

There are two types of land in Singapore – common law titled land and land under the LTA. Virtually all land in Singapore has been brought under the LTA. A legal mortgage for land under the LTA has to be in a statutorily prescribed form and registered with the Singapore Land Authority (***SLA***). Where title has not been issued for land under the LTA, a lender would take an equitable mortgage over the sale and purchase agreement, lease or building agreement in relation to the land, with an accompanying mortgage-in-escrow for perfection upon issue of title.

Commonly, an appropriate caveat may also be lodged with the SLA against the land to protect the lender's interest during the time between the acceptance of the facility and the registration and perfection of the security.

Related security like an assignment over insurances, rental and sale proceeds and agreements and in the case of land under construction, assignment over construction contracts and performance bonds are usually also taken.

Procedure and perfection steps briefly include taking of relevant title documents, registration with the SLA (or Registry of Deeds, if applicable), registration of the charge with ACRA under s131 of the CA, stamping, consents from lessor of the land or other third parties (if applicable), corporate authorisations, whitewash/shareholders' approval (if applicable), etc. In practice, some banks require shareholders' approval where the assets to be mortgaged/charged constitute the whole or substantially the whole of the company's undertaking or property.

Machinery and equipment

A fixed charge granted by way of a debenture or charge is commonly taken over machinery and equipment.

Registration with ACRA will be required under s131 of the CA. Other perfection steps are (to the extent applicable) discussed above.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, security over receivables (being choses in action) can be taken by way of an assignment or charge (fixed or floating) through a deed of assignment/charge or a debenture, depending on the entire security package to be taken. Generally, lenders may also, for control purposes, obtain a charge (fixed or floating) over the accounts into which the receivables are paid (see question 3.5 below).

In order to take a legal assignment over receivables, it has to be in writing with express notice in writing given to the debtor of the receivables. The giving of notice also enables the lender to secure priority.

A charge to be taken over receivables can be fixed or floating. Where the lender is able to control the receivables and they are not subject to withdrawals without consent, a legal assignment or fixed charge may be created over the subject receivables. Often, however, the receivables are part of the ongoing business of the security provider and the lender does not seek to take control over the same. In such a situation, only a floating charge may be created in substance, regardless of how the charge is termed or labelled in the documentation.

Registration with ACRA will be required if the charge is floating or the receivables fall under one of the prescribed categories of s131 of the CA. Other perfection steps are, to the extent applicable, discussed in question 3.3 above.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, security over cash deposited in bank accounts (being choses in action) can be taken in the same way as receivables and the principles and requirements in question 3.4 apply.

In practice, it may be difficult to obtain a legal assignment or fixed charge over cash deposited in a bank account unless the bank account is opened with and controlled by the lender. Where that is not practicable and/or it is necessary to enable the chargor to make withdrawals from the bank account freely, the lender may be left with taking only a floating charge over the account.

Registration with ACRA will be required if the charge is floating or if it falls under one of the prescribed categories of s131 of the CA. Other perfection steps are as discussed in question 3.3 above.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Shares in Singapore may be in certificated/scrip or scripless form.

Where shares are certificated, a legal or equitable mortgage may be taken over the shares. A legal mortgage may be granted by way of a share mortgage, accompanied by a transfer and registration of the shares and delivery of share certificates in the mortgagee's name. The procedures and restrictions for the transfer will be set out in the company's constitutive documents and the CA. An equitable mortgage/charge may be granted by way of a share mortgage/charge and deposit of share certificates together with a blank transfer executed by the mortgagor/chargor on the agreement that the mortgagee/chargee may complete the transfer forms upon occurrence of a default event under the facility or by notice.

Where shares are in scripless form (i.e. book-entry securities, being essentially listed shares of companies on the Singapore stock exchange – Singapore Exchange Limited), by statute, a different regime will apply. Security may be taken over such shares by way of a statutory assignment or statutory charge in prescribed form registered with the Central Depository (Pte) Limited in Singapore or by common law subject to certain requirements prescribed.

There is no specific restriction to prohibit the general terms of security over shares to be governed by New York or English law, but the creation and grant of security over shares should be governed by Singapore law as the shares of Singapore companies (and exercise of certain enforcement rights) are regulated by the CA and local property rules.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Registration with ACRA will be required if the charge is floating or the shares fall under one of the prescribed categories of s131 of the CA. Other perfection steps are as discussed in question 3.3 above.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, a floating charge is most commonly created over inventory as it is ambulatory in nature. The chargor in this instance will generally be permitted to deal with the inventory in the ordinary course of its business until the occurrence of a default event under the facility or notice from the lender.

Registration with ACRA is required under s131 of the CA. Other perfection steps are as discussed in question 3.3 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes for both cases, subject to considerations such as the existence of corporate power and corporate benefit, s162/163 of the CA (prohibition on loans, quasi-loans and credit transactions to directors and related companies) and financial assistance etc., as set out in this chapter.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The fee for the registration of a charge/security instrument with ACRA in accordance with s131 of the CA is currently S$60 per charge.

In addition, security interest over certain assets (e.g. aircraft, ships, intellectual property rights and land) will need to be registered at specialist registries and additional fees will be payable. For example, the fee payable for the registration of a mortgage over land with the SLA is currently S$68.30 per mortgage.

Stamp duty is payable on a mortgage, equitable mortgage or debenture of any immovable property and stock or shares. A legal mortgage is subject to *ad valorem* duty at the rate of 0.4% of the amount of facilities granted on the mortgage of immovable property or stocks and shares, subject to a maximum of S$500. An equitable mortgage is subject to *ad valorem* duty at the rate of 0.2% of the amount of facilities granted on the mortgage of immovable property, subject to a maximum of S$500.

Notarisation is not required for security documents which are executed and to be used in Singapore.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The charge/security instrument to be lodged with ACRA under s131 CA must be lodged within 30 calendar days after the creation of the charge where the document creating the charge is executed in Singapore (or within 37 calendar days if executed outside Singapore). The filing (once filing forms are completed) is instantaneous and confirmation of registration from ACRA will normally take 2–3 business days.

Registration at specialist registries will each have its own timeframe. For example, the registration of a mortgage with the SLA may take several weeks if complex and involving multiple units. In the interim, a lender may protect its interest by the lodgement of a caveat with the SLA.

Fees payable for such registrations are as discussed in question 3.9 above.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Regulatory consents may be required in certain circumstances; for example, where the subject land is state land leased from the Government or Government statutory boards like the SLA and Urban Redevelopment Authority.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Under Clayton's rule, security taken over a revolving loan may be 'reducing' as the loan 'revolves' as a result of the 'first in first out' rule. In the absence of contrary indication, a secured revolving facility may technically lose the security once an amount equal to the original loan and any associated charges and interest has been paid into the account, even though sums have been paid out in the meantime. In practice, this is, however, rarely an issue, as finance documents will be drafted to provide for inverse order of payment and/or for security to be continuing notwithstanding any intermediate payments made as long as there is anything outstanding under the loan.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Execution requirements are predominantly set out in the company's constitutive documents and the CA. In addition, certain instruments are also statutorily required to be in writing or executed by deed. For example, a legal mortgage over land must be by deed. Certain statutory remedies (e.g. power to sell the mortgaged property, to insure the property, to appoint a receiver, etc.) given to mortgagees will also not be available unless the mortgage is by deed. Commonly, it is prudent in any event for securities to be executed by deed so that there is no issue of past consideration.

Where it is envisaged that the execution of the security instrument be completed by virtual means or using pre-signed signature pages, it is also good practice for it to be done in line with the principles set out in the English case *R (on the application of Mercury Tax Group and another) v HMRC*.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

S76 of the CA provides, *inter alia*, that a public company or a company whose holding company or ultimate holding company is a public

© Published and reproduced with kind permission by Global Legal Group Ltd, London

company, shall not, whether directly or indirectly, give any financial assistance for the purpose of, or in connection with the acquisition by any person (whether before or at the same time as the giving of financial assistance) or proposed acquisition by any person, of shares in the company or in a holding company or ultimate holding company (as the case may be) of the company. The prohibition does not extend to sister subsidiary companies. The CA further provides that financial assistance for the acquisition of shares may be provided by means of a loan, the giving of a guarantee, the provision of security, the release of an obligation or the release of a debt or otherwise.

These provisions may therefore be triggered in the event of the giving of guarantees/securities or other accommodation which may directly or indirectly provide 'financial assistance' within the meaning of the CA. There are, however, whitewash provisions available under our laws, including short form whitewash procedures that would enable the company to effect a whitewash through, *inter alia*, board approval if doing so does not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors, or the passing of shareholders' and directors' resolutions and lodgement of solvency statements and papers with ACRA without the need for public notification and objection period or court order. Where the company is unable to effect a short form whitewash, parties have to bear in mind that the need for public notification and objection period for a long form whitewash will mean that a timeframe of six to eight weeks (assuming no objections) may be required.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes, Singapore recognises the role of an agent and trustee and these roles are normally taken up by the lead bank to whom the borrower has granted the mandate to arrange the syndicated loan. An express trust will be created to ensure the desired consequences.

The creation of the trust must comply with the relevant formalities. For example, s7 of the Singapore Civil Law Act (Cap. 43, 1999 Rev. Ed.) requires a trust in respect of immovable property to be manifested and proved in writing signed by the person who is able to declare such trust. In addition, a validly constituted express trust has to be certain as to intention of the settlor to create the trust, identity of the subject matter and identity of the beneficiaries. Provided the relevant mechanics are set out in the finance documents and the trust is properly constituted, the security trustee will be able to hold the security on trust for the syndicated lenders and will have the right to enforce the finance documents and collateral security, including applying the proceeds from the collateral to the claims of the syndicated lenders in accordance with the finance documents.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable. Please refer to question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The right of Lender B to enforce the loan and guarantee exists provided the procedure for assignment or novation of Lender A's rights and obligations, as set out in the finance documents, are complied with (e.g. consent of borrower and guarantor if required) and the continuity of the guarantee is provided for expressly and preserved under the documents.

Where there are no proper procedures or transfer/preservation provisions within the finance documents or the security agency/ trust is not properly constituted, an assignment or novation of the underlying loan may result in an assigned or new debt which is not covered by the guarantee. A transfer in such a situation may fail and the guarantee rendered unenforceable over the assigned or new debt. In such an instance, a fresh guarantee will be required for Lender B to be guaranteed. In practice, confirmation by the guarantor is often sought even if the documents provide expressly for preservation without consent.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Withholding tax is applicable by virtue of s12(6) read with s45 or 45A of the Singapore Income Tax Act (Cap. 134, 2014 Rev. Ed.) (***ITA***) where a person is liable to pay another person not known to him to be resident in Singapore any interest, commission, fee or any other payment in connection with any loan or indebtedness or with any arrangement, management, guarantee, or service relating to any loan or indebtedness if such payments are borne, directly or indirectly, by a person resident in Singapore or a Singapore permanent establishment or is deductible against any income accruing in or derived from Singapore. Interest and agency fee payments are generally subject to this withholding tax unless otherwise exempted.

Assuming that such income is not derived by the non-resident person from any trade, business, profession or vocation carried on or exercised by him in Singapore and is not effectively connected with any permanent establishment in Singapore of the non-resident person, the current withholding tax rate is 15% of the gross payment.

There are, however, various exceptions to this. For example, s12(6) payments made to Singapore branches of non-resident banks are not subject to withholding tax. In addition, if the non-resident bank is a resident of a tax treaty country, the Avoidance of Double Taxation Agreement may provide for a different/reduced tax rate.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Singapore has various governmental agencies to assist foreign investors and creditors. The Economic Development Board is the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

lead governmental agency responsible for planning and executing strategies to attract foreign businesses and investments. International Enterprise Singapore works to position Singapore as a base for foreign businesses to expand into the region, in partnership with Singapore-based companies.

Although incentives are generally industry-specific, and not affected by the residency of the investors or creditors, there are selected schemes directed to attract foreign investors and creditors. For example, Singapore allows for reduced withholding tax rate on interest payments on loans taken to purchase productive equipment for the purposes of trade or business.

Save for withholding taxes as discussed in question 6.1, no taxes specific to loans, mortgages or other security documents, either for the purposes of effectiveness or registration are applicable. Stamp duty as discussed in question 3.9 will be applicable.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Where the bank is not a tax resident in Singapore, withholding tax as discussed in question 6.1 may apply.

Where the bank is a tax resident in Singapore or has a branch in Singapore, any interest, commission, fee or any other payment in connection with any loan or indebtedness or with any arrangement, management, guarantee, or service relating to any loan or indebtedness that is borne, directly or indirectly, by a person resident in Singapore or a Singapore permanent establishment or is deductible against any income accruing in or derived from Singapore that accrues to or is derived by the bank or its Singapore branch will be deemed to be sourced in Singapore and subject to income tax in Singapore by virtue of s12(6) read with s10(1) of the ITA.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Apart from fees and tax payable as discussed above (i.e. questions 3.9 and 6.1), the provision of certain services, for example the provision of guarantee services, may be subject to goods and services tax (***GST***) in Singapore if the provider of the service is registered for GST purposes pursuant to the Singapore Goods and Services Tax Act (Cap. 117A, 2005 Rev. Ed.) unless the service qualifies as an international service or is an exempt supply on which no GST is chargeable. The rate at which GST is chargeable on standard-rated supplies of goods and services is presently 7%.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Thin capitalisation principles are not applicable in Singapore. However, it should be noted that should the banks be organised under the laws of a foreign jurisdiction, and no express choice of law is made in the finance documents, the applicable law for the finance documents may be that of the foreign jurisdiction. In such a situation, the borrower may not be able to enjoy the rights and remedies available to a borrower in Singapore, but not in that foreign jurisdiction.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Provided that it is *bona fide* and legal and there is no reason for avoiding the choice on the grounds of public policy, the express choice of the laws made by the parties to a contract will be upheld as valid and binding in any action in the courts of Singapore and the courts will enforce a contract that has a foreign governing law.

In January 2015, the Singapore International Commercial Court (***SICC***) was established to hear international commercial disputes, including those governed by foreign laws.

The key features of the SICC are: (i) it is a division of the Singapore High Court. This means that SICC judgments can be enforced as judgments of the Supreme Court of Singapore; (ii) it has a diverse panel of judges that will include eminent international jurists and existing Supreme Court Judges; (iii) its proceedings are open court proceedings although parties may apply for the proceedings to be confidential; and (iv) there is flexibility for parties to seek leave of court to apply alternative rules of evidence (i.e. rules which differ from the existing Singapore rules of evidence) which they may be more familiar with; and to appoint foreign-qualified lawyers to represent them in court where the cases have no substantial connection to Singapore or to address the Court on matters of foreign law.

The SICC heard its first case in May 2015: a US$809 million dispute between Australian and Indonesian companies over a joint venture agreement for the production and sale of upgraded coal from East Kalimantan in Indonesia.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A final judgment for a sum of money obtained against a company in Singapore (which is not a judgment for the payment of a fine, penalty or tax, or anything of that nature) in a superior court in England will be enforceable against the company in Singapore subject to the provisions of the Singapore Reciprocal Enforcement of Commonwealth Judgments Act (Cap. 264, 1985 Rev. Ed.) (***RECJA***).

Judgments of a similar nature issued by New York courts will be enforced in Singapore in accordance with the common law. This is because there is no reciprocal agreement or convention between Singapore and the United States of America in respect of the enforcement of court judgments. Under the common law, a money judgment may be enforced, provided it is final and conclusive. It will then be for the defendant to prove that the New York courts had no jurisdiction over the matter, or that the judgment was obtained by fraud, or that there were any major procedural irregularities in arriving at the judgment or that enforcement would be contrary to the public policy of Singapore. The Singapore court will not re-examine the merits of the case.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The timeline for each case would depend on its own facts. Generally, if the claim is against a defendant in Singapore and based on a straightforward loan agreement or guarantee, it is possible to obtain default or summary judgment within three to six months of filing the claim (assuming there is no appeal).

There are generally four main methods of enforcement, namely, a writ of seizure and sale, garnishee proceedings, examination of judgment debtor and bankruptcy proceedings. Depending on which method of enforcement is selected and whether any challenge is mounted by the debtor, the process could take two to six months or longer.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

There is no specific requirement for a public auction, although sale by public auction is commonly carried out as a matter of practice. Secured creditors typically have wide powers under the terms of the security document to take possession, dispose or otherwise deal with the secured assets, or appoint a receiver in respect of the secured assets, to satisfy the secured debts. There may be requirements for regulatory consent in respect of certain types of borrower (for example, where it is a regulated entity).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

There are no specific restrictions on foreign lenders filing a suit or foreclosing on collateral security so long as the Singapore courts have jurisdiction over the matter.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The legislation provides for an automatic moratorium where a provisional liquidation, liquidation or judicial management (or administration) order is made. Notwithstanding the moratorium, secured creditors may enforce their security in a provisional liquidation or liquidation. However, where a judicial management order has been made, a creditor may not enforce any security over the company's assets without permission from the court.

The court may also grant an order for a temporary stay of proceedings if requested by an applicant proposing a scheme of arrangement. Generally, a temporary stay of proceedings does not restrict the enforcement of collateral security unless the terms of the scheme of arrangement being proposed apply to secured creditors.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Arbitral awards may be recognised and enforced in Singapore in accordance with the New York Convention or under the Singapore Arbitration Act (Cap. 10, 2002 Rev. Ed.) without having its merits re-examined. However, the courts may refuse to enforce such awards on the following grounds: incapacity of a party; failure to give proper notice to a party or the inability of a party to present his/her case; issues with the selection of the arbitrators; the award falling outside of the scope of the arbitration agreement; invalidity of the arbitration agreement; the award having been set aside; and/or the enforcement of the award being contrary to the public policy of Singapore.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy proceedings in respect of a company include receivership, winding up, schemes of arrangement and judicial management. The right to appoint a receiver over a company can arise statutorily, contractually in accordance with the terms of the security document such as a debenture or by an exercise by the court of its power to appoint a receiver on the application of the secured creditor. In such a case, the receiver would act in furtherance of the interests of the secured creditor that appointed the receiver to realise the collateral security. The right of secured creditors to enforce their rights over the collateral security are not affected in a winding up. However, once a judicial management order is made, secured creditors may not enforce their rights over the collateral security without permission from the court.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes. Liquidators and judicial managers, but not receivers, can apply to set aside or clawback certain transactions entered into before commencement of winding up. Such transactions include transactions at an undervalue, preferences, avoidance of floating charges and unregistered charges and transactions defrauding creditors. The clawback period ranges from five years (transactions at an undervalue) to six months (preference) from the commencement of winding up. Generally, floating charges created within six months of the commencement of winding up are void unless there is proof that the company was solvent at the time the floating charge was created.

The CA also contains provisions against fraudulent trading i.e. where the business of a company has been carried on with the intent to defraud creditors or for any fraudulent purpose. A liquidator can in such an instance apply for a declaration for the person/director to be personally responsible for the debts/liabilities of the company.

The tax authorities and employees who are owed wages (up to a certain limit) are preferential creditors and are paid ahead of unsecured creditors but behind secured creditors.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Entities incorporated in Singapore are generally not excluded from bankruptcy proceedings in Singapore.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

See question 8.1 above. In addition, creditors may apply for a writ of seizure or to garnish the assets of the debtor.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, a party's submission to a foreign jurisdiction may be legally binding and enforceable, provided the conditions for recognition are satisfied. Money judgments from certain Commonwealth countries may be registered for purposes of enforcement under the RECJA. In addition, the Singapore Reciprocal Enforcement of Foreign Judgments Act (Cap. 265, 2001 Rev. Ed.) allows judgments from a list of prescribed countries to be enforced in Singapore. Currently, only the Hong Kong Special Administrative Region is on the list of prescribed countries. Judgments from all other countries will usually be enforced through new Singapore proceedings under the common law.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A party's waiver of sovereign immunity may be legally binding and enforceable provided it satisfies the conditions as set out in the Singapore State Immunity Act (Cap. 313, 1985 Rev. Ed.).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Under Singapore law, unless exempted or excluded, a person may not carry on the business of a moneylender without holding the requisite moneylenders' licence. The relevant legislation, the Singapore Moneylenders Act (Cap. 188, 2010 Rev. Ed.), also provides that any person who lends a sum of money in consideration of a larger sum being repaid (i.e. charge interest), shall be presumed until the contrary is proved to be a moneylender. 'Any person licensed, approved, registered or otherwise regulated by the MAS under any other written law' would fall outside the ambit of the prohibition as an 'excluded moneylender'. These would include banks or finance companies which are licensed and regulated under the Banking Act (Cap. 19, 2008 Rev. Ed.) and Finance Companies Act (Cap. 108, 2011 Rev. Ed.) respectively. The question is whether overseas lenders that are not so licensed, approved, registered or otherwise regulated by the MAS are necessarily excluded. With effect from 1 March 2009, an amended Moneylenders Act came into force in Singapore pursuant to which 'any person who lends money solely to corporations' would be an 'excluded moneylender'. Accordingly, a lender can be an 'excluded moneylender' provided on the facts it lends (and has lent) money solely to corporations. There has been academic debate on whether an overseas unlicensed lender would not be deemed to be excluded if it had in the past lent otherwise to individuals who were not accredited investors, but the prevailing view is that the Singapore courts are unlikely to allow such a defence without more to succeed in the context of legitimate financial activity of commercial entities.

Corporations convicted of unlicensed moneylending will be imposed a fine of not less than S$50,000 and not more than S$500,000. In addition, subject to certain exceptions, the contracts for such loans, and guarantees or securities given for such loans, shall be unenforceable and any money paid by or on behalf of the unlicensed moneylender under the contracts for the loans will not be recoverable in any court of law.

The granting of loans to corporations *per se* is not otherwise regulated in Singapore. There are no eligibility requirements in Singapore for a lender lending to a company and, subject to the above, it need not be licensed or authorised provided that no other regulated activities (e.g. banking, securities or financial advisory activities) are being conducted.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The principal Singapore law considerations for lenders when participating in financings in Singapore have been covered by the above questions and answers.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Valerie Kwok

Drew & Napier LLC
10 Collyer Quay
Ocean Financial Centre, 10th floor
Singapore 049315

Tel: +65 6531 2222
Fax: +65 6535 4864
Email: valerie.kwok@drewnapier.com
URL: www.drewnapier.com

Valerie is a Director of the firm and heads up the Banking & Finance practice group. She is recognised in industry publications as a leading banking and finance practitioner.

Valerie handles a wide range of matters that include bilateral and syndicated loans, bond issues, acquisition financing, debt restructuring, and banking advisory and regulatory work. She is also heavily involved in Singapore project finance and real estate and construction financing deals, and has led some of Singapore's largest integrated, residential, commercial, and retail real estate financing projects including landmarks like the NOL Building, Rochester Hotel & Shopping Mall, TripleOne Somerset and Scotts Tower, to name a few. She is also frequently asked to act as Singapore counsel for financial institutions and syndicates in major, cross-border financing transactions.

Valerie has been consistently recommended as a leading lawyer by *IFLR1000* and *Practical Law Company Which Lawyer?*. She has also received accolades from *Asia Pacific Legal 500*, *Chambers Global/Asia-Pacific* and various other prestigious legal publications.

Blossom Hing

Drew & Napier LLC
10 Collyer Quay
Ocean Financial Centre, 10th floor
Singapore 049315

Tel: +65 6531 2494
Fax: +65 6535 4906
Email: blossom.hing@drewnapier.com
URL: www.drewnapier.com

Blossom is a Director in Drew & Napier LLC and is part of the Corporate Restructuring & Workouts practice group. Blossom's practice is focused on debt restructuring and insolvency work. She also has considerable litigation and arbitration experience, handling contentious shareholder, employment and other commercial disputes. She works extensively with clients based in Indonesia, China, Hong Kong, the US and Europe as well as Singapore.

Leading law publications *Chambers Asia-Pacific*, *IFLR1000* and *Asialaw Profiles* have all named her as a leading individual and a rising star in her field. Blossom is praised by clients as being a "*highly skilled, intelligent, creative and aggressive litigator*". Observers also say that she is "*smart, tenacious and always going the extra mile for her clients*".

One of Singapore's leading and largest full-service law firms, Drew & Napier LLC was named Singapore National Law Firm of the Year 2012 by prestigious legal ranking publication, *Chambers & Partners*. The firm is preeminent in Dispute Resolution, Competition & Antitrust, Corporate Insolvency & Restructuring, Intellectual Property (Patents and Trademarks), Tax, and Telecommunications, Media & Technology, and has market-leading practices in Mergers & Acquisitions, Banking & Finance and Capital Markets.

Drew has five Senior Counsel and their involvement in landmark, high-profile cases and transactions gives them a unique perspective in tackling clients' evolving challenges.

Drew counts governmental agencies and multinational corporations from a diverse range of industries amongst their clients. Their promise of quality has earned favourable repute amongst international law firms and Drew is often instructed to handle large-scale and complex matters that involve multiple parties and span across multiple jurisdictions.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Slovenia

Luka Gaberščik

Mina Kržišnik

Brulc, Gaberščik in Kikelj o.p., d.o.o.

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The Slovene lending market has been heavily influenced by the recent economic recession, which saw several large Slovene companies in workout and restructuring proceedings, where lenders were forced to act as a syndicate. Several factors, such as many concurrent workouts going on at the same time, lack of exit strategies and lack of experience were the reasons that borrowers started looking for alternative sources. Due to this, several borrowers have managed to refinance and consolidate their financing sources with the help of foreign hedge funds. We feel that the industry is focused on non-performing loan ("NPL") transactions, mainly influenced by the DUTB ("bad bank") as the main market leader, with a clear mandate to liquidate the bad investments of the Slovenian economy.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

On an ongoing basis, the major lending transactions include government borrowing for public spending (bond issue) or government guaranteed loans for infrastructure companies (syndicated loan agreements). The European Investment Bank is the most notable of the large lenders in Slovenia, investing in infrastructure projects (€145 million for motorways) or in EU-funded projects (€500 million). In 2015 a new act allowed the Motorway Company of the Republic of Slovenia to refinance its debts at €300 million per year, paving the way for significant transactions in 2016 and forward.

Several major Slovene banks have put their portfolios of NPLs on the market. We believe that at the time of writing, half of the available portfolios of "known" NPLs have been sold, and the other half are being prepared for the market. These are not technically lending transactions, but effectively they represent actual refinancing going on in Slovenia.

On a general note, commercial banks have used up their renewed "bad bank" boost and have little room for competition regarding A and B credit score clients. A surplus of available funds will push clients that were cut off from bank lending due to the recent financial crisis to the sub-prime market.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Most Slovenian companies are either limited liability companies – LLC (*družba z omejeno odgovornostjo*) or stock companies – SC (*delniška družba*).

Downstream guarantees for loans of LLCs or SCs subsidiaries are not limited and are considered standard banking practice.

LLC. Assets that are required for the maintenance of registered share capital may not be distributed to its shareholders. Any loans given to the shareholders (receivables) do not count towards the minimal assets required for the maintenance of registered share capital. A guarantee is considered a conditional debt for the purpose of capital maintenance having the same legal status as a loan, even if it is an off-balance item. The legality of an upstream guarantee is therefore conditional on the amount of registered capital, underlying assets and the guaranteed sum.

SC. The stricter capital maintenance rules consider any non-dividend payments by a SC to, or for the benefit of, its shareholders prohibited, including any similar giving of benefits, such as guarantees.

Recent case law suggests that a prohibited guarantee may be considered null and void for the beneficiary, if a due diligent review cannot be proven.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Slovenian prosecutors and criminal courts are currently focused on white-collar crime, of which a substantial part falls in the category of "Defrauding of Creditors" criminal act, similar to embezzlement. Offering credits without proven standard of care, namely without security or with no substantial benefit, could constitute elements of such criminal act if the credit is given in the creditor's pre-insolvency phase. We suggest a conservative approach, when the risk for the loan giver's insolvency becomes substantial. With the exception of a clear civil liability that goes together with the above-mentioned criminal charges, we see no other administrative limitations.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.3 Is lack of corporate power an issue?

A transaction which does not generally fall within a company's registered business scope is valid unless the contracting party knew of the lack of the other contractor's corporate power. Access to the Slovene Business Register (www.ajpes.si) is free with a well-supported English language site. Information on the limitations of a director's corporate power is public. It is standard business practice to check the registry status of a company, as a legal document without due signature is generally considered null and void.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Issuing guarantees or sureties in a consistently ongoing manner is considered a financial service regulated by banking regulations, namely Banking Act-2 (ZBan-2). A licence issued by the Bank of Slovenia is required.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

In general, guarantees or sureties are not limited by law. The Bank of Slovenia (the banking regulator) may impose rules on capital requirements that may influence the issuance of bank guarantees.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Slovene law does not impose exchange controls or other obstacles on the enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Mortgage: standard real estate mortgage; maximum mortgage; and supra-mortgage (pledge on a claim secured with a mortgage).

Pledge: standard pledge of movables (*pignus*); notarised pledge without possession of movables; securities; other material rights such as intellectual rights; and shares.

Fiduciary transfer of title: real estate, e.g. sale-lease back; securities; receivables; other material rights such as intellectual rights; and shares.

The cash account pledge is possible in theory, but due to specifics in Slovene insolvency and enforcement regulation, cash deposits cannot be used as effective collateral.

A not-so-recent change in the Property Act removed the Land Charge (known in the German legal environment as non-accessory abstract collateral), due to abuse by debtors.

In Slovene business practice, bills-of-exchange, sureties, guarantees, assignment of insurance policies and notarised executable orders are referred to as collateral, although they do not hold any value in themselves.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Slovene law does not allow for a floating charge as a general rule. It has, on the other hand, several floating charge-like rules for specific assets. A fiduciary assignment/cession or pledge can be agreed over future and conditional receivables which may increase in value. A pledge on movable material stock or inventory can allow for fluctuating levels of inventory.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral over real property – mortgage (*hipoteka*) – is the most common security requested by Slovene lenders. In standard form it is accessory to the receivable, and by law is considered transferred together with the receivable. The registration in the land book is required for perfection of collateral. It is established by registering a written security agreement, with notarised signatures by a local notary public. The joint mortgage is a type of mortgage covering several different properties and is used by land developers. The maximum mortgage is a mortgage for floating receivables, limited to a maximum amount and supposedly used to secure supply agreements. Nonetheless it was extensively used by Slovene banks and put to the NPL market without notification that it is not transferable.

Collateral over equipment (movables) in standard form requires the transfer of possession, but in practice a notarised deed and registration in the Non-Possessory Pledge Registry is more common. The latter is basically equal to mortgage collateral on real estate, with a more flexible approach in enforcing the collateral (auction by creditor).

Both types of securities, movables and real estate property, can be transferred on a fiduciary basis with a notarised signature on the sale agreement. A common practice is the sale and lease-back agreement, where the title is transferred to the lender. Complex standard terms usually manage typical issues in the relationship (insurance, responsibility, taxes, mid-term transfer of title, etc.). It should be noted that, due to an inadequate regulatory framework, the fiduciary transfer is extensively regulated by court case law (real estate) and possible investors in this type of security should look for robust legal advice.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Receivables are a common last-resort security being offered to lenders, mostly in workout procedures. Two types are predominant. A pledge over receivables requires the pledger to notify the debtor of the pledged receivables, who can repay the loan only to the secured creditor. This "indiscrete" pledge is not common in financing structures, due to notification requirements. A discrete fiduciary cession/assignment is commonly used instead. It is established with a notarial deed on future, conditional receivables. The pledger generally reserves the right to manage receivables as it sees fit, but the collateral holder keeps the security in case of insolvency proceedings.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Due to specifics of the Claim Enforcement and Security Act (***ZIZ***) and the Slovene "Insolvency Code" (***ZFPPIPP***), a cash deposit cannot be effectively collateralised by a third party. The holding bank usually stipulates terms in the deposit contract, allowing it the right to set-off the balance and to keep a pledge over cash deposits. Such terms have been confirmed by the Supreme Court of Slovenia (2014) as legally feasible for the bank as the collateral holder, but effective collateralisation of cash deposits in favour of third non-holding parties remains to be developed.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

LLC shares: Security over standard LLC shares set up with registration of a notarial deed in the Slovene Business Registry or Court Registry. The shares may be subject to limitations stipulated in the LLC's articles of association, sometimes prohibiting burdens such as collateral on the shares. The same principle applies to fiduciary sale of shares, where a "closed" LLC may not allow transfer of title. Even "open" LLCs have standard rights of first refusal, which limit the effectiveness of such approach. Those limitations are not applicable when the collateral is set up through court assistance (enforcement of claims/execution proceedings).

SC joint stock: All joint stock in Slovenia is registered at the Central Securities Clearing Corporation in non-material form. Any transfer of title or burden may only be performed through appointed brokers. A simple written order form suffices for the establishment of the pledge once the account has been open to the creditor's account. An AML check is usually the timeliest burden in cases regarding new market players.

In case of a loan contract and contract (notarial deed) for collateral security of shares governed by the law of New York or English law, Regulation EC 593/2008 on the Law applicable to Contractual Obligations (***Rome I***) shall apply. A contract shall be governed by the law chosen by the parties, and the chosen law shall be applied regardless of whether it is the law of the Member State or not. If the security is agreed for the shares of Slovene company, then the procedural rules of Slovenia for registration of the security shall apply. However, Slovene court case law applies strong restrictions on the use of foreign law between two Slovene subjects.

For foreign documents (foreign contracts, notarial deeds, etc.) and their execution, Regulation (EC) 805/2004, creating a European Enforcement Order for uncontested claims, shall apply. The Regulation serves for the free circulation of judgments, court settlements and authentic instruments (such as notarial deeds) throughout all Member States without any intermediate proceedings needing to be brought in the Member State of enforcement prior to recognition and enforcement.

In practice, however, a shorter execution security agreement is drafted stipulating the relevant clauses applicable to the security, foregoing the direct approach, due to administrative issues (translation requirements, etc.). Insolvency and execution proceedings cannot be subject to foreign law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

The security over inventory is standard collateral in car dealerships. It is set up with registration of security agreement in notary form. The inventory stock may be fluctuating but should not fall under a minimum level (except operative exceptions). The registration of the inventory collateral can only be set up on specific real estate with the owner's permission. In court execution proceedings, inventory stock is usually stamped and seized by the bailiff and used as collateral.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

In both cases a company can grant security over own assets. The granting of security for third party obligations may be set up as limited to the secured assets or it may be combined with a surety/guarantee statement. In practice, Slovene companies are asked to provide, as standard, joint and several liability when in a surety role.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notary fees are incurred for the creation of pledges in LLC shares, mortgages and non-possession/inventory pledges. Brokerage fees are incurred for setting up pledges over publicly tradeable securities (SC shares). The amount of the notary fees depends upon the amount of credit and is based on a statutory fee schedule, but limited to *ca.* €2,000. Registration duties include applying for registration in public registries such as the land book, intellectual property register and movables registry, but are not significant. There is no tax burden on setting up pledges, but a "transfer of title" tax will be incurred at the time of sale, even if the liquidation is done through the court execution process.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

As a general rule, the time of registration of a security in a public register is the relevant factor for transfer of risk between the parties. As such, it is also considered by the tax and accounting standards, which are applied accordingly in closing of agreements. The time for registering a security agreement and setting up a pledge is therefore limited to the notary public's availability. For smaller local communities this may present an issue during holidays, since only a local notary may set up mortgages.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

We wish to point out that specific measures need to be taken in cases where a syndicated loan requires the setting up of security over assets. The technical capabilities within the public registries do not allow security beneficiaries to be registered in the same priority order. In practice, an intercreditor agreement (***ICA***) is stipulated allowing for formally registering syndicate members in ordinal order, but with a side note explaining that they represent the same rank with shared interest. A solution with a security agent was proposed, but banks are reluctant to develop this service due to accounting, regulatory reporting standards and general legal risks, making room for law firms' offering of agency services. We cannot point out any other special concerns with the creation of security.

© Published and reproduced with permission by Global Legal Group Ltd, London

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

As a general rule, no. From a legal perspective it is sufficient that the revolving facility is limited to a maximum amount. Please refer to question 3.3 for the description of maximum mortgage, which is the optimal mortgage type for such credit lines.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

A notarial deed is generally required for registration of collateral to avoid the risk of imperfection. All notarial deeds require the personal presence of the legal representative of the company or a power of attorney in notarial deed form. In case of sale of goods with retention of title (leasing agreements), notarisation of signatures is required. Fiduciary cessions/assignment of receivables may be done without notarisation, but will not be upheld as priority rank in case of insolvency proceedings. Even if a notarial deed is not required, at least the notarisation of signatures is advised to avoid possible claw-back issues. Agreements are executed in as many counterparts as needed by the parties; notarial deeds are deposited and available for additional copies if needed.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

The Slovene Companies Act explicitly bans financial assistance where a stock corporation supports the acquisition by third parties in order for such third parties to acquire shares of the corporation. Any such agreement is null and void, and the company and management are subject to a fine of up to €45,000 for misdemeanour.

The above does not apply in cases where financial assistance is granted in the course of the regular business of financial institutions and in cases of employee equity participation plans.

LLCs are not subject to comparable financial assistance rules if they uphold the limitations described in the answer to question 2.1.

(b) Shares of any company which directly or indirectly owns shares in the company

There is no direct prohibition in the law; however, the recent Slovene case law leads us to the conclusion that a very restrictive approach is advised. The law gives the court broad discretionary power to decide if the intent of the proposed transaction was to provide financial assistance by the target company and the courts have established that a broad approach in identification of cases of financial assistance is required. We have not identified specific cases regarding the issue, but would advise potential clients on expected risks.

(c) Shares in a sister subsidiary

Please refer to the answer under point b) above, although the clarity of this situation in this case is not as evident as in previous cases.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Slovenian law does not recognise the trustee as recognised in other common law legal jurisdictions. Several practical solutions have addressed the need for a trustee in syndicated proceedings, although with certain limitations. As already mentioned in question 3.11, the lenders will have difficulty to register the syndicate's collateral rights in public registries and an inter-creditor agreement (***ICA***) is usually required to address this issue. From a procedural point of view, a lawyer may be nominated as a representative of multiple creditors, appointed to execute several collaterals according to ICA. Fiduciary assignment of rights or collateral have been used to similar effect on assets, where such registration is possible in public registries. We would like to point out that banks offer agency services without the enforcement of collateral, which would require the mentioned fiduciary cession, due to legal, accounting and regulatory risks.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

As explained above, a law firm may accept multiple non-conflicting mandates to enforce the rights of the syndicate members. The law firm is officially not a holder of rights on collateral or receivables, but has full power of attorney to represent a syndicate (joint venture or *societas*) based on an ICA.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The surety (which we understand is the intent of the question) is accessory to the transferred receivable; therefore, theoretically such transfer does not even need to recognise such surety, which is effective automatically by law. There are several legal provisions regulating such transfer, like rules on set-off against the initial creditor and notification rules, which may have an effect on the value of such "collateral".

Slovene law still contains a valid part of an old pre-transition era Obligations Act, which regulates bank guarantees, including demand guarantees. It governs transferability of the bank guarantee as accessory to the claim and obligations, effectively requiring an agreement amendment instead of cession or assignment of rights. Notwithstanding the above-mentioned, model rules, such as UCP 600, ISP 98 or URDG 758 supersede such regulatory provision if referred to in guarantee documents.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest is considered revenue and is therefore taxable in accordance with the Slovene Corporate Income Tax Act; according to domestic and foreign law, legal entities are considered taxpayers. The Act provides that a taxpayer must be a company and/or any association of persons, including a civil law company subject to foreign law, which does not have legal personality and is not considered a taxpayer subject to the Act regulating personal income tax.

Tax shall be paid at the rate of 17% of the tax base.

a) The tax shall be calculated, withheld and paid at the rate of 15% on the income of residents and non-residents – other than dividends and income similar to dividends paid through a non-resident's business unit located in Slovenia – whose source is in Slovenia, i.e. on interest payments other than the interest: a) on loans raised by and securities issued by Slovenia; b) on loans raised with and debt securities issued by an authorised institution in accordance with the law regulating insurance and financing of international business transactions for which, subject to the aforementioned law, guarantees are issued by Slovenia; and c) paid by banks, other than on interest paid to persons who have their seat or place of effective management or residence in countries other than the EU Member States, where the general and/or average nominal profit tax rate is lower than 12.5% and the country is published on a list of countries pursuant to Article 8 of this Act. For the purpose of this chapter, interest shall comprise the income arising from all types of receivables, regardless of whether they are collateralised with a mortgage, and interest arising from all debt securities and other debt financial instruments, including premiums and bonuses belonging to such securities and financial instruments, other than interest for late payment. It is important to emphasise that both the borrower and lender shall adhere to the *Rules on the recognised rate of interest*, which provides a methodology for determining the recognised interest rate for interest on loans between related parties, and must be taken into account when determining the revenue and expenditure of the taxpayer.

b) No withholding tax is payable.

Withholding tax does not apply to interest payments made to resident companies. Interest payments are exempt from withholding tax if conditions from the Interest and Royalty Directive are fulfilled. The Interest and Royalty Directive is implemented in Article 72 of CITA-2.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

The Slovenian government has set up a Public Agency for Entrepreneurship, Internationalization, Foreign Investments and Technology (***SPIRIT***) based on the promotion of the Foreign Direct Investment and Internationalisation of Enterprises Act which serves mainly as the regulatory framework for several public lenders, but does not regulate any automatic tax breaks or incentives for lenders.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Slovenian law does not regulate taxation based exclusively on these criteria.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Except for legal drafting costs, notarial fees and registration fees, no.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

The provenance of lenders does not present any risk or adverse consequences for the borrower. Please note that this is notwithstanding anti-money laundering provisions and terrorism financing or international sanctions against certain subjects. Pursuant to article 32 of the Slovene Corporate Income Tax Act (ZDDPO-2), if a loan from a related party exceeds four times the capital, the interest on the loan surplus is not recognised as a tax deductible expense.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

If a Slovene court has jurisdiction for claims arising from a contract, Regulation (EC) 593/2008 on the Law applicable to Contractual Obligations (***Rome I***) shall apply. The Slovene court shall rule in accordance with the law chosen by the parties (Article 3 Rome I) and shall recognise a contract made in another jurisdiction. The Regulation applies to civil and commercial matters, regardless of whether the chosen law is the law of the Member State or not. The choice of law shall be clearly expressed/demonstrated by the terms of the contract or the circumstances of the case, wherein later modifications of the chosen law for the part or the whole contract are possible. It has to be noted that even when governing law for the contract is chosen, it shall not prejudice the application of provisions of the law of the country that has jurisdiction or of the Community law, which cannot be derogated from by agreement. Moreover, where crucial for safeguarding public interest (violation of public order), mandatory provisions of Slovenia shall override provisions of the contract.

Slovene law is based on the civil law system and strongly influenced by German law. Choice of law other than Slovene law may in practice be connected to difficulties when ruling, additional costs for legal opinions and interpretations of the chosen foreign law, translation costs, etc., especially when ruling by a law that is based on the common law approach.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Two different situations are to be distinguished in this regard: (i) judgments rendered in an EU Member State; and (ii) judgments rendered in a Non-EU State.

(i) Recognition and enforcement of foreign judgments rendered in **EU Member States** are regulated by Regulation (EU) 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (***Brussels 1 Recast***). A judgment rendered in one Member State shall be recognised in the other Member State without any special procedure being required. Furthermore, no judgment shall be reviewed as to its substance in the Member State addressed. According to that, a judgment from a UK court shall be recognised with no special procedure and no re-examination of the merits of the case unless there are grounds for refusal of recognition – according to the Slovene Private International Law and Procedure Act, a foreign court decision shall not be recognised if the effect of its recognition would be contrary to the public order of the Republic of Slovenia. This similarly applies to the enforcement of a judgment rendered in the UK, which shall be enforced without any declaration of enforceability (*exequatur*) being required. The judgment creditor is required mainly to present the enforcing court with a copy of the judgment and a standard certificate delivered by the UK court that rendered a judgment (Article 53 Brussels 1 Recast).

(ii) Pursuant to the Slovene Private International Law and Procedure Act, foreign court decisions shall be equal to the decisions passed by courts in Slovenia, and shall have the same legal effect in Slovenia, but only if having been recognised by a court in Slovenia. In general, a judgment rendered in a **Non-EU State** shall be recognised in Slovenia *unless*: (a) the effect of its recognition would be contrary to the public order of the Republic of Slovenia; (b) following an objection by the person against whom it was issued, irregularities have been committed in the procedure which prevented this person from taking part in the procedure; (c) the subject matter is within the exclusive jurisdiction of the court or another body of the Republic of Slovenia; (d) following an objection by the person against whom it was issued, the court which issued the decision did not take into account the agreement on jurisdiction of courts in the Republic of Slovenia; (e) the court or another body of the Republic of Slovenia has issued on the same matter a legally binding decision, or if some other foreign decision on the same matter has been recognised in the Republic of Slovenia; and (f) if mutuality does not exist.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) First-instance court judgments are generally obtained within 12 months from the date of filing a claim; however, the timeframe will depend on the complexity of the case and workload of the court. In case of an appeal, courts of appeals issue decisions within six months. In case of a need of enforcement procedure, it may take up to 12 months to enforce a judgment; or 18–24 in real estate cases (including auction calls, disbursement, etc.). In case of no opposition by the opposing party, the enforcement procedure may be resolved immediately, except in real estate (mortgage) sales, which are estimated at 12 months minimum.

(b) In case of no opposition, the recognition and enforcement procedure shall take up to 12 months.

It has to be noted that the timeframe for closing the case varies from case to case, depending on the complexity of the case, the district court that has territorial jurisdiction, their workload, and number of appeals filed. To secure the debtor's assets and if the conditions are met, it is possible to apply for an interim injunction on the assets of a debtor.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

All types of collateral security must in general go through a formal enforcement procedure, conducted by the enforcement court. The timing depends on the workload of the court and the complexity of the case, whereas the costs of the enforcement procedure (legal fees, court fees, notary fees, costs for enforcement of collateral security and costs of executors) depend on the value of the claim and on the number of means of execution.

There are different types of collateral, namely: (i) real estate collateral (mortgage, collateral on non-registered real estate, (property) encumbrance); (ii) movables (possessory and non-possessory pledge); (iii) shares, stock, financial instruments; (iv) receivables; (v) other material rights such as intellectual property and not strictly collateral; and (vi) surety/guarantee.

In order for a lender to enforce its collateral and get repayment of the loan, his claim is required to have matured and have a proper title for enforcement.

In Slovenia, loan agreements and security documents are usually confirmed in the form of a directly enforceable notarial deed before a notary in order to attempt to achieve direct enforceability of the claims through the court system and to somewhat simplify the enforcement in the event of default. In such cases, the burden of process and proof is entirely transferred to the debtor, which does not necessarily mean that the collateral is available for liquidation.

In certain cases a lender may enforce his claim in the out-of-court sale of collateral; however this is only possible for certain types of collateral (sale of pledged shares, dematerialised securities, movables, etc.) and certain conditions must be met. Immovable property must always be sold by the court and in one of several public auctions. Minimum price limits are in place for interested bidders.

Slovene law does not provide for any regulatory consents for the enforcement of security.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

When a foreign citizen or a person without citizenship who does not have permanent residence in Slovenia initiates a suit before a court in Slovenia, a deposit towards the costs of the suit is due, but *only upon the defendant's request*. The deposit towards the court costs shall be made in cash; the court may permit the deposit to be made in another appropriate form.

The defendant shall not be entitled to a deposit towards court costs if citizens of Slovenia are not obliged to pay deposits in the country

© Published and reproduced with kind permission by Global Legal Group Ltd, London

that the defendant is a citizen of, and in cases of suits concerning bills of exchange or cheques, counter-suits or suits requesting issuance of a payment order, among others.

The court may, by its own discretion, reject a request for a deposit. (Articles 90–93 of the Slovene Private International Law and Procedure Act).

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Within insolvency and financial restructuring legislation, Slovenia distinguishes: (i) compulsory settlement; (ii) bankruptcy; (iii) personal insolvency proceedings; (iv) legacy bankruptcy proceedings; and lastly (v) pre-insolvency preventive financial restructuring. It is a general rule that after insolvency proceedings have been initiated, issuing an order on execution or securing against the insolvent debtor shall not be permitted.

(i) Enforcement and securing procedures started prior to the initiation of **compulsory settlement** shall be interrupted upon the initiation of insolvency proceedings. (Article 132 of the Slovene Financial Operations, Insolvency Proceedings, and Compulsory Dissolution Act.)

(ii) Initiation of **bankruptcy proceedings** has the following legal consequences for the initiated enforcement and securing procedure: (a) if in the enforcement and securing procedure the creditor has not yet acquired preferential rights by the beginning of a bankruptcy proceeding, the enforcement and securing procedure stops; (b) if the preferential right has been acquired but the sale of assets has not been carried out, the enforcement and securing procedure is terminated; (c) if the sale of assets has been carried out on the basis of preferential right, initiation of bankruptcy proceedings does not affect the course of the enforcement procedure; and (d) an initiated civil procedure (litigation) for enforcement of a claim that started prior to initiation of bankruptcy proceedings shall be temporarily terminated. Litigation shall continue if the creditor's claim, filed in a bankruptcy proceeding, was negated by the liquidator and if the creditor, within one month following the publication of the resolution, proposes the continuation of the interrupted civil procedure.

All creditors must file their claims in a bankruptcy proceeding within 3 (three) months from the commencement of proceedings. If they fail to do so, they lose their right to repayment. Claims by EU residents may be filed in native language.

Rules under (ii) apply *mutatis mutandis* also for personal bankruptcy proceedings and legacy bankruptcy proceedings.

For preventive financial restructuring (max. eight months) the moratorium on enforceability only applies to financial lenders, whereas workers, suppliers and tax authority are excluded from the moratorium.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

In Slovenia the recognition and enforcement of arbitral awards is governed by the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958). Arbitral awards shall be recognised and enforced on this basis. Slovene courts will generally not re-examine the merits of the case. Slovene courts shall re-examine the merits and (potentially) decline the recognition and execution of a foreign arbitration decision if the effects of recognition or execution of the decision would be contrary to the public order.

A foreign arbitration award shall be recognised and executed if the party requesting the recognition and execution supplements the request submitted to the court the following: 1) the original arbitration decision or an authenticated copy thereof; and 2) the original agreement to arbitrate or an authenticated copy thereof.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Secured lenders (loans secured with mortgages, pledges, etc.) generally have a preferential right in insolvency proceedings. This right is executed with a preferred distribution from the proceeds of the enforced security, whereas unsecured creditors only participate *pro rata* in the remainder of the proceeds (if any) from the bankruptcy proceedings.

A recent change in the Insolvency Act (***ZFPPIPP***) moved away from the absolute protection of secured creditors, establishing the possibility to force a minority of collateral holders to change their underlying receivable terms, such as prolonged maturity or "haircut". These exceptions are applicable in creditors' compulsory settlement procedures and preventive financial restructuring procedures, subject to a high majority vote of the collateral holders (75%).

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Priority claims, which must be compensated before other claims, are, in general, salaries and wage compensation for the three months prior to the initiation of insolvency proceedings, compensation for accidents related to work and occupational diseases, unpaid compensation for the termination of a working relationship prior to the initiation of bankruptcy proceedings, compensation to employees who had their employment contract terminated by the administrator, and taxes and duties which the payer shall charge or pay (Article 21 ZFPPIPP).

Besides that, legal actions made by the insolvent party that impaired third-party creditors during the applicable preference (claw-back) period may be challenged if certain additional statutory requirements are satisfied. The applicable preference period runs for 12 months (36 months in *causa donandi* agreements) prior to the filing of a petition for insolvency (Article 269 ZFPPIPP).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Governmental organisations are excluded from insolvency proceedings. Recent developments in the Slovene banking sector showed the inadequacy of Slovene insolvency regulation, which, although present, did not allow for relatively minor banks to be brought in bankruptcy proceedings, but were instead put under forced liquidation management by the regulator. In this case a governmental guarantee was issued to bondholders and other creditors. In case of organisations that are not subject to insolvency, execution procedures are available, with limitations to assets that are not subject to enforcement (infrastructure, defence and law enforcement, public service, etc.).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

In general, creditors must enter into proceedings in enforcement court in order to seize and sell the assets and get repayment. The creditor and the pledger may agree in a contract of pledge that the pledged (movable) property can be sold out of court. An agreement on an out-of-court sale must be concluded in writing. In the case of contracts of pledge, which under the provisions of obligation law are considered to be business contracts, the existence of an agreement on an out-of-court sale is presumed. The same standard in principle applies to monetisable rights, such as receivables, intellectual rights, LLC shares, etc.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

According to Article 25 Brussels 1 Recast, if the parties have agreed that a court of one Member State shall have jurisdiction to settle a dispute, then that court shall have jurisdiction and Slovene courts shall respect that decision (prorogation of jurisdiction). The parties may choose such jurisdiction to be exclusive or to agree otherwise, while all such arrangements must be in writing.

However, the agreed jurisdiction shall have no legal force in Slovenia if the agreement on jurisdiction is contrary to the provisions on exclusive jurisdiction (rights *in rem* in immovable property, nullity of the companies or other legal persons and validity of the decisions of their organs, validity of entries in public registries, registration or validity of patents, trademarks, designs, etc., and proceedings concerned with the enforcement of judgments).

Slovene courts have the exclusive power to permit and conduct execution of a ruling, if this is carried out in the territory of the Republic of Slovenia. The same applies for the insolvency procedure over assets in Slovene territory.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

In principle, yes. Judicial proceedings in cases involving foreign citizens who enjoy immunity in the Republic of Slovenia, and in cases involving foreign states or international organisations, shall be governed pursuant to the rules of international law (Article 28 Slovene Civil Procedure Act).

Therefore, the Vienna convention on consular relations applies in this regard. The sending State may waive, with regard to a member of the consular post, any of the privileges and immunities given to their members. The waiver shall in all cases be express, except as provided in section 3 of this chapter, and shall be communicated to the receiving State in writing. The waiver of immunity from jurisdiction for the purposes of civil or administrative proceedings shall not be deemed to imply the waiver of immunity from the measures of execution resulting from the judicial decision; in respect of such measures, a separate waiver shall be necessary.

A scarce case law also supports the theory that sovereign states may not invoke immunity in standard business or civil procedures with non-sovereign plaintiffs.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

For performance of money lending to consumers as an ongoing business activity, the Slovene Consumer Credit Act is applicable (ZPotK-1). According to this Act, the creditor must obtain a licence issued by the Ministry of Economic Development and Technology. The Ministry shall issue or renew a licence if the applicant meets certain requirements, namely: human resources; education; and spatial, organisational, and technical conditions, among others. An applicant must also not be convicted of an offence of fraud or extortion or be a person from whom the licence has been withdrawn. A licence is issued for a period of three years with the possibility of extension.

Such a licence is not required for banks and saving banks that are authorised to provide banking services, creditors who give loans only to their employees, or non-profit organisations that provide loans only for social and educational purposes.

Licensing of banking service providers is regulated by the Slovene Banking Act (***ZBan-2***), which requires a difficult administrative and detailed licensing procedure, led by Bank of Slovenia as main banking regulator.

Control of creditors which operate under a licence issued by the Ministry, and control over their credit intermediaries is performed by the Inspectorate, which must report suspected violations to the Ministry. The same applies to the Bank of Slovenia for the supervision of banking licence holders.

Creditors which operate under a licence issued by the Ministry, must report to the Ministry annually regarding concluded credit agreements and the agreed effective interest rate or the lack of such.

A legal or natural person who provides credit without a licence may be fined for misdemeanour up to €125,000.

Banks and saving banks have extensive reporting requirements to the Bank of Slovenia.

Syndicated loans are not explicitly regulated in Slovene law; however, simplified LMA standards are used in the definition of roles, terms and conditions. Due to the fact that only banks offer agency and book-running services, no issues have yet been raised on licensing requirements for such activities by the Bank of Slovenia. A bank, however, requires a licence for so-called "mutually recognised banking services", which include intermediary services in international monetary markets, effectively limiting non-bank book-runners to the Slovene market.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are no special material considerations which should be taken into account.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Luka Gaberščik
Brulc, Gaberščik in Kikelj o.p., d.o.o.
Dunajska cesta 9
1000 Ljubljana
Slovenia

Tel: +386 41 724 880
Email: luka.gaberscik@bgk.si
URL: www.bgk.si

Luka Gaberščik graduated with honours from the Faculty of Law in Ljubljana in 2002. After having completed the programme of judicial traineeship at the Higher Court, he became employed at a major Slovene law firm, where he continued his career as a lawyer. He began his career as an independent lawyer in 2008 and upgraded it two years later with the establishment of the BGK law firm. He primarily deals with banking and finance law, deal structuring, corporate/M&A and insolvency law. His recent projects have mostly consisted of acting for Slovene and foreign financial institutions in distressed/insolvency/restructuring situations. Mr. Gaberščik has extensive experience in dealing with corporate group structures, and regularly provides advice in relation to legal issues in project financing, insolvency and restructuring law. He is also a Chairman of the HR Committee of Slovene Sovereign Holding.

Mina Kržišnik
Brulc, Gaberščik in Kikelj o.p., d.o.o.
Dunajska cesta 9
1000 Ljubljana
Slovenia

Tel: +386 40 475 546
Email: mina.krzisnik@bgk.si
URL: www.bgk.si

Candidate attorney Mina Kržišnik graduated at the Faculty of Law in Ljubljana in 2011. After she graduated, she started her career as a junior associate in BGK law firm and now continues her work as an attorney candidate. Before that, she gained experience in several law firms and worked as legal and HR specialist in one of the biggest Slovene companies that produces measuring instruments. Mina passed the bar exam in July 2014. She studied at Reykjavik University (Iceland) and Erasmus University Rotterdam, and holds a Master`s degree (LL.M.) in commercial and company law, obtained at Erasmus University Rotterdam – Erasmus school of law (Netherlands). In February 2015 she attended a winter school at University and a research institute in Wageningen (Netherlands) in food safety law and obtained a certificate in this field of law. After her return to the law firm, she is specialised in commercial and company law. Her work includes national and international corporate law, commercial law, civil law and food safety law.

B G K L A W

BGK Law Firm is a team of legal experts covering all major private law fields. The core of the team is the partners: Damijan Brulc, Luka Gaberščik and Tina Kikelj. Mr. Brulc mainly works for pharmaceutical and chemistry-related companies and is an expert on real estate and property law, Mr. Gaberščik on investment and banking issues, whereas Ms. Kikelj covers insurance and general regulatory compliance. Apart from the cited specialisations, all attorneys cover labour, corporate and general civil matters, with their services ranging from consulting and business support to litigation and transactions. The team is supported by three senior and two junior associates and offers services in a variety of languages, from English, German, Spanish and Italian to Croatian and Serbian.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Chapter 51

Spain

Manuel Follía

Cuatrecasas, Gonçalves Pereira

María Lérida

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

After years of financial restructuring, which implied an important reduction in the number of Spanish saving banks, the sale of troubled institutions and the stimulation of mergers between credit entities, the Spanish financial sector seems to be getting healthier, keeping the main focus on achieving healthy balance sheets. As a natural consequence of the above, the Spanish financial sector has conducted a very active deleveraging activity over the last few years, with huge sales of non-performing loan portfolios and distressed assets (including real estate assets) to prestigious international distressed and real estate funds.

Likewise, refinancing and restructuring transactions have increased too, mainly due to the benefits arising from the review of the Spanish insolvency legal framework (briefly described under section 8). In terms of corporate and acquisition financing transactions, these are playing an important role too. In particular, the real estate sector has come into the spotlight following a willingness to provide financing, and new transactions concerning the hotel industry are moving forward.

On significant developments, particularly of a legal nature, the Spanish law for the promotion of business financing ("*Ley de Fomento de la Financiación Empresarial*") dated 27 April 2015 takes the prize for developing lending markets in Spain, by creating alternative financing structures and providing certain level of regulation and formality. Such law aims to respond to Spanish companies' traditional dependence on bank financing, which is particularly critical among small and medium-sized companies. The preamble to the law states that this "strong bankerisation" has exacerbated the financial crisis in Spain, characterised by a marked drop in lending and a parallel increase in its cost. The law proposes a series of measures to increase and facilitate SMEs' access to bank credit. It also introduces new developments to promote alternative sources of financing and corporate financing mechanisms.

The immediate future looks particularly promising for lending markets in Spain (including the upward trend on high yield debt issuances within Spanish companies).

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

2015 has been another successful year for our practice not only in terms of number of deals, but also in terms of amount, volume, variety of structures and client portfolio, and we have strengthened our participation in many transactions located in the Latin American region.

- Refinancing and debt restructuring processes: This is still a market trend, taking into account the Spanish economic context. For some years now, and particularly this year, we have participated actively in debt refinancing and restructuring processes, involving large national and international companies from different sectors, which have required forming multidisciplinary teams with a high international element. Some examples include our advice to certain Investment Funds in the restructuring of FCC and its homologation process (€4,528 billion), and our participation in the restructuring of Grupo Iberostar (€930 million).
- Corporate and real estate finance: After several years of putting this advice "on hold" due to Spanish economic recession, we have become active again advising on transactions involving fresh money. We advised on the Colonial refinancing (€350 million) and Grupo Zeta's refinancing and corporate restructuring (€140 million).
- Distressed debt: We are one of the most specialised law firms advising on distressed debt transactions, acquisition of corporate debt, loan portfolios and restructuring debt processes. We have been chosen by major international and prestigious funds and have advised either the distressed/special situations funds (as a purchaser), or the financial institution (as a seller) in many significant deals. Among others, some recent transactions include selling a Catalunya Banc loan portfolio to an Investment Fund and to the Fund for Orderly Bank Restructuring (FROB) via an asset-backed securitisation programme (€6,500 billion), and advising on the sale of secured and unsecured loan portfolios, such as Project Atalaya (€785 million), Project More (€546 million) or Project Tower (€240 million).

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, subject to the restrictions of financial assistance (see question 4.1 below). In addition, although Spanish law does not provide for any specific obligation to justify a company granting a guarantee or security based on corporate benefit, it is advisable (and in some cases expressly required by law) for both the Management Body and the General Meeting of Shareholders to pass a resolution approving the transaction, referring to the corporate interest or benefit that the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

company granting the guarantee or security or the group as a whole will obtain through such transaction.

Finally, subject to certain case law, the relevant guarantee constituted by a Spanish subsidiary in favour of its parent company might be challenged by a Spanish court if no consideration (*contraprestación*) is provided to such subsidiary.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Directors of a Spanish company have a duty of care towards the company and must act faithfully and loyally towards it. When there is an evident disproportion between the benefit for the company and the granting of collateral by the guaranteeing/securing company, often borrowers request that certain limitation language is included both in the collateral documentation and in the corporate resolutions to minimise a potential liability risk for the Management Body of the company.

Additionally, in case of an eventual insolvency situation on the part of the company, there is a potential risk that the insolvency administrators might presume that the granting of collateral by the company could have resulted in the insolvency and allege that it is detrimental to the insolvency estate; in such case the Management Body could be held liable for its actions.

2.3 Is lack of corporate power an issue?

Yes, in Spain the agreements need to be executed by duly empowered representatives of the company, with sufficient corporate power to act on its behalf.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Usually, no governmental consents or filings are required to grant guarantees/security interests in Spain (see question 3.11 below).

Regarding internal corporate approvals, in general terms, any actions or activities which fall within the scope of the corporate purpose of the company are subject to fewer formalities. However, in case of private limited liability companies (*sociedades de responsabilidad limitada*), shareholders' approval may need to be obtained before carrying out certain transactions. In public limited liability companies (*sociedades anónimas*), despite not being mandatory, the shareholders' approval is also usually obtained. See also question 2.1 above in relation to corporate benefit.

Additionally, and taking into account the amendments in this field introduced by Law 31/2014 of 3 December, a disposal of an asset may occur in respect of an essential asset of the company (such as taking security over the essential asset), and in such case it is advisable to obtain the relevant shareholders' approval.

For the purposes of the above, an asset shall be deemed essential when the value of the transaction related to such asset exceeds 25% of the value of the assets included in the last balance sheet approved by the company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, although certain limitation language is included in case of disproportions (see question 2.2 above).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control regulations on the enforcement of a guarantee. However, Spanish Insolvency Law imposes an important restriction on lenders facing imminent or real insolvency of their debtors, as it renders unenforceable contractual early termination clauses solely based on a declaration of insolvency.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The types of collateral most commonly used to secure financing transactions are generally classified into two main groups: (1) *in rem* security interests, the most common being: (i) mortgage over real estate (*hipoteca inmobiliaria*); (ii) ordinary pledge over movable assets with transfer of possession *(prenda ordinaria)* (e.g., pledge over shares, over credit rights or over bank accounts); (iii) chattel mortgage (*hipoteca mobiliaria*); and (iv) non-possessory pledge over assets (*prenda sin desplazamiento de la posesión*); and (2) personal guarantees, mainly being first demand guarantees (*garantías a primer requerimiento*).

The main difference between *in rem* security interests and personal guarantees is that, in the former, a specific asset secures fulfilment of the obligation, while in the latter, an individual or corporate entity guarantees fulfilment of the obligation. There are also material differences in proceedings for their enforcement and their treatment during insolvency (*concurso*) under the Spanish Insolvency Act.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Spanish law does not provide for a so-called "universal security" over the entire debtor's assets. Nor does it generally admit the creation of a "floating" or "adjustable" lien or encumbrance, except for certain mortgages over real estate. Therefore, a security agreement is usually required in relation to each type of asset.

The creation of guarantees and security interests requires notarisation in order for them to be considered as an executive title (*título ejecutivo*) in an enforcement scenario. Notarial deeds (being either *pólizas notariales* or *escrituras públicas*) provide certainty of the date and content of the applicable document *vis-à-vis* third parties. Furthermore, some of these types of security interests are subject to compulsory entry on public registries, such as the Land Registry (*Registro de la Propiedad*) (e.g., real estate mortgage) or the Chattel Registry (*Registro de Bienes Muebles*) (e.g., mortgage on inventory or non-possessory pledge over assets), while such registration is not required for other collateral (e.g., ordinary pledge with transfer of possession).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Real property is taken as security by means of a real estate mortgage (*hipoteca inmobiliaria*). Under Spanish law, real estate mortgages cover: (i) the plot of land and the buildings built on it; (ii) the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

proceeds from the insurance policies insuring such property; (iii) the improvement works carried out on the property; and (iv) natural accretions. Should the parties agree so, such mortgage may also include (i) movable items located permanently in the property, (ii) civil fruits, and (iii) due rents that had not been already satisfied.

Security over machinery and equipment can be created by means of a chattel mortgage (*hipoteca mobiliaria de maquinaria industrial*) or a non-possessory pledge (*prenda sin desplazamiento de maquinaria industrial*). The choice will depend on whether the specific asset meets certain legal requirements.

For both types of security, notarisation is necessary, as well as registration with the relevant public registry (see question 3.2 above).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables can be taken in two different manners: (i) by creating a possessory pledge *(prenda ordinaria)*; and (ii) by creating a non-possessory pledge (*prenda sin desplazamiento de la posesión*) which may be registered in the Chattel Registry.

With respect to the possessory pledge over receivables, in order for the pledge to be perfected, notification to the debtor is required. However, and taking into consideration the commercial impact of the notification, sometimes the notice to the relevant debtors will only be given upon potential or effective default.

On the contrary, the non-possessory pledge (*prenda sin desplazamiento de la posesión*) does not require notification to the relevant debtor on the basis that the filing of such pledge with the relevant Chattel Registry would give it the necessary publicity *vis-à-vis* third parties.

Further to the above, those claims secured by a pledge over future receivables shall be considered privileged in an insolvency proceeding provided that, among other requirements: (i) the security interest is documented by means of a public deed (*escritura pública*) when it comes to ordinary pledges; and (ii) the security interest is formalised by means of a deed (*póliza notarial*) and is registered in the relevant Chattel Registry in case of a non-possessory pledge.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

The pledge over bank accounts is simply a pledge of the credit rights of the holder of the account *vis-à-vis* the bank, which should typically correspond to the account balance.

The formal requirements are identical to those that apply in the case of any other possessory pledge over receivables (notarisation is needed). Possession is transferred by notification to the depository bank. The creation of the pledge does not imply, unless otherwise agreed by the parties, the freezing of the accounts.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, collateral security can be taken over shares in companies incorporated in Spain. However, and by virtue of the *lex rei sitae* principle, such pledges should be always governed by Spanish law, not New York or English law. Exceptionally, creating a pledge under a law other than Spanish law might be considered, although enforcement proceedings will be longer and burdensome.

Perfection requirements for pledges over shares in Spain usually include: (i) endorsement of share certificates (if these have been issued); (ii) registration of the pledge in the relevant Registry Book of Shareholders or Shares, as applicable; (iii) registration of the pledge in the deeds of acquisition of the relevant shares; and (iv) in the event of shares represented by book entries (*anotaciones en cuenta*), registration of the pledge in the book entry register.

Further to the above, and according to Law 14/2013 of 27 September, on Support to Entrepreneurs and its internationalisation (“*Ley de Apoyo a los Emprendedores y su internacionalización*”), the relevant Registry Book of Shareholders or Shares, as applicable, shall be kept, updated and legalised by electronic means (enabling a smooth and faster control of the relevant entries).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, Spanish law foresees a specific mechanism for creating security over inventory, which is the non-possessory pledge over inventory (*prenda sin desplazamiento de inventario*). As provided in questions 3.2 and 3.3 above, this type of collateral requires notarisation as well as registration in the relevant Chattel Registry.

However, it is also possible to create a security over inventory by means of granting a chattel mortgage over business (*hipoteca de establecimiento mercantil*), which will include not only the inventory, but the whole business.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, it can be done, although always subject to the Spanish prohibition of financial assistance (see question 4.1 below) and certain corporate benefit issues (see question 2.1 above).

Aside from this, and considering the restriction in Spain regarding floating charges (see question 3.2 above), if the obligations to be secured arise from different types of credit agreements, the Spanish principle of integrity (by virtue of which a security interest can secure only a main obligation and its ancillary obligations, such as interest, costs, etc.) must be complied with, which in practice means that where two different main obligations are to be secured, two different security interests (over different assets or portions of the same asset) must be created.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notary fees are fixed amounts that vary according to the secured liability (approximately 0.03% of the secured liability), although in transactions with aggregate value higher than €6 million, they can be reduced if negotiated with the notary.

As regards security subject to compulsory entry on public registries (particularly mortgages and non-possessory pledges), in addition to registry fees (approximately 0.02% of the secured liability), some mortgages and certain non-possessory pledges (in particular, those which have been documented by means of a public deed (“*escritura pública*”) rather than a deed (“*póliza notarial*”)), also imply payment of stamp duty tax (varying from 0.5% to 1.5% of the secured liability – principal, interest and any related costs –

© Published and reproduced with kind permission by Global Legal Group Ltd, London

depending on the Spanish region where the collateral is located). Stamp duty tax is not levied on ordinary pledges.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

As regards security documents that need to be filed within a public registry, the expected amount of time from the date the documents are notarised to the actual filing by the public registry is usually from two to six weeks, assuming the relevant security document was correctly drafted and no errors were found by the registry that need to be amended by the parties. As to related expenses, see question 3.9 above.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Regulatory or other consents with respect to the creation of security over real property or machinery would apply only in very limited cases, depending on the exact location of the asset, its nature and the parties involved (e.g. mortgage over administrative concessions).

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

In rem security interests securing a financing have, as a general rule and according to the Spanish Insolvency Act, the status of credits with special privilege. This privilege will be granted to claims arising under the credit facility as a whole, independent of the fact that it is of a revolving nature. Please see section 8 for a better understanding regarding the priority of such privilege.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

As explained in question 3.2 above, in Spain security interests are almost always notarised. To appear before a Spanish Notary, all parties must be duly empowered (they can act under powers of attorney, which in case of foreign entities, must bear an apostille in accordance with The Hague Convention).

Signature in counterparts is not used in Spanish law governed agreements. It is worth mentioning that all parties that are signatories to a Spanish notarial deed must have a Spanish Tax Identification Number (*Número de Identificación Fiscal* or "NIF"), even for non-resident parties and their non-resident attorneys (either individuals or entities), which must request such number before the Spanish Tax Authorities (*Agencia Tributaria*).

Additionally, the Spanish Anti-Money Laundering Law ("*Ley 10/2010, de 28 de abril, de prevención del blanqueo de capitales y de la financiación del terrorismo*"), requires certain disclosure obligations when executing transactions before a Spanish Notary Public (with certain exceptions, such as those for listed companies). In particular, individuals executing a public deed before a Notary Public on behalf of a company need to disclose the identity of the ultimate beneficial owner (*titular real*) of the company, which is:

(i) the ultimate shareholder or shareholders (individuals) of the company, in the event there is a person holding (individually), directly or indirectly, a stake exceeding 25% in the share capital of this company; or

(ii) the individual controlling, directly or indirectly, the management of such company.

In the event that no individuals hold such a direct or indirect stake or control, the directors/members of the management body of the company are to be regarded as the ultimate beneficial owners and need to be identified too.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Generally, Spanish law prohibits funds being provided (whether by way of loans, guarantees or any other kind of financial support provided before or after the acquisition) by a target company to a third party so that the third party is able to acquire shares or quotas issued by the target company, or by any other company in the group to which the target company belongs.

Financial assistance is currently prohibited in Spain for:

(a) *sociedades anónimas* (*S.A.*) (public limited companies): for their own shares or the shares of any direct or indirect parent company; and for

(b) *sociedades de responsabilidad limitada* (*S.L.*) (private limited companies): for their own units and the units of any member of their corporate group.

The consequence is that, if financial assistance is deemed to have been provided, any such financial assistance will be null and void.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Spanish law does not recognise trusts as a legal figure. Therefore, security trustees, although used in transactions where foreign lenders are involved, are seldom used for the Spanish security package. Instead, lenders tend to appoint an agent for the Spanish security, which would hold the Spanish security in its own name and on behalf of the other lenders.

It is possible for the security agent to enforce claims on behalf of the lenders and the other secured parties, as long as each party grants a notarised power of attorney to the security agent, authorising it expressly to carry out the enforcement proceedings. However, authors and case law are inconsistent regarding the role of an agent acting on behalf of the syndicate of lenders upon enforcement.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

As stated in question 5.1 above, the appointment of an agent for Spanish security is usual market practice for cross-border financings.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

In Spain, debt is traded through assignment (*cesión*), and due to the accessory nature of security interests under Spanish law, any assignment of a participation in a secured financing agreement would entail the proportional assignment of the security interests created to secure the full and punctual satisfaction of such financing agreement.

However, for certain types of collateral (mainly those acceding to registers such as mortgages and non-possessory pledges), in order to be effective against third parties, the assignment of the relevant collateral must be notarised and registered with the relevant public registry.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

In general, interest that Spanish borrowers pay for loans made to domestic lenders (other than financial institutions) is subject to 19% withholding tax in 2016. Likewise, interest income payable on loans made to non-EU tax residents is subject to 19% withholding tax, unless a lower rate applies under a tax treaty (treaty rates range between 5% and 15%). Interest payments to EU residents and EU permanent establishments (except those residing in tax-haven jurisdictions) are not subject to withholding tax (irrespective of whether payments are made to a financial institution or a company).

Second, proceeds of a claim under a guarantee or the proceeds of enforcing security are generally subject to withholding tax as if these payments were made by the borrower.

Since 2012, under the Spanish Corporate Income Tax Act, there have been some limitations to the deductibility of financial expenses:

(a) Financial expenses derived from intergroup indebtedness are not tax deductible if the funds are used to make capital contributions to other group entities, or to acquire from other group entities shares in other entities, unless the taxpayer proves there are valid economic reasons for doing so.

Overall, financial expenses deriving from indebtedness used for any other reason are fully deductible, unless anti-abuse clauses apply.

However, since 1 January, 2015, interest paid for leveraged buy-out share acquisitions is not tax deductible unless some requirements are met:

- Indebtedness must be lower than 70% of the purchase price.
- Indebtedness will be reduced proportionally in the eight years following the transaction by up to 30% of the mentioned price.

(b) Net financial expenses (financial expenses minus financial income) exceeding 30% of the operating profit for the financial year are not tax deductible, with a minimum of €1 million deductible amount guaranteed. Net financial expenses that, by applying the 30% limit, are not tax deductible, may be deductible in the following financial years without a time limitation. If the 30% limit is not reached, the difference may increase the applicable limit for the following five financial years.

(c) Interests paid on shareholder loans or participative loans granted by another company, which is part of the same group of companies under section 42 of the Spanish Commercial Code, are not tax deductible.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

As a member of the European Union, Spain benefits from free movement of capital within the EU, including exchange rate fluctuations and transaction costs. Therefore, Spain's EU membership represents a significant part of its foreign policy.

Additionally, Spain currently has more than 90 income tax treaties in force and a solid treaty network with Latin American countries that reduce or eliminate Spanish taxes payable to residents of treaty countries.

The main tax incentive is the Spanish international holding companies regime, ("ETVEs"), a well-established legal framework that has helped Spain become one of the most favourable jurisdictions in the EU to channel and manage international investments. ETVEs can benefit from an exemption on inbound and outbound dividends and capital gains provided several requirements are met. Since ETVEs are Spanish regular entities, they are treated like regular limited liability companies, thus benefitting from tax treaties signed by Spain and from EU Directives.

Under Spanish law, no relevant additional taxes apply to foreign investments besides those applicable to Spanish investors.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

No, under current Spanish Corporate Income Tax regulations, interest or fees paid to the lenders will not be subject to any withholding or deduction, provided that the lenders are lending entities or financial credit establishments entered on the special registries of the Bank of Spain and have their registered office in Spain, or entities resident in the European Union that have submitted certification of their tax residence.

None of the parties to a loan or guarantee and/or security from a company will be deemed as being domiciled, as being a resident or as having a permanent establishment in Spain solely because of entering into or performing its obligations under the above agreements.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

To obtain enforceability regarding third parties and benefit from summary proceedings (see question 7.3 below) a loan, a guarantee or a security document must be notarised and eventually registered (depending on the asset).

For more detailed information on notarial and registry fees and stamp duty tax, please see question 3.9 above.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Most tax consequences do not differ as a result of the tax residency or applicable law of the borrower. Exceptionally, adverse tax consequences (documentation obligations) might arise when the borrower/lender is a tax resident in a tax-haven jurisdiction.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, courts in Spain recognise a foreign governing law in contracts in line with Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June, 2008, on the law applicable to contractual obligations ("Regulation Rome I").

Regulation Rome I has *erga omnes* effects. Hence, whatever it is, the foreign law chosen to govern the contract is enforceable, irrespective of whether or not it is an EU Member State.

Spanish Courts will certainly enforce a contract governed by foreign law; however, the choice of the parties will not avoid the application of *ius cogens* provisions of Spanish law that cannot be derogated by agreement (public policy). Also, the content and validity of foreign law must be proved in the proceedings; if the foreign law is not proved, the court will resort to Spanish law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A distinction must be made between judgments rendered in English courts or courts of EU Member States and judgments rendered in New York ("NY") courts.

Regarding a judgment rendered in English courts, Council Regulation (EC) No. 1215/2012 of 12 December, 2012, on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ("Regulation Brussels I"), establishes that a judgment rendered in an EU Member State is to be recognised without special proceedings in any other EU Member State, unless the recognition is contested. Under no circumstances can the merits of a foreign judgment be reviewed. A declaration that a foreign judgment is enforceable is to be issued following purely formal checks of the documents supplied.

However, a judgment will not be recognised if: (i) the recognition is manifestly contrary to public policy in the EU Member State in which recognition is sought; (ii) the defendant was not served with the document that instituted the proceedings in sufficient time and in such a way as to enable the defendant to arrange for his defence; (iii) it is irreconcilable with a judgment given in a dispute between the same parties in the EU Member State in which recognition is sought; (iv) it is irreconcilable with an earlier judgment given in another EU or non-EU country involving the same cause of action and the same parties; or (v) the judgment was adjudicated by a court lacking jurisdiction in case of exclusive jurisdiction.

Regulation Brussels I does not apply to a judgment rendered in NY courts. In the absence of a multilateral or bilateral treaty between Spain and the United States addressing the matter, under the recent *Act 29/2015, on International Cooperation*, final judgment rendered by US courts will have the same force as is given in the US provided that it complies with the requirements for its recognition set forth in article 46 of the *Act on International Cooperation* (*inter alia*, the judgment does not infringe Spanish public policy, the defendant has been properly served with the originating process, the matter is not subject to Spanish exclusive jurisdiction for certain matters, or is not in contradiction with a previous Spanish judgment). Once the exequatur is granted, the judgment can be enforced according to the rules set forth in the Spanish Civil Procedure Act.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

This depends primarily on whether the enforcement action is grounded on an executive title, such as public instruments (i.e. a public deed), or on an ordinary title, such as private contracts.

(a) Executive titles can be enforced directly, through summary proceedings, which consist of a swift procedure that should take between 6 and 12 months. Otherwise, the so-called ordinary proceedings, which inevitably lead to a decision which should be enforced through an enforcement proceeding, may take on average 15 months plus the 6 to 12 months of the enforcement proceeding.

(b) Enforcement of an English court decision will follow the same proceeding as explained in point a), given that the judgment will be recognised without special proceedings. Enforcement of a US judgment would require prior exequatur proceedings (it takes on average between six and nine months). Once the judgment has been recognised, enforcement will follow the same proceeding as explained in point a) above.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Enforcement of collateral security is typically carried out through a public auction, in the context of judicial or notarial proceedings. For notarial enforcements see question 8.4 below. Additionally, the enforcement of pledges over credit rights may also be achieved through set-off or assignment of claims.

The rights derived from the relevant security can be judicially enforced either through declaratory civil proceedings or summary proceedings. The latter action is faster and more effective, while the former is costly and time-consuming. However, to start summary proceedings certain requirements must be met, particularly the determination of the due and payable amount in accordance with the Civil Procedure Act.

Once the court has published a date for auction, the debtor will only be able to object under limited circumstances, such as the prior extinction of the pledge, full payment of the secured obligation, or the existence of a material mistake.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Concerning the enforcement of pledges over shares, the Financial Collateral Directive was transposed in Spain by means of Royal Decree Law 5/2005, which sets forth a speedy proceeding that applies to obligations of a "financial" nature and which permits direct appropriation of the collateral by the creditor where the financial agreement expressly states so.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

Generally there is no distinction between domestic and foreign entities when it comes to foreclosing Spanish security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Bankruptcy declaration triggers an automatic stay of one year (unless the debtor gets the approval of a composition agreement or files for liquidation earlier). This automatic stay concerns secured creditors with collateral over assets that are necessary to continue the ordinary course (except security interests subject to the special regime on financial collateral).

During the stay, the bankruptcy officer may decide to treat the secured claim as an administrative expense (pre-deductible claims from the estate) in order to avert enforcement of the security interest.

This automatic stay can also apply if the debtor serves a "5 *bis*" notice, which enables the debtor to negotiate an out-of-court solution to financial distress in a four-month period. The stay of enforcement actions lasts for a three- or four-month period (there are different criteria) and concerns assets that are necessary to continue the ordinary course. Yet any enforcement action conducted by holders of financial claims may be stayed if the debtor obtains a standstill supported by 51% of the financial claims. Security interests subject to the special regime on financial collateral escape this automatic stay in any event.

Lastly, if the secured creditor fails to enforce prior to liquidation, it may lose control over the collateral if 75% of the secured claims from the same class consent to a liquidation plan that sets forth the sale of the business unit as a going-concern, in which case, however, it would get a portion of the price equivalent to the weight of the collateral in the estate. Lastly, the Civil Procedure Act provides the moratorium on enforcement on the grounds of criminal procedure may halt the enforcement and performance of such agreements until the criminal court issues a final resolution in such proceedings.

On another front, the Civil Procedure Act provides a moratorium on enforcement on the grounds of criminal procedure which may halt the enforcement and performance of such agreements until the criminal court issues a final resolution in such proceedings.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes, Spain has been a party to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention") since 1977, and it is therefore subject to recognition and enforcement of foreign arbitral awards in the terms established therein.

Given that Spain has not made any reservation to the New York Convention, its proceeding is applied to the enforcement of all arbitral awards, including those rendered in countries that did not sign the convention. The Spanish Arbitration Act specifically establishes that the exequatur of foreign awards will be governed by: (i) the New York Convention, without prejudice to the provisions of other, more favourable international treaties on the granting of foreign awards; and (ii) the proceedings established in the civil procedural system for judgments handed down by foreign courts.

Spanish courts will not re-examine the merits of the case. However, an arbitral award might not be recognised if certain requirements are not met (e.g. the arbitration agreement is not valid, irregularity in the composition of the arbitration authority or in the arbitral procedure, etc.). Furthermore, an award will not be recognised if the subject matter cannot be settled by arbitration in Spain or the recognition is contrary to the public policy of Spain.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy declaration triggers an automatic stay of one year (unless the debtor gets the approval of a composition agreement or files for liquidation earlier). This automatic stay concerns secured creditors with collateral over assets that are necessary to continue the ordinary course (except security interests subject to the special regime on financial collateral).

During the stay, the bankruptcy officer may decide to treat the secured claim as an administrative expense (pre-deductible claims from the estate) in order to avert enforcement of the security interest.

This automatic stay can also apply if the debtor serves a "5 *bis*" notice, which enables the debtor to negotiate an out-of-court solution to financial distress in a four-month period. The stay of enforcement actions lasts for a three- or four-month period (there are different criteria) and concerns assets that are necessary to continue the ordinary course. Yet any enforcement action conducted by holders of financial claims may be stayed if the debtor obtains a standstill supported by 51% of the financial claims. Security interests, subject to the special regime on financial collateral, escape this automatic stay in any event.

Lastly, if the secured creditor fails to enforce prior to liquidation, it may lose control over the collateral if 75% of the secured claims from the same class consent to a liquidation plan that sets forth the sale of the business unit as a going-concern, in which case, however, it would get a portion of the price equivalent to the weight of the collateral in the estate.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Pursuant to compulsory priority rules, claims are divided into privileged, ordinary, and subordinated. Privileged claims, which are in turn divided into special privileged (secured) claims and general privileged claims (such as certain torts, tax, social security and employees' claims), are given preferential treatment over ordinary claims, which in turn have preference over subordinated claims. A controlling principle is the equal treatment of creditors from the same class.

Administrative expenses (*créditos contra la masa*) have a cash flow privilege over claims (*créditos concursales*). In contrast to administrative expenses, claims can only be settled pursuant to a plan of reorganisation or with the proceeds arising out of liquidation (either piecemeal or, preferably, as a going-concern business). Having said that, secured creditors may auction or repossess the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

collateral to apply the proceeds thereof to settle their claims (over which administrative expenses have no priority).

Acts or transactions beyond the ordinary course of business, entered into within two years prior to bankruptcy declaration, may be subject to clawback, so long as: (i) the debtor does not receive reasonably equivalent value in exchange; or (ii) certain creditors are preferred to others when the company is currently insolvent (i.e. unable to regularly pay its debts as they come due). The hardening period in both cases is two years.

The law sets forth certain rebuttable and non-rebuttable presumptions of transactions that are detrimental to the estate. There are also certain safe harbours (namely acts and transactions done within the ordinary course of business, and certain ring-fenced out-of-court solutions).

Actual intent or fraud is not required to bring a clawback action successfully. Yet in case of actual fraud the reach-back period is four years (and the action can be brought both within and aside from an insolvency proceeding). Moreover, fraud is a requirement to claw back security interests subject to the special regimen on financial collateral.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Governmental entities of any type (whether territorially based – such as national, regional, municipal authorities – or of a functional nature) are excluded from bankruptcy proceedings. However, companies directly or indirectly controlled by governmental entities are subject to general bankruptcy law.

Additionally, certain types of companies (such as insurance companies) are subject to specific insolvency regulations, although the composition, appointment and operation of the insolvency administration will still be regulated by general bankruptcy law.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes, out-of-court enforcement proceedings, available for certain types of security, are typically carried out by a Notary Public and take the form of a public auction. The terms and conditions of such auction are not entirely regulated in the law and hence they usually follow the provisions agreed by the parties in the relevant security document. Absent a specific agreement, the Notary Public also tends to follow equivalent provisions applicable to judicial enforcements.

In the case of security over bank accounts or listed securities, particularly when the secured obligation consists of cash settlement agreements or derivative contracts, secured lenders may appropriate directly and immediately the secured assets (or offset), without conducting a public auction. Equally, certain regional laws (such as Catalonian law) expressly permit either private sales or, in the case of highly liquid security, appropriation by set-off.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission by the parties to a foreign jurisdiction is valid, binding and enforceable in Spain:

(i) in the case of submission to the courts of an EU Member State: in accordance with the provisions on *prorogation of jurisdiction* contained in Regulation (EU) No. 1215/2012 of the European Parliament and of the Council, of 12 December, 2012, on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters ("Regulation 1215"), except in cases where the rules on exclusive jurisdiction of Regulation 1215 are to be applied (in general, concerned with proceedings referred to: (a) *in rem* rights or tenancies in immovable property; (b) the validity of the constitution, nullity or dissolution of companies or other legal persons, or the validity of the decisions of their organs; (c) the validity of entries in public registers; (d) the registration of patents, trademarks, designs or other similar rights subject to deposit or registration; and (e) the enforcement of judgments);

(ii) in the case of submission to non-EU foreign courts abided by conventions: in accordance with the applicable international bilateral convention; and

(iii) in the case of submission to foreign courts not covered by conventions: in accordance with the domestic conflict of law regulations of the relevant foreign jurisdiction, which would reject the choice of foreign courts in cases where the exclusive jurisdiction of the Spanish courts pursuant to the Spanish Organic Law of the Judiciary is violated (in general, the same cases described *supra* in (i) (a) to (e), with regard to Regulation 1215).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Under Spanish law, the waiver of sovereign immunity (either of jurisdiction or from execution) by a foreign state is legally valid and enforceable. The waiver may be explicit (by means of an international agreement, a written contract or a declaration, or written communication made within the proceedings, to the relevant tribunal) or tacit (as a result of certain acts on the side of the foreign state), in accordance with Spanish Organic Law 16/2015 of 27 October, 2015.

Absent the waiver of sovereign immunity, no asset owned or controlled by a foreign state and allocated to public and official (i.e., non-commercial) purposes can be seized or subject to enforcement proceedings in Spain. This includes assets: (a) used by the diplomatic missions or consular offices of the foreign state for the performance of their duties and functions (including bank accounts, with the exception of accounts exclusively used for commercial purposes); (b) used for military purposes; (c) of the central bank or similar monetary authority of the foreign state and used for the performance of their duties and functions; (d) forming part of the foreign state's cultural heritage or with scientific, cultural or historical interest (with the exception of assets offered for sale); and (e) official vessels and airships, exclusively attached to public services of a non-commercial nature.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There is no need for foreign lenders or agents under a syndicated facility to be resident, licensed, qualified or entitled to do business

© Published and reproduced with kind permission by Global Legal Group Ltd, London

in Spain to execute or enforce any rights in Spain under financing agreements or collateral agreements, provided that in their jurisdiction of incorporation they are qualified to do so (generally, there is no distinction between domestic and foreign creditors for the purposes of granting loans or security).

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Most of the relevant issues have already been covered in the previous sections.

Manuel Follía

Cuatrecasas, Gonçalves Pereira
Paseo de Gracia, 111
08008 Barcelona
Spain

Tel: +34 932 905 425
Fax: +34 933 127 240
Email: manuel.follia@cuatrecasas.com
URL: www.cuatrecasas.com

Manuel Follía is a partner at Cuatrecasas, Gonçalves Pereira, with ample experience in banking law and finance, having advised national and international clients on corporate and acquisition finance, the financing of infrastructures and projects. He has also advised on complex restructuring and refinancing deals, and is currently focused on debt restructuring and distressed debt, including insolvency matters arising from these transactions. He regularly assists national and international banks, and is a reference for the main operators in the Iberian market.

In the past few years, he has led some of the major Iberian corporate finance transactions, including the debt refinancing of major Spanish listed companies, and has actively participated in international projects within Latin America.

Recommended by several directories, including *Best Lawyers*, *Latin Lawyer*, *IFLR* and *The Legal 500 Latin America* in Banking & Finance and Project Finance, Manuel is a collaborating lecturer at training courses and conferences specialising in finance and corporate law; he has also written several articles on insolvency law and the legal aspects of financing transactions.

María Lérida

Cuatrecasas, Gonçalves Pereira
Paseo de Gracia, 111
08008 Barcelona
Spain

Tel: +34 932 905 425
Fax: +34 933 127 240
Email: maria.lerida@cuatrecasas.com
URL: www.cuatrecasas.com

María Lérida is a senior associate at Cuatrecasas, Gonçalves Pereira, with broad experience in banking law and finance.

Her career is mainly focused on providing advice to national and international clients on corporate and acquisition finance transactions as well as debt restructuring and refinancing transactions. Most of her legal advice to clients is provided in cross-border and multijurisdictional deals.

In the past few years she has actively participated in distressed debt transactions, advising national and international clients on the sale and purchase of secured and unsecured non-performing loan portfolios, corporate debt and distressed assets.

CUATRECASAS, GONÇALVES PEREIRA

With over 950 lawyers and almost a century of professional practice, Cuatrecasas, Gonçalves Pereira is a leading law firm in Spain and Portugal. We advise on Spanish, Portuguese, Moroccan and European Union law; and in all areas of business law, through 19 legal specialties and 15 industry groups. We have 14 offices in Spain, two in Portugal, and eight international offices in cities in Europe, America, Asia and Africa. Both the firm and our lawyers receive prestigious national and international awards year after year, acknowledging our reputation and technical skills. In 2014, Chambers & Partners recognised the firm as the "Spain Law Firm of the Year". We are also highlighted as leading firm for the main law practices by international directories such as *Chambers*, *IFLR* or *The Legal 500*.

The firm's Finance Practice consists of nearly 50 lawyers based in Madrid, Barcelona, Lisbon and London, with expert knowledge and extensive experience in complex national and international financial transactions. The lawyers work seamlessly from different locations, ensuring wide coverage for their clients, wherever they are based. The team has extensive expertise advising sponsors and banks in all types of domestic or foreign, corporate and structured, financial and debt capital markets transactions. Among others, such transactions consist of structured and project financial facilities, refinancing, acquisition finance and other sorts of repackaging, synthetic and mortgaged-backed securitisation, credit assignments, issuance of fixed-interest securities and other financial instruments, and consumer credits. In addition, we deal with bankruptcy issues in order to efficiently ensure bankruptcy remoteness and an adequate security package structure, extending the scope of our advice to the restructuring of debt. Likewise, we advise on matters and relevant issues related to equity requirements for credit institutions as well as for other entities.

"**Bankruptcy & Restructuring Law Firm of the Year**" – (Corporate Livewire, Global Awards, 2012).

"**Standout in the category of Finance**" – (*FT* Innovative Lawyers, 2013).

"**Only Iberian law firm among top 10 by volume for syndicated loan transactions (EMEA region)**" – (Bloomberg, 2014) (Thomson Reuters, 2015).

"**Ranked as leading Firm (1st tier) in Banking & Finance, Project Finance, Capital Markets and Debt Restructuring**" – (*Chambers and Partners*, 2014 and 2015).

"**14 lawyers ranked in Finance practices in Spain**" – (*Best Lawyers*, 2016).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Sweden

Carl Hugo Parment

White & Case LLP

Tobias Johansson

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The debt capital markets in Sweden have been very strong during the last couple of years. The local banks remain strong and international banks and financial institutions are showing increasing interest in doing business in Sweden. Competition among lenders is fairly intense as many Swedish blue chip companies have limited need for debt funding due to strong balance sheets and plenty of liquidity. Another development that has increased the competition among debt providers is the development of a substantial and growing Swedish bond market where bonds are issued under local law documentation.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

The general rule under Swedish law is that a limited company (*Sw. Aktiebolag*) is free to guarantee the obligations of one or more other members of its corporate group, subject to certain restrictions described below under questions 2.2 and 4.1.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

A guarantee or security interest granted by a limited company may be invalid and unenforceable if the transaction reduces the company's net worth and cannot be commercially justified (i.e. lacking sufficient corporate benefit). Such a transaction is considered to be a value transfer under Swedish law. Such a value transfer may only take place if the company's restricted equity is fully covered after the transfer and the transfer can be justified in light of any additional funding requirements that might follow from the company's nature of business as well as the company's consolidation requirements, liquidity and financial position in general. The transaction will be considered to be an unlawful value transfer if these requirements are not fulfilled. In the event of an unlawful value transfer, the recipient of such a transfer must return what he or she has received if the company shows that he or she knew or ought to have realised that the transaction constituted a value transfer from the company.

If a deficiency arises when restitution is made as described above, then those involved in the decision to make the value transfer will be liable for such shortfall. The same applies to those involved in implementing the value transfer. A director can therefore be held responsible for any losses incurred by the company as a result of guarantees and security interests being issued or granted without sufficient benefit for the issuing company.

Granting guarantees and security for wholly owned subsidiaries is typically considered to be commercially justified and therefore not subject to the value transfer restrictions referred to above. However, upstream as well as cross-stream guarantees and security interests are sensitive and may not be considered to be commercially justified. The value transfer restrictions may therefore be relevant in the case of such guarantees and security interests.

2.3 Is lack of corporate power an issue?

Lack of corporate power is generally not an issue when Swedish companies enter into financing arrangements.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental or other consents or filings are required in order for a Swedish limited liability company to provide guarantees or grant security interests. Shareholder approval is generally not required for granting guarantees and security interests, but may sometimes be advisable, for example in the case of guarantees and security interests granted by companies that are not wholly owned.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

As further described in question 2.2 above, the granting of guarantees and security interests may in certain situations be deemed to constitute value transfers. As such, they may only be allowed if the company's restricted equity is fully covered after the value transfer, and the transfer can be justified in light of any additional funding requirements that might follow from the company's nature of business as well as the company's consolidation requirements, liquidity and financial position in general.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Guarantees and security interests granted by an insolvent Swedish company will be subject to clawback risk should the company enter into bankruptcy within certain hardening periods. Any director of an insolvent company that gives preferential treatment to certain creditors of the insolvent company may be held criminally liable as well as liable to pay damages.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Sweden has no exchange control provisions or similar obstacles restricting the enforcement of a guarantee issued by a Swedish limited company.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are a number of different types of collateral and security interests that can be made available under Swedish law. The most common security interest under Swedish law is the pledge agreement. Under Swedish law, as a general rule, any property or asset can be validly pledged.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Swedish law does not recognise the concept of a general security agreement covering all or almost all of the assets of a security provider. Instead, the starting point is that separate security agreements must be entered into in respect of separate assets or separate classes of assets.

Notwithstanding the above, it is possible to grant security over different assets and different types of assets by way of one single security agreement. However, this is often rather impractical, as different perfection and enforcement requirements often apply for different types of assets, which makes all-inclusive security agreements rather extensive and burdensome to draft and apply.

The most common way to take security over assets in general is by way of a floating charge, in accordance with the Floating Charges Act.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

The primary means of taking security over real property (i.e. land and buildings and other fixtures thereon) is by way of real estate mortgages. However, such real estate mortgages may, as described in question 3.9 below, be subject to stamp duty, so alternative security arrangements such as share pledges over the ring-fenced property companies are also common.

Collateral can be taken over machinery in a variety of different ways depending on the type of machinery. Machines that are movable goods can be pledged as collateral, but this requires that the movable goods are handed over to the pledgee or to a third party representing the pledgee. If the security provider needs to continue to use the machinery, then a so-called chattel-sale (*Sw. lösöreköpsregistrering*) can be made whereby a perfected security interest is created by way of a public announcement followed by a registration with the Swedish Enforcement Authority (*Sw. Kronofogdemyndigheten*).

Certain equipment and machinery which is more or less permanently incorporated into a real property can, subject to the prevailing circumstances, be either included in the real property (and thus covered by a real estate mortgage) or be considered as assets which are separated from the real property, and can therefore be subject to other security arrangements besides a real estate mortgage.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security can be taken over receivables and such security is established through a notification of the debtor under the receivable which is subject to such security arrangement. In order for the security interest to be perfected, all payments under the receivables must be paid to the secured party or to a representative of the secured party. This can sometimes be commercially sensitive as well as administratively onerous at least as regards account receivables. It is therefore quite common with delayed perfection so that the notification of the debtor and the re-direction of payments are only made following a certain credit event relating to the security provider.

It should be noted that relying on delayed perfection (in respect of receivables as well as any other security interests) stands the risk of clawback during certain hardening periods should the security provider file for bankruptcy shortly after the completion of delayed perfection.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Security can be granted over cash deposited in bank accounts. Such security is granted by way of the bank account being pledged to the secured party. It should be noted that Swedish law contains very strict perfection requirements regarding bank account pledges. In order for the pledge to be perfected and enforceable, the pledgor must be deprived of all disposal rights to the bank account. Bank account pledges are therefore not suitable for bank accounts used in the day-to-day activities of the pledgor.

Due to the restrictions set out above, the standard approach in Sweden is to take security over deposit accounts rather than current accounts used for daily business. To the extent that current accounts are pledged, it is common to use delayed perfection arrangements so that the pledgor is only deprived of its disposal rights over the pledged current account following certain credit events.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Security over shares is one of the most common security interests in Sweden and is established through a pledge agreement. The perfection requirements for a share pledge depend on whether the shares are represented by physical share certificates or if the shares are dematerialised (i.e. in register form). Physical share certificates must be handed over to the secured party or to a third party representing the secured party, whereas dematerialised shares are pledged via account entries with the Central Securities Depository as further set out in the Swedish Financial Instruments (Accounts) Act.

A share pledge agreement in respect of shares in a Swedish limited company does not have to be governed by Swedish law and can for example be governed by English or New York law. However, Swedish law would nevertheless, as a general rule, still apply in respect to perfection requirements. Furthermore, Swedish law contains certain

© Published and reproduced with kind permission by Global Legal Group Ltd, London

mandatory duty of care provisions that are aimed at protecting a pledgor, for example in connection with a security enforcement. It is therefore advisable that the share pledge agreement is governed by Swedish law; this is also the prevailing market standard.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

As mentioned above under question 3.1, any property or asset can be validly pledged as long as it meets certain criteria. However, in order for an inventory pledge to be perfected and enforceable, the pledgor cannot remain in the possession of the pledged inventory. Inventory pledges are therefore very impractical. A more common way to take security over a floating asset base such as inventory is instead to issue a floating charge as further described in question 3.2 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, please see above under questions 2.1 and 2.2 and below under Section 4 for further details. The restrictions described above in respect of granting of guarantees also apply to the granting of security.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No notarisation or registration costs, stamp duties or other fees are payable in relation to the granting of security over receivables and shares.

An application for new real estate mortgages is subject to a stamp duty of two (2) per cent, payable on the face value of such new real estate mortgages. Existing real estate mortgages can, however, be re-pledged an indefinite number of times without incurring any additional stamp duty.

An application for new floating charges is subject to a stamp duty of one (1) per cent, payable on the face value of such new floating charges. As with real estate mortgages, existing floating charges can also be re-pledged an indefinite number of times without incurring any additional stamp duty.

Finally, it should be noted that minor application fees are payable when applying for new real estate mortgage or floating charges, as well as when applying for a chattel sale to be registered.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Most security interests can also be established more or less immediately and there are no significant costs for granting security other than the stamp duty referred to in question 3.9 above.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

There are no such consents required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

There are no such requirements.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

The restrictions on financial assistance are set out in the Swedish Companies Act. According to the Companies Act, a Swedish limited company may not pay an advance, grant loans or provide security for loans to a borrower (or certain affiliates to such a borrower) for the purpose of funding the borrower's acquisition of shares in the company or any parent company in the same group as the company granting the financial assistance.

A Swedish limited company can therefore not support borrowings incurred for the purposes of (a) and (b) in the question above. As regards (c), there is some uncertainty under Swedish law. It is clear that the intention of the legislator has been that such financial assistance shall be forbidden, but the relevant provisions of the Companies Act seem to indicate otherwise. Great caution should therefore be exercised when considering such transactions.

It should be noted that Swedish law provides for some opportunities to grant financial assistance after the completion of an acquisition. Furthermore, there is a regime in the Companies Act whereby exemptions can be granted for otherwise unlawful financial assistance.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Lenders may appoint a facility and/or security agent to represent them in all matters relating to the finance documents as well as any security interests. Such agents are allowed to enforce any rights that the lenders might have under the finance documents. Furthermore, the agent may enforce any collateral security and apply the proceeds from such enforcement in order to satisfy the secured claims of the lenders.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Please see question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

A transfer of a loan is perfected and made valid and enforceable against third parties by way of notification of the debtor under the loan that is being transferred.

A guarantee in respect of a loan obligation will continue to apply and may be called upon by any new lender that has validly acquired the loan that is being guaranteed. The guarantor is sometimes notified of the loan transfer in order to avoid the guarantor fulfilling its guarantee obligation by way of payments to the initial holder of the loans.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Swedish law neither contains an obligation to withhold tax as regards interest payable on loans made to a domestic lender or foreign lender, nor on proceeds of a claim under a guarantee or the proceeds following from an enforcement of security interests.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No tax incentives are provided preferentially to foreign lenders.

No taxes apply to foreign lenders provided that such foreign lenders do not have any permanent establishment in Sweden with which the income from the loan, guarantee or security interest is effectively connected.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

No, provided that such foreign lender does not have any permanent establishment in Sweden with which the income from the loan, guarantee or security interest is effectively connected.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No. Please see question 3.9 above.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no adverse consequences for a Swedish borrower if some or all of the lenders are non-Swedish, as long as such loans are made on market terms and are not made between related parties.

Swedish legislation does not contain any thin capitalisation rules. However, Swedish legislation does contain interest deduction restriction rules on intra-group loan structures including back-to-back structures involving third party lenders (e.g. banks). These rules apply both for loan structures involving only Swedish companies as well as loan structures involving both Swedish and non-Swedish companies.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The application of foreign law is recognised by Swedish courts, except to the extent that provisions in foreign law are contrary to the *ordre public* (i.e. such provisions that are inconsistent with fundamental principles of the legal system in Sweden).

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A judgment rendered against an entity in the courts of a country which is not a contracting state under Council Regulation (EC) No 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, the Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters made in Brussels on 27 September 1968 or the Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters made in Lugano on 16 September 1988, would not be recognised or enforceable in Sweden as a matter of right without a retrial on the merits (but will be of some persuasive authority as a matter of evidence before the courts of Sweden or other public authorities). However, there is Swedish case law to indicate that such judgments could, under specific circumstances, be acknowledged without retrial on the merits.

A final and conclusive judgment rendered by a court in England which is enforceable in England can be recognised and enforceable by the courts of Sweden, according and subject to Council Regulation (EC) No 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters. In order to enforce a judgment under the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

aforementioned regulation in Sweden, the concerned party must submit an application for enforcement (*Sw. exekvatur*) to the Svea Court of Appeal (*Sw. Svea hovrätt*) and comply with the procedures of that court (as required).

From 10 January 2015, Council Regulation (EC) No 44/2001 has been repealed and replaced by Regulation (EU) No 1215/2012 (the "**Recast Regulation**"). The Recast Regulation is applied by EU Member State courts from 10 January 2015 to all new legal proceedings. While much of the wording of Council Regulation (EC) No 44/2001 remains the same, there are some key changes. The Recast Regulation shifts the burden in relation to enforcement of judgments from the judgment creditor to the judgment debtor, who now has to apply to challenge the enforcement. In the absence of challenge, enforcement is automatic. The Recast Regulation abolishes 'exequatur'. A judgment creditor seeking to enforce (e.g. a judgment by an English court) now need only present the competent enforcement authority (in Sweden, the Enforcement Authority) with a copy of the judgment and a standard form certificate from the court which granted the judgment. Should the judgment debtor wish to oppose enforcement, it must apply to the designated court in the EU Member State of enforcement (in Sweden, certain designated district courts). Grounds for refusal are limited, and include, for example, public policy. Proceedings commenced before 10 January 2015 will continue to be dealt with under Council Regulation (EC) No 44/2001 as described above.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The time it takes is highly dependent on which Swedish court is relevant in each case. If actions are taken by the lenders as fast as possible, it should not take longer than one (1) year to obtain an enforceable judgment against the assets of the company (however, it also depends on which asset is at hand). The application for enforcement (*Sw. exekvatur*) with the Svea Court of Appeal takes approximately three to six months to process. If the Recast Regulation applies (see question 7.2 above), a foreign judgment can, upon application, be enforced by the Enforcement Agency more or less immediately if delay places the applicant's claim at risk and the judgment debtor does not apply for refusal of enforcement with the designated district court.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

If the pledge agreement has an enforcement clause, the creditor is free to enforce the collateral according to the regime set out in such enforcement clause. Otherwise the creditor may seek enforcement (assuming he has a title of execution) with the Swedish Enforcement Authority. The procedure is governed by the Enforcement Execution Act.

Notwithstanding the above, certain security interests, such as, for example, real estate mortgages and floating charges, can only be enforced through the Swedish Enforcement Authority.

There is a general duty of care obligation under Swedish law whereby a secured party must also look after the interests of the security provider when enforcing security interests. Any excess amounts following such enforcement must also be accounted for and paid out to the security provider.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

(a) If required by an EU or EFTA defendant (i.e. including a Swedish defendant), a foreign plaintiff not domiciled in an EU or EFTA country must furnish security for the legal costs that he might be obliged to pay as a result of the proceedings. By virtue of several multilateral treaties to which Sweden is a party, plaintiffs of a large number of countries have been relieved from the obligation to furnish security.

(b) There are no restrictions for foreign lenders in the event of foreclosure on collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. Please see question 8.1 below.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Foreign awards based on an arbitration agreement are recognised and enforced in Sweden. In 1972 Sweden ratified the New York Convention (*the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards*) without reservation. Its provisions have been incorporated into Swedish law by the Swedish Arbitration Act.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Following a bankruptcy order, no independent enforcement is, as a general rule, available for secured creditors. However, a creditor that has a valid and perfected possessory pledge (*Sw. handpanträtt*) may sell such collateral at a public auction, subject to such an auction not occurring earlier than four (4) weeks after the meeting for administration of oaths. Such a creditor must also give the administrator the opportunity to redeem the collateral to the bankruptcy estate.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The Swedish Bankruptcy Act states that certain transactions can be made subject to clawback, and thus be recovered to a bankruptcy estate. There are several different circumstances that might give rise to such recovery.

There is a general right to clawback addressing *improper transactions* whereby: a creditor has been preferentially treated; the assets of the debtor have been withheld or disposed of to the

© Published and reproduced with kind permission by Global Legal Group Ltd, London

detriment of the debtor's creditors in general; or whereby the debtor's total indebtedness has been increased. Such transactions can be recovered if the debtor was insolvent, or became insolvent as a result of the transaction, and the benefitting party was aware, or should have been aware, of the debtor's insolvency and the circumstances making the transaction improper. An improper transaction is subject to a five (5)-year hardening period, and a transaction made more than five (5) years prior to the bankruptcy may only be recovered if the transaction was made to a party closely related to the debtor (e.g. a person who has a substantial joint interest with the debtor based on entitlement to a share or financial interest equivalent thereto, or who through a management position has a decisive influence on the business operations conducted by the debtor).

In addition to the general principle of recovery, there are a number of recovery rules addressing specific types of transactions (e.g. gifts, payment of wages, payment of debts, granting of guarantees or granting of security interests). The majority of the specific rules differ from the general recovery rule in that they do not require the debtor to be insolvent or the benefitting party to have any knowledge of the debtor's insolvency. Furthermore, the hardening periods vary depending on the type of transaction and range between three (3) months and three (3) years.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

No. All natural persons and legal entities may be subject to bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes. A creditor that has a title of execution (e.g. judgment, an arbitral award or a summary decision under the Summary Proceedings Act) can seek enforcement with the Swedish Enforcement Authority. The procedure is governed by the Enforcement Execution Act. A decision by the Enforcement Authority may be appealed to the district court.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes. Swedish law permits that parties agree between themselves to have their disputes adjudicated outside Sweden. The parties are free to choose forum. The agreement must, however, be in writing. If the agreement is exclusive, it will divest the Swedish court of jurisdiction, at least if a foreign court is willing to hear the case. Where one party is a weaker party, e.g. an employee or a consumer, a jurisdiction clause (i.e. an agreement on forum) which limits such a party's access to Swedish courts will be disregarded, at least if the submission to foreign jurisdiction leads to the application of a foreign law which is less favourable to the employee or the consumer (than Swedish law).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes. It is, for example, generally accepted under Swedish law that a valid arbitration clause constitutes a waiver of sovereign immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Granting of credit to a company (i.e. not to a consumer) does not in itself require a licence or authorisation under Swedish law, but this may be required in case the lender conducts other types of financial activities as well. A Swedish lender might – even if no licence or authorisation is required – be obliged to notify its activities to the Swedish Financial Supervisory Authority pursuant to the Certain Financial Operations (Reporting Duty) Act (the "**Reporting Act**") and may thereby be subject to certain limited supervision, e.g. in form of ownership assessments. The Reporting Act does not apply to non-Swedish entities granting credit to Swedish companies.

There is no specific Swedish regulation applicable to agents or a security agents.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The key legal issues to be considered when lending to Swedish entities, and taking security over Swedish assets, have been addressed above.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Carl Hugo Parment
White & Case LLP
Box 5573, Biblioteksgatan 12
114 85 Stockholm
Sweden

Tel: +46 8 506 32 300
Fax: +46 8 611 21 22
Email: carl.hugo.parment@whitecase.com
URL: www.whitecase.com

Carl Hugo Parment is a partner at the Stockholm office. He focuses on banking and finance law and has extensive experience of advising both lenders and borrowers in domestic and international transactions, especially within leveraged finance and real estate finance.

Carl Hugo also has significant experience working with insolvency law and distressed debt, including both formal and informal insolvency proceedings, enforcement of security interests and workouts relating to private equity owned companies.

Finally, Carl Hugo has in-depth knowledge of mergers & acquisitions within the financial industry, especially regarding acquisitions of both public and private financial institutions and debt portfolios.

Tobias Johansson
White & Case LLP
Box 5573, Biblioteksgatan 12
114 85 Stockholm
Sweden

Tel: +46 8 506 32 300
Fax: +46 8 611 21 22
Email: tobias.johansson@whitecase.com
URL: www.whitecase.com

Tobias Johansson is a member of the firm's Bank Finance practice. He has experience advising banks and corporate borrowers in relation to various financing transactions, in particular within leveraged acquisition finance. Tobias also advises on regulatory matters related to financial institutions and services and was in 2014 appointed by the Swedish Government as an independent legal expert in connection with the Swedish implementation of the European framework for bank recovery and resolution.

WHITE & CASE

White & Case LLP, a leading international law firm with 39 offices in 26 countries, advises clients on complex, groundbreaking work in almost every area of law across emerging and established markets.

In Sweden, White & Case LLP offers clients substantial experience in complex issues of Swedish law and regulation and the resources of a leading global law firm. The firm's lawyers in Sweden advise clients on a variety of transactions within the country, in other Baltic Rim countries, in Europe, and throughout the world. Key practice areas include mergers & acquisitions, joint ventures, banking, securities and capital markets and dispute resolution.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Switzerland

Oliver Widmer

Pestalozzi Attorneys at Law Ltd

Urs Klöti

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Banks continued to lend to corporates and the availability of credit facilities remained high. This is to be seen before the background of the difficult economic environment for banks (from a financial and regulatory perspective), in particular also with the negative interest rates introduced by the Swiss National Bank. Given the difficulty to place liquidity, lending remained attractive for the banks, in particular with solid borrowers. However, it was notable that margins started to rise. The quality of assets (to serve as security) became more and more important.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

In 2015, the biggest lending transactions in Switzerland occurred in relation to M&A transactions, such as, e.g., Teva and/or Orange/Salt. One the biggest financing transactions has been Teva's USD 33.75 billion financing commitment received from a syndicate of banks for its acquisition of Allergan's generic pharmaceuticals business.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, a Swiss company can guarantee borrowings of one or more other members of its corporate group. Guarantees are widely used in secured lending transactions. According to Swiss law, a guarantee is a promise to another person that a third party will perform and that the guarantor will compensate for the damages caused as a result of the third party's failure to perform. There are no specific requirements as to the form of the contract. Once validly concluded, the existence of a guarantee is, in principle, independent from the existence of the obligation guaranteed.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Such concerns exist in certain circumstances.

First of all, a director of a Swiss company must act in the interest of the company. Non-compliance with such duty may lead to director liability. Further, Swiss corporate law does not recognise the overall legal concept of integrated company groups. Consequently, the board of directors of a Swiss group company may not take a consolidated view and fulfil its fiduciary duty merely by considering the overall interests of the entire group. It must rather assess and secure the financial status of the Swiss company on an independent and standalone basis, focusing on the company's distinct identity and status as a legally independent corporate entity.

In case the granting of a guarantee leads to so-called 'financial assistance', guarantees might not be enforceable and directors might become liable. Please refer to section 4 (financial assistance).

2.3 Is lack of corporate power an issue?

Yes, please see the answers to question 2.2 above and section 4 below.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Generally no. However, in the case of financial assistance, it is customary practice in Switzerland to require formal approval of upstream or cross-stream guarantees (which potentially qualify as constructive dividends) not only by the board of directors, but also by the shareholders of the Swiss guarantor. Please see the answers in section 4.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

This is the case for financial assistance. Please see the answers in section 4. An upstream guarantee may not be given in an amount exceeding the guarantor's so-called 'free equity'.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, there are not.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The most common types of collateral in Switzerland are security in the form of a pledge or a transfer of ownership (for security purposes) of real estate, tangible moveable property, financial instruments, claims and receivables, cash and intellectual property.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Different types of security can theoretically be contained in a single general security document. In practice, each type of security is usually documented in a separate agreement, particularly if a specific security must be documented in a public deed.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes, collateral security can be taken over real property.

The definition of real estate under Swiss law includes: edified and unedified land (that is, land with or without buildings); a flat or floor of a building; and the right to build on a track of land for a limited period of time (*Baurecht*).

The following forms of security are commonly granted over immoveable property:

Mortgage assignment (*Grundpfandverschreibung*). This is to secure any kind of debt, whether actual, future, or contingent. The creditor of a claim secured by a mortgage assignment can demand an extract from the land register.

Mortgage certificate (*Schuldbrief*). A mortgage certificate establishes a personal claim against the debtor and is secured by a property lien. The mortgage certificate constitutes a negotiable security, which can be pledged or transferred for security purposes and is issued either in bearer form, in registered form or as a paperless version. An outright transfer has certain advantages in case of the security provider's bankruptcy and in multi-party transactions. Therefore, practitioners in cross-border banking transactions often prefer granting an outright transfer of a mortgage certificate instead of a pledge.

In both forms of security, the secured party's claims can be backed by property belonging to the borrower or a third party (third party security), subject to the rules on financial assistance and similar limitations (see question 2.2 above).

Mortgage assignments and mortgage certificates are created and perfected by the parties entering into an agreement regarding the creation of the security and finalised by means of a notarised deed and an entry into the land register.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, collateral security can be taken over receivables and rights under contracts in general. Common types of claims and receivables over which security is granted are: rights under contracts in general (existing and future); trade account receivables (existing and future); and balances in bank accounts.

Claims and receivables can be pledged or assigned for security purposes. The granting of security is based on the same principles as for security over moveable property (see question 3.7) and, in particular, requires a valid agreement between the security provider and the security holder.

The security agreement must be in writing. There is no transfer of possession. In addition, an assignment of receivables or other claims requires that the assignor sign the assignment itself and not just the related undertaking in the assignment agreement. Perfection of a first-ranking security also requires that the claims or receivables be assignable under the governing law of those claims or receivables.

If a Swiss bank account (that is, the balance of the account standing to the credit of the security provider) is used as collateral, the Swiss bank's business terms usually provide that the bank has a first-ranking security interest over its client's account. A third party therefore only gets a second-ranking security interest over a Swiss bank account, unless the bank waives its priority rights. To create and perfect a second-ranking security interest, the bank must be given notice.

In the case of assignments, the third party debtors of the receivables are either: immediately notified of the assignment (open assignment (*offene Zession*)); or notified only in case of default of the assignor or other events of default (equitable assignment (*Stille Zession*)).

On notification, the assignee, as the new creditor of the assigned claims, can directly collect the receivables from the third party debtors. Because Swiss law also allows the assignment of future receivables arising before a potential bankruptcy of the assignor, assignments are commonly used in practice. If all of the present and future trade receivables are taken as security, notice of the creation of the security interest is usually only given to the relevant debtor if there is a default. Until this notification, a *bona fide* debtor can validly discharge its obligation to the security provider.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. See question 3.4 above.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, collateral security can be taken over shares in companies incorporated in Switzerland. Shares can be in bearer, registered or dematerialised form. The perfection formalities depend on the form of the shares. Security can be validly granted under a New York or English law-governed document. This is, however, not recommended due to conflict of law issues.

Shares can be pledged, transferred outright and/or assigned for security purposes.

Creation of a security is always based on a valid security agreement. Perfection of a security, however, differs according to the type of shares: certificated shares require possession of the certificates to be

© Published and reproduced with kind permission by Global Legal Group Ltd, London

transferred to the security holder. Additionally, registered certificates must be duly endorsed and transferred to the security holder. Uncertificated financial instruments must be pledged, transferred or assigned in writing. Since 1 January 2010, the Federal Intermediated Securities Act has set out new rules in relation to intermediated securities (including the granting of security over intermediated securities).

A security over intermediated securities can be granted in one of the following ways: (i) by transferring the intermediated securities to the securities account of the secured party. This requires the security provider to give instructions to the bank to effect the transfer; and (ii) by crediting the intermediated securities to the securities account of the secured party. Alternatively, they can be granted by an irrevocable agreement (a so-called control agreement) between a security provider and its intermediary that the intermediary will comply with any instructions from the secured party. The security provider can, through the control agreement, grant a security right in specified intermediated securities, all intermediated securities in a securities account or a certain quota of intermediated securities in a securities account, determined by value.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Inventory is a form of tangible moveable property. Tangible moveable property comprises all property that is not classified as immoveable. Security over tangible property is commonly granted in the form of a pledge or an outright transfer.

The pledge is the most widely used type of security. A pledge entitles the lender to liquidate the pledged property if the debtor defaults, and to apply the proceeds in repayment of the secured claims.

In case of an outright transfer, the transferee acquires full title in the transferred assets, but can, under the terms of the transfer agreement, only use its title to liquidate the assets on the debtor's default to apply the proceeds to the repayment of debt. Although the transfer has certain advantages over a pledge on the bankruptcy of a Swiss security provider and in multi-party transactions, its use is restricted by increased liability concerns.

Perfection of a pledge or an outright transfer requires both: a valid security agreement; and the secured party to obtain physical possession of the relevant assets. The security holder does not have a security interest over the collateral as long as the security provider retains possession and control over it (certain moveable property, such as aircraft or ships, is not subject to this principle).

Certain moveable assets are subject to particular rules. The most important are aircraft, ships and railroads where the security is perfected by the entry of the security in the respective register. In addition, the Federal Intermediated Securities Act sets out specific provisions for the granting of a security over intermediated securities.

Swiss law generally does not recognise the concept of a floating charge or floating lien. Therefore, taking a security over inventory, machinery or equipment (often used as collateral in other jurisdictions) is not practical under Swiss law, at least in relation to assets necessary for running the pledgor's business. The requirement of physical control over the relevant assets is generally too burdensome, costly and unmanageable.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

There are no particular company law rules on a Swiss company granting collateral to secure debt used to purchase its own shares or the shares of a parent company or of a subsidiary. The company itself must not purchase more than 10% of its own voting shares.

The granting of security by a Swiss company to secure debt used to purchase its own shares can result in Swiss income tax being levied on the party selling the shares. In addition, the restrictions under corporate benefit rules (see section 4) apply to the granting of any upstream security (for the benefit of a direct or indirect parent company) and/or any cross-stream security (for the benefit of another group company not fully owned by the party providing the security). This is irrespective of the purpose of the secured obligations.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The granting or enforcement of a guarantee or security does not in itself trigger any Swiss taxes. However, certain transactions may be subject to Swiss tax.

If loans are secured over real estate, the following fees may be payable depending on the transaction: notaries' fees; registration fees (land register); and cantonal and communal stamp duties. The rates depend on the security's face value and the location of the real estate. The rates for fees vary widely from canton to canton.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Generally, filing, notification or registration of security interests is done within a couple of days. However, in case of a mortgage over real estate, the notarisation and, in particular, the entry into the land registry might take some time. Similarly, in case of registration of a pledge over intellectual property rights, such registration might take some time.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally, there are no regulatory consents required with respect to the creation of security. In case of a regulated entity granting security over certain of its assets, consents might be required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In case of a mortgage, the mortgage agreement needs to be notarised.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Yes, there are general limitations as to such upstream or cross-stream guarantees or security. The respective limitations apply in relation to guarantees or a security interest that guarantees or secures the finance or refinance of an acquisition of the shares of the company or shares of any company which directly or indirectly owns shares in the company or shares in a sister subsidiary.

Under Swiss law, it is market practice to deal with financial assistance as follows:

So-called upstream or cross-stream guarantees, i.e., guarantees granted to parent or affiliated companies (other than its direct and/or indirect subsidiaries), must generally meet arm's length conditions, as they would be requested by an unrelated third party, such as a bank, when granting the same guarantee. This means, generally, that: (a) the Swiss guarantor should carefully consider the third party's creditworthiness, as well as its willingness and ability to fulfil its obligations that shall be guaranteed; (b) the upstream guarantee should have customary terms of duration, termination and amortisation; (c) the upstream guarantee should provide for adequate interest to be paid regularly (and not just accrued); and (d) the upstream guarantee should be adequately secured (e.g., by the borrower providing a pledge or another form of security).

Non-compliance may notably lead to the invalidity of an upstream guarantee, as well as to directors' and officers' personal liability. Further, non-compliance may have adverse tax implications and may even, under certain conditions, qualify as a criminal offence (e.g., creditor preference or disloyal management) or as a fraudulent conveyance under the applicable provisions of Swiss bankruptcy law.

The following issues should be considered when granting a guarantee:

Corporate purpose: As a general rule, a commitment entered into on behalf of a Swiss company is binding on the company, to the extent it falls within the company's corporate purpose as set forth in the articles of incorporation. If that is not the case, the commitment in question could be deemed *ultra vires* (i.e., beyond the scope of its powers) and thus null and void from the outset. The fulfilment of this prerequisite is often questionable for upstream guarantees which are not entirely on arm's length terms. In case of doubt, it is advisable for the Swiss guarantor to amend its articles of incorporation by extending the article on corporate purpose to provide explicitly for the granting of financial assistance to group companies, including through upstream guarantees. In addition, it may be advisable to insert in the articles of incorporation a clear reference to the fact that the Swiss guarantor is part of a particular group of companies.

Adequate risk diversification: As a general rule, the board of directors of a Swiss company must adhere to the principle of adequate risk diversification. When granting an upstream guarantee, the board of directors must thus avoid an undue risk concentration by a substantial portion of the company's balance sheet assets consisting of such a guarantee to the benefit of a third party.

Guarantor's free equity: Unless it clearly meets the arm's length test, an upstream guarantee may not be given in an amount exceeding the guarantor's so-called 'free equity'. Free equity corresponds to the amount of the guarantor's total equity (as shown in the statutory balance sheet), minus 150% (or, in the case of a holding company, 120%) of the nominal issued share capital, minus any remaining special reserves which are not available for dividend distributions, such as any special paid-in surplus reserve.

An upstream guarantee exceeding the free equity threshold could be deemed to be an unlawful return of the shareholder's capital contributions and to violate the statutory limitations on the use of the company's legal reserves. As a consequence, such upstream guarantee could be challenged by any party as being null and void from the outset. This is particularly true where the guarantee was fictitious or where it was clear from the beginning that the borrower would not be in a position to fulfil its obligations when due.

Constructive dividend: Under Swiss corporate law, shareholders and related parties are obliged to return any benefits they receive from a Swiss company if those benefits are clearly disproportionate to the consideration received by the company, as well as to its financial status. An upstream guarantee which does not clearly have arm's length terms could be deemed as a constructive dividend. As a consequence, the board of directors of the guarantor would be forced to demand immediate repayment of the guarantee irrespective of its term. Characterisation as a constructive dividend would also lead to adverse tax consequences.

In this context, it has become customary to require formal approval of upstream guarantees (which potentially qualify as constructive dividends) not only by the board of directors, but also by the shareholders of the Swiss guarantor. However, this formal step as such does not necessarily prevent the upstream guarantee from being deemed as a constructive dividend.

Directors' and officers' duty of care: In general, the directors and the senior management of a Swiss company may become personally liable to the company, as well as to its shareholders and creditors, for any damage caused by an intentional or negligent violation of their duties. Such liability may also be incurred by the Swiss company's parent (and its corporate bodies) if the latter is deemed to be a *de facto* corporate body of the Swiss company. In addition, according to the Swiss Withholding Tax Act, directors and officers may become personally as well as jointly and severally liable for unpaid withholding tax obligations of a Swiss company which is liquidated or becomes bankrupt. This liability is stricter than the general directors' and officers' liability insofar as the officers and directors, in order to avoid liability, must prove that they have done everything which could reasonably be expected from them to ascertain and fulfil the company's payable taxes.

Withholding and income tax implications: Ordinary, as well as hidden, profit distributions by resident companies are subject to Swiss withholding tax (currently at 35%) at source. Subject to certain conditions and upon request, the tax may be fully or partially refunded to the recipient of the profit distribution. For non-Swiss recipients, a refund may only be granted based on a double tax treaty between Switzerland and the country of residence of the recipient. Further, profit distributions are not income tax deductible – they are added back to the taxable profit of the distributing company and thus become subject to corporate income tax. From a tax standpoint, a constructive dividend is always assumed when a company executes non-arm's length transactions with related parties. This is also the case with regard to upstream guarantees.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

In Switzerland, the agent concept is recognised and frequently used for syndicated facilities and agency arrangements governed by Swiss or foreign law.

As for trustees, a substantive trust law does not exist in Switzerland. Therefore, it is not possible to set up a trust under Swiss law. Since July 2007, the Hague Convention on the Law Applicable to Trusts and on their Recognition 1985 (Hague Trust Convention) is applicable in Switzerland. Certain provisions of the Swiss Private International Law Act (PILA) transpose the Hague Trust Convention into national law. These provisions essentially allow recognition of foreign trusts (as defined in the Hague Trust Convention) in Switzerland. The relevant PILA provisions grant a settlor unfettered freedom to choose the law applicable to the trust. The trust can also contain a choice of jurisdiction, which must be evidenced in writing or in any equivalent form. A Swiss court cannot decline jurisdiction if either a party, the trust or a trustee has their domicile, place of habitual residence or a place of business in the canton of that court or a major part of the trust assets is located in Switzerland.

A decision by a foreign court on trust-related matters is recognised in Switzerland if it is made in any one of the following cases: (i) by a validly selected court; (ii) in the jurisdiction in which the defendant has its domicile, habitual residence or establishment; (iii) in the jurisdiction where the trust has its seat; and (iv) in the jurisdiction whose laws govern the trust. The decision is recognised in the country where the trust has its seat, provided the defendant was not domiciled in Switzerland.

Generally, a security trustee can enforce its rights; however, this depends on the nature of the security:

Pledge: Swiss law is based on the doctrine of accessory (*Akzessorietätsprinzip*), meaning that the secured party must be identical to the creditor of the secured claim. A pledge cannot be vested in a third party acting as a security holder in its own name and right; instead, the pledge must be granted to the lender or, in the case of syndicated loans, all of the lenders as a group. The lender(s) can, however, be represented by a third party acting in the name and on behalf of the lender(s).

Security transfer or security assignment: The doctrine of accessory (see above) does not apply. For this type of security, therefore, a security trustee can enter into the security agreement and hold the security in its own name and on its own account for the lender(s).

Intermediated securities: It is not clear yet whether the doctrine of accessory applies under the Federal Intermediated Securities Act. It is probable that it will not apply where securities are transferred to the secured party's account, but it may apply where a control agreement is entered into.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

The agent and/or the trust concept is recognised in Switzerland.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

A transfer from Lender A to Lender B is only possible if such transfer is not prohibited under the guarantee. Legally, such transfer will be effected by an assignment.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

The granting of security upstream or cross-stream on terms other than arm's length may trigger a 35% dividend withholding tax which must be deducted from the gross payment made.

Dividend withholding tax is fully recoverable if the recipient is a Swiss-resident entity. Non-resident companies with a permanent establishment in Switzerland can claim a full refund, if the relevant asset is attributable to the Swiss permanent establishment. Non-resident companies can claim a full or partial refund of the dividend withholding tax, based on an applicable double tax treaty between their country of residence and Switzerland. If no double tax treaty applies, the dividend withholding tax may become a final burden for the recipient (subject to any measures required in the country of residence of the recipient).

The Swiss Confederation and the cantons or communes levy an interest withholding tax on interest which is secured by a mortgage on Swiss real estate. The combined rate of the tax varies between 13 and 33%, depending on which canton the real estate is located in. This interest withholding tax is reduced to zero under many double tax treaties, including the ones with the US, the UK, Luxembourg, Germany and France.

Further, the transfer of ownership of a bond, note or other securities to secure a claim may be subject to securities transfer stamp tax of up to 0.3%, calculated on the transaction value, if a Swiss bank or other securities dealer as defined in the Swiss stamp tax law is involved as a party or intermediary. The tax is paid by the securities dealer and may be charged to parties who are not securities dealers. If no securities dealer is involved, no transfer stamp tax will arise.

In addition to this stamp tax, the sale of bonds or notes by or through a member of the SIX Swiss Exchange may be subject to a minor SIX Swiss Exchange levy on the sale proceeds.

The sale of goods for consideration in the course of a business is generally subject to VAT. The standard tax rate is currently 8%. Most banking transactions, including interest payments and transactions regarding the granting of security, are exempt from VAT. However, corresponding input taxes on related expenses are not recoverable.

VAT on the sale of real estate is only chargeable if the seller opts for tax. The option is permissible for buildings (but not for land) unless the new owner uses the buildings only for private purposes.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no specific incentives of such types and no specific taxes that apply to foreign lenders.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Generally, the granting or taking of security between related parties must be at arm's length. This may mean that a security commission or guarantee fee is payable to the security provider. This commission or fee can be subject to income tax for a Swiss security provider as part of his overall earnings. The transfer of ownership of an asset to secure a loan may trigger corporate income taxes on the net income as part of the overall earnings of a Swiss security provider. Income tax rates depend, among other things, on the place of incorporation or residence of a person, entity or permanent establishment.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please see question 3.9.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes. Subject to certain reservations, courts in Switzerland will generally recognise a governing law clause in a contract and will generally enforce a contract that has a foreign law-governed contract.

The rules relating to conflicts of law applicable in Swiss courts are set out in the PILA. Generally, a contract is governed by the law chosen by the parties. The choice of law must be expressly and clearly evident from the terms of the contract or the circumstances.

These rules apply to different forms of security in the following ways:

Acquisitions or losses of rights *in rem* in moveable goods. These are governed by the *lex rei sitae*, that is, the law of the country of the asset's location at the time of the event giving rise to that acquisition or loss. The PILA allows the parties to subject the acquisition and loss of those rights to the law governing the underlying legal transaction (see above). However, that choice of law cannot be invoked against third parties who can rely on the *lex rei sitae*.

Outright transfers of a claim and/or of uncertificated securities effected by way of security. These assignments are subject to the law (PILA) chosen by the parties or governing the claim, in the absence of a choice. However, that choice of law cannot be invoked against the debtor of the claim and the issuer of uncertificated securities without the debtor's prior consent.

Pledges of securities and debts. If the parties have not chosen the applicable law, the pledge of securities and debts is not governed by the *lex rei sitae* but by the law of the pledgee's domicile. (However, if the parties make a choice of law, it cannot be invoked against third parties (see above).) Irrespective of the law applicable between the parties, the only law which can be invoked against the issuer of a security or the debtor of a claim is the law governing the pledged security or right.

Specific rules apply to intermediated securities. The law applicable to dispositions over intermediated securities, as well as further rights to such intermediated securities, is the law chosen by the parties to the relevant account agreement (Hague Convention on Intermediated Securities). However, this law can only apply if the relevant intermediary has an office (as described in the Hague Convention on Intermediated Securities) in that jurisdiction at the time the agreement is entered into. Otherwise, the applicable law is the law of the jurisdiction in which the intermediary's office, with which the relevant account agreement was entered into, is located.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A final judgment obtained in New York or English courts is amenable to recognition and enforcement in the courts of Switzerland according to (i) the Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters dated 30 October 2007, (ii) such other international treaties under which Switzerland is bound, or (iii) PILA, provided that the prerequisites of the Lugano Convention, such other international treaties or the PILA, as the case may be, are met.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In case the guarantor is in possession of a so-called '*Rechtsöffnungstitel*', i.e. if the debtor recognised in a written document that it owes the amount to the guarantor, the guarantor's rights might get enforced in summary proceedings which may take two to three months. In the more likely case that no such '*Rechtsöffnungstitel*' is available, the guarantor will have to go through normal court proceedings. A judgment might be rendered within one year (first instance).

The latter is true also in case (b) if a foreign judgment needs to be enforced.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Under Swiss law, it is possible that in the security agreement the parties mutually agree that a pledgee take over the pledge in case of enforcement (‘*Selbsteintritt*’) and/or that the pledgee is entitled to sell the pledge (‘*Privatverwertung*’). In case there is no such agreement and/or in case of formal bankruptcy proceedings, the enforcement of collateral will take place by public auction in accordance with the Swiss procedural rules. The Swiss bankruptcy law foresees several different time lines depending on the type of collateral (moveables, real estate, etc.).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

No, they do not.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Generally, in the case of bankruptcy, pledged assets form part of the bankrupt estate. As a result, the private enforcement of pledged assets is no longer permitted and enforcement can only occur according to the Debt Enforcement Act. Intermediated securities traded on a representative market are not subject to this restriction, and private enforcement remains possible.

The pledgee's priority rights remain effective, and the proceeds from the sale of the pledged assets in the bankruptcy proceedings are first used to cover the claims secured by the pledge. If the proceeds from the sale of the pledged assets exceed those secured claims, the surplus is available for distribution to other creditors.

All claims against the bankrupt company become due at the time the bankruptcy is declared and the enforcement of all claims occurs in accordance with the procedures prescribed by the Debt Enforcement Act.

As to moratorium, Swiss law provides for company rescue procedures (*Nachlassverfahren*) in the Debt Enforcement Act. The rescue proceedings can be started by the company or in certain circumstances by a company's creditor. In those proceedings, the competent court can grant a moratorium (*Nachlassstundung*). A moratorium may, if certain conditions are fulfilled, lead to a composition agreement (*Nachlassvertrag*) that is binding on all creditors and affects the creditors' unsecured claims. For a composition agreement to be effective, it must be approved by at least a majority of the creditors holding two-thirds of all the debts or a quarter of the creditors holding three-quarters of the debt, and the competent bankruptcy court.

If a moratorium is granted by the competent court, the security granted by the company is not directly affected. However, as a rule, enforcement proceedings for the security cannot be started or continued as long as the moratorium is in effect. Private enforcement (see question 8.4) should still be possible and not be affected by a moratorium. If the rescue proceedings result in a composition agreement, the security granted by the company will not be affected by this. A composition agreement does not affect security granted by the company.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

An arbitration award rendered against a Swiss company in an arbitration proceeding is generally enforceable in Switzerland according and subject to the New York Convention of 10 June 1985 on the recognition and enforcement of foreign arbitral awards.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

All claims against the bankrupt company – as well as claims resulting from a guarantee – become due at the time the bankruptcy is declared and the enforcement of all claims occurs in accordance with the procedures prescribed by the Debt Enforcement Act.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The Debt Enforcement Act provides, in connection with bankruptcy and composition of a security provider, that a transaction is voidable if any of the following apply:

The security provider or the guarantor disposes of assets for free or for inadequate consideration (not at arm's length) in the year before the adjudication of bankruptcy or an equivalent event.

The security provider repays debts before they become due, settles a debt by an unusual means of payment or grants collateral for previously unsecured liabilities, which the security provider was not obliged to secure, in the year before the adjudication of bankruptcy or an equivalent event, provided that both the security provider was overindebted (i.e., its liabilities exceeded its assets) at that time and the secured party was aware of the overindebtedness of the security provider. A *bona fide* secured party is therefore protected. However, the law presumes the secured party's knowledge of the security provider's overindebtedness, so the secured party bears the burden of proof in relation to his good faith.

The granting of security by the security provider (or the granting of the guarantee) occurred in the five years before the adjudication of bankruptcy proceedings or an equivalent event, provided that the security provider intended to disadvantage or favour certain creditors or should reasonably have foreseen that result and the security provider's intent was, or must have been, apparent to the secured party.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Under Swiss law, it is not possible to start debt enforcement proceedings against Swiss municipalities (‘*Gemeinden*’) with the aim of inducing bankruptcy. In accordance with the applicable ordinance on debt enforcement, only enforcement proceedings on the enforcement of collateral are possible against Swiss municipalities.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The conditions under which security (including guarantees) can be enforced are determined by general principles of law, as well as by the specific provisions of the security agreement. This applies to loans, guarantees, pledged assets and assets transferred by way of security. For a secured party to be permitted to enforce security, the secured party must have a secured claim, and this claim must be due. The relevant security agreement may set out additional conditions for the enforcement of the security. Usually, security agreements refer to the occurrence of an event of default, as specified in the credit agreement governing the secured loan, as a condition for enforcing the security.

Guarantees under Swiss law are basically independent from the underlying claim. Therefore, it is not a requirement for the enforcement of a guarantee that an underlying claim must exist or be due (in contrast to pledges). It is sufficient that the conditions for enforcement set out in the guarantee are fulfilled. However, depending on the circumstances, the enforcement of a guarantee where there is no underlying claim may constitute an abuse of rights, which is not protected under Swiss law.

In the case of pledged assets, there are two main forms of enforcement, namely by way of a private enforcement and under the rules of the Debt Enforcement Act. Private enforcement is generally only permitted where the parties have agreed to this in advance, for example, in the security agreement. Private enforcement is possible in relation to all forms of assets, but in practice mainly occurs in connection with moveable assets. Private enforcement can take place by a private sale or a public auction or, in relation to assets, the value of which can be objectively determined (for example, listed securities), the pledgee itself purchasing the pledged assets, and applying the proceeds to its claims (*Selbsteintritt*). For securities over intermediated securities, as a matter of law, private enforcement does not need to have been agreed between the parties but is only permitted in respect of intermediated securities that are traded on a representative market. Pledges over intermediated securities can also be enforced privately on the bankruptcy of the security provider. This is in contrast to pledges over any other assets.

In all forms of private enforcement the pledgee must protect the interests of the pledgor and, in particular, must obtain the best price possible in the sale of the pledged assets, fully document the enforcement and provide the documentation to the pledgor and return any surplus remaining after the application of the proceeds to the secured debt to the pledgor.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Basically, yes.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A sovereign entity is either acting with its so-called administrative assets or with its financial assets. The administrative assets are the assets that directly serve the administrative tasks of an administration. The financial assets do not directly serve such purpose. If a sovereign entity is entering into agreements concerning its financial assets, it may validly waive sovereign immunity because in such cases the sovereign entity is acting as a normal third party. In the case of administrative assets, a sovereign entity may also waive sovereign immunity; however, in extreme cases (e.g. public policy issues) such waiver might be doubtful.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

No, there are no licensing or eligibility requirements in Switzerland for a lender to a company. Any person can lend to a third party. Lending is not an activity that requires a licence. However, given that lending is typically an activity done by a bank, it is noteworthy that the banking business does require a licence, even if not the lending activity. A bank that is not domiciled in Switzerland and does not have any physical presence in Switzerland is entitled to do banking activities on a cross-border basis into Switzerland, which includes the lending business. Note that Swiss law will change and such cross-border exemptions will no longer be possible without a licence. The change in law is expected to occur in 2017/2018.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

No, there are not.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Oliver Widmer
Pestalozzi Attorneys at Law Ltd
Loewenstrasse 1
CH-8001 Zurich
Switzerland

Tel: *+41 44 217 92 42*
Fax: *+41 44 217 92 17*
Email: *oliver.widmer@pestalozzilaw.com*
URL: *www.pestalozzilaw.com*

Oliver Widmer is a Partner and Head of Pestalozzi's Private Clients group and member of Pestalozzi's Financial Services group. He primarily advises domestic and international banks, financial institutions, wealth management service providers and high-net-worth individuals on banking, finance and capital markets matters. Further areas of work include domestic and cross-border trust, foundation and estate planning matters.

He is highly regarded by *The Legal 500* (Banking and Finance and Capital Markets), by *Chambers Global 2012* (Banking and Finance) and by *Chambers Europe 2012* (Banking and Finance), by Citywealth Leaders List 2012 (International Lawyer), by Legal Media Group in its *Expert Guides 2012* (Trust and Estates) and in its *Best of Best Lawyers 2012* (Trust and Estates).

He graduated from the University of Zurich (*lic. iur.*, 1998) and the London School of Economics and Political Science (M.Sc., Law and Accounting, 2002). He was admitted to the bar in Switzerland in 2000 and, as a solicitor (not practising) of England and Wales in 2003, is an authorised issuer's representative at the SIX Swiss Exchange and is recognised as a trust and estate practitioner (TEP) by STEP. Oliver Widmer joined Pestalozzi in 2001. In 2003/2004, he was seconded to head the Swiss law and compliance department of one major US investment bank.

Urs Klöti
Pestalozzi Attorneys at Law Ltd
Loewenstrasse 1
CH-8001 Zurich
Switzerland

Tel: *+41 44 217 92 92*
Fax: *+41 44 217 92 17*
Email: *urs.kloeti@pestalozzilaw.com*
URL: *www.pestalozzilaw.com*

Urs Klöti is Managing Partner of Pestalozzi and heads Pestalozzi's Financial Services group. His practice is focused on banking and capital markets, corporate finance, securities, insurance and corporate law.

Urs Klöti, born in 1965, graduated in economics from the University of St. Gall in 1990. In 1991/1992, he worked for a Swiss firm in Indonesia. In 1994, he graduated in law from the University of St. Gall and joined Pestalozzi in 1995. In 1998, he was admitted to the bar in Switzerland. From 2000 to 2003, Urs Klöti was Head of Law and Compliance of the Swiss institutional client bank in Zurich of one of the world's leading US investment banks. Urs Klöti's professional languages are German and English and he also speaks some Spanish.

Pestalozzi's roots go back to 1911. Of the major and most respected Swiss law firms, Pestalozzi has the longest tradition.

Supporting our international and domestic clients from our offices in Zurich and Geneva to reach their goals is our paramount ambition. With the extensive know-how, experience and the strong commitment of our staff of about 150 people, we help our clients achieve their goals quickly and efficiently. We are known for our integrity and our high quality, as well as for our efficacy.

For each project we form a customised team to accommodate your specific needs. We have direct access to an international network of lawyers and can introduce you to an appropriate law firm in jurisdictions worldwide.

Three distinctive values guide us:

- We care for our clients: we provide them with result-oriented, effective and realisable solutions.
- We act responsibly: both competence and integrity are at the core of our services.
- We are committed to attracting and retaining dedicated and skilled people.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Taiwan

Hsin-Lan Hsu

Cyun-Ren Jhou

Lee and Li, Attorneys-at-Law

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

In spite of its weak economic performance, Taiwan was the sole bright spot in a shrinking Asian loan market in 2015 as easier funding conditions for the island's lenders helped buck a regional decline in deal volumes. The volume of syndication loans in Taiwan increased by 9% compared to 2014. However, most of the syndication loans were refinancing. The top five banks in the recent syndication loan transactions are all state-run banks.

Because of oversupply in Taiwan's domestic lending market, offshore lending has since become a major growth driver for several large banks. However, exposure to China's private sector was still a sticking point, as country limits and growing fears of corporate defaults underlined the importance of working with the right credits. In addition, consumer lending slowed significantly in 2015 compared to 2014. A combination of factors impacted on growth. Low consumer confidence, lack of income growth and employment uncertainty all led to flagging growth. Card lending is well developed, while the development and popularity of other non-lending payment methods, such as pre-paid and debit cards, appeal to many consumers. Mortgages/housing also continued to take a hit from declining housing affordability.

On October 19, 2015, the Bankers Association of the Republic of China and the Japanese Bankers Association signed a memorandum of understanding (MOU) on cooperation that pledged to jointly promote the future development of the banking industry in the two countries. The two organisations will work together to create better and healthier conditions for the future development of the banking industry in the two countries by sharing information and learning from each other through seminars.

Taiwanese banks also strengthened their international capacity by entering into memorandums of understanding with foreign banks, especially Japanese banks. On October 20, 2015, Bank of Taiwan, the largest lender in Taiwan, and Japan's third largest bank, Mizuho Bank, Ltd., signed a memorandum of understanding (MOU) on cooperation in a wide variety of business fields, including syndicated lending, trade lending, funding support, electronic finance, personnel training and trust management. CTBC Bank also signed a memorandum of understanding with a Japanese bank, Aozora Bank, in June 2015 to cooperate in the international syndication business.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

(1) It was reported that in November 2015, the National Communications Commission (NCC) of Taiwan approved Dafu Media's acquisition of 20% shares in Kbro Co. from Carlyle Group's, and a syndicated loan with the lending amount of NT$59 billion was formed by seven local banks led by Bank of Taiwan.

(2) In February 2015, Formosa Plastics Group entered into a syndication loan of US$1.2 billion with 13 local and foreign banks led by Bank of Taiwan to finance the capital expenditure of its steel plant in Ha Tinh, Vietnam. The term of the loan is five years and can be extended for another two years.

(3) In July 2015, China Steel Corporation (CSC) obtained the participation of two banks, Land Bank of Taiwan and Taiwan Cooperative Bank, in US$400 million five-year amortisation term loans with the highest loan commitment subscribing for more than US$1 billion. The leading banks and bookkeepers are Bank of Taiwan and Taipei Fubon Bank. Ten banks have joined in consortium with differentiated lower loan commitment, with unsecured loans adding 30% over-allotment options and choices for extension by two years. The loans will be used for supporting investment in steel plant under Formosa Plastics Group in Ha Tinh, Vietnam, which is a joint venture between Formosa Plastics Group and CSC.

(4) On September 11, 2015 AU Optronics Corp. signed a NT$37.5 billion dual-tranche facility with Bank of Taiwan, CTBC Bank, Cathay United Bank, DBS, Land Bank of Taiwan, Mega International Commercial bank, Taipei Fubon Commercial Bank, Taishin International Bank and Taiwan Cooperative Bank as the joint bookkeepers and mandated lead arrangers. The facility is split into a NT$26.5 billion five-year tranche and a NT$11 billion three-year tranche.

(5) On May 19, 2015, Powerchip Technology Corp ("PTC") entered into a NT$15 billion syndication loan agreement through joint bookkeepers and mandated lead arrangers Chang Hwa Commercial Bank, Land Bank of Taiwan and Taiwan Cooperative Bank, to repay its current outstanding debts. The three-year term loan is equally split into two NT$7.5 billion tranches. After paying back all of its loans and escaping from the financial distress status, PTC will be back to its normal operation and reapply for listing on Taiwan Stock Exchange.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

According to the Company Act, any company cannot act as a guarantor of any nature, unless otherwise permitted by law or by the company's Articles of Incorporation. Thus, if permitted by its Articles of Incorporation, the company may provide guarantees for other members of its corporate group.

If the company is a public company, there will be additional restrictions. Pursuant to the Regulations Governing Loaning, Endorsement or Guarantees of Public Companies ("Guarantee Regulation"), a public company may provide guarantees only for the following companies: (1) a company with which the public company conducts business; (2) a company in which the public company directly and indirectly holds more than 50% of the voting shares; and (3) a company that directly and indirectly holds more than 50% of the voting shares in the public company. In addition, guarantees provided by a public company should comply with the internal rules adopted in accordance with the Guarantee Regulation.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Generally, there is no concern about the enforceability under this circumstance so long as all legal requirements are satisfied. However, if a company provides guarantees for others in return for only a disproportionately small benefit or without benefit in return in the absence of a justifiable cause, there may be concern that the directors resolving the guarantees may breach their fiduciary duties. Further, the creditors of the guarantor may apply to the court for revoking the guarantee if, due to the guarantee, the guarantor has no sufficient assets to repay the debts owed to its creditors.

2.3 Is lack of corporate power an issue?

Please refer to our answer to question 2.1. If a company's Articles of Incorporation do not permit the company to provide guarantees to others, but the company's responsible person, such as a director, still provides guarantees to others on behalf of the company, the responsible person alone should be liable for the guarantees. The guarantee does not constitute a valid obligation of the company.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental approval is required for a company to provide guarantees. As for due authorisation, a board resolution adopted by the board of directors of the company to provide guarantees normally would suffice unless the Articles of Incorporation provide otherwise. In practice, however, it is not common for a company's Articles of Incorporation to require that the provision of guarantees be approved by a shareholders' meeting.

However, where a Taiwanese company provides a guarantee to its overseas affiliate (incorporated in a jurisdiction other than Mainland China) who borrows funds to make investment in Mainland China, the guarantor will require a prior approval of the Investment Commission ("IC") of the Ministry of Economic Affairs ("MOEA") with respect to the investment in Mainland China.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

The Guarantee Regulation and a company's internal rules adopted in accordance therewith impose certain limitations on the aggregate amount of the company's guarantees to all counterparties and the amount of the company's guarantees to a single counterparty. If the internal rules are incorporated into the company's Articles of Incorporation, the violation of the internal rules and the Articles of Incorporation by the company in providing a guarantee may affect the enforceability of the guarantee. By contrast, if the company only violates the internal rules in providing the guarantee, it is generally considered that violation of such limitations will only result in an administrative fine imposed by the Financial Supervisory Commission or breach of fiduciary duty by the directors but will not affect the enforceability of the guarantees.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

A Taiwanese corporate entity or individual has an annual foreign exchange quota of US$50 million (or its equivalent) or US$5 million (or its equivalent), respectively. No prior approval from the CBC is required if the Taiwanese onshore guarantor converts New Taiwan Dollars into foreign currency for remittance to the offshore guaranteed and the conversion does not exceed the above quota. The CBC has the sole discretion to grant or withhold its approval on a case-by-case basis if the onshore Taiwanese guarantor's quota would be exceeded for such conversion.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Among other things, the following types of collateral are commonly seen in secured lending transactions:

(1) a mortgage over real property, such as land and buildings;

(2) a chattel mortgage over a movable asset, such as machinery and equipment;

(3) a pledge over movable assets or securities, or a pledge over the pledgor's property rights which are transferable, such as the pledgor's rights in bank accounts, accounts receivable or patents; and

(4) an assignment of property rights, which are transferable.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

As a general rule, the security provider and the security interest holder should enter into an agreement to identify the specific asset subject to the security interest. A general security agreement without identifying such specific asset, such as a floating charge, is not enforceable under Taiwan law. In addition, different types of assets may be subject to different requirements, such as registration or filing with the competent authorities, on the perfection of the security. We will briefly advise on such requirements in our answers to questions 3.3 to 3.7.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. In order to create a valid mortgage over the land, buildings and plants, the mortgagor and the mortgagee should enter into a written agreement, and registration with the competent authority is required.

As for machinery and equipment, the security to be created may be a pledge or a chattel mortgage. The machinery and equipment on which a chattel mortgage can be created are subject to the list promulgated by the authority. Both security interests (pledge and chattel mortgage) give the security interest holder a first priority over the machinery and equipment. To create a pledge, the pledgor and the pledgee have to enter into a written agreement and the pledgor should deliver the possession of the machinery and equipment to the pledgee, but a registration with the competent authority is not required. To create a chattel mortgage, the mortgagor need not deliver the possession thereof to the mortgagee; however a registration with the competent authority would be necessary in order for the mortgagee to claim the chattel mortgage against a *bona fide* third party.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. To create a pledge over receivables, the pledgee and the pledgor must enter into a written agreement. In addition, the receivables must be identifiable according to the content of the pledge agreement. Further, the obligor should be notified of the creation of the pledge in order for the pledgee to be able to claim the pledge against the obligor.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. To create a pledge over cash deposits, the pledgee and the pledgor must enter into a written agreement. The pledge shall not become effective against the account bank taking the cash deposits unless the account bank is notified of the creation of the pledge. Nevertheless, please note that the concept of a floating charge is not recognised under Taiwan law. In other words, the pledge covers only the cash in the bank account when such pledge is created and notified to the account bank. The pledge will not cover the cash deposited in the bank account after the account bank is notified of the pledge. To deal with this issue, the pledgor in practice will be required to periodically confirm with the account bank the amount of cash in the bank account to ensure that the pledge also covers the cash deposited after the creation of the pledge.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes. According to the Company Act, a company should issue shares in certificated form if its issued capital reaches a certain amount specified by the competent authority. Currently, the threshold amount is NT$500,000,000. In addition, a public company may issue shares in scripless form. To create a pledge over shares in certificated forms, a written agreement is required. The certificates of the pledged shares shall be duly endorsed and delivered by the pledgor to the pledgee. Furthermore, the company issuing the shares shall be notified of the creation of a pledge in order to register such pledge on the shareholders' roster. The creation of a pledge is valid between the pledgee and the pledgor when the certificates of the shares have been endorsed and delivered to the pledgee. However, the creation of the pledge cannot be claimed against the company unless the company is notified of the creation of the pledge.

To create a pledge over listed shares which are traded and transferred through the book-entry system of Taiwan Depository and Clearing Corporation ("TDCC"), the pledgor and the pledgee have to sign a form prescribed by the TDCC and have the pledge registered with the TDCC.

A pledge over shares can also be created based upon the document governed by New York or English law, as long as the creation and perfection of the pledge follow the procedures and requirements described above.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

A floating charge over the inventory is not enforceable under Taiwan law. Please refer to our answer to question 3.2.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

(i) Yes, it can.

(ii) This issue is whether a company may provide guarantees for others. Please refer to our answer to question 2.1.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No notarisation or stamp duty is required for the creation of security over different types of assets, mentioned in our answer to question 3.1. The registration fee for creating a chattel mortgage over a movable asset is NT$900. The registration fee for creating a mortgage over real property is equivalent to 1/1,000 of the total amount secured by the mortgage.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Regarding the registration fee, please refer to our answer to question 3.9. The authority in charge of the registration will only conduct a formality review and it is not expected that the registration will take a significant amount of time.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In addition to the requirement of registration for certain types of security interests as mentioned above, generally the creation of the security interests does not require a regulatory or similar consent.

However, it is worth noting that, according to the interpretation of the MOEA, a foreign company having no branch office in Taiwan,

© Published and reproduced with kind permission by Global Legal Group Ltd, London

the Republic of China is not allowed to be registered as a security interest holder. In local practice, the competent authorities will not permit such a foreign company to be registered as a mortgagee of real property or a chattel mortgagee of a movable asset.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Take a real property mortgage, for example. The mortgage can be divided into a general mortgage and a maximum amount secured mortgage. As for a general mortgage, the obligations to be secured should exist upon the creation of the mortgage. Otherwise, the mortgage will be held unenforceable. By contrast, a maximum amount secured mortgage is to secure the obligations created and owed to the mortgagee for a period of time. So long as the secured obligations exist at the end of the mortgage period, the mortgagee may foreclose the real property. Since the obligations under a revolving credit facility may arise and be satisfied from time-to-time according to the borrower's drawdown and repayment, the mortgage to secure such obligations should be a maximum amount secured mortgage instead of a general mortgage. The above also applies to a chattel mortgage and a pledge.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

No, there are not.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Regarding the prohibitions and restrictions on the provision of guarantees by a company, please refer to our answers to question 2.1. The provision of security other than a guarantee generally will be deemed as providing a guarantee as well, and is subject to the same prohibitions and restrictions.

In addition, according to the Company Act, a company cannot redeem or buy back any of its outstanding shares unless permitted by law. For instance, a company may purchase up to 5% of its outstanding shares and transfer the same to its employees. To give another example, a listed company may buy back its outstanding shares in the circumstances permitted under the Securities and Exchange Act. The restriction on a company's ability to buy back its outstanding shares extends to the company's controlled company; in addition, the violation of such restriction may cause the buy-back to be void. A subsidiary of the parent company cannot purchase the shares of the parent company. Nevertheless, the Company Act does not prohibit a sister subsidiary from purchasing the shares of another sister subsidiary.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

As a general practice for a syndicated loan, syndicated banks will appoint an agent bank to act for and on behalf of the syndicated banks, including registering the agent bank as, for instance, a mortgagee and foreclosing the mortgaged property. In addition, there will be a clause in the syndicated loan agreement to the effect that the syndicated banks' claims against the borrower under the syndicated loan agreement are joint and several. Given this, the agent bank may claim the whole amount of the loan from the borrower and distribute the proceeds obtained therefrom to the syndicated banks in accordance with their proportion of participation in the loan.

Nevertheless, under Taiwan law, it is questionable whether or not a third party, who is not a creditor/lender, could validly hold the collateral as a trustee or a security agent for other creditors/lenders. Pursuant to the Civil Code, a mortgage/pledge would not be validly created in favour of the creditor/mortgagee/pledgee if there is no underlying credit owned by the mortgagee/pledgee against the debtor.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

As advised in question 5.1 above, in practice, if the lenders' claims against the borrowers are joint and several, one of the lenders may be appointed as the agent bank by syndicated banks to act for and on behalf of all the syndicated banks, including registering the agent bank as, for instance, a mortgagee and foreclosing the mortgaged property.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The transfer of the loan from Lender A to Lender B will not be effective against the borrower and the guarantor until either Lender A or Lender B has notified the borrower and the guarantor of such transfer.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) For a domestic non-bank lender, who is a Taiwan resident or a profit-seeking enterprise with a fixed place of business in Taiwan, the withholding tax rate for interest is 10% but such

© Published and reproduced with kind permission by Global Legal Group Ltd, London

withholding tax is applicable to corporate borrowers only. Individual borrowers are not required to withhold tax on interest.

For a foreign lender, who is a non-Taiwan resident or a profit-seeking enterprise without a fixed place of business in Taiwan, the withholding tax rate for interest applicable to a corporate borrower is 20%, but if the interest derives from short-term commercial papers, securitised instruments, government/corporate/financial institution bonds, or conditional transactions, the withholding tax is 15%. Moreover, most of the tax treaties provide a reduced income tax withholding rate of 10%. Taiwan has signed tax treaties with 28 jurisdictions, namely, Australia, Austria, Belgium, Denmark, France, Gambia, Germany, Hungary, India, Indonesia, Israel, Kiribati, Luxembourg, Macedonia, Malaysia, the Netherlands, New Zealand, Paraguay, Senegal, Singapore, Slovakia, South Africa, Swaziland, Sweden, Switzerland, Thailand, the United Kingdom and Vietnam.

(b) Where the portion of the proceeds is to indemnify the principal of the loan made by the lender, it will not be subject to income tax. If the portion of the proceeds is to indemnify the default interest sustained by the lender, it may be subject to income tax as mentioned above. Moreover, in the event that the proceeds include a penalty pursuant to an agreement between the lender and the borrower, such penalty will be subject to income tax unless the lender may prove that the penalty is to indemnify losses suffered by the lender.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

(1) Income tax on the following categories of income shall be exempted:

- Interest derived from loans offered to the Taiwanese government or legal entities within the territory of Taiwan by foreign governments or international financial institutions for economic development, and interest derived from the financing facilities offered to their branch offices and other financial institutions within the territory of Taiwan by foreign financial institutions.
- Interest derived from loans extended to legal entities within the territory of Taiwan by foreign financial institutions for financing important economic construction projects under the approval of the Ministry of Finance.
- Interest derived from favourable-interest export loans offered to or guaranteed for the legal entities within the territory of Taiwan by foreign governmental institutions and foreign financial institutions which specialise in offering export loans or guarantees.

Moreover, some of the tax treaties provide an exemption from income tax withholding for interest payment. For example, the Netherlands-Taiwan Tax Treaty provides that the interest which is paid in respect of a bond, debenture or other similar obligations of a Taiwanese public entity, or of a subdivision or local authority of Taiwan, should be taxed only in Netherlands.

(2) For the purposes of effectiveness or registration, there is no tax applicable to foreign investments, loans, mortgages or other security documents.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

No; a foreign lender (except for a foreign entity's Taiwan branch) will not be subject to Taiwan income taxes solely because of a loan to or guarantee and/or grant of security from a Taiwanese company.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please refer to our answer to question 3.9.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

A thin capitalisation rule was incorporated into the Income Tax Act effective from January 28, 2011. That is, retroactively from January 1, 2011, if the ratio of a company's debts (to its related party) to its equity exceeds a certain ratio, the interest expense arising out of the portion of the debts exceeding said ratio is not deductible, except for financial institutions (including banks, cooperatives, financial holding companies, bills finance companies, insurance companies, and securities firms). The Ministry of Finance, by referring to international practices, has set a safe harbour debt-equity ratio of 3:1.

The same treatment in respect of the thin capitalisation rule applies to both domestic and foreign lenders.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Generally, the choice of a foreign governing law to govern a contract would be recognised as a valid choice of law and given effect by the courts of Taiwan, provided that the relevant provisions of the foreign governing law would not be applied to the extent such courts hold that: (i) the application of such provisions would be contrary to the public order or good morals of Taiwan; or (ii) such provisions would have the effect of circumventing mandatory and/or prohibitive provisions of Taiwan law. However, where the contract is about the creation/perfection of a security interest, such as a pledge and mortgage, the choice of law will be subject to the conflicts of law of Taiwan.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Any final judgment rendered by a foreign court shall be recognised and enforceable in Taiwan without review of the merits, provided that the court of Taiwan in which the enforcement is sought is satisfied that:

(i) the foreign court rendering the judgment has jurisdiction over the subject matter according to Taiwan law;

(ii) the judgment and the court procedures resulting in the judgment are not contrary to the public order and good morals of Taiwan;

(iii) if a default judgment was entered into against the losing party, the losing party was (a) duly served within a reasonable period of time within the jurisdiction of such court in accordance with the laws and regulations of such jurisdiction, or (b) process was served upon the losing party with the judicial assistance of Taiwan; and

© Published and reproduced with kind permission by Global Legal Group Ltd, London

(iv) judgments of the Taiwan court are recognised by the foreign court on a reciprocal basis.

To our knowledge, there is reciprocity for enforcement of judgments between Taiwan and New York/England.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) Depending on the complexity of the case in dispute, it could take half a year to one year or longer for each of the district court, the high court and the Supreme Court to render a judgment. Regarding the enforcement of the final judgment against the assets of the company, it also depends on the value and types of the company's assets. For example, to foreclose a mortgaged real property, it may take from several months to one year or longer to conduct the auctions for the real property if there is no bidder or if the bid price is below the set auction price.

(b) Depending on whether the Taiwan court or the counterparty has raised any objections to the elements set forth in our answer to question 7.2, it may take months or one year or longer for the Taiwan court to render a judgment recognising the foreign judgment. In addition, as mentioned in our answer to question 7.3 above, the enforcement of a final judgment against the assets of the company depends on the value and types of the company's assets.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

(a) Depending on the types of collateral security, foreclosure of collateral security through a court proceeding may require a public auction. For instance, if the real property is foreclosed through a court proceeding, the court will designate an expert to assess the value of the real property and hold a public auction to sell it. If the real property has not been sold due to the fact that no bidder has attended the auction or the bidding price is below the auction price set by the court, the court will have to reduce the auction price and repeat similar exercises to sell the real property in accordance with the Mandatory Execution Act. Accordingly, foreclosing the real property may take longer through a public auction than by other means of enforcement such as a private agreement between the mortgagor and the mortgagee to settle debts by transferring ownership of the real property to the mortgagee.

(b) Generally, no regulatory consent is required in order for the security interest holder to enforce the collateral interest.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

(a) Generally, no. However, according to the Code of Civil Procedure, if a plaintiff has no domicile, office, or place of business in Taiwan, the court shall, by a ruling on motion filed by the defendant, order the plaintiff to provide a security for the litigation expenses. Such requirement will not apply in the case where either the portion of the plaintiff's claim is not disputed by defendant or the plaintiff's assets in Taiwan are sufficient to compensate the litigation expenses.

(b) Please refer to our answer to question 3.11.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Regarding bankruptcy, all enforcement actions against the debtor will be stayed by the bankruptcy of the debtor and all unsecured creditors must follow the bankruptcy proceeding administered by the court to file their claims against the debtor. Nevertheless, if a creditor, such as a lender, has a mortgage, pledge or right of retention over the debtor's assets, the lender may enforce such collateral security without going through the bankruptcy proceeding.

As for reorganisation, all enforcement actions against the debtor subject to reorganisation will be stayed no matter whether the lender is a secured (such as a mortgagee or a pledgee) or unsecured creditor. The lender may not foreclose the collateral security regardless of other stakeholders and should follow the reorganisation proceeding administered by the court.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

According to the Arbitration Law, a foreign arbitration award would be recognised and enforceable by the courts of Taiwan without reviewing the merits, provided that none of the followings exists:

(i) where the recognition or enforcement of the arbitral award is contrary to the public order or good morals of Taiwan; or

(ii) where the dispute is not arbitrable under the laws of Taiwan.

In addition, if there is no reciprocity in the recognition and enforcement of an arbitral award between Taiwan and the country in which the arbitral award is made or the country whose arbitration rules are applicable, the Taiwanese court may dismiss the petition for the recognition of a foreign arbitral award.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Please refer to our answer to question 7.6 regarding foreclosure of the collateral interest by a lender. In addition, if a lender's claims cannot be fully satisfied by foreclosing the collateral security, the lender may still participate in the bankruptcy proceeding as an unsecured creditor to seek possible repayment.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Regarding the preference period/clawback right, according to the Bankruptcy Law, the bankruptcy administrator shall, within two years after the declaration of the bankrupt's bankruptcy, file with the court to rescind the transaction which the bankrupt conducted with

© Published and reproduced with kind permission by Global Legal Group Ltd, London

or without consideration before the declaration of the bankrupt's bankruptcy if such transaction is deemed to be detrimental to the rights of the bankrupt's creditor and is revocable under the Civil Code. In addition, the bankruptcy administrator may cancel the collateral security which is created by the bankrupt within six months before the declaration of the bankrupt's bankruptcy (i) to secure the bankrupt outstanding debts except that the bankrupt has committed to create collateral security before the foregoing six-month period; and (ii) to secure debts which have not yet become due and payable.

As for preferential creditors' rights, below are certain examples:

(i) land value increment tax, land value tax and house tax levied on the sale of the real property which will rank prior to the mortgagee and the unsecured creditors;

(ii) labour wages due and payable by the employer but overdue for a period up to six months which will rank prior to unsecured creditors; and

(iii) fees and debts incurred for the benefit of the bankruptcy estate which will rank prior to unsecured creditors.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

According to the Deposit Insurance Act, the Central Deposit Insurance Corporation may set up a bridge bank as a vehicle to take over a distressed bank. The bridge bank may assume the businesses, assets and liabilities of a distressed bank and the Bankruptcy Law will not apply to the bridge bank during its existence.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

According to the Civil Code, the creditor may initiate certain self-help remedies to seize the debtor's property and will not be liable therefor, provided that: (i) the assistance of the court or of other relevant authorities is not accessible in time and the satisfaction of the creditor's claim will be impossible or manifestly difficult without the self-help remedy; and (ii) the creditor shall apply for the court's assistance immediately after the self-help remedy is exercised.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The Judicial Yuan of Taiwan has held an internal conference and reached a conclusion that a submission to jurisdiction clause will be valid in the absence of any of the following circumstances: (1) it would be unfair for the subject matter to be adjudicated by the chosen jurisdiction; (2) the consent of a party to submit to the chosen jurisdiction was obtained by fraud, duress or other unlawful means; (3) the parties were not equal-footed when they entered into the submission to jurisdiction agreement; (4) it would be inappropriate or inconvenient for the chosen jurisdiction to adjudicate the subject matter; and (5) the country of the chosen jurisdiction does not recognise and enforce judgments of Taiwan courts on a reciprocal basis. The conclusion made by the Judicial Yuan is, however, subject to test in court.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, it is. It will be binding upon that party under Taiwan law unless (i) the waiver would be contrary to the public order or good morals of Taiwan, or (ii) the waiver would have the effect of circumventing mandatory and/or prohibitive provisions of Taiwan law.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There is no particular licence or other eligibility requirement to lend money to a company in Taiwan. However, the Company Act provides that the capital of a Taiwanese company shall not be lent to any person unless the lending arrangement is due to business transaction or is necessary for short-term financing and the aggregate amount of such short-term financing should not exceed 40% of the company's net value. As a result, in local practice, no company in Taiwan except banks, securities firms, insurance companies or pawn shops may engage in lending as an ordinary business. Taiwan has not opened the establishment and operation of lending companies. Accordingly, currently it is not possible to set up a company to operate a lending business in Taiwan.

Since there is no particular licence or eligibility requirement, the main distinction under the laws of Taiwan between a lender that is a bank *versus* a lender that is a non-bank, would be the application of the above lending restriction under the Company Act to a non-bank lender.

There is no restriction on a foreign lender for making a loan to Taiwanese borrowers outside of Taiwan regardless of whether the foreign lender is licensed or not. Nevertheless, in the case of a foreign loan to a Taiwanese borrower, the foreign exchange control, as advised in our answer to question 2.6, would apply unless such foreign debts have been registered with the CBC by the Taiwanese borrower.

There are no licensing and other eligibility requirements in Taiwan for an agent under a syndicated facility for lending to a company in Taiwan.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

For foreign lenders who will participate in financing in Taiwan, please refer to our answer to question 3.11 regarding the MOEA's ruling on the ability of a foreign entity without a local presence to take collateral security.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

If a foreign lender provides a loan with the term of more than one year to a Taiwanese company in which it owns shares or capital or a Taiwanese partnership in which it is one of the partners or a Taiwanese business of which it is the sole proprietor or a branch created by it, please note that a prior approval from the Investment Commission of the MOEA is required.

As to foreign exchange control, please refer to our answer to question 2.6.

Hsin-Lan Hsu
Lee and Li, Attorneys-at-Law
7F, 201 Tun Hua N. Road
Taipei, 10508
Taiwan, R.O.C.

Tel: +886 2 2715 3300 ext. 2551
Fax: +886 2 2514 9841
Email: hsinlanhsu@leeandli.com
URL: www.leeandli.com

Hsin-Lan Hsu graduated from National Taiwan University (LL.B.). She served as a notary public at Keelung and Taipei District Courts for nearly two years. Then she won a scholarship from the Ministry of Education to study International Economic Law in France, where she obtained a DEA at Paris I University.

Hsin-Lan Hsu is a partner in the Banking and Capital Market Department. Hsin-Lan's major practice areas are banking, capital markets and corporate finance, and she specialises in securities, banking, financial, M&A and corporate finance-related laws and regulations.

Hsin-Lan has advised on many: (1) offshore and onshore fund raising projects, such as ADRs issued by Chunghwa Telecom, ECBs issued by Taiwan High Speed Rail and EEBs issued by Yuen Foong Yu Paper MFG. Co., Ltd. and Asia Cement, as well as several TDR offerings and IPOs in Taiwan; (2) mergers and acquisitions of financial institutions, such as the tender offer of Grand Cathay Securities by China Development Bank, the acquisition of Hsinchu Commercial Bank by Standard Chartered Bank and the acquisition of Polaris Securities by Yuanta Financial Holding Co., Ltd.; and (3) asset sale and purchases and general corporate finance. In addition to transactions, Hsin-Lan has provided general advice in the field of financial, investment, data protection and corporate-related inquiries.

Education

- University of Paris I Pantheon-Sorbonne (*Diplôme d'études approfondies*, 1998).
- University of Paris II Pantheon-Assas (*Diplôme supérieur d'université*, 1996).
- National Taiwan University (LL.B., 1992).

Cyun-Ren Jhou
Lee and Li, Attorneys-at-Law
7F, 201 Tun Hua N. Road
Taipei, 10508
Taiwan, R.O.C.

Tel: +886 2 2715 3300 ext. 2170
Fax: +886 2 2514 9841
Email: crowdjhou@leeandli.com
URL: www.leeandli.com

Cyun-Ren Jhou is a senior attorney in the Banking and Capital Markets Department of Lee and Li. He holds an LL.B., with a minor in Economics, from National Taiwan University. He also received Master of Laws degrees from National Taiwan University and the University of Pennsylvania. Before joining Lee and Li, he was an in-house lawyer at China Trust Commercial Bank. In addition to being a licensed Taiwan lawyer, he is admitted to practise law in New York State.

Mr. Jhou advises financial institutions on corporate/securities/insurance regulation compliance issues, applications and permits, syndicated loans, financial instruments/financial derivatives, drafting and review of relevant transaction documents for banking businesses. Mr. Jhou has extensive experience in: mergers and acquisitions deals; foreign investment; project finance; IPOs; asset management, investment and trust legal matters; research projects; drafting and review of transaction documents; and other regulatory matters. Mr. Jhou also assists in financial litigation and dispute resolution.

Education

- University of Pennsylvania (LL.M., 2012).
- National Taiwan University (LL.M., 2008).
- National Taiwan University (LL.B., 2005).

Lee and Li, Attorneys-at-Law now is the largest law firm in Taiwan, and its services are performed by over 100 lawyers admitted in Taiwan, patent agents, patent attorneys, trademark attorneys, more than 100 technology experts, and specialists in other fields. With expertise covering all professional areas and building on the foundations laid down over decades, the firm has been steadfast in its commitment to the quality of services to clients and the country and is highly sought after by clients and consistently recognised as the preeminent law firm in Taiwan.

Lee and Li is often named as one of the best law firms in evaluations of international law firms/intellectual property right firms. For instance, it was selected as the best *pro bono* law firm in Asia and the best law firm in Taiwan many years in a row by the *International Financial Law Review* (the *IFLR*); it is also consistently named the National Deal Firm of the Year for Taiwan and awarded Super Deal of the Year by *Asian Legal Business*.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Turkey

Sera Somay

Paksoy

Esen Irtem

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Despite the banks still being major players in the lending markets, non-bank financial institutions such as leasing and insurance companies have also shown significant growth in recent years in Turkey. In addition, participation banks opened by state-owned banks are boosting the lending markets with more competitive and innovative financing instruments. The strategic sectors are energy, infrastructure, telecommunication, healthcare, education.

Lending mainly occurs in the form of revolving lines of credit, SME loans by Turkish banks, ECA-backed loans, corporate syndication and club loans by international banks, limited recourse project finance mostly underwriters by Turkish banks, structured and off-balance sheet financing.

Regarding the regulatory framework, in order to implement the rules published by the Basel Committee in December 2010 and revised in June 2011 (Basel III) into Turkish law, the Banking Regulation and Supervision Agency (BRSA) has adopted several regulations. One of the most important regulations is the Regulation on Equities of Banks which sets forth the rules on calculation of equities of banks in Turkey.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The European Export Credit Agency-guaranteed Italian tax lease provided USD 315,000,000 for Turkish Airlines; Garanti Bankası, T. İş Bankası, Akbank, Finansbank, Deutsche Bank, Yapi Kredi Bankası, Ziraat Bank, Halk Bank and Vakıfbank provided a USD 4,956,000,000 PPP loan facility for Otoyol Yatırım ve Isletme A.S. for financing the Gebze-İzmir Motorway Project; and Garanti Bankası, T. İş Bankası, Halk Bank, Ziraat Bank, Turkiye Sanayi ve Kalkınma Bankası (TSKB) and Yapı Kredi Bankası provided a USD 3,000,000,000 loan facility for Limak Energy and Ic Energy for the privatisation of the Yeniköy Kemerköy thermal power plant.

The Société Générale and Bank of America Merrill Lynch club facility provided a club loan for Türk Telekomünikasyon for corporate financing amounting to EUR 420,000,000 and USD 380,000,000; and BNP Paribas, Citibank, HSBC, ING and Intesa Sanpaolo provided a club loan for Turkcell for corporate financing amounting to USD 500,000,000 and EUR 445,000,000 in the telecommunication sector in Turkey.

In terms of Islamic financing markets: ABC Islamic Bank (E.C.), Barwa Bank Q.S.C., Emirates NBD Capital, Kuwait International Bank K.S.C. and Standard Chartered Bank provided financing through a syndicated *murabaha* facility for Albaraka Türk, amounting to USD 278,000,000 and EUR 154,500,000; and Turkiye Finans ve Kalkınma Bankası (TFKB) provided a Tier II *murabaha* facility amounting to USD 150,000,000 as regulatory capital in Turkey.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

In upstream guarantees, the parent which is the beneficiary of the guarantee should either (i) reimburse its subsidiary providing the guarantee within the fiscal year in which the loss has occurred, or (ii) issue a reimbursement undertaking (or sign a reimbursement agreement), which is executed within the fiscal year in which the loss has occurred, and which sets forth how and when the subsidiary providing the guarantee will be reimbursed.

In addition, a listed company or its affiliates (*bağlı ortaklık*) can provide a guarantee only in favour of (i) itself, (ii) corporations fully included in their consolidated financial statements, and (iii) third parties with whom ordinary commercial activities are concluded. These companies may also provide guarantee to subsidiaries (*iştirak*) and business partnerships, to which they are directly participating, in proportion to their participation, in the share capital. The failure may result in certain sanctions by the Capital Markets Board of Turkey.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

The guarantee would not become unenforceable, but in upstream guarantees, the beneficiary of such guarantee or the board members of the beneficiary may be personally liable against the loss incurred by shareholders or creditors of the guaranteeing company.

2.3 Is lack of corporate power an issue?

Guarantees must be signed by authorised representatives as per the corporate authorisations and constitutional documents of the company.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Save for regulatory or constitutional requirements that might be applicable for the guarantor, no governmental or other consents or filings are required.

However, Turkish resident guarantors providing a guarantee in favour of foreign parties should inform the Turkish Treasury within 30 days following the date of the guarantee.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no specific limitations.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, there are not.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In general, the following collaterals are utilised under Turkish law:

1. Pledge:
   - Commercial enterprise pledge.
   - Pledge over shares.
   - Pledge over bank accounts.
2. Mortgage.
3. Transfer/assignment of receivables.
4. Guarantee and suretyship.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

In principle, a commercial enterprise pledge enables the pledgee to establish pledge over the followings assets in whole: (i) the trade name and commercial title; (ii) the machinery, equipment, tools and transportation vehicles (with motors); and (iii) intellectual property rights such as patent rights, licences, trademarks, models and drawings.

The commercial enterprise pledge agreement, which includes a list of pledged assets, is executed (*ex officio*) before the notary public and registered within 10 days at the relevant trade registry; i.e., where the commercial enterprise is located.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes, a mortgage can be established over a real property or certain rights connected to the real property, e.g., right of superficies (*üst hakkı*). In principle, mortgage covers the components and fixtures (*mütemmim cüz*) and accessories (*teferruat*) of that property.

A mortgage is created validly by means of an official mortgage deed, which shall be executed (*ex officio*) before the title deed registry having jurisdiction on the relevant real property.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, the transfer of receivables agreement is executed between the transferor and transferee as a security. Although notification of the third party debtors is not required by law for the validity, a notification is required to direct the payments to the transferee and an acknowledgment by such debtors confirming no prior ranking assignments, transfers or counterclaims on the transferred receivables are recommended.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, bank account pledge agreements are executed between the pledgor and the pledgee as a security. Although consent/notification from the account bank is not required by law for validity, a notification against an acknowledgment notice from the account bank is recommended in order to ensure certain obligations of the account bank, such as restricting withdrawals and to confirm that no prior ranking pledge, assignment or counterclaims exist.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, the shares of Turkish companies can be pledged by executing a share pledge agreement, endorsing such shares and delivering them to the pledgee.

Share certificates of joint stock companies must be in printed form (registered or bearer) and the pledged shares should be endorsed by the shareholder(s) and delivered to the pledgee. Approval decision of company whose shares are pledged and registration of the pledge to the share book of the company are also recommended.

Share certificates of limited liability companies may not be in printed form in which case the shareholders' resolution approving the pledge and registration to the share book of the company are required.

Share pledge agreements for pledge over Turkish company shares cannot be governed by foreign law since agreements creating security over the assets located in Turkey, e.g., share pledge, should be subject to Turkish law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over inventory is established through a written pledge agreement and actual delivery of the pledged inventories to the pledgee. Since the pledgor cannot continue its commercial activities when the inventory is in the possession of the pledgee, the inventory pledge is not common in practice. There are also alternative warehouse pledge models which are again not commonly used except in agriculture.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

There are no legal restrictions for providing security interest under Turkish law for a company in order to secure its obligations (i) as a borrower under a credit facility, and (ii) save for the explanations provided in section 4 below, as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

In principle, a stamp tax of 0.948% is applied for each of the security agreements but shall be capped at approximately TL 1,800,000. Negligible notarial fees and costs are accrued for commercial enterprise pledges (and share pledge agreement in limited liability companies). Commercial enterprise and trademark pledges are also subject to negligible registration fees. Mortgage is subject to deed charges of 4.55% over the mortgage amount. Please note that exemptions generally apply to financings by banks, foreign credit institutions or international finance institutions.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

In case the relevant registries do not request any further documents, the registration for commercial enterprise pledge and mortgage are completed within a couple of days following the appointment date. However, trademark pledges may take up to three weeks. Share pledges, bank account pledges and transfer of receivables are established upon execution since there is no central registration system. Please refer to question 3.9 for expenses.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Except for the regulated markets such as energy (electricity, petroleum, gas and LPG), there is no specific regulatory consent required from the governmental authorities for the creation of security in Turkey. Please refer to question 2.4 for details regarding the Turkish Treasury.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Authorised signatories must be ready before the relevant registries for execution of commercial pledge or mortgage agreements. If preferred, security agreements can be executed by proxy through duly issued powers of attorney. There is no specific provision under Turkish law restricting the counterpart signing; however, it is not a market practice and, to our knowledge, not tested before the Turkish courts.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

According to the Turkish Commercial Code (TCC), legal transactions comprising of the granting of an advance, loan or security by the company to a third party for the acquisition of its shares are null and void. This financial assistance prohibition is applicable to both public and private companies without distinction.

There are two exceptions to this prohibition: (i) transactions performed within the scope of the field of activity of credit and finance institutions; and (ii) transactions performed with regard to the granting of an advance, a loan or security to employees of a company or its subsidiaries for the purpose of acquiring said company's shares. However, such exceptions are not applicable if such transactions reduce the statutory legal reserves of the company.

Although not explicitly stipulated under TCC, it is generally accepted that the financial assistance provided by a company for the acquisition of shares of its parent or sister subsidiary shall be caught within the ambit of such prohibition.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Turkish law does not recognise the trust concept. The general principle is that the beneficiary of security is assumed to be the creditor of underlying debt and the security may not be enforced without such unity of the underlying debt and the security. Furthermore, the security cannot be segregated from the private assets of trust, and, as a result, the protection of the secured loan in favour of the lenders may not be possible in the case of the insolvency of trust.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

The lack of trust concept reveals alternative structures. Depending on whether the debt will be kept on the books of the existing lenders or transferred by novation or assignment, the structure may differ. If the loan will not be transferred, the lenders might be named expressly and *pro rata* security arrangements could be considered, whereas if the loan is planned to be transferred, formation of parallel

© Published and reproduced with kind permission by Global Legal Group Ltd, London

debt structure or abstract acknowledgment of debt by the borrower in favour of trust may be used. To our knowledge, the abstract acknowledgment of debt and the parallel debt mechanisms have not been tested before Turkish courts but have been widely used in syndications and have subsequently become market practice.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

No. However, since guarantee under Turkish law is deemed independent from the underlying guaranteed obligations, when an existing lender assigns its rights and the guaranteed obligations to a new lender, we advise its rights under guarantee to be assigned separately.

Further, novation is a ground for termination of contractual rights together with all ancillary rights including the security interest under Turkish law. Therefore, novation requires the security interest to be established again.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Turkish law requires Turkish borrowers to withhold taxes from interest and similar payments to foreign lenders under facility agreements. The general rate of applicable income tax, i.e., through withholding, is 10% for foreign lenders that are not licensed banks or financial institutions while it is 0% for regulated banks or qualified financial institutions.

In addition, banking and insurance transaction tax (BITT) of 5% over the interest or other income such as fees is applied for Turkish banks or to any facility office of foreign lenders located in Turkey. The proceeds of enforcing security or of a claim under a guarantee, on the other hand, is not be taxable unless the beneficial owner has a taxable presence in the form of a permanent establishment in Turkey.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

All facility and security documentation where the loan is granted to Turkish borrowers by banks, foreign credit institutions or international finance institutions are exempt from stamp tax. However, this exemption is only applied if loan is utilised in Turkey. Otherwise, stamp tax is applied and must be paid for each original copy.

BITT is also not payable when the lender is a foreign bank.

The loans granted to Turkish borrowers by foreign financial institutions are subject to the resource utilisation support fund (RUSF), calculated on the principal amount for the foreign currency and on the accrued interest for TL currency loans. RUSF applicable for commercial loans extended by Turkish banks is 0%. In TL currency loans, RUSF is 3% while for foreign currency loans it is (i) 3% if the average maturity of the loan is less than one year, (ii) 1% if the average maturity of the loan is one to two years, and (iii) 0.5% if the average maturity of the loan is two to three years. Foreign currency loans with an average maturity of more than three years are subject to 0% RUSF.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Yes; please refer to question 6.1.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please refer to question 3.9.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Please refer to the explanations for RUSF in question 6.2.

Thin capitalisation rules are applied irrespective of the relevant party's country of incorporation. The applicable debt-to-equity ratio is 3:1.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The choice of foreign law is legal, valid and binding on the parties and it will be enforceable against them, except to the extent that the recognition of, and giving effect to, such choice of law would be clearly against Turkish public policy rules.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A judgment rendered against a Turkish company by a court in New York or England would be recognised and enforced by courts in Turkey without re-examination, subject to the following conditions being fulfilled:

(a) the foreign judgment has become final and binding with no recourse for appeal or similar revision process under the laws of the foreign country;

(b) there is *de facto* or *de jure* reciprocity between the foreign country and Turkey, and such reciprocity must be evidenced either by (a) a treaty between Turkey and the foreign country providing for reciprocal enforcement of court judgments, or (b) a provision in the laws of the foreign country permitting the enforcement in such country of judgments rendered

© Published and reproduced with kind permission by Global Legal Group Ltd, London

by Turkish courts, or (c) *de facto* enforcement of Turkish judgments by the foreign country's courts. There are Turkish court judgments confirming that there is *de jure* reciprocity between Turkey and England/New York;

(c) the subject matter of the judgment does not fall under the exclusive jurisdiction of the courts of Turkey;

(d) the judgment is clearly not against Turkish public policy rules;

(e) due process is observed under the rules of the foreign country; and

(f) the judgment is not incompatible with a judgment of a court in Turkey between the same parties and relating to the same issues, or in certain circumstances, with an earlier foreign judgment which satisfies the same criteria and is enforceable in Turkey.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

If the defaulting company has no legal defence to payment, it would take (a) up to one year to obtain a judgment before the local court, and if the judgment is appealed, an additional six months to obtain the Court of Appeal's confirmation, and (b) enforcement before the Turkish courts takes three to nine months, and if the judgment is appealed, an additional six months to obtain the Court of Appeal's confirmation. The debt collection proceedings to enforce the judgment may take between three months and one year depending on the debtor's assets.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

(a) In principle, the foreclosure process of a security is carried out by the competent execution office, which will initiate a public auction for the sale of the pledged assets. Although public auction is a transparent method and has a likelihood of being challenged by the debtor or third parties, it has certain disadvantages with respect to its complicated procedure and long duration.

(b) Except for the regulated areas such as the Turkish energy markets (electricity, petroleum, gas and LPG), there is no specific regulatory consent required for enforcement.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

Lawsuits filed or debt collection proceedings (including foreclosure proceedings of a security) by foreign lenders may be subject to *cautio judicatum solvi*, or security costs for foreigners, unless there is *de facto* or *de jure* reciprocity with the country of such foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Turkish courts may grant a moratorium by suspending debt collection proceedings against the debtor in case that debtor's request for reorganisation or postponement of bankruptcy is accepted by the court. In postponement of bankruptcy, the court may also suspend other debt collection proceedings with a provisional injunction during the course of the litigation process.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Turkey is party to the 1958 New York Convention on the Recognition and Enforcement of Arbitral Awards (NY Convention) and enforces arbitral awards of other contracting states without re-examination of the merits subject to the conditions set forth under the NY Convention. Arbitral awards falling outside the scope of NY Convention may also be similarly enforced subject to these conditions, without any reciprocity requirement.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In case the debtor company is declared bankrupt by the courts and the liquidation process is commenced against the company via official bankruptcy offices, then the secured party may not proceed with an individual debt collection proceeding, but would have to apply to the bankruptcy offices to be registered and recorded during liquidation process. Sale of the secured assets is handled together with the sale of "all assets in the bankruptcy estate" and the proceeds may be held off from the creditor if there are challenges against the ranks or receivables.

Please refer to question 8.2 for ranking.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

According to the Turkish Execution and Bankruptcy Law (EBL), the receivables of secured creditors have priority over the sale proceeds of the secured assets after deduction of the relevant taxes *in rem* (i.e., taxes arising from the use or mere existence of the secured assets such as real estate taxes, motor vehicle taxes, custom duties, etc.) and expenses arising from the administration or preservation of the secured assets or from sale auctions.

The distribution of the sale proceeds of the bankruptcy estate to the creditors, which do not have secured receivables, will be ranked as follows:

<u>First rank</u>

- Receivables of the employees including notice and severance pay accrued within a year prior to the bankruptcy, and notice and severance pay that accrues due to the termination of the employment following the bankruptcy of the company.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

- Debts of the employer to the institutions and funds being a legal entity incorporated to establish aid funds for employees.
- Any and all alimony receivables arising from family law accrued within a year prior to the bankruptcy.

Second rank

Receivables of persons whose assets have been left to the administration of the bankrupt as a guardian/administrator.

Third rank

Receivables that are privileged pursuant to the provisions of special laws.

Fourth rank

All other receivables of the creditors which do not enjoy a privilege.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Public bodies are excluded. However, commercially operated or managed companies established by public bodies/enterprises under private law provisions can be subject to bankruptcy proceedings under the principles of the EBL.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

If the debtor company is declared bankrupt by the courts, the creditors cannot individually seize the assets of a company in an enforcement or debt collection proceeding. If there is no bankruptcy or a (pending) postponement of bankruptcy with respect to the debtor, creditors may also initiate debt collection proceedings against the debtor, without filing any lawsuit before the courts.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

In principle, the parties may agree on jurisdiction of a foreign court in a dispute that contains a foreign element as per the International Private and Procure Law. However, a Turkish court which is petitioned by a party to the agreement to resolve a dispute arising from such agreement may find that it has jurisdiction if (i) the subject matter of the dispute falls in the exclusive jurisdiction of Turkish courts, (ii) a foreign court finds that it has no jurisdiction due to the jurisdiction clause being not valid, or (iii) or an objection to the jurisdiction of such Turkish court is not filed on time.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Assuming that the party is not a sovereign entity, the waiver of immunity by such party is legal, valid, binding and enforceable.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

In general, lending business is mainly regulated under the Banking Law No 5411, where the banks are required to be established through approval of the Ministry of Science Industry and Technology and authorisation of the BRSA. In addition, prior to operating lending activities, an operation permit should also be obtained by the BRSA. Foreign banks may operate in Turkey either by opening branches, which is subject to the similar requirements, or by establishing a bank in Turkey. However, a foreign lender may provide loans for Turkish borrowers without being subject to these requirements. No lender is deemed to be resident, domiciled or carrying on business in Turkey or subject to taxation as a result only of the execution, performance and/or enforcement of the finance documents.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Subordination rules and claw-back risk may be deemed as potential liabilities for a lender.

In contractual subordination, it may not be possible to obtain a specific performance before the execution offices since it is not recognised nor tested by law, and secondly, in case of bankruptcy, all the creditors of the bankrupt debtor will be ranked in accordance with the provisions of EBL.

In addition, the lenders may have claw-back risk *vis-à-vis* other creditors of a Turkish debtor that is unable to pay its debts (insolvent) whereby other creditors are entitled to apply to courts to invalidate certain transactions entered into by the insolvent debtor. These voidable transactions generally consist of those made for no consideration (including donations) or for a consideration that is significantly less than the actual value of the transaction or that is made with the intention to harm its creditors.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Sera Somay

Paksoy
Orjin Maslak, Eski Buyukdere Cad.
No:27 K:11 Maslak 34398
Istanbul
Turkey

Tel: *+90 212 366 47 76*
Email: *ssomay@paksoy.av.tr*
URL: *www.paksoy.av.tr*

Sera Somay is the partner heading the banking and finance practice of the firm.

Sera works on financing transactions, representing lenders and borrowers including club loans, syndicated loans, regulatory capital, ECA covered loans, acquisition financing, various forms of secured financing and other structured financings.

Sera has a specific focus on Islamic finance transactions and advised on the first international *Sukuk* issuance by the Republic of Turkey and the first *Sukuk* issuance by a Turkish Islamic bank. She also works on *murabaha* syndications of Turkish participation banks and Turkish corporates.

Sera also advises on regulatory M&As across a variety of sectors with a focus on banking M&As.

Sera is a member of the International Bar Association.

Esen Irtem

Paksoy
Orjin Maslak, Eski Buyukdere Cad.
No:27 K:11 Maslak 34398
Istanbul
Turkey

Tel: *+90 212 366 47 73*
Email: *eirtem@paksoy.av.tr*
URL: *www.paksoy.av.tr*

Esen Irtem specialises in both cross-border and domestic financing projects, M&As, joint ventures and corporate restructuring for a variety of large foreign and Turkish banks and financial institutions, industrial players and financial investors.

Esen has also been involved in major bond issuances by Turkish and foreign banks and financial institutions in and outside Turkey.

She has developed key experience advising both lenders and borrowers in relation to foreign and Turkish law governed loan transactions, including preparation of finance documents, creation and implementation of security packages and preparation of legal opinions. Esen has been further involved in innovative projects such as Islamic finance structuring under Turkish law.

Esen joined a secondment programme at an international law firm, working with the EDM, M&A and project finance and infrastructure practice groups in the firm's London and Munich headquarters. During her secondment practice, she enriched her experience by being involved in multi-jurisdictional deals.

Paksoy

Paksoy is an independent full-service law firm in Istanbul, Turkey, focused on helping clients in a wide range of legal areas, cross-border investments, international business transactions, investigations, compliance and disputes.

Paksoy has a diverse practice which encompasses M&As, company and commercial law, banking and finance, capital markets, Islamic finance, project finance, energy and infrastructure, PPPs, real estate, privatisations, competition, dispute resolution, employment and insolvency.

Established in 1997, Paksoy stands today as one of the strongest local legal brands in Turkey focusing on numerous practice groups and sectors. Paksoy has lawyers and specialists from a background of varied sectors and industries, including international accounting and consultancy firms, industry regulators and private practice.

Tel: +90 212 366 47 00 / Fax: +90 212 290 23 55 / Email: contact@paksoy.av.tr

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Ukraine

Anna Pogrebna

CMS Reich-Rohrwig Hainz

Kateryna Soroka

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

As the Ukrainian economy is currently severely affected by the ongoing conflict, one may expect a decline in the amount of lending transactions on the market. The market is currently dominated by a number of commodity-based export credit facilities.

Considering the economic problems arising in connection with the ongoing conflict, as well as aiming to regulate the foreign currency exchange market and prevent capital outflow from Ukraine, the National Bank of Ukraine has adopted a number of resolutions imposing restrictions on foreign currency exchange transactions and introducing additional anti-crisis measures in the implementation of some currency transactions.

Such restrictions include, among others, the following:

- mandatory sale (subject to certain exceptions) of 75% of foreign currency proceeds received from abroad by legal entities (except banks);
- a restriction on cross-border payment of dividends to foreign investors;
- a restriction on cross-border payment of the purchase price to a foreign seller as a result of the sale of his/her shares or participatory interest in Ukrainian companies to a Ukrainian resident buyer;
- a restriction on cross-border payment to a foreign investor as a result of decrease of a Ukrainian company's charter capital or withdrawal of a foreign participant/shareholder from a Ukrainian company; and
- a restriction on cross-border payment of the purchase price to a foreign company/individual for the securities issued by Ukrainian companies (except for the sale of the debt securities by a non-resident at a stock exchange or sale of the state bonds).

In February 2015 the Ukrainian Parliament adopted a number of laws as part of an austerity strategy to secure IMF loans. The international creditor announced a new USD 17.5 billion lifeline for Ukraine which raises the total bailout to USD 40 billion.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

One of the most significant transactions in 2014–2015 was the restructuring by Ukraine of a USD 15 billion sovereign and sovereign-guaranteed Eurobond. The settlement with creditors achieved a 20% debt reduction (*circa* USD 3 billion) and allowed Ukraine to avoid paying any of the previously scheduled USD 8.5 billion of principal falling due under such bonds through the end of 2018. Other major transactions included:

- a USD 3.9 billion financing to the Independent Petroleum Company for the establishment of a joint venture with Alliance Group;
- a EUR 1 billion macro-finance to Ukraine under the EU MFA-II programme;
- a USD 500 million pre-export financing to Duferco S.A. from a group of lenders, arranged by, among others, BNP Paribas;
- a USD 400 million sunflower oil-based pre-export financing for Kernel Group, Ukraine's leading agribusiness, arranged by ING Bank N.V., UniCredit Bank AG; and
- a EUR 350 million Ukrainian security in relation to the multicurrency revolving credit facilities agreement provided by JP Morgan to Goodyear Dunlop Tires, the world's largest tire company.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, corporate guarantees are often used to secure lending transactions in Ukraine. Under Ukrainian law, guarantees can only be granted by banks or other financial institutions. Entities other than banks or financial institutions can grant suretyships. A suretyship under Ukrainian law is an accessory undertaking to the underlying obligation.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Under Ukrainian law, a director is required to act in the best interests of the company, in good faith, reasonably and within his/her authority established by law and a company's charter. Under the general rule, the director cannot represent the company in transactions which benefit him/her personally or for the benefit of a third party if that third party is represented by him/her. However, in joint-stock companies (JSC), if the conflict of interest has been timely and duly disclosed by the director, the transaction may be permitted by the JSC's supervisory board or general shareholders' meeting.

According to Ukrainian court practice, a security agreement may be held invalid on the ground that it does not constitute a "profitable"

© Published and reproduced with kind permission by Global Legal Group Ltd, London

transaction for the guaranteeing/securing company, lacks economic sense and therefore contradicts requirements of Ukrainian law. The issue of commercial benefit to the company may also be taken into account if the guarantee is challenged in the course of bankruptcy proceedings as described under question 8.2 below.

2.3 Is lack of corporate power an issue?

Corporate approvals should be obtained if specifically required by the charter of the guaranteeing company or by law (see question 2.4 below for specific corporate approvals for joint-stock companies). Failure to obtain such approvals may result in challenging and invalidation of the respective transaction.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Governmental consent (provided by the Ministry of Finance of Ukraine with respect to long-term or cross-border obligations or by the State Property Fund of Ukraine in all other cases) is required if the guaranteeing company and/or enterprise (except for banks) is owned 50 or more per cent by the Ukrainian state.

Corporate approvals for joint-stock companies:

The shareholders' approval is required by law for "major" transactions (i.e. the market value of a particular asset or service that is the subject matter of a particular transaction exceeding 25% of the total value of the guarantor's assets). The approval of the supervisory board is required if (a) the value of a "major" transaction amounts to 10 to 25% of the total value of the guarantor's assets, and/or (b) the transaction is qualified as an "interested party" transaction.

Other corporate approvals:

The shareholders of a JSC and a limited liability company (LLC) may include a requirement for a separate corporate approval for all guarantees issued by the company, irrelevant of the amount in the company's charter.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no specific limitations on the amount of a guarantee. The solvency considerations may be taken into account if the guarantee is challenged in the course of bankruptcy proceedings as described under question 8.2 below.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are currently a number of currency control issues related to the enforcement of a guarantee issued by a Ukrainian resident guarantor to a non-resident lender. In particular, purchase of foreign currency and its transfer abroad by a Ukrainian guarantor for the performance of its obligations under a suretyship is prohibited until 4 March 2016. The exemptions include: (i) cases where the loan was provided by an IFI or with participation of an ECA; and (ii) cross-border payments made during a month under an individual licence issued by the NBU for the amount of up to USD 50,000.

Ukrainian law also prohibits a Ukrainian resident guarantor from purchasing foreign currency for the performance of its obligations under a suretyship securing the obligations of a non-resident debtor. Obligations under such suretyship may be fulfilled only by the guaranteeing company's own hard currency funds, which have been neither purchased nor borrowed by the company.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Various types of collateral are available in Ukraine, including mortgage over immovable assets (including land, buildings and/or construction in progress), pledge over movable assets (including equipment, plant, machinery), pledge of securities, pledge of participation interest, receivables, funds at bank accounts and pledge of rights under a contract.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Separate agreements are usually used in relation to each type of asset as their pledge is subject to different perfection requirements. General security agreement can be used in case of pledge of assets registered as a so-called "integral property complex", which usually consists of land/buildings, equipment, machinery, etc.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Mortgages may be established over real estate and property rights thereto, construction in progress and property rights thereto, lease rights to real estate and ships and aircrafts (the regime of real estate assets extends to these objects). Mortgage of land lease rights is subject to prior consent of the landlord, which may be difficult to obtain if the land is leased from a local authority (i.e., a local council) as is often the case. Mortgage over real property is subject to notarisation and state registration with the State Register of Proprietary Rights to Immovable Property.

Pledges over other types of assets are made in writing. A registration of pledge of any assets other than immovable assets with the State Registry of Encumbrances over Movable Property is not mandatory; however, it is recommended as it gives the pledge effect and validity in relation to third parties and defines the priority range if security over the same property is given to several creditors. Pledge of securities is registered with the custodian who maintains the securities account of the pledgor.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, collateral security over receivables can be taken by way of pledge of present or future rights under a contract. The debtors should be notified of the pledge. Unless otherwise stated in the pledge agreement, if the rights are the right to receive payments, such payments must be transferred by the pledgor to the pledgee on receipt.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Collateral security over cash deposited in bank accounts is taken by way of pledge of the pledgor's property rights over the bank account and not the money itself. The bank in which the money is held

© Published and reproduced with kind permission by Global Legal Group Ltd, London

is usually also a party to this agreement. The pledgor may not be restricted from using the money. However, the bank may withdraw money on behalf of the pledgee (on the basis of an account service agreement that directly stipulates such a possibility).

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Collateral security over shares in an LLC is taken by way of pledge of participatory interest. However, as there are a number of corporate law-related issues that may constitute an obstacle to enforcement of such pledge, the pledge of participatory interest cannot be considered as an effective security instrument. It is recommended that a conditional sale/assignment agreement on the participatory interest is also entered in order to ease the enforcement process.

Security can also be taken over shares in a JSC and is registered with the custodian who maintains the securities account of the pledgor. This is done to prohibit any unauthorised transfer of shares, as once the security is registered, the shares are "blocked". If applicable, any right of first refusal held by the other shareholders must be waived when the pledge is enforced.

Security over shares can be granted under a New York or English law governed document if agreed by parties to the transaction. Enforcement of such security, however, will be carried out under Ukrainian law. It is therefore advisable to include the respective mandatory provisions on enforcement into the foreign law governed pledge agreement. It is also established market practice that security over Ukrainian-based assets is taken by way of a Ukrainian law governed pledge.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over inventory is created by pledge of goods in circulation or processing. The pledged inventory can be identified by providing a description of their general characteristics in the pledge agreement as well as the locations at which they are deemed pledged.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, this is possible.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Fees related to the signing of the agreement

For pledge agreements – if the agreement is to be notarised, then the parties must pay a state duty in the amount of 0.01% of the value of the pledged property up to a maximum of approximately EUR 35, as well as a notarial fee, which will vary.

For mortgage agreements: state duty – up to 0.01% of the value of the mortgaged property and notary fees (negotiable).

Fees related to the blocking of shares in case of pledge of shares in a JSC

These costs will depend on the custodian's internal rates.

Fees related to registration of the pledge/mortgage

Fees related to registering the pledge with the State Register of Encumbrances over Movables Property – approximately EUR 1.50.

Fees related to registering the mortgage with the State Register of Proprietary Rights to Immovable Property – approximately EUR 3–EUR 27 (depending on the required urgency of registration).

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The registration of the mortgage with the State Register of Proprietary Rights to Immovable Property is carried out by the notary simultaneously with the execution and notarisation of the mortgage agreement. The data in the State Register is updated on the same day.

The registration of the pledge with the State Register of Encumbrances over Movable Property is carried out on the day of filing the application for registration by the pledgee.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory consents are usually required with respect to the creation of security in Ukraine except for certain limitations applicable to some types of security. For example, only banks can act as mortgagees with respect to Ukrainian agricultural land and proprietary rights to it. Also, state-owned assets which are prohibited from being privatised, objects of cultural heritage, state or municipal cultural values included or to be included into the national register and rights to use state-owned or municipal land are prohibited from being mortgaged.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Special attention should be paid to the amount of the secured obligation in each collateral document. For example, if a suretyship is granted to secure a revolving credit facility, such suretyship is deemed terminated under Ukrainian law upon increase of an amount of underlying secured obligations without a prior surety provider's consent resulting in the increase of amount of the surety provider's liability.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Notarisation is mandatory only for mortgage agreements. Both parties should provide to the notary respective documents confirming their authority to sign and execute the agreement as well as corporate approvals (if necessary).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

There is a general prohibition for formation of the charter capital of business entities (including, LLCs and JSCs) out of borrowed funds.

The law also explicitly prohibits JSCs from issuing guarantees with respect to financing given for the purpose of acquisition of shares in the same JSC.

Specific corporate approvals may be required for JSCs if a transaction qualifies as an interested party transaction (i.e. a transaction for the benefit of a company's officers or affiliates) (please refer to question 2.4 above).

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The concept of parallel debt is not yet recognised or widely used in Ukraine. Under Ukrainian law collateral security must be granted in favour of the respective creditors.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

The following structures are commonly used in Ukraine:

- lending to an SPV structure, whereby security is granted by the borrower to the SPV, which distributes to the borrower the funds borrowed from the lenders;
- a joint and several structure, whereby security is granted to only one party, which acts as a joint and several creditor with other lenders; and
- proportional distribution of collateral security among the lenders, whereby each lender is granted with a separate collateral security object.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

First of all, cross-border loans from foreign lenders to Ukrainian borrowers are subject to registration with the National Bank of Ukraine. Transfer of such loan to another lender should also be registered with the National Bank of Ukraine.

In case of change of the lender, changes to the existing guarantee agreements should also be made in order to make the guarantee enforceable by the new lender.

6 Withholding, Stamp and other Taxes; Notarial and other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) Interest payable by Ukrainian resident companies on loans made to foreign lenders is subject to withholding tax. The general withholding tax rate applicable to different types of Ukrainian sourced income is 15% (unless more favourable rates are provided for by an applicable double tax treaty). In order to benefit from any applicable relief, non-residents should provide the Ukrainian taxpayer with an annual residency certificate as issued by the tax authorities of their country of residence.

Thin capitalisation rules apply to Ukrainian taxpayers whose debts to non-resident related parties exceed their equity 3.5 times (more than 10 times for financial institutions and leasing companies). The interest expense deduction for these taxpayers is limited to 50% of earnings before interest, taxes, depreciation and amortisation. Non-deductible interest can be carried forward indefinitely, but with an annual reduction of 5% of the residual amount.

(b) Taxation of proceeds of a claim under a guarantee received by a non-resident is not specifically regulated in the Ukrainian Tax Code. Payments related to the principal amount of obligation should not be subject to Ukrainian withholding tax. Any other payments, which can be attributable as interest, would be subject to withholding text as described under (a) above.

Proceeds of enforcing security could be subject to Ukrainian withholding tax in case of private sale of the collateral by the pledgee/mortgagee to a third party.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives for foreign lenders. Please refer to question 6.1 above on taxes applicable to foreign lenders with respect to interest payable on loans and proceeds of enforcing security.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

A foreign lender is not subject to Ukrainian corporate income tax unless withholding tax applies (please refer to question 6.1 above) or unless a permanent establishment of such foreign lender is created in Ukraine.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please refer to question 3.9 above on costs incurred by foreign lenders in relation to taking security in Ukraine.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Cross-border loans from foreign lenders to Ukrainian borrowers are subject to registration with the National Bank of Ukraine prior to the disbursement of any funds. This registration is free of charge.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Please refer to question 6.1 above on thin capitalisation rules.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Ukrainian courts should generally recognise and enforce a contract that has a foreign governing law, if an agreement involves a foreign element, i.e. at least one of the parties to an agreement is a foreign party.

However, mortgages over real estate assets located in Ukraine should be governed by Ukrainian law. Ukrainian courts have exclusive jurisdiction over the matters involving real estate, including enforcement of mortgages.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Foreign court judgments will be recognised and enforced in Ukraine based only on the respective multilateral/bilateral international treaties or in the absence of such treaty on the basis of the principle of reciprocity whose existence is presumed by the domestic rules of civil procedure.

As there are no international treaties governing issues of recognition and enforcement of court judgments in civil and commercial matters between Ukraine and the USA and/or the United Kingdom respectively, New York and/or English court judgments are enforceable in Ukraine on the basis of the reciprocity principle only.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The court proceedings in a court of first instance may take approximately four to six months. Proceedings in a court of appeal may take six to eight months. Timing of enforcement of a court judgment may vary depending on the assets being enforced.

The approximate timing of the proceedings in the court of first instance on recognition and enforcement of foreign court judgments is four to eight months.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Under Ukrainian law, a collateral can be enforced either through out-of-court settlement (if so provided for by the agreement), a notary writ or court judgment. In practice, out-of-court enforcement is impossible without the cooperation of the pledgor. Therefore, the most reliable method of enforcement is through a court judgment. Typically, collateral is sold by public auction; however, the security agreement can permit the transfer of the collateral into the ownership of the pledgee, or the sale of the collateral by the pledgee to a third party.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

There are no special restrictions as foreign lenders enjoy the same procedural rights as Ukrainian parties.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

A moratorium on enforcement of creditors' claims is imposed by the court in the pre-trial rehabilitation procedure of the debtor, which can be initiated by the debtor or any creditor prior to the commencement of the debtor's declaration of bankruptcy in court. Upon the court's approval of the debtor's rehabilitation plan, the court will impose a moratorium prohibiting satisfaction of creditors' claims during the debtor's rehabilitation, which cannot last longer than 12 months.

The court may also impose a moratorium on enforcement of the claims of the debtor's creditors that arose before the date of the initiation of the bankruptcy proceedings.

The moratorium applies to all creditors' claims that arose before the date of approval of the debtor's rehabilitation plan or the initiation of the bankruptcy proceedings, including enforcement of collateral security.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

A foreign arbitral award will be recognised and enforced in Ukraine without retrial or examination of the merits of the case, subject to the exceptions set forth by the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards and Code of Civil Procedure of Ukraine. In addition to the exceptions set forth by the New York Convention, according to the Code of Civil Procedure of Ukraine, the recognition and enforcement of foreign arbitral award can be refused in Ukraine if (i) the Ukrainian court has an exclusive jurisdiction over the case, (ii) the Ukrainian court has rendered its judgment in respect of a dispute between the same parties, regarding the same subject, and on the same grounds and such judgment has become effective, (iii) the Ukrainian court is in the process of consideration of the same case between the same parties and on the same grounds, and (iv) the term for submission of motion for recognition and enforcement of a foreign arbitral award in Ukraine

© Published and reproduced with kind permission by Global Legal Group Ltd, London

as such term is defined by respective international treaty and Code of Civil Procedure of Ukraine, is missed. According to the general rule, the motion for recognition and enforcement of a foreign arbitral award should be submitted to the competent Ukrainian court within a three-year period after such arbitral award has become effective.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

As mentioned under question 7.6 above, if a court imposes a moratorium on enforcement of the claims of the debtor's creditors that arose before the date of the initiation of the bankruptcy proceedings, the lender may not be able to enforce the collateral security for the duration of the moratorium.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Under the Insolvency Law, a transaction entered into by the debtor one year prior to or after the commencement of the bankruptcy proceedings may be challenged by the bankruptcy administrator or by any of the competitive creditors and invalidated by the court, if:

- the debtor alienated its assets, assumed obligations or refused its claims without compensation;
- the debtor has fulfilled its obligations prior to the due date;
- prior to commencement of the bankruptcy proceedings, the debtor entered into the agreement that led to its insolvency;
- the debtor paid to its creditor or accepted any property/assets as a set-off of payment obligations of its contractor when the debtor's assets became insufficient to satisfy the creditors' claims;
- the debtor alienated or acquired property at a price that was lower or higher, respectively, than the market price, provided that the debtor's assets were insufficient for the satisfaction of the creditors' claims at that time; or
- the debtor pledged its property to secure the fulfilment of the pecuniary claims.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes, certain categories of debtors are excluded from bankruptcy proceedings based on the Insolvency Law and certain other Ukrainian legislation. For example, state enterprises included in the list approved by the Law of Ukraine "On the list of state-owned objects which cannot be privatised", certain municipal enterprises in cases established by law, some mining companies, etc.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No proceedings other than court proceedings are available, and security should also be enforced through court proceedings.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The parties may generally submit their disputes to a foreign jurisdiction if one of them is a non-Ukrainian party. Ukrainian courts should generally recognise and enforce this submission if it does not violate the exclusive jurisdiction of Ukrainian courts (see the example under question 7.1 above on exclusive jurisdiction over matters involving real estate, including enforcement of mortgages).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The concept of waiver of sovereign immunity is not developed under Ukrainian law.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no specific requirements for foreign lenders or agents/ security agents involved in loan transactions with Ukrainian companies.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

As anti-crisis measures and further restrictions on foreign exchange and cross-border payment transactions are imposed and prolonged (as the case may be) by the Ukrainian Government and the National Bank of Ukraine, it is recommended to pay close attention to proper structuring of lending transactions with Ukrainian companies.

Foreign lenders should take into consideration the requirement to register a loan agreement with the National Bank of Ukraine prior to the disbursement of any funds as well as the maximum interest rate limitations with respect to such loans, which are as follows:

(i) for fixed interest rate loans: with maturities less than one year – 9.8% *per annum*; with maturities from one to three years – 10% *per annum*; and with maturities over three years – 11% *per annum*; and

(ii) for floating interest rate loans: LIBOR for three-monthly USD deposits plus 750 basis points.

© Published and reproduced with permission by Global Legal Group Ltd, London

For the purposes of calculation of the maximum interest rate, the National Bank of Ukraine reviews "total borrowing costs" which represent the "nominal" interest rate under the loan agreement increased to take into account any and all commissions/fees, default interest and "other charges" (which may include any payments other than the repayment of principal) that may be payable by the borrower pursuant to the loan agreement.

The restriction on early repayment under loan agreements between Ukrainian borrowers and foreign creditors (subject to certain exceptions), which is currently in force until 4 March 2016, should also be taken into consideration.

Anna Pogrebna
CMS Reich-Rohrwig Hainz
19B Instytutska St.
01021 Kyiv
Ukraine

Tel: +380 44 500 1718
Fax: +380 44 500 1716
Email: anna.pogrebna@cms-rrh.com
URL: www.cms-rrh.com

Anna Pogrebna joined CMS Reich-Rohrwig Hainz in Kyiv in April 2012. She completed her studies of law at the Taras Shevchenko National University in Kyiv. She also holds a Master's degree in translation for German and English. With over eight years of experience in an international law firm and more than five years as in-house counsel for an agricultural company in Ukraine, Anna Pogrebna not only offers outstanding legal advice, but also knows the needs of clients from a company perspective.

As a local partner, she focuses on the fields of Banking & Finance, Real Estate and Tax Law.

Anna has developed strong banking and finance and real estate practices in the office. Clients praise Anna for her professionalism and for her understanding of their business. Over recent years, Anna has been a trusted advisor for IFIs, international and domestic banks, insurance companies and other financial institutions as well as major domestic and international industrial groups.

Anna Pogrebna speaks Russian, Ukrainian, English, German and Dutch.

Kateryna Soroka
CMS Reich-Rohrwig Hainz
19B Instytutska St.
01021 Kyiv
Ukraine

Tel: +380 44 500 1718
Fax: +380 44 500 1716
Email: kateryna.soroka@cms-rrh.com
URL: www.cms-rrh.com

Kateryna Soroka joined CMS Reich-Rohrwig Hainz in Kyiv in April 2014 as an associate. Previously, she worked for several renowned Ukrainian and international law firms. Her main areas of focus are Corporate and M&A, Capital Markets, and Banking and Finance. She has extensive experience of advising clients on legal aspects of M&A transactions and cross-border financing. She also provides legal support of the clients' ongoing corporate governance proceedings and commercial activities. Among her clients are major domestic and international industrial groups and financial institutions.

Kateryna is a member of the American Chamber of Commerce, European Business Association and Ukrainian Bar Association. She takes an active part in the work of the above associations, focusing on corporate law and corporate governance. Kateryna is an author of numerous publications on corporate governance, debt financing, and anti-corruption regulation, etc.

Kateryna holds an LL.M. degree in European and International Business Law from the University of Leeds (England) and a Master's degree in Private Law from one of the Ukrainian universities. She holds a Securities Trader's Certificate obtained from the National Securities and Stock Market Commission in 2008. Kateryna is fluent in Ukrainian, Russian and English.

C/M/S/
Law.Tax

CMS Reich-Rohrwig Hainz Kyiv is one of the Ukrainian branches of CMS, the leading European legal and tax services organisation. CMS has entered the Ukrainian market as one of the first internationally active law firms and is now among the most respected legal advisors in Ukraine. Our legal experts, who can draw on years of experience in foreign countries and have handled many cross-border projects, know the particularities of the local market and the needs of their clients well and also entertain good relations with local economic players and relevant authorities. Our legal advice fulfils international standards, living up to the expectations of international investors.

CMS Reich-Rohrwig Hainz Kyiv is a full-service law firm and deals with all issues related to banking and international finance. We deliver quality and integrity to our clients and put an expert network at their disposal, thus creating a considerable competitive edge for them. Moreover, the international presence of CMS offers fast access to expert knowledge and comprehensive cross-border legal services in mandates covering several countries.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

United Arab Emirates

Ayman A. Khaleq

Morgan, Lewis & Bockius LLP

Amanjit K. Fagura

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Based on our observations, as well as feedback from market leaders, banking institutions in the UAE had a mixed 2015 which included a number of challenges. The low oil and commodity prices, low margins, an increase in trade finance defaults and a strong UAE dirham (due to its peg to the dollar) against other currencies as well as a slowdown in bank lending, are factors which have affected the sector and created a more cautious approach to lending in the UAE.

The UAE entered into the Model 1 intergovernmental agreement (IGA) with the United States in May 2014, where the commercial banks and financial institutions were required to comply with certain reporting requirements under the US Foreign Account Tax Compliant Act (FATCA). In addition, it is anticipated that banks will soon have to comply with further regulatory requirements in the form of Basel III which may limit banks' resources.

The restrictions on financial assistance by UAE companies following the new UAE Federal Law No. 2 of 2015 (as discussed further in question 2.2), is also a reflection on the increase in regulations in the UAE which creates less risk and encourages investment.

There has also been a growth in the availability of alternative lenders, in the form of credit and mezzanine funds, and investment vehicles supported by regional family offices which have somewhat filled the gap left by conventional lenders in the context of the finance needs of small and medium enterprises (SMEs).

When reading this chapter it is important to note that the UAE provides the option for companies to incorporate either 'onshore' (for which 51% of the company must be owned by a UAE national or 100% by a Gulf Cooperation Council (GCC) national) or 'offshore' (in one of over 35 free zones, including, but not limited to, the Dubai International Financial Centre (DIFC)). Each free zone typically has its own laws and regulations (with the exception of criminal law) and crucially, companies may be 100% owned by foreign investors. The focus of this chapter will be on onshore UAE companies and companies incorporated in the DIFC (as the DIFC is the most relevant insofar as financial institutions and their activities are concerned).

Practitioners should also be aware that UAE onshore law is influenced by *Shari'a* (Islamic law); this is confirmed by its constitution, which provides that: "*Islamic Shari'a is a main source of legislation in the UAE*." However, the UAE (and certain individual Emirates) have decreed that free zones (such as the DIFC) may enact their own civil and commercial laws, in parallel to UAE onshore law. However, any companies operating, lending or taking security in the UAE should be sensitive to UAE law and customs. A key example of this relates to the language used in underlying transaction documentation. Terms such as "lender", "borrower", "debt" and "loan", although used within this chapter to assist the reader, are not *Shari'a*-compliant and should be interpreted as (and used when working on *Shari'a*-compliant deals) "financier", "obligor", "facility" or "financing", as applicable.

The new Commercial Companies Law (Federal Law No. 2 of 2015) ("CCL 2015") (effective as of 1 July 2015) and the draft insolvency law are two pertinent pieces of legislation that are expected to positively influence the region by lowering investment risk for foreign companies thereby stimulating investments.

CCL 2015 makes a number of changes to the previous law, by enhancing lending in the UAE and strengthening finance structures. The new law allows for a pledge to be created over shares of an LLC which in turn can be registered in the Commercial Register, hence potentially reducing the enforcement risk of an unregistered pledge. Nonetheless, the inability to take possession of share certificates and pre-signed but undated share transfer forms (akin to the system in the UK) means that the pledgee (even under the CCL 2015) is not free from all enforceability risks.

The insolvency regime in the UAE is largely reliant on the Commercial Transactions Law (Federal Law No. 18 of 1993) ("Commercial Transactions Law"), although it is not commonly used in practice. The draft insolvency law introduces a specialised tribunal to hear and oversee insolvency proceedings to facilitate the insolvency process and to make it quicker and simpler with the hope this will allow distressed companies to restructure their assets and liabilities. The new insolvency law was passed by the UAE Council of Ministers in July 2015 and requires ratification by the relevant governing bodies before it will come into force.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Both commercial businesses and the large Muslim population in the Gulf Co-operation Council (GCC) continue to show interest in *Shari'a*-compliant financing products. In an attempt to attract a wider customer base and profit from this demand, Islamic financial institutions are expanding their catalogue of financial products. For example, the *Ijara* structure (sale and leaseback) has become extremely popular and successful in the region.

On 24 March 2015, the government of Ras Al Khaimah completed a public issuance of a US$1 billion *Sukuk*. The *Sukuk* issuance was structured in accordance to the *Ijara* principles. The issuance

© Published and reproduced with kind permission by Global Legal Group Ltd, London

highlighted geographic and investor diversification and was taken up by banks, funds and pension and insurance agencies across the globe.

In the same month, Emirates Airline completed the world's first export credit agency guaranteed *Sukuk* worth US$913.02 million. The *Sukuk* issuance was guaranteed by the Export Credit Guarantee Department of the UK (ECGD). The transaction involved four aircraft being delivered post issuance and the *Sukuk* were tradable from the issuance date. The transaction was the largest ECA-wrapped and ECGD-guaranteed debt capital markets transaction in the aviation industry and the finance market as a whole.

There has also been an increase in large ground-breaking financings, highlighting regional expertise. In June 2015, the Islamic Corporation for the Development of the Private Sector (ICD) secured a 13-month US$300 million Islamic *Murabahah* facility representing ICD's largest financing to date. Dubai Islamic Bank acted as the sole coordinator of the facility and the mandated lead arranger together with First Gulf Bank, Mizuho Malaysia and Mizuho Bank Nederland.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company can generally guarantee the borrowings of members of its corporate group in the UAE, subject to certain restrictions as set out in the response to question 4.1.

For both onshore and offshore entities, authority to provide guarantees is predominantly governed by its constitutional documents and obtaining the relevant corporate authorisations (see the response to question 2.3).

Generally, guarantees provided under certain Islamic financing structures that are subject to *Shari'a* principles may not be permitted, if their objective is to guarantee a specified return to the lenders or investors. The purpose of the guarantee must be clearly defined from the outset as per the laws of the UAE. Further, all documents relating to a *Shari'a*-compliant transaction must be pre-approved in writing by *Shari'a* scholars who issue compliance certificates (each a *Fatwa* and collectively *Fatawa*) per transaction and are expected to audit the transaction on a regular, often annual, basis to ensure that it continues to comply with *Shari'a* and its requirements, as interpreted by the relevant *Shari'a* scholars and documented in the relevant *Fatwa*.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Whilst no specific restrictions are identifiable, the main concern revolves around a director's fiduciary duties to the relevant company.

Onshore

A director of an onshore company in the UAE is required to act in the company's best interests, as set out in the CCL 2015, replacing the previous Commercial Company Law (Federal law No. 8 of 1984) ("CCL"). Notably, as this legislation is still new it is yet to be tried and tested in the courts; however, it is still heavily premised on the CCL albeit with certain enhancements.

The directors of an onshore company must have regard to the legislative requirement for the pursuit of profit (CCL 2015 Article 8), and to further the company's objectives (CCL 2015 Article 22). With those interests in mind, there are also some distinct provisions that the directors should adhere to, including a restriction on guaranteeing any loan agreement with a board member and third party (CCL 2015 Article 153) and entering any loan agreements (typically interpreted as including guarantees) for a term that exceeds three years (CCL 2015 Article 154) (see the response to question 2.3).

Offshore

Similarly, free zone entities place similar responsibilities on the directors. Further, the DIFC's Companies Law (DIFC Law No. 2 of 2009) (DCL) states that directors must, amongst other things, 'act honestly, in good faith and lawfully with a view to the best interests of the Company' (DCL Article 53).

Directors for both onshore and offshore companies should therefore take care when committing a company to guarantee the financial risk of another entity, and should conduct appropriate due diligence to ensure the company is able to meet its payment obligations and that the company is not insolvent or likely to become insolvent.

2.3 Is lack of corporate power an issue?

Similar to the Western markets the first step for both onshore and offshore companies is to review their constitutional documents to ensure that the company can provide a guarantee.

Onshore

By way of its constitutional documents, or articles of association, an onshore company may grant management with broad powers that enable it to run the company without involving its board of directors and shareholders (subject to certain restrictions for public companies – explored in more detail below).

In respect of onshore public joint stock companies (PJSC), directors may not enter into a loan agreement (which is interpreted by most practitioners and based on most court rulings to include guarantees) with a term that exceeds three years (CCL 2015 Article 154), unless the constitutional documents expressly permit this. If not expressly permitted, shareholder approval should be obtained. For onshore limited liability companies (LLC), which had previously avoided hefty regulation, directors should be aware that CCL 2015 now includes an article (Article 104) that states that the provisions therein, which apply to PJSC and private joint stock companies (PrJSC), shall now also apply to an LLC unless otherwise stated. However, the scope and application of this article is not yet known.

Offshore

Offshore companies must similarly act in accordance with their articles, though notably they need not comply with the CCL 2015, except to the extent they also operate onshore within the UAE.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In general, there are not any governmental consents or filings required in order to give effect to a guarantee in the UAE. However, a guarantee should be properly authorised by the company's constitutional documents and authorisations as previously stated. For onshore companies, a guarantees form and substance should satisfy the requirements of the Civil Transactions Law (Federal Law No. 5 of 1985, as amended) ("Civil Transactions Law") and the Commercial Transactions Law, as applicable. Practitioners should also consider that offshore companies may have their own legislation that governs such form and substance.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Additionally, if a transaction needs to comply with *Shari'a* principles, the pre-approval of *Shari'a* scholars is required as more fully described in the response to question 2.1.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

As mentioned above, depending on the *Shari'a* structuring of the transaction, certain guarantees that assure a specified return for the lender may be restricted, and specific advice should be sought in this regard.

Onshore

For onshore companies, Civil Transactions Law (Article 1061) requires that guarantees must be issued with respect to a specified debt or certain amount. In addition, the guarantee should be within the capacity of the guarantor to discharge. Therefore, whilst there is not a limit *per se*, a guarantor should not guarantee more than it can afford to repay. Guarantees should also be specific in nature, and whilst judgments have been made in the UAE that have recognised 'all-monies' guarantees, the above restrictions should be carefully considered on a case-by-case basis.

Offshore

There are no such limitations placed on offshore or DIFC companies, other than those outlined in the response to question 2.2.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange controls in the UAE that would restrict the enforcement of both onshore and offshore guarantees, aside from certain restrictions arising under international sanctions or local boycott regulations.

Onshore

The interpretation of the limitation period for onshore companies may affect enforcement of guarantees. UAE law states that in relation to surety, a creditor should claim the debt within six months of the date on which payment fell due. Dubai's Court of Cassation interpreted this as applying to all guarantees; however, Abu Dhabi's Supreme Court has suggested that the applicable period may be 10 years for commercial guarantees. It is therefore common practice to disapply the provision that states the limitation period is six months in the relevant transactional documents, though it is not clear if this would succeed in ensuring that the provision would not have effect.

Offshore

Offshore companies will be governed by their own laws. For example, the legislation in the DIFC states that, excluding fraud, a claim cannot be commenced more than six years after the date of the events that gave rise to the claim. However, should the free zones' legislation be silent regarding limitation, the period will be the same as under UAE law.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Although there are differences between the types of collateral available to onshore and offshore companies, both allow (with certain restrictions and limitations) security over: (i) real estate/land; (ii) tangible movable property (e.g., machinery or stock); (iii) shares; (iv) receivables; and (v) cash deposits.

A key difference is that an onshore company cannot provide a conventional 'floating charge', but instead may seek to utilise a commercial mortgage (see the response to question 3.7).

In respect of any assets located onshore in the UAE over which security is to be granted, local UAE law, Civil Transactions Law and the Commercial Transactions Law will typically govern the enforceability and validity of the relevant contract. For each free zone, the Federal or Emirate decree that created the free zone should be reviewed, as it may grant authority for that free zone to regulate matters relating to taking and enforcing security. Most free zones will only have the power to regulate and promulgate laws regarding the incorporation of companies, and therefore the relevant Federal laws of the UAE and specific Emirate will continue to apply to all aspects not expressly regulated by the free zone.

Foreign lenders should also bear in mind that ownership of land may be restricted to UAE (or GCC) nationals in certain Emirates. Dubai, however, is generally more progressive in this regard as it permits foreign ownership of land in certain designated areas (Regulation No. 3 of 2006 Determining Areas for Ownership by Non-UAE Nationals of Real Property in the Emirate of Dubai). Such restrictions could affect the perceived value placed on any such security by lenders; the ability of a foreign lender to enforce its security package over, for example, real estate in an area that is not designated as freehold or over shares in a company incorporated onshore up to a percentage that exceeds the maximum that foreigners are entitled to own, should be borne in mind when negotiating the security package for any given transaction. This often triggers the need to consider a structured solution, or the involvement of a security agent or trustee.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Whilst general over-arching security agreements can be provided in the UAE, the general practice and advisable approach is to have separate agreements wherever possible. Further, as certain security documents may have to be notarised and registered with different government entities, it may create uncertainty and result in additional costs if they were to be included in the same agreement.

Additionally, in *Shari'a*-compliant transactions *Shari'a* scholars will insist on the separation of subject matters in documentation to ensure there is a reduced chance of material ambiguity (*Gharar*) in the agreements.

The procedures for the relevant security agreements vary from asset to asset (see the response to questions 3.3 and 3.8).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Onshore

A person or company owning property in the UAE (with the legal capacity to sell) can create a mortgage in favour of a mortgagee licensed by the UAE Central Bank. The mortgage can be over: (i) land and buildings; (ii) a leasehold interest; and/or (iii) a building erected on leased land.

In order to perfect a valid mortgage in the UAE, registration (typically by a simple pre-determined form) needs to be made in writing and provided to the mortgage registrar with the land department or the local municipality of the relevant Emirate. A fee, which is usually payable, is dependent on the specific Emirate; however, it can commonly be linked to a percentage of the mortgage

© Published and reproduced with kind permission by Global Legal Group Ltd, London

amount (see the response to question 3.9). This can be onerous on the borrower if they are covering the costs of the transaction. Further, enforcement of such security can incur additional fees and expenses which may be prohibitive to the lending entity when it comes to an enforcement scenario and transferring title.

As discussed in the response to question 3.1, foreign lenders should also bear in mind that ownership of land, onshore companies and other assets may be restricted to UAE (or GCC) nationals in certain Emirates and as such, the involvement of a local bank or a local/regulated security agent or trustee may be necessary. Furthermore, regardless of foreign ownership restrictions certain types of security can only be given in favour of a bank licensed by the UAE Central Bank.

Lenders should also be aware that it is possible to take mortgages over ships and aircraft under the laws of registration of the relevant assets. In the case of mortgages over aircrafts, the mortgage instrument may be filed with the General Civil Aviation Authority and a UAE pledge will also typically be taken over these assets. It is also worth noting that in 2008 the UAE ratified the Convention and Aircraft Protocol on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment, commonly known as the Cape Town Convention.

UAE law does not provide for security in the form of a floating charge; however, market players have attempted to secure inventory by use of a commercial mortgage (see the response to question 3.7).

Offshore

Interests in land in free zones are normally subject to their own regulations. The DIFC, for example, is governed by Real Property Law (DIFC Law No. 4 of 2007), which outlines that land transactions must be registered in a central register administered by the DIFC and should include: i) a description to identify the property; ii) a description to identify the interest to be mortgaged; and iii) a description of the secured debt or liability.

As with land, security over machinery and equipment in free zones may be subject to its own regulation, and the relevant Federal or Emirate decree which created the free zone should be consulted. The DIFC for example, unlike UAE law, generally allows for the registration and enforcement of a floating charge (see the response to question 3.7).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, typically security over receivables is taken by an assignment of the contractual rights under the agreement giving rise to the receivables.

Onshore

Under a strict interpretation of local UAE law, an acknowledgment of assignment by the counterparty of the underlying receivables agreement is required, following notice from the assignor. Notably, in relation to the assignment of rights (not obligations) there have been a number of court decisions that have allowed notice only. However, judgments on the topic are not consistent, and as there is no system of precedent in the UAE it is advisable for lenders to obtain the relevant acknowledgment in any assignment.

Offshore

Such an assignment is permissible in offshore transactions. Specifically, security in the DIFC is governed and permitted by the Law of Security (DIFC Law No. 8 of 2005). Notably, the DIFC does not provide different rules depending on the asset to be secured (excluding land); hence all security to be taken in the DIFC must ‘attach’ to be effective. For ‘attachment’ to occur:

i) a value must be given;

ii) the debtor must have rights in the collateral or the power to transfer its rights in the collateral to a security party; and

iii) one of the following: (a) the obligor must be bound by a security agreement that provides a description of the collateral; or (b) the collateral must be a negotiable document of title, a negotiable instrument, money, deposit account or financial property and the secured party must have control pursuant to the obligor’s security agreement.

Perfection of the relevant security is attained once: (i) it is ‘attached’; and (ii) a ‘financing statement’ is filed with the DIFC Security Registrar. The ‘financing statement’ should be filed within 20 days of the date of the security agreement and will lapse five years from the date it is filed (notwithstanding the term of the security agreement itself), pending a continuation statement.

However, it should be noted that a financing statement is not appropriate for security taken over the assignment of certain receivables (as set out in the DIFC Security Regulations) and monies held in an investment account (as defined in DIFC Personal Property Law).

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Onshore

Typically, security over funds in a bank account is by way of an account pledge and assignment agreement. An assignment of rights in relation to the relevant accounts (which normally include signing rights) is important, as the balances within them are likely to fluctuate.

Non-resident foreign banks should also be aware that, under UAE law, a pledge over funds in a bank account can only be granted in favour of another bank or financial institution licensed in the UAE.

Offshore

Currently, the only free zone permitted to regulate banks is the DIFC, and any relevant account charges are regulated by the DIFC Security Law. The procedure and restrictions (including monies held in an investment account) are set out in the response to question 3.4. For any other free zone, UAE law applies.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Security can be taken over shares in the form of a share pledge in relation to all onshore types of companies, including onshore LLCs and most offshore companies. The pledge documentation should always be governed by the relevant jurisdiction of the pledgor, which would typically be UAE onshore law or in the case of the DIFC, DIFC law. Security can be granted under a different jurisdiction; however, it is not advisable as the merits of any dispute would have to be looked at again in accordance with and by the courts of the jurisdiction where the pledgor is located if the security was ever enforced upon (see the response to question 7.1).

Onshore

The procedure for pledging shares in a PJSC or PrJSC is by the physical delivery of the share certificates to the pledgee and entry of the pledge in the company register (though if the shares are not in certificated form physical delivery is not required). A PJSC will usually be required to be listed at one of the UAE’s stock exchanges and the pledge should be recorded in the share register maintained by the relevant exchange. A PJSC will appoint a share register keeper (such as the Dubai Financial Market (“DFM”) or Abu Dhabi Securities Exchange (“ADX”)) to record the pledge. Upon such registration the pledgee typically has the right to collect dividends and entitlements attached to the shares, though in most cases these are returned to the borrower (with certain limitations) unless the borrower defaults.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Onshore LLCs did not previously have any clear legal guidance on how its shares can be pledged, and the pledge perfected. However, the CCL 2015 implements a new system (under Article 79) that allows pledges of shares in an LLC to be made in accordance with such company's articles, and under an official notarised document to be registered at the companies registrar, for which the Minister of Economy intends to issue specific regulation. It is anticipated in the market in Dubai that pledges over shares must be registered with the DED to be effective, which is an important development which may facilitate the extension of credit to SMEs, start-ups and family businesses.

As indicated before, lenders should also bear in mind that foreign investors are still restricted in their ownership of capital regarding onshore companies (at least 51% should be owned by a UAE national) therefore enforcement can be difficult; and typically, a local security agent or trustee will need to be employed.

Offshore

Most offshore companies (including the DIFC) have physical share certificates that can be pledged and delivered, although this is not always the case. Most free zones also have their own registration requirements for such security, which may include execution of certain forms and filing of executed documents with the relevant free zone registrar.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Onshore

For onshore companies, security over inventory that fluctuates does not exist along the lines of a 'floating charge', hence market players have attempted to use a commercial mortgage in its place. We are not aware of a case in which the enforceability of such mortgage has been tested, and local practitioners generally believe it may only apply to mortgages over businesses that are owned by unincorporated entities.

However, if enforceable, the commercial mortgage can provide security over goods, contract rights, goodwill, trade name, IP and licence rights. To register a commercial mortgage it must be executed in writing and the agreement must be notarised and registered in the commercial register of the relevant Emirate's Department of Economic Development. Notice of the mortgage should be given in two local Arabic newspapers two weeks prior to such registration. The registered mortgage will only be valid for a period of five years unless renewed and updated (notwithstanding the term in the underlying agreement).

Offshore

Security over such assets in free zones is permitted but subject to the relevant free zone requirements. In the DIFC, for example, it is possible to create a security interest over future assets/advances, acquired assets and the debtor's right to use, or dispose of all or part of the relevant items in line with the procedure set out in the response to question 3.4.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Both onshore and offshore companies should be able to grant security to secure their own borrowings and those of other borrowers subject to the requirements and restrictions set out herein.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Stamp duty and taxes are not applicable for either onshore or offshore companies given the nil rate of direct tax applicable to most sectors in the UAE (see the response to question 6.1). However, transfers of land may incur registration fees akin to stamp duty, payable to the relevant Emirates' land registry. These costs vary from Emirate to Emirate.

Notarisation is commonplace in the UAE, and even if not expressly required, may be used in order to add authority to documents. Fees in relation to this are normally charged at a very low percentage (approximately 0.25% and subject to a cap) of the secured amount, and importantly notarisation for onshore documentation is always in Arabic.

Onshore

Onshore mortgage registration varies between Emirates; the Dubai Land Department for example, currently charges 0.25% of the value of the mortgage amount. The fees for registration of other types of security vary depending on which Emirate the security is registered in but commonly involves a percentage of the amount secured and is subject to a cap.

Offshore

Registration at the relevant free zone again varies in the DIFC; for example, a mortgage fee is US$100 (or US$273 for an Islamic mortgage), and if the property has not yet been registered with the DIFC Registrar of Real Property an additional fee (currently 5% of the total value of the property) is also payable. The cost of filing a 'financing statement' (see the response to question 3.4) is currently at a cost of US$1 per US$1,000 secured, subject to a minimum of US$250 and a maximum of US$5,000.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

In comparison to the United Kingdom and United States the process of securing assets is generally more complex and expensive. Arguably, the relevant free zones have a more straightforward approach although it is still more uncertain than the established Western systems. This is somewhat due to a lack of formalised or standard structure of registrars for registration of each type of security in the relevant Emirates. Further, a lack of established case law and clarity regarding the perfection of security and which department security should be registered with can make it difficult to assess what registration steps to take next.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Typically, no regulatory or similar consents prior to the creation of a security are required. However, to the extent that a regulatory or government-owned body must accept registration of a certain security this may be deemed a form of consent. Moreover, in circumstances where the secured assets are equities or other forms of securities, certain approvals may be required and structural considerations taken into account. Further, any security against government-owned assets or certain individuals within government organisations will require consent.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no specific concerns or case law relating to such matters that are apparent. Further, if such a facility is secured by an assignment of an account, in the UAE such assignment is absolute, there is no room for a floating security (see the response to question 3.7) or second ranking security over the relevant account.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

The procedures and requirement for security are set out in the answers to the questions above. For both onshore and offshore companies it should be noted that signing in counterparts is generally accepted practice, however for enforcement purposes, there should always be a 'counterparts' provision in the documentation.

For onshore entities executing specific security documents, including power of attorneys, it may need to be executed in front of the relevant notary public and/or registrar. Notably, the concept of deed is not recognised in the UAE outside the DIFC and therefore security will be by contract. In addition, certain assets will require registration in a form as required by the relevant government or regulatory authority. Though counterparts are generally accepted, it is also advisable, based on judicial precedents, to encourage the signing parties to initial every page and clearly identify themselves and their authorities. In the case of corporate signatories, a company stamped should be affixed. Offshore entities will follow their own relevant execution requirements.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Onshore

There are currently no express provisions regarding the restrictions on a company's ability to guarantee or give security to support the acquisition of itself, its parent, or its subsidiary company.

However, the CCL 2015 states that a PJSC or PrJSC or any of its subsidiaries "*may not provide financial aid to any shareholder to enable the shareholder to hold any shares, bonds or Sukuk issued by the company*" (Article 222). The definition of such financial aid includes any security, guarantee or providing company assets as security. Notably, as mentioned in the response to question 2.3, the law includes a provision (Article 104) that states the laws applying to PJSCs also apply to LLCs.

Offshore

The relevant rules and regulations of the applicable free zone would need to be reviewed to understand their position in respect of financial assistance, but typically parties tend to err on the side of caution in such matters.

By way of example, within the DIFC, a company limited by shares is prevented from providing financial assistance by granting security and providing guarantees by a company limited by shares in relation to the acquisition of shares in itself or in a holding company unless: (i) such assistance would not materially prejudice the interests of the company or its shareholders or the company's ability to discharge its liabilities as they fall due and must be approved by the shareholders (90% in share value); (ii) finance or financial assistance is part of the company's ordinary business and is on ordinary commercial terms; or (iii) it is specified in DIFC Company Regulations (2009) as exempt. However, in relation to point (iii), should such financial assistance not fall under these exemptions, companies may consider using DIFC incorporated special purpose vehicles to provide financial assistance, if permitted by the DIFC Special Purpose Company Regulations.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The concept of 'trusts' and 'trustees' are more commonly referred to in the UAE as 'agent', 'security agent' or 'security trustee'. They are widely recognised concepts and often utilised in onshore, offshore (including DIFC) and Islamic finance structures. In Islamic transactions, if the deal is structured in compliance with *Shari'a*, the addition of an agent is not uncommon, in order for them to represent a group of lenders and protect their interests.

Further, as outlined in the response to question 3.6, onshore and offshore (including DIFC) entities in the region may require that a security agent is employed, particularly in the context of security which is granted in the region and can only be enforced by local institutions or entities that have specific licences. For example: (i) security over accounts – where a bank or financial institution should be the beneficiary of the security; and (ii) a lender who funds an organisation which has a teaching licence and is granted security by way of shares in itself – security can only be enforced over the shares if the lender itself has a teaching licence. Typically, this only becomes an issue upon enforcement; however, lenders should be mindful of this as it may affect the value they place on such types of security.

If a foreign lender is taking security over shares of an onshore entity it may become difficult for them to enforce upon this security unless they are represented by a UAE national to ensure they do not contravene any ownership restrictions. This is not an issue for offshore entities for which 100% foreign ownership is permitted.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Agency is recognised, and in the DIFC both agency and trustee roles are, as more fully described in the response to question 5.1.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The UAE is a relatively new financial centre, and the practitioners based here are keen to emulate a system as advanced as those established in the United Kingdom and the United States. Thus, many of the practices and customs for financing transactions (especially for certain progressed offshore entities, including the DIFC to a much larger degree) are similar to those utilised in the Western markets albeit occasionally with an additional tier of Islamic structuring. Hence, similar to Western markets an amended and restated facility would typically be entered into and the guarantee would be reaffirmed with the new parties.

Nonetheless, the practices for onshore entities and certain free zones are often not as structured or stringent and a simple side letter or amendment may suffice.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Whilst the UAE has tax laws, currently the governmental authorities do not currently impose corporate taxes on companies other than on branch offices of foreign banks and certain energy companies (e.g., oil, gas and petrochemical). There is speculation in the market that a tax regime (most likely a value-added tax) is set to be implemented in the region, however, the UAE business community are awaiting further updates as to the scope and extent of the same.

Currently, customs duties are typically very low, and personal income tax is not applicable; however, there are municipality service charges on individuals in the UAE by way of hotel and service (food) charges. Additionally, as of the date of this publication, it has been reported that the UAE authorities have also been discussing the introduction of corporate tax laws in the UAE, drafts of which are currently under review. If implemented, these laws would reflect a major change in policy and may have a detrimental effect on foreign investment in the market.

Various fees are payable for transferring property or land from one name to another (akin to stamp duty), registration and notarisation fees (see the response to question 3.9). Notably, no income tax regime is in place which makes the region an attractive market for both individuals and corporations.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No preference is given to foreign lenders or financiers; however, the nil tax rate (subject to some exceptions as outlined in the response to question 6.1) is viewed as an incentive to invest in the region.

See the response to question 3.3 in respect of costs of registration. It should be noted that some free zones do not recognise the registration of security; hence the lenders have to rely on their contractual remedies in a default situation.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

See the response to question 6.1. Although there are tax laws, they are not commonly applied.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Other than as outlined in the response to question 3.9, the costs to the lender are those that are imposed on them in their own jurisdiction of incorporation, if any.

Additionally, if a transaction is to be structured Islamically in accordance with the principles of *Shari'a*, this may also increase costs due to the document-heavy nature of such transactions and the need to involve *Shari'a* advisory boards.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Onshore

Yes, both the UAE Civil Procedures Law (Federal Law No. 11 of 1992), and the Civil Transactions Law provide for the recognition of foreign governing law in contracts, provided that the conditions set out in the Civil Procedures Law are satisfied. However, if a UAE Court accepts jurisdiction, especially in an enforcement scenario where assets are located in the UAE, it may ignore the choice of foreign governing law in a contract and apply UAE law insofar as enforcement relates to the domicile of the parties, and the location of assets in the UAE. There are some claims where the parties cannot contract out of the application of UAE law, for example real estate disputes where the real estate is onshore in the UAE.

Offshore

In the DIFC, Article 6 of the DIFC Judicial Authority Law (Dubai Law No. 12 of 2004 (as amended)) provides that the DIFC Courts may apply the laws of another jurisdiction where the parties to a dispute have explicitly agreed that such laws shall govern a dispute between the parties, provided that such law does not conflict with the public policy and morals of the UAE.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Onshore

The UAE Civil Procedures Law sets out in its Article 235 the basis upon which UAE Courts will recognise and enforce foreign judgments or orders.

Article 235 provides that a foreign judgment may be recognised and enforced if:

i) the law of the country in which the judgment was issued would recognise and enforce a UAE Court judgment. This usually means that the two countries either have a bilateral treaty providing for recognition and enforcement of judgments. As neither the United States nor the United Kingdom have such treaties with the UAE, judgments would not be automatically enforceable without re-examination of the merits;

ii) the UAE Courts have no grounds for jurisdiction to try the case in which the order or judgment was made;

iii) the foreign court had jurisdiction in accordance with the rules governing international judicial jurisdiction within that country's own laws;

iv) the parties to the action in which the foreign judgment was issued received proper notice;

v) the judgment is final and not subject to appeal in the jurisdiction in which it was issued;

vi) the judgment does not conflict with a judgment already made by a UAE Court; and

vii) enforcement of the judgment does not conflict with the morals or public order of the UAE.

As a result, although a UAE Court may enforce a foreign judgment if it satisfies all of the conditions set out in Article 235, it is usually difficult for these requirements to be met. The fact that an applicant is seeking to enforce a judgment in the UAE implies that there is a nexus to the UAE in the factual circumstances underlying the case. On that basis, it is likely that a UAE Court may assert jurisdiction and reopen the merits of the case. A common pitfall for potential enforcement is to prove that the UAE Courts did not have jurisdiction to try the case, and even if all the other conditions set out in Article 235 are satisfied the courts may refuse to enforce the foreign judgment on these grounds.

The UAE is signatory to many bilateral treaties and international conventions for the mutual recognition of judicial and arbitral awards.

Offshore

The DIFC Courts Law (DIFC Law No 10 of 2004 (as amended) provides the DIFC Courts with discretion to ratify judgments of foreign courts. The DIFC Courts Law also requires that the DIFC Courts abide by any mutual enforcement or judicial cooperation treaties entered into between the UAE and other countries. The DIFC Courts have entered into a Memorandum of Guidance with each of the United States District Court for the Southern District of New York, and the Commercial Court, Queen's Bench Division, England and Wales, Australia and Singapore. These memoranda address only money judgments, are not legally binding, and set out guidelines to be followed by the respective jurisdictions when assessing whether to enforce the judgments of the courts of the other jurisdiction.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Onshore

i) Commencing an action for default is a relatively straightforward process. However, seeking a money judgment at the lower courts and enforcing such a judgment upon assets is usually a lengthy process that requires trying a case on the merits, and defending appeals if any are filed by an interested party. This process may in some instances, and depending upon the form of security and nature of the assets, take up to 24 months or even longer, even if there are no legitimate legal defences to non-payment.

ii) The enforcement of a non-appealable judgment requires the filing of a separate "execution" case. Execution cases are subject to appeal. If the specific assets of the debtor in the UAE are undetermined, a series of inquiries with various UAE government authorities such as the land registries of the respective Emirate(s), the UAE Central Bank, the Securities and Commodities Authority, and the financial markets (the DFM and the ADX) must be made through the courts to identify assets. Real estate, securities, and movable assets such as vehicles and machinery will be subject to a public auction process.

Offshore

The enforcement of a security interest over assets located in the DIFC does not require a court order. The DIFC Law of Security (DIFC Law No. 8 of 2005) governs the creation and enforcement of security over collateral located in the DIFC. The secured party must first notify the defaulting party to make payment or otherwise discharge its obligation to the secured party. The secured party must also notify any other priority creditors of which it is aware. If there is no objection by a priority secured creditor, the secured party may take steps to enforce its security interest over assets located within the DIFC. If the collateral is real property located within the DIFC, the secured party may record with the DIFC Security Registrar a written statement that a default has occurred and that the secured party is entitled to enforce the security interest.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Yes.

i) Certain collateral such as real estate and movable property including vehicles, vessels, machinery, shares, and financial instruments must be liquidated through a public auction procedure in accordance with the UAE Civil Procedures Law.

ii) The attachment and liquidation of publicly listed securities must be conducted in accordance with the procedures prescribed by the UAE Securities and Commodities Authority.

In relation to the enforcement of collateral security in the DIFC, see the response to question 7.3.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

There are no foreign lender-specific restrictions relating to filing suit against a company in the UAE or initiating security enforcement proceedings in the UAE.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Onshore

As of January 2016 the UAE does not have a standalone bankruptcy law. The Commercial Transactions Law contains bankruptcy procedures in relation to both individuals and companies. Articles 704 to 710 of the Commercial Transactions Law provide for a stay on all actions by creditors following the declaration by the court that the debtor is bankrupt. The assets of the debtor will thereafter be distributed by a court appointed administrator (see question 1.1).

Offshore

The DIFC's Insolvency Law (DIFC Law No. 3 of 2009) governs insolvency proceedings in the DIFC. The Insolvency Law allows the DIFC Courts to grant a moratorium, including in relation to the enforcement of collateral, to an eligible applicant (see question 1.1).

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Onshore

Article 236 of the UAE Civil Transactions Law stipulates that the same conditions set out in Article 235 for the enforcement of foreign judgments are applicable to foreign arbitral awards, which are set out in the response to question 7.2. The UAE is also a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral awards (New York, 1958), as well as other bilateral treaties and Conventions dealing with the mutual recognition of arbitral awards.

Offshore

In the DIFC, an arbitral award, irrespective of the jurisdiction in which it was made, is recognised as binding within the DIFC and upon application to the DIFC Court, is enforceable. A party may challenge enforcement under certain circumstances including when a party to an arbitration was under some type of incapacity, when the underlying arbitration agreement is invalid under the laws to the parties have subjected it to, when the party against whom an award was granted was not provided with proper notice, when the dispute in relation to which the award was granted falls outside the scope of issues contemplated by the parties to be submitted to arbitration, when the composition of the arbitral tribunal or the arbitration procedures was inconsistent with the agreement of the parties or laws of the jurisdiction in which the arbitration to place, the award is not yet binding or has been suspended by a court of the jurisdiction in which it was made, the subject matter of the underlying dispute would not have been capable of settlement by arbitration under the laws of the DIFC, or if enforcement would be contrary to public policy in the UAE.

Where the UAE has entered into a mutual enforcement of judgments treaty, the DIFC Courts (as a Court of Dubai) will uphold the terms of the treaty.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Onshore

The concept of a "secured lender" as the term is generally understood, does not exist in the UAE to the extent that it denotes a lender having the benefit fixed or floating liens or charges over the assets of the debtor. However, creditors that have the benefit of registered mortgages or pledges over assets in relation to which such registration is available (real estate, vehicles, listed securities, and vessels) will have priority over other "unsecured" creditors insofar as those assets are concerned.

The Commercial Transactions Law allows for creditors with registered security rights to enforce their rights pursuant to their registered mortgages and pledges under the supervision of the court appointed bankruptcy administrator. Such enforcement will be through sale by public auction pursuant to the procedures for such auctions set out in the Civil Transactions Law.

Offshore

In the DIFC, the Insolvency Law allows the DIFC Courts to grant a moratorium, including in relation to the enforcement of collateral, to an eligible applicant.

Dubai World – Decree 57

The Special Tribunal related to Dubai World ("Tribunal") was established by Dubai Decree No. 57 of 2009 issued by His Highness Sheikh Mohammed Bin Rashid Al Maktoum, in his capacity as the Ruler of Dubai. The Tribunal was established to hear claims against Dubai World, a Dubai Government-owned holding company, and its subsidiaries. The Tribunal was established following Dubai World's November 2009 announcement of its intention to seek the rescheduling of its debt obligations. The Tribunal applies the DIFC's Insolvency Laws and, as such, allows the granting of moratoria including in relation to the enforcement of collateral.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes. Creditors with registered mortgages and pledges will have priority to be paid from the proceeds of the liquidation of the subject assets. The employees of a debtor also have priority over other debtors in respect of assets that are not subject to registered mortgages or pledges.

In the DIFC, the Law of Security ranks conflicting perfected security interests according to priority in time of perfection. The Law of Security grants perfected security interest priority over a conflicting, unperfected security interest, and provides for priority of the first security interest to attach if conflicting security interests are unperfected.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The Commercial Transactions Law does not bar any specific type of entities from applying for or being declared bankrupt. However, as stated in previous responses, the bankruptcy provisions of the Commercial Transactions Law are rarely used, and restructurings,

© Published and reproduced with kind permission by Global Legal Group Ltd, London

informal arrangements, the enforcement of money judgments, and the enforcement of registered mortgages and pledges on real estate, listed securities, and certain movables are the usual means of recourse for creditors and debtors.

In the DIFC, the Insolvency Law applies to any company that falls under the jurisdiction of the DIFC and has been incorporated pursuant to the DIFC Companies Law (DIFC Law No. 2 of 2009 (as amended)).

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No. All enforcement measures must be conducted through the courts. The concept of "self help" or "self remedies" are not recognised in the UAE. Furthermore, seeking to seize assets outside of the court mandated procedures may expose the creditor to criminal liability.

In the DIFC, a secured party may take steps to enforce its security interest over assets located within the DIFC without a court order.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes. However, if there are grounds for a UAE Court to assert jurisdiction, the UAE Courts are likely to do so. See the response to questions 7.1 and 7.2 for more background on this topic.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

There are no laws in the UAE specifically addressing the issue of waiver of sovereign immunity. The UAE Court's may consider a variety of factors, including public policy issues, before accepting jurisdiction in a case involving a foreign sovereign government or government entity. Insofar as the Federal and local governments of the UAE are concerned, the Civil Procedures Law contains a prohibition on the seizure of "public property" belonging to the UAE Federal Government or the governments of any of the individual Emirates to satisfy a judgment debt.

Some Emirates may also require the written consent and approval of the respective Emirate's Ruler's court or legal department is obtained prior to the filing of a claim against an Emirate's Ruler, government, or government entity. For example, in the Emirate of Dubai, the Dubai Government Lawsuits Law (Dubai Law No. 3 of 1996, as amended) requires the prior approval of the Ruler of Dubai before filing a lawsuit against the Ruler or a Dubai Government entity. Failing the approval, the claim will not be accepted at the court. The requests for such approvals must be made to the Dubai Government's legal department.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Onshore

Licensing requirements in the UAE:

The Central Bank and the Securities and Commodities Authority (SCA, also known as ESCA) are the main regulatory bodies for financial services in the UAE. Pursuant to Federal Law No. 10 of 1980 (the Banking Law) the Central Bank regulates the financial institutions, including those who wish to provide financing in or from the UAE.

Whilst there are no local licensing requirements for foreign lenders which lend to UAE companies, if such entity wishes to be based in the UAE, it must be appropriately licensed. UAE lenders including commercial banks, investment banks, investment companies, finance companies, Islamic banks, Islamic finance companies and real estate finance companies based in the UAE are regulated by the Central Bank and require a licence. Each of the institutions listed above must be 51% owned by a UAE national if incorporated in the UAE; however, for finance companies, commercial banks and investment banks, the minimum UAE national shareholding is 60%. Branches of foreign banks can also be licensed as commercial banks in the UAE.

In order to obtain a licence from the Central Bank, a letter of application, certain corporate documents of the applicant and a business plan are submitted to the Central Bank. The specific documents required for the licence are not listed by the Central Bank but the applicant should expect to be notified if additional documents are necessary for the process to be finalised.

UAE lenders who enter into financial arrangements with a borrower in the UAE without a licence may face imprisonment for up to three months and/or fined up to AED2,000. Additionally, the institution may be liable for civil and criminal claims.

Additionally, an agent for a syndicate of foreign lenders is also not required to be licensed unless it is operating from and based in the UAE. Please note the requirements in respect of local agents relating to security as addressed in sections 3 and 5.

Offshore

Licensing requirements in the DIFC:

The principal regulator for regulating financial services within the DIFC is the Dubai Financial Services Authority (DFSA). An individual or entity based in the DIFC which provides a financial service must be authorised by the DFSA by obtaining the appropriate licence. If both the lender and the borrower are based in the DIFC, a Category 2 licence must be obtained, whereas if the lender is foreign, providing a credit facility to a borrower in the DIFC, licensing requirements do not exist.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

An entity who wishes to satisfy the eligibility requirements in the DIFC must be structured as any one of the following forms of business: limited liability company; company limited by shares; limited liability partnership; protected cell company; investment company; branch of foreign company or partnership; or special purpose company.

The consequences of licensing violations can be severe. If a lender does not satisfy the requirements, DFSA, under the Regulatory Law and DFSA's Enforcement (ENF) Rulebook, can enforce the following actions as punishment: a fine of US$100,000 per contravention; damages or restitution; injunctions and restraining orders; corporate penalties – unlimited fines through the Financial Markets Tribunal (the FMT); and a banning order through the FMT. As a consequence of violating the Financial Services Prohibition section of the Regulatory Law, lenders will also face censure by way of publication of any enforcement action leading to critical reputational damage and the loan agreement will be considered unenforceable.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The UAE banking market is still relatively young, and whilst there is extreme wealth and numerous opportunities in the region the obligors or borrowers may often be limited in the types of transactions and financings they can enter into, particularly in cases where the relevant funding transaction is highly structured and involves the issuance of debt securities. In addition, limitations arise when the relevant financiers and/or borrowers are *Shari'a*-compliant. However, most of the major international lenders have their own Islamic banking desks and many retain *Shari'a* advisory boards. Such institutions are growing more comfortable with the main Islamic financing mechanisms, and view Islamic finance assets, which reached US$1.35 trillion in 2012, as an area of major opportunity and growth, notwithstanding the additional costs.

Acknowledgment

The authors would like to acknowledge the contributions of the following colleagues for providing input and reviewing the contents of this chapter:

Rebecca Kelly, Partner, +971 4 312 1830, rkelly@morganlewis.com.

Victoria Mesquita Wlazlo, Senior Associate, +971 4 312 1850, vmesquita@morganlewis.com.

David McDonald, Associate, +971 4 312 1930, david.mcdonald@morganlewis.com.

Galadia Constantinou, Associate, +44 20 3201 5000, gconstantinou@morganlewis.com.

Ayman A. Khaleq
Morgan, Lewis & Bockius LLP
Emirates Towers Offices, Office No. C
10th Floor, PO Box 504903
Sheikh Zayed Road, Dubai
United Arab Emirates

Tel: +971 4 312 1880
Email: akhaleq@morganlewis.com
URL: www.morganlewis.com

Ayman A. Khaleq, managing partner of Morgan Lewis's Dubai office, advises clients on cross-border structured finance, debt capital markets, and private placement transactions, and on the structuring and formation of private investment funds. In particular, he helps regional and international clients address the structural and documentation requirements associated with Islamic finance and investment products. Ayman also acts for a wide range of international clients on matters relating to doing business in the broader Middle East region. He currently teaches a course on transactional Islamic law at George Washington University Law School, and acts for the International Monetary Fund as an expert in the field of debt capital markets. Ayman is listed as a leading lawyer in banking and finance, Islamic finance, capital markets, and investment funds in *Chambers Global*. In addition, he was named in *Private Equity Manager*'s "Legal Power 30" list. Ayman is fluent in Arabic and English.

Amanjit K. Fagura
Morgan, Lewis & Bockius LLP
Emirates Towers Offices, Office No. C
10th Floor, PO Box 504903
Sheikh Zayed Road, Dubai
United Arab Emirates

Tel: +971 4 312 1860
Email: afagura@morganlewis.com
URL: www.morganlewis.com

Amanjit K. Fagura is a finance associate in Morgan Lewis's Dubai office. She brings international experience and a global perspective to her work on finance and debt capital markets transactions. Amanjit assists regional and international clients on matters such as conventional and Islamic financings and refinancings, and *Sukuk* and bond issuances.

Before joining Morgan Lewis, Amanjit was an associate in the finance practice of another international law firm, resident in Dubai.

Amanjit earned her M.A. in law from the University of Cambridge in 2010 and received her Legal Practice Course from BPP Law School, England in 2007. She earned her B.A. (Hons) from the University of Cambridge in 2006. Amanjit is admitted to practise in England and Wales as a Solicitor.

Morgan Lewis

Morgan Lewis's market-leading practices are focused on global financial services firms and Fortune 100 companies. We have approximately 2,000 lawyers in 28 offices in the US, Europe, the Middle East and Asia, including financial centres such as New York, London, Paris, Moscow, Frankfurt, Dubai, Singapore, Beijing and Tokyo. Our diverse practice covers a wide range of debt financings, including syndicated lending, leveraged and investment grade financings, cash flow and asset-based financings, private note placements and multicurrency and cross-border financings.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

USA

Thomas Mellor

Morgan, Lewis & Bockius LLP

Rick Eisenbiegler

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The corporate lending markets in the United States are broad and deep. Market trends are often associated with certain segments of the lending markets, and market segmentation in the United States is based on a number of factors. These factors include: the size of the borrower (from so-called "large-cap" borrowers, to those in the "middle-market" to "small-cap"); the credit profile of the borrower (from investment-grade to below investment-grade or "leveraged"); the type of lender (banks, *versus* non-bank lenders, such as hedge funds, finance companies and insurance companies); the number of holders of the debt (from syndicated loans, to "club" and bilateral facilities); whether the loan is secured, and the relative positions of the lenders *vis-à-vis* one another (from senior unsecured, to senior secured, mezzanine and second-lien loans); the basis on which the loan is made and repayment is (hopefully) assured (from a company's general credit rating, to cash flow loans, to asset-based loans); and the purpose of the loans (from acquisition finance, asset finance, to general working capital loans, to the development of specific projects). While there are trends within each of these market segments, there are also some broad trends which impact multiple segments. For example:

Rising Interest Rates. After keeping interest rates low for many years, the Federal Reserve reversed course in late 2015 by announcing it would raise interest rates for the first time since the start of the financial crisis in the United States. The Federal Reserve had kept interest rates low during and after the financial crisis in an effort to strengthen economic growth and curb unemployment by making it cheaper for companies to borrow. This low interest rate environment contributed to a borrower-friendly market: lower rates and higher leverage levels, with lenders and loan investors seeing lower yields and weaker covenants and structures. Improving economic conditions in the United States, including a considerable improvement in the labour market in 2015 (as evidenced by an unemployment rate that fell to prerecession levels), led the Federal Reserve to start raising short-term interest rates in December of 2015, with an initial increase in the benchmark interest rate by 0.25 percentage points. It is anticipated at the time of the writing of this chapter that the Federal Reserve will continue to gradually increase short-term rates in the United States (in contrast to moves by the European Central Bank, which is experimenting with lower, and in some cases, even "negative" interest rates). Such interest rate moves in the United States suggest a gradual decline of the "easy-money" conditions of the past few years.

Certain Trends in Loan Documentation. As mentioned above, trends are often identified with market segments. What is trending in one corner of the market may not necessarily be trending in another corner. One of the most vibrant and innovative segments of the loan markets in the US is the fast-paced leveraged loan market. "What is market" on a variety of pricing, structural and other points, including leverage levels, spreads, baskets and intercreditor issues changes from month to month. Drivers of these changes include the demands of determined and resourceful borrowers and sponsors, the ebb and flow of the demand for leveraged loans, ambitions to command greater market share, due regard for credit risk and the other factors described below. Some broader trends in the market in recent years can be identified.

Convergence. The same investors often invest in leveraged loans and high-yield bonds. All-in pricing on leveraged loans is generally lower than high-yield bonds. Leveraged loans typically have more restrictive covenants than high-yield bonds (although the gap is narrowing) and are generally secured, so recoveries on leveraged loans after default are generally better. Investors judge the relative values of each of these instruments on a company-by-company basis. With each of these asset classes "competing" with the other, over the years many leveraged loans have taken on more bond-like characteristics, thus blurring the traditional distinctions.

The Rising and Receding Tide of Covenant-Lite. When demand for leveraged loans is high (and borrowers have more leverage in negotiations) the trend is toward "looser" bond covenants, otherwise known as "covenant-lite". In covenant-lite loans, the borrower generally pays a premium in exchange for less restrictive covenants and no financial maintenance covenants (similar to high-yield bonds). While financial maintenance covenants test the borrower on a periodic basis, covenant-lite loan agreements typically only include "incurrence" covenants (which test the borrower upon a specific activity such as the incurrence of liens or debt, the making of acquisitions or restricted payments, etc.). Covenant-lite loans are viewed as having a greater risk of loss after default; with a covenant-lite loan, the first default is often a payment default, occurring long after a financial covenant default would have occurred. By that time, the borrower's financial condition is likely to have deteriorated substantially. Covenant-lite loans were popular before the financial crisis, dried up during the crisis and its aftermath, and have made a comeback in recent years.

The Rising (and perhaps Waning) Power of Equity Sponsors. Equity sponsors originate much of the work in the highly competitive and lucrative leveraged acquisition finance market and increasingly exercise their market power. "SunGard" provisions continue to be standard in commitment papers. SunGard provisions help equity sponsors who rely on financings to fund an acquisition to compete with strategic buyers who do not need such financing,

© Published and reproduced with kind permission by Global Legal Group Ltd, London

by aligning the conditionality of lending commitments closely to conditions in the acquisition agreement. More recently, some of the most prominent equity sponsors require loan arrangers to use the sponsor's form of commitment letter so the sponsor can more easily compare the proposals of different financing sources; some sponsors also even prepare initial drafts of loan documentation based on sponsor-friendly forms. But perhaps no development is more controversial than sponsors using their market power to "designate" acceptable counsel for arrangers and lenders, freezing out lawyers and law firms that appear to be "getting in the way of getting a deal done". However, the recent downturn in the United States leveraged lending market could signal a shift in the power of equity sponsors to dictate the terms of loan documentation. As discussed in more detail below, increased regulatory pressure has made it more difficult for lenders to make and hold highly leveraged loans and such regulatory pressure, when combined with other factors, including lower CLO issuances, has created a market environment in which lenders are beginning to see somewhat increased power in the negotiation of loan documentation with equity sponsors.

The Borrower's Desire for Flexibility: Unrestricted Subsidiaries, Equity Cures, Builder Baskets, and Incremental Facilities. All equity sponsors and borrowers desire flexibility in their financing documents. This comes in many forms. The "unrestricted subsidiary" concept is consistent with features seen in bond indentures and this feature has become much more common in leveraged loan documentation. These provisions typically exclude specified subsidiaries from coverage in the representations, covenants and events of default, thus allowing a borrower to use an unrestricted subsidiary to incur indebtedness and liens or make investments without being subject to loan agreement restrictions. In effect, the lender loses the ability to monitor or restrict the unrestricted subsidiaries. A trade-off is that financial attributes of the unrestricted subsidiaries are excluded from the loan agreement provisions (including any benefit the borrower may have otherwise realised from cash flow generated by such subsidiaries for purposes of loan agreement financial ratios). "Equity cures" remain common fare. An equity cure allows a borrower's shareholders to make an additional equity investment in the borrower to cure breaches of its financial covenants. Loan agreements also continue to give borrowers more flexibility around so-called "builder baskets" which provide the borrower with more alternatives for using its excess cash flow. Typically, borrowers are permitted to use builder baskets for capital expenditures, permitted investments and acquisitions, and sometimes for equity distributions and repayment of subordinated debt (subject to leverage governors). Non-committed incremental facilities also remain common fare in loan agreements, permitting in some cases an uncapped amount of additional debt, so long as certain *pro forma* leverage ratios are satisfied.

The Regulatory Environment: Pushing the Needle in the Opposite Direction? While the Federal Reserve kept interest rates low to boost economic activity, other federal regulators with a mandate to protect the US economy from excessive risk-taking associated with the financial crisis have helped push the needle in the opposite direction by increasing the cost of making loans. For example, the "Guidance on Leveraged Lending" issued by federal regulators, and which became effective in May 2013, applies to all federally supervised financial institutions that are substantively engaged in leveraged lending activities. The guidance outlines high level principles to assist institutions in establishing safe and sound leveraged finance activities and will likely increase lending costs as lenders re-evaluate their internal policies and programs and tighten their underwriting standards. This already has had an effect, for example, by decreasing the issuance of covenant-lite loans in 2015. "Risk retention rules" and the "Volcker Rule" could seriously impact CLO managers and banks that structure, warehouse and make markets in CLOs. The final Volcker Rule was released on December 10, 2013, and will limit certain investing and trading operations of banking entities. In addition, banking entities engaged in permitted fund activities and permitted trading will be required to create extensive compliance programs and meet new reporting requirements. Although the Federal Reserve extended the Volcker compliance period to July 2017, the new reporting requirements became effective in June 2014. The foregoing, combined with CLO capital requirements under Basel III, very likely had a chilling effect on CLO issuances in the United States during 2015, with CLO issuance declining significantly from the CLO issuance levels seen in 2014.

Sanctions and Anti-Corruption Laws. Federal regulators have recently increased their enforcement of sanctions, anti-terrorism and anti-corruption laws, meting out record fines. In addition to being more strident in their due diligence of borrowers, lenders are requiring stronger provisions in loan agreements to try and address these issues (and to demonstrate to regulators that they are doing the same). These provisions typically require the borrower and its affiliates to comply with sanctions regulations enacted by the US and other applicable authorities, to not use any borrowed proceeds in restricted countries or in doing business with restricted entities, and to comply with and have policies to comply with anti-bribery laws. Borrowers sometimes attempt to negotiate these provisions, including by adding materiality or knowledge qualifiers, with some limited success.

FATCA. In an effort to fill the government tax coffers, the Foreign Account Tax Compliance Act ("FATCA"), which became effective July 1, 2014, is a major revamp of the US withholding tax regime. FATCA imposes a 30% gross withholding tax on certain amounts, including interest and, by January 1, 2019 at the earliest, principal, paid by US borrowers to a foreign lender unless that lender (i) enters into an agreement with the IRS to identify and report specified information with respect to its US account holders and investors, or (ii) is resident in a jurisdiction that has entered into an intergovernmental agreement (an "IGA") with the United States pursuant to which the non-US government agrees to report similar information. This sweeping law could have a significant impact on loan payments and receipts and have prompted loan parties to manage FATCA risk (express allocation of risk set forth in loan documentation, operation of gross-up clauses, etc.). In the US loan market, for example, loan agreements now typically contain provisions whereby any FATCA withholding is exempt from a borrower gross-up obligation, and a borrower may request information from a lender to determine whether such lender is in compliance with FATCA.

The Courts: Pay Attention to UCC Filings! A recent case in the United States Court of Appeals for the Second Circuit concerning perfection of security interests under the Uniform Commercial Code ("UCC") attracted much attention. In *The Official Committee of Unsecured Creditors of Motor Liquidation Company v. JP Morgan Chase Bank*, JP Morgan mistakenly filed a UCC termination statement for the collateral securing a term loan. The Second Circuit held that because JP Morgan authorised the filing of the mistaken termination statement, the filing was effective and JP Morgan's security interest under a $1.5 billion term loan was no longer perfected, regardless of what JP Morgan subjectively wanted to accomplish. This decision emphasised the importance of paying close attention to UCC financing statement filings and terminations of any such filings.

Bankruptcy Reform. In December 2014, the American Bankruptcy Institute (the "ABI") released its long-awaited report recommending changes to the US bankruptcy code. The recommendations mostly targeted the rights of secured creditors, including, among other things, changes to valuation for adequate protection and qualification for DIP financing. The recommendations have generated much

© Published and reproduced with kind permission by Global Legal Group Ltd, London

commentary in the lending community and financial press and, despite the "blue-ribbon" luminaries on the panel, mixed reviews. Many loan market participants feel the overall effect of the revisions would be to materially reduce secured loan recoveries in a default. When the ABI released its report, it made clear that part of the intent of the report was to open a meaningful dialogue over bankruptcy reform and the debate over the proposed reforms continued throughout 2015 and will likely continue during 2016. However, given the current nature of partisan politics in the United States Congress, it very unlikely that any meaningful bankruptcy reform legislation will be passed in the near future by Congress; therefore, the focus has shifted to potentially implementing certain of the ABI's proposals at the bankruptcy court level, whether by bankruptcy judges adopting proposals unilaterally in individual cases or by the bankruptcy courts adopting certain of the proposals as "best practices".

Continued Innovations in the Loan Markets. Given the depth and breadth in the loan markets in the US, many loan market innovations originate or are further developed here (consider, for example, the development of a sophisticated secondary trading market, certain mezzanine and second-lien structures, the securitisation of loans and CLOs). Some recent innovations include the following:

The Unitranche Facility. One innovation that remained popular in 2015 is the so-called "unitranche" facility. Unitranche loans combine what would otherwise be separate first/second-lien or senior/mezzanine facilities into a single debt instrument, where all the debt is subject to the same terms, and with a blended interest rate. Lenders in unitranche facilities typically enter into a so-called "agreement among lenders" ("AAL") which legislates payment priorities among lenders in a manner that may not be visible to the borrower. One advantage of unitranche loans for a borrower is speed and certainty of closing (important in a competitive acquisition process), since negotiation of an intercreditor agreement is not a condition to funding. Another advantage for the borrower is the simplicity of decision-making during the life of the loan since there is no "class voting" from the perspective of the borrower (though the AAL may impact voting issues in ways not visible to the borrower). The use of these facilities has so far been restricted to the middle-market, and lenders of unitranche loans are typically finance companies and hedge funds (and not banks). 2015 saw increased complexity in the terms of AALs, and borrowers and their equity sponsors have had some success in seeking disclosure of terms of AALs, especially with respect to voting. The use of AAL's in unitranche structures was bolstered by the United States Bankruptcy Court's implicit recognition in March 2015 in the *In re RadioShack Corp.* bankruptcy of the court's ability to construe and enforce the provisions of an AAL (to which the borrower is not a party) in a borrower's bankruptcy. It is noteworthy that prior to the *RadioShack* bankruptcy, the enforceability of an AAL had not been tested in a borrower's bankruptcy proceeding.

Litigation Finance. While more commonplace in countries such as Australia, the business of litigation finance has gained traction in the United States and is poised for growth. A common type of litigation finance occurs when a third party investor provides funds to a plaintiff (or plaintiff's attorney) in exchange for a contractual commitment to receive a share of the award or settlement (or contingency fee) resulting from litigation. Such financing is typically limited recourse, and the investor is only repaid if the plaintiff (or plaintiff's attorney) wins an award, though investors can realise significant returns, usually a multiple of their initial investment. Litigation finance has its share of critics, including those who characterise such finance as "turning the court system into a stock exchange". Other legal observers argue litigation finance helps to "level the playing field" when parties in litigation have unequal financial or bargaining positions. In recent years, established financial institutions and new investment firms have raised hundreds of millions of dollars to invest in litigation finance and the US market will likely see an increase in this form of financing in the future.

Peer-to-Peer Lending. Peer-to-peer ("P2P") lending is a form of financing that allows lenders and borrowers to bypass traditional brick-and-mortar lenders by connecting through online platforms. While many believe P2P lending will not enter the corporate lending markets in the foreseeable future, P2P lending already reaches other asset classes such as residential and commercial real estate and car loans, with corporate lending perhaps not far behind. In light of the recent strong growth of P2P lending, federal and state regulatory regimes within which it operates continue to evolve and it has garnered attention from the SEC. Critics believe P2P platforms will have to overcome fraud issues as the platforms become more prominent in the lending markets. In any event, this innovative source of financing has attracted attention from Wall Street and will continue to evolve.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Given the large number of transactions in the US corporate loan markets, it is difficult to differentiate certain lending transactions as being more significant than others. Any such comparison necessarily excludes transactions for which documentation is not publicly available and therefore favours large corporate deals filed with the SEC compared to those in the middle-market, where much loan product innovation takes place. Nevertheless, some transactions that illustrate some of the concepts discussed above include: *Covenant-Lite*: Lannett Company, Inc. (November 25, 2015); and Eldorado Resorts, Inc. (July 23, 2015). *Equity Cures*: Cambium Learning Group, Inc. (December 10, 2015); and Party City Holdings Inc. (August 19, 2015). *Builder Baskets*: Mattress Holding Corp. (October 20, 2014); and Texas Competitive Electric Holdings Company LLC (May 5, 2014). *Unrestricted Subsidiaries*: Albany Molecular Research, Inc. (October 24, 2014); and Verifone, Inc. (July 8, 2014). *Incremental Facilities*: Ancestry.com Inc. (August 28, 2015) and Six Flags Theme Parks Inc. (June 30, 2015).

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Generally, yes. In the US, guarantees are commonly referred to as one of three types: (a) "downstream" guarantees, whereby a parent company guarantees the debt of a subsidiary; (b) "upstream" guarantees, whereby a subsidiary guarantees the debt of a parent; and (c) "cross-stream" guarantees, whereby a subsidiary guarantees the debt of a "sister company". Generally, "upstream" and "cross-stream" guarantees may be subject to increased scrutiny given enforceability issues in the context of a bankruptcy, as further described below.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

First, as a matter of contract law, some "consideration" (bargained-for contractual benefit to the guarantor) must be received for the guarantee to be enforceable, though this contract law threshold is typically easy to meet.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

As a matter of insolvency law, certain types of enforceability issues arise in the context of a bankruptcy. These issues are analogous to, but not the same as, contractual concepts of "consideration". With downstream guarantees, there is typically little concern, since the parent will indirectly realise the benefit of a loan through the value of its equity ownership of the subsidiary (unless the subsidiary is already, or is rendered, insolvent). However, "upstream" and "cross-stream" guarantees should be subject to increased analysis since the benefit to the guarantor is less evident.

For example, a guarantee or other transaction may be voided by a bankruptcy court in the US if it is found to be a "fraudulent transfer". Very generally, under the federal Bankruptcy Code, a guarantee may be considered a fraudulent transfer if, at the time the guarantee is provided, (a) the guarantor is insolvent (or would be rendered insolvent by the guarantee), and (b) the guarantor receives "less than reasonably equivalent value" for the guarantee. (Note that both prongs of the test must occur in order for the guarantee to be voided as a fraudulent transfer; if the guarantor receives "less than reasonably equivalent value" though is nevertheless solvent at the time the guarantee is provided (after giving effect to the guarantee), then the guarantee should not be voided as a fraudulent transfer.) As mentioned above, in a downstream guarantee context, the parent would more likely receive "reasonably equivalent value", therefore fraudulent transfer is less of a concern for these types of guarantees. In addition to the federal Bankruptcy Code fraudulent transfer test, under state laws there exist similar fraudulent transfer statutes and a federal bankruptcy trustee may also use these tests to void the guarantee in a bankruptcy.

Loan documentation will often provide for solvency representations from borrowers and guarantors in order to address fraudulent transfer concerns. In some high-risk transactions (such as acquisition loans or loans provided so the borrower can make a distribution to shareholders), a third party is required to provide a solvency opinion in order to provide protection from fraudulent transfer attack, though the more common practice today is for lenders to do their own analysis given the expense of such outside opinions.

Under relevant corporate law, if a guarantee or similar transaction is structured in such a way that it would be tantamount to a distribution of equity by a company while the company is insolvent (or is rendered insolvent), or would impair the company's capital, the transaction may be improper under the corporate law and could result in director liability. See also question 2.3 below for a general discussion of corporate power issues.

2.3 Is lack of corporate power an issue?

Entity power to enter into a guarantee is generally governed by the corporation (or equivalent) law in the state in which the company is organised, as well as the company's charter and bylaws (or equivalent documentation).

For corporations, the corporation law of most states provides a broad range of permitted business activities, so few activities are considered to be *ultra vires* or beyond the power of a corporation (note that certain special purpose or regulated entities, such as banks, insurance companies, and utility companies, may be subject to additional statutes which impact corporate power). In a lending context, however, many state corporation statutes limit the power of subsidiaries to guarantee the indebtedness of a corporate parent or a sister company, and a guarantee may be *ultra vires* if not in furtherance of the guarantor's purposes, requiring analysis of the purpose of the guarantee and the benefit to the guarantor. If the benefit to the guarantor is intangible or not readily apparent, this may provide additional concern. Many corporate power statutes, however, provide safe harbours for certain types of guarantees, irrespective of corporate benefit, including if the guarantor and the borrower are part of the same wholly owned corporate family, or if the guarantee is approved by a specified shareholder vote, for the guarantor entity. For limited liability companies, state statutes are usually more generous, with a limited liability company generally able to engage in any type of legal activity, including entering into guarantees, unless the charter provides otherwise.

In lending transactions in the US, the analysis that a company has the corporate or other requisite power to enter into a guarantee is often provided in a legal opinion provided by the guarantor's internal or external counsel (though these opinions will typically assume away the tough factual issues, such as the level of corporate benefit).

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In addition to having "corporate power" (or equivalent power for other types of entities) to enter into a guarantee, the guarantee must be properly authorised, which generally means that the procedural rules of the corporation, as set forth in its charter or by-laws, must be followed and that the stockholders or the governing board take the proper measures to authorise the transaction. These procedures are customary and also typically covered in a legal opinion provided by the guarantor's counsel.

One situation that requires special attention in a guarantee context is when a guarantor is providing an upstream or cross-stream guarantee, and the guarantor has minority shareholders. In this context, often the consent of the minority shareholders would be required in order for the guarantee to be provided in order to address fiduciary duty concerns.

Generally, no governmental consents, filings or other formalities are required in connection with guarantees (though, as noted above, certain special purpose companies and regulated entities may be subject to additional requirements).

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Yes; please see question 2.2.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Generally, no. However, there are a few other issues worth mentioning that do not relate to "enforcement" *per se*. For example, there may be withholding tax issues if the payment is to a foreign lender (please see question 6.1).

Also, there may be adverse US tax consequences for a US borrower resulting from the involvement of any foreign subsidiary guaranteeing the debt of a US borrower. Under US tax rules, such a guarantee could be construed to result in a "deemed dividend" from the foreign subsidiary to the US parent in the full amount of the guaranteed debt, and this deemed dividend would generally be subject to US tax. The same result could apply if collateral at the foreign subsidiary is used to secure the loan to the US parent, or if the US parent pledges more than 66% of the stock of a first-tier foreign subsidiary. These types of tax issues are important to consider when structuring a transaction with credit support from foreign subsidiaries of US companies. There are many ways to address these types of issues, including having the loans made directly to the foreign subsidiary.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

A wide variety of assets (including land, buildings, equipment, inventory, accounts, contract rights, investment property, deposit accounts, commercial tort claims, etc.) are available for use as security for loan obligations with many of the most common types of collateral described more fully below. Assets used as security are often divided into two broad categories: (a) "personal property" which generally refers to property other than real property (land and buildings); and (b) real property.

The Uniform Commercial Code ("UCC") provides a well-developed and predictable framework for providing security interests in a wide variety of personal property assets. The UCC is a state law statute rather than a federal one, but the UCC has been adopted by all 50 states in the US and the District of Columbia, with only a few non-uniform amendments of significance.

Under the UCC, when a security interest "attaches", it becomes enforceable as a matter of contract by the lender against the borrower. "Attachment" typically occurs when credit is extended to the borrower, the borrower has ownership or other rights in the collateral in which to grant a security interest, and the borrower signs and delivers to the lender a written security agreement describing the collateral.

After attachment, the security interest must be "perfected" by the lender in order for the lender's security interest to have priority over the rights of an unsecured creditor who later uses judicial process to obtain lien on the collateral. Since a federal bankruptcy trustee has the same status as a state law judicial lien creditor under US law, a bankruptcy trustee will be able to set aside the security interest if the security interest is not perfected.

The method of perfecting a security interest under the UCC depends on the type of collateral in question. The most common method of perfecting a security interest is by "filing" a financing statement in the appropriate state filing office. The UCC provides specific rules for where to file a financing statement, with the general rule that the filing takes place in the jurisdiction where the borrower is located. A borrower organised under a state law in the United States as a corporation, limited partnership, limited liability company or statutory trust is considered to be located in the state in which it is organised. The filing contains only brief details including the name of the borrower, the name of the secured party and an indication of the collateral, and the filing fee is generally fairly nominal. Security interests in some collateral may be perfected by "possession" or "control" (including directly-held securities, securities accounts and deposit accounts). A security interest in certain collateral may be perfected by more than one method.

If two or more lenders have perfected security interests in the same collateral, the UCC provides rules for which lender has "priority" over the other security interest. This is usually determined by a "first-in-time" of filing or perfection rule, but there is a special rule for acquisition finance ("purchase-money") priority and special priority rules also apply to certain collateral (e.g., promissory notes, investment securities and deposit accounts) if a security interest is perfected by possession or "control".

In addition, security interests in certain types of personal property collateral may to some extent be governed by federal statutes and pre-empt the UCC rules. For example, the perfection of a security interest in an aircraft is governed by the Federal Aviation Act and the perfection of a security interest in a ship above a certain tonnage is governed by the federal Ship Mortgage Act.

The requirements for taking a security interest in real property (referred to as a "mortgage" or "deed of trust" in the US) are determined by the laws of the state where the real property is located. Typically, the office in which to file the mortgage or deed of trust is in the county of the state where the land is located. These statutes are fairly similar from state to state, but less consistent than the rules for personal property. As a result, mortgage documents from state to state appear quite different, while security agreements with respect to personal property (governed by the more consistent UCC of each state) are more uniform. Lenders often obtain a title insurance policy in order to confirm the perfection and priority of their security interest in real property.

A security interest in fixtures (personal property that permanently "affixes" to land) is generally perfected by filing in the place where the real property records are filed. A security interest in fixtures may be perfected under the UCC or under the local real estate law.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

In general, a single security agreement can cover all UCC personal property which is taken for security as a loan, no matter where the personal property is located.

With respect to real property, generally a separate mortgage or deed of trust document is used for each state where real property is located, given that the mortgage document is typically governed by the laws of that particular state.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Please see question 3.1.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. Receivables are considered personal property, and a security interest in the receivables granted under a security agreement would typically be perfected by filing a financing statement in the appropriate filing office. If the receivable is evidenced by a promissory note or bond or by a lease of or loan and security interest in specific goods, the receivable may also be perfected by the lender's possession or "control". Debtors on the receivables are not required to be notified of the security interest in order for perfection to occur.

The security agreement can grant a security interest in future receivables. An already filed financing statement will be effective to perfect a security interest in a future receivable when it arises.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. A security interest granted under a security agreement in a deposit account as original collateral must be perfected by control (not by filing). To obtain control of the deposit account, a secured lender typically enters into a control agreement with the borrower and the institution that is the depositary bank by which the bank agrees to follow the lender's instructions as to the disposition of the funds in the deposit account without further consent of the borrower.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Many depositary banks have forms of control agreements which they will provide as a starting point for negotiations. (However, if the secured lender is also the depositary bank or the lender becomes the depositary bank's customer on the deposit account, control is established without the need for a control agreement to perfect the security interest.)

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under an English law governed document? Briefly, what is the procedure?

Yes. Companies are typically incorporated under the laws of individual states in the US, and usually not under federal law. Shares may be issued in either certificated or uncertificated form.

A security interest may be created by either a New York law or English law-governed security agreement. If the security agreement is governed by English law, the UCC in New York requires that the transaction bear a reasonable relationship to England for the choice of law clause to be enforceable. (Please also see question 7.1 as to the extent a court in New York will enforce a contract that has a foreign governing law.)

In general, a security interest in such directly-held shares can be perfected either by filing or by control, though perfection by control has priority. The law governing perfection of such security interest in certificated securities depends on whether perfection is achieved by filing (location of debtor) or by control (location of collateral).

If the shares are credited to a securities account at a bank or broker and are therefore indirectly held, a borrower's interest in the securities account can be perfected either by filing or control. Once again, perfection by control has priority. The law governing perfection of a security interest in a securities account depends on whether perfection is achieved by filing (location of debtor) or by control (location of bank or broker as determined usually by the law governing the securities account relationship).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. Please see question 3.1. A security interest may be granted under security agreement and may be perfected by the filing of a financing statement in the appropriate UCC filing office. Perfection may also be achieved by possession, though this method is seldom practical from a secured lender's perspective.

The security agreement can grant a security interest in future inventory. An already filed financing statement will be effective to perfect a security interest in a future inventory when it is created or acquired.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes to both (i) and (ii). Note that with respect to item (ii), a guarantor would be subject to the same fraudulent transfer analysis discussed in question 2.2.

A security agreement may also secure obligations relating to future loans. An already filed financing statement perfecting a security interest securing existing loans will be effective to perfect a security interest in a future loan when the loan is made.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

With respect to personal property governed by the UCC, and the filing of financing statements, there are typically no material costs and UCC filing fees are usually minimal.

With respect to real property, there may be significant recording taxes and fees. These taxes and fees will depend on the state and local laws involved. A number of practices are used in loan transactions in an attempt to minimise such costs. For example: in the case of refinancings, lenders may assign mortgages rather than entering into new mortgages; and in the case of mortgage tax recording states, lenders may limit the amount secured by the mortgage, so that the mortgage tax payable is set at a level commensurate with the value of the property as opposed to the overall principal amount of the loans.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Please see question 3.9. In terms of a time-frame, UCC personal property security interests may be perfected in a matter of days. Real property security interests typically take longer, though they can usually be completed in a couple of weeks.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally no, except in the case of certain regulated entities where consent of the regulatory authority may be required for the grant or enforcement of the security interest.

Also, please see question 2.6 for a quick summary of tax issues that may arise in connection with foreign subsidiaries providing guarantees or collateral to secure loans to US borrowers.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Under the UCC, many traditional concerns under revolvers have been addressed by the "first to file or perfect" rule, though lenders should be aware of certain priority issues. For example, with respect to secured creditors who each have perfected security interests in UCC collateral, as stated previously certain "purchase-money" security interests and security interest in certain collateral perfected by possession or control may obtain over a security interest perfected merely by the filing of a financing statement. In addition, tax liens and some other liens created outside of the UCC may obtain priority over a UCC perfected security interest. Judgment liens may pose a priority problem for future advances, and tax liens may pose a priority problem for some after-acquired property and future advances. Otherwise, under the UCC, the first secured creditor to "file or perfect" has priority

With respect to real property, the matter is less clear. As a general matter, absent special legislation in the state, future loans may not have same priority as loans advanced when the mortgage or deed of trust is recorded if there is an intervening mortgage, deed of trust or lien recorded before the future loan is made. Accordingly, a close

© Published and reproduced with permission by Global Legal Group Ltd, London

review of state rules and individual state documentary requirements is required in order to ensure priority.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

With respect to UCC collateral, the documentation requirements are spelled out clearly in the UCC and the requirements generally are straightforward. No notarisation is required. Under prior versions of the UCC, the debtor was required to sign a written security agreement, though as the world moves away from paper and into electronic media, the model UCC, including the UCC as adopted in New York, now requires the debtor to "authenticate a record" that may include an electronic record. Nevertheless, most lenders in corporate loan transactions still generally require a written security agreement. With respect to real property collateral, the documentary and execution requirements tend to be more traditional by looking to a writing, but various law reform efforts are underway to permit electronic mortgages and deeds of trust and electronic recording of mortgages and deeds of trust. The requirements may vary significantly from state to state (for example, real property mortgages often require notarisation under state law, whereas this is generally not the case for UCC collateral).

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

(b) Shares of any company which directly or indirectly owns shares in the company

(c) Shares in a sister subsidiary

Generally no. There is no "financial assistance" law *per se* in the United States, but please see the discussion of fraudulent transfer and related principles described in question 2.2.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. In loan documentation, the role is typically that of an "agent", with bond documentation typically using a "trustee".

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable; please see question 5.1.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

In a syndicated lending transaction that includes a lender acting in an agency capacity, a guarantor typically would provide a guaranty to the agent "for the benefit of the lenders under the loan agreement" (or some similar formulation). As such, it should not be necessary for a guarantor to sign the transfer (assignment) documentation in order to be bound, though the contractual language should be carefully reviewed for specific requirements. In the case of a bilateral loan, the contractual terms should also be closely reviewed, though it is advisable to obtain the guarantor's consent to such assignment in any event.

6 Withholding, Stamp and other Taxes; Notarial and other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

There is no US federal income tax withholding from payments of interest or principal to US lenders, provided certain documentation requirements are complied with. With respect to the payment of interest to foreign lenders (other than such payments to a US branch of a foreign lender that is engaged in business in the US), the general rule is that a withholding rate of 30% is applied to the gross amount of payments constituting interest and other income (but, subject to the discussion of FATCA below, not to principal). The US has in place bilateral treaties with many jurisdictions, which reduce or entirely eliminate this withholding tax for qualifying foreign lenders. A listing of these treaties is available at http://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-Treaties---A-to-Z. Such withholding taxes may also be avoided if the requirements of the so-called "Portfolio Interest Exemption" are satisfied. This exception is generally not available to banks, but could be available to non-bank lenders such as hedge funds. Note that under FATCA (mentioned in question 1.1), foreign lenders generally will be required to identify and report directly to the US Internal Revenue Service information about accounts in such institutions that are held by US taxpayers. The failure to comply with FATCA would result in withholding as discussed above even for treaty-resident lenders, which would then be required to file a refund claim pursuant to the applicable bilateral tax treaty to recoup any amounts withheld. Generally, the proceeds of a claim under a guarantee or the proceeds of enforcing security are taxed in a manner similar to payments made directly by the borrower.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders?

The US federal government has generally provided few incentives targeted to foreign lenders (as there has not been a policy focus on promoting foreign loans into the United States), though please refer to the bilateral tax treaties and Portfolio Interest Exemption referred to in question 6.1.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

In general, a foreign lender, with no presence or activities in the US, does not become subject to US federal income taxation on its net income solely as a result of loaning to, or receiving a guarantee or grant of security from, a borrower or guarantor in the US. However, income derived specifically from a loan made to a US borrower (i.e., interest and other income) would be subject to gross-basis US taxation, typically at a rate of 30%, unless a treaty specified a lower rate, or the Portfolio Interest Exemption applied (please see question 6.1). Moreover, if a foreign lender has a presence or activities in the United States (for instance, employees or agents working out of, or a lending office located in, the US), the foreign lender could be viewed as being engaged in a trade or business in the US, and if so would be subject to net-basis US taxation on any income deemed "effectively connected" with that trade or business.

6.4 What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration? Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

With regard to mortgages and other security documents, there are generally no taxes or other costs applicable to foreign lenders that would not also be applicable to lenders in the US (please see question 3.10 for a general summary of such costs).

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

If a corporation is "thinly capitalised" and certain other factors are present, the US tax authorities may assert that instruments described as debt actually constitute equity for US tax purposes. The effect of such re-characterisation would be that payments on the instrument would not be deductible to the borrower for US federal income tax purposes and could be subject to withholding in a manner different than interest payments (for instance, because the Portfolio Interest Exemption would not be available). Moreover, even if treated as debt, US tax rules may deny a deduction (in whole or in part) for payments of interest by a thinly capitalised borrower (i.e., a borrower with a debt to equity ratio in excess of 1.5 to 1) to a "related party" that is exempt from US federal income tax on the interest, taking into account any treaty-based reductions in tax rate. If the lenders are organised in a jurisdiction other than that of the borrower, this should not impact the thin capitalisation analysis itself, but, as mentioned above, may impact the withholding rate as well as any relevant "gross-up".

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Generally, yes, so long as the choice of law bears a "reasonable relation" to the transaction and application of the foreign governing law would not be contrary to the public policy of the forum state.

On a related note, in connection with a choice of *New York* law as a governing law, a New York statute allows for New York law to be chosen by parties to a contract and, with certain exceptions, such choice of law will be given effect by New York courts if the transaction exceeds $250,000 in value, regardless of whether the choice of New York law bears any reasonable relationship to the transaction. (The choice of New York as a forum is subject to additional requirements under the statute.) California has a similar statute.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company by English courts (a "foreign judgment") without re-examination of the merits of the case?

In most instances, yes. Despite the strong commercial ties between the United States and the United Kingdom, there is no international treaty on reciprocal recognition and enforcement of court judgments (attempts to come to terms on a bilateral treaty in 1981 broke down over the negotiation of the final text). Nevertheless, the Uniform Foreign Country Money Judgments Recognition Act has been adopted by most states (including New York) and sets out basic rules of enforceability in connection with the enforcement of judgments between states in the United States, with "foreign-country" judgments treated in a similar manner as the judgment of a sister state. Generally, if a judgment is obtained in accordance with procedures compatible with United States due process principles, it will be recognised under the Uniform Act. There are many examples of English judgments having been enforced in New York courts.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In New York, a court could rule almost immediately, perhaps within three to six months or fewer, with enforcement against assets of the company in New York beginning as soon as the judgment was entered (unless the defendant obtained a stay of enforcement). However, in practice, particularly if an opposing party appears and raises procedural or other issues; matters could take materially longer, up to a year or more.

Enforcement of a foreign judgment is generally pursued in New York by having the foreign judgment "confirmed", with time frames similar to those mentioned above.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

In a non-bankruptcy context, the timing and restrictions that apply to enforcement of collateral can vary significantly, depending on the type of collateral and relevant state law that applies. The UCC provides a great deal of flexibility in the rules governing disposition of personal property collateral (see question 3.1). The UCC generally permits either "private" or "public" sale, with the only real limitation on the power to sell that the secured party must "act in good faith" and in a "commercially reasonable manner". Under the UCC, after the sale, the secured party generally may pursue the debtor for amounts that remain unpaid (the "deficiency"). The requirements with respect to real property collateral will vary significantly from state to state (and note in particular that in California, there may be limitations with respect the ability of a creditor to collect on a deficiency if the creditor is secured with real property collateral). With respect to regulated entities (including certain energy and communications companies) enforcement may require regulatory approval.

In a bankruptcy context, enforcement would be restricted by the automatic stay (please see question 8.1).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

For the most part, distinctions will not be made between foreign and domestic creditors in such proceedings. However, there are certain issues a foreign lender would need to consider in connection with such activities. For example, generally a foreign creditor will need to be authorised to do business in New York before availing itself as a plaintiff of the New York courts. In addition, foreign creditors may be subject to federal or state limitations on or disclosure requirements for the direct or indirect foreign ownership of certain specific types of companies or collateral, including in the energy, communications and natural resources areas.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, please see question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The United States is party to the New York Convention. As set forth in the Convention, the Convention requires courts of contracting states to give effect to private agreements to arbitrate and to recognise and enforce arbitration awards made in other contracting states, subject to certain limitations and/or potential challenges. Note, however, that loan agreements under New York law generally do not include arbitration clauses.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In the US, a bankruptcy proceeding may be initiated by either the company (debtor) itself or by its creditors. Once the proceeding is commenced, the relevant statutes in the United States (the "Bankruptcy Code") provide that an "automatic stay" immediately occurs. This automatic stay is effectively a court order that prevents creditors from taking any actions against the debtor or its property, including enforcement actions against collateral. A creditor that violates the automatic stay could face severe penalties, including actual damages caused to the debtor and other creditors, as well as having its enforcement action declared void (punitive damages are typically limited to individual, rather than corporate debtors).

There are, however, a number of protections for a secured creditor who has properly perfected its liens and such liens are not subject to avoidance. First and foremost, upon a liquidation of a debtor, a secured creditor is paid its claim (up to the value of its collateral) prior to the payment of general unsecured creditors or, alternatively, it may receive its collateral back in satisfaction of its secured claim. Also, in the case of a reorganisation of a debtor, cash collateral cannot be used by the debtor without specific authorisation from the bankruptcy court or consent of the secured party, and in other circumstances the Bankruptcy Code mandates that a secured party's interest in its collateral be "adequately protected".

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In short, yes. A lender's security interest could be voided as a "preferential transfer" if it is provided to the lender within 90 days before a bankruptcy filing (or one year if the lender is an "insider", or related party of the debtor) and as a result of the transfer the lender receives more than it would have otherwise received in the liquidation of the debtor. There are a number of exceptions to this rule, including where there has been a substantially contemporaneous exchange for new value. Please also see the discussion of "fraudulent transfers" in question 2.2.

There are certain claims that may have priority even over a properly perfected security interest, including tax liens, mechanics liens, and certain costs associated with the bankruptcy itself.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

There are a number of entities that are either excluded from the Bankruptcy Code or for which special provisions of the Bankruptcy Code or other special legislation apply, including banks, insurance companies, commodity brokers, stockbrokers and government entities and municipalities. Municipalities and government-owned entities (but not states themselves) are eligible for relief under Chapter 9 of the Bankruptcy Code.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes. The UCC allows for so-called "self-help" remedies without first commencing a court proceeding. Note that the relevant provisions of a security agreement and governing law should be considered before exercising these types of remedies. These remedies typically can only be used so long as no "breach of the peace" would occur. Subject to the above, the market generally accepts these types of remedies for collateral, such as bank accounts and certificated securities.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Generally, yes.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws ofyour jurisdiction?

Yes. The Foreign Sovereign Immunities Act ("FSIA") codifies the law of sovereign immunity in the US. The FSIA allows for such immunity to be waived, and generally upholds waivers, with some limitations (for example, non-commercial property of a sovereign cannot be attached). Certain organisations also receive immunity under authority separate from the FSIA: the International Organizations Immunity Act covers immunity for certain institutions like the IMF, the OECD and the African Union. One issue in connection with the enforcement of such waivers is whether a borrower actually had the immunity to waive when it provided a waiver. Such scenarios arise in the context of the nationalisation of a company. In such a case, a company may not have had any immunity to waive (since it was not previously owned by the state) when it entered into the loan, so any waiver provided prior to being taken over by a state may be considered void. For this reason, New York law-governed loan agreements often include a representation that a loan represents a "commercial act", which excludes the transaction from protection under relevant immunity statutes, whether or not such immunity was in fact effectively waived.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of in your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

In the US, a lender is not required to be a bank (indeed, many lenders are non-banks). A lender should be aware of any relevant state lending licensing laws which may require a lender to be licensed. These licensing laws are much more stringent in the consumer lending area than in the commercial or corporate lending area, though in any event are typically easier to obtain than a "banking licence". In some cases, one needs to be "in the business of making loans" in order for the licensing statute to be given effect (for example, the New York lender licensing law indicates those lenders who engage in "isolated, incidental or occasional transactions" are not "in the business of making loans" and therefore not covered for purposes of the statute). Non-compliance with a licence statute could have a material impact on the lender, from not being able to access a state's court system to having a loan be determined to be unenforceable. Whether an agent on a lending transaction would also need to be licensed will depend on the wording of each state's particular statute.

Note there are often contractual restrictions in New York law-governed loan documentation that require a lender be a certain type of organisation that is in the business of making loans. The rationale for this is many-fold, from securities law concerns to the preference of the borrower to only deal with sophisticated financial institutions should the loan be sold.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The material considerations to be considered in connection with a financing in the US will vary depending on the type of financing and the parties involved, and a discussion with counsel is encouraged before entering into any financing in the US. However, the above questions address many of the main material issues that arise.

Acknowledgment

The authors would like to thank Ed Smith, Alan Beloff, Charles Bogle and Neal Curtin for reviewing sections of this chapter.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Thomas Mellor

Morgan, Lewis & Bockius LLP
101 Park Avenue
New York, NY 10178-0060
USA

Tel: +1 212 309 6995
Email: thomas.mellor@morganlewis.com
URL: www.morganlewis.com

Thomas Mellor is a partner in Morgan Lewis's Banking and Leveraged Finance Group, Project Finance Group and Financial Restructuring Group. Tom has extensive experience representing banks and other financial institutions in structuring and negotiating a variety of debt finance transactions both in the United States and globally, including syndicated, club and bilateral lending transactions (investment grade and leveraged), as well as project finance and restructuring transactions. Tom is particularly experienced in cross-border financings (especially in Latin America, Europe and Asia) as well as financings with structural or other sorts of complexity. Tom is listed as *a leading lawyer in banking and finance* in *Chambers Global*, *Chambers USA*, *Chambers Latin America*, *The Legal 500 Latin America*, *IFLR 1000* and *Latinvex*. Tom is author of "*China's Investment in Latin America: Themes, Challenges and Future Trends*", which appeared in the Winter 2012 issue of *Global Infrastructure*.

Rick Eisenbiegler

Morgan, Lewis & Bockius LLP
101 Park Avenue
New York, NY 10178-0060
USA

Tel: +1 212 309 6720
Email: frederick.eisenbiegler@morganlewis.com
URL: www.morganlewis.com

Rick Eisenbiegler is a partner in the Banking and Leveraged Finance Group at Morgan Lewis. Rick is one of the country's leading leveraged finance lawyers and has extensive experience representing first and second lien senior lenders, mezzanine investors, and equity sponsors and borrowers in senior debt, mezzanine and private equity financing arrangements. His areas of focus include: acquisition, recapitalisation and other leveraged financings; cash flow and asset-based financings; debtor-in-possession and exit financings; cross-border financings; first lien, second lien and mezzanine financings; and restructurings, workouts and bankruptcies. Rick has appeared on a number of "leading lawyer" lists, including *The Best Lawyers in America*, *Super Lawyers*, *Chambers USA* and *Chambers Global*.

Morgan Lewis

Morgan Lewis's market-leading practices are focused on global financial services firms and Fortune 100 companies. We have approximately 2,000 lawyers in 29 offices in the US, Europe, the Middle East and Asia, including financial centres such as New York, London, Paris, Moscow, Frankfurt, Dubai, Singapore, Beijing and Tokyo. Our diverse practice covers a wide range of debt financings, including syndicated lending, leveraged and investment grade financings, cash flow and asset based financings, private note placements and multicurrency and cross-border financings.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Venezuela

Rodner, Martínez & Asociados

Jaime Martínez Estévez

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Domestic lending activities are to a large extent determined by compulsory lending mandated by law and regulations for the housing, tourism, agriculture and industrial sectors of the economy. International lending has been practically reduced to the financing of Government projects and, particularly, further development of the Orinoco heavy oil basin, which are not subject to the foreign exchange restrictions.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

International lending has been low, given the Venezuelan economic crisis. Recent major lending transactions are mostly in the oil sector and include those to Petrowarao S.A. (US$ 420 MM, Perenco), Petrocabimas (US$ 620 MM, Suelopetrol), Petrozamora (US$ 1,000 MM, Gazprombank), Petroquiri-quire (US$ 1,200 MM, Repsol), Petrolera Sinovensa S.A. (US$ 4,015 MM, China Development Bank Corporation), Petroboscán S.A. (US$ 2,000 MM, Chevron Boscan Finance B.V.), PDVSA Petróleo S.A. (US$ 1,000 MM, Credit Suisse A.G.) and Petrobicentenario S.A. (US$ 1,742 MM, ENI Investments Plc.).

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

There are no particular legal restrictions for intercompany loans. However, tax provisions on presumed dividends and transfer pricing could be applicable.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

No, absent a conflict with the corporate charter or an insolvency situation.

2.3 Is lack of corporate power an issue?

Definitely. If there is no capacity to issue the consent, the act would not be valid (Article 1141 of the Civil Code and Articles 243 and 270 of the Commercial Code).

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental consent or filing is required. Shareholder approval would be necessary if the respective charter and by-laws establish that the power to guarantee third party obligations rests on the shareholders.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

None, except that the enforceability of the guarantee could be set aside if given while insolvent (Article 946 of the Commercial Code).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There has been an exchange control in effect since 2003. Conversion of local currency into foreign currency ordinarily requires a governmental authorisation (from CENCOEX or the Central Bank). A new system, named SIMADI, was created on February 10, 2015, for the free conversion of local currency into foreign currency. The system has failed to satisfy local demand. There is no prohibition on Venezuelan companies holding foreign currency assets abroad. If the guarantor has foreign currency funds abroad, it can make the payment in foreign currency without authorisations. Government-controlled entities require Central Bank authorisation to hold foreign currency abroad.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Security interest can be created over tangible and intangible assets, including real estate, chattel property, inventory, a business establishment, credit rights, intellectual property rights, shares and other securities.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Depending on the type of collateral, the security interest document will vary. Some security interest can be created by way of a mortgage (e.g. real estate, chattel property) and others pursuant to a pledge (e.g. shares, account receivables). Some require governmental authorisation and special filings. A single security interest document can cover different types of collateral and forms of encumbrance (mortgage, pledge without transfer of possession). Registrations of the same security interest document may be done in registries of various municipal jurisdictions.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

A real estate mortgage may cover the land and the plant (governed by the Civil Code, Article 1877), and the machinery and equipment may be covered by a chattel mortgage (governed by the Chattel Mortgage and Pledge Without Transfer of Possession Act). The mortgage document must be registered in the registry with jurisdiction over the location of the assets.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security interest may be taken over receivables by way of a pledge. The pledge agreement must be executed before a notary or filed with a notary (to have a certain date). Notice must be given to the debtors (notice of transfer as security interest, Article 1550 of the Civil Code).

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A pledge agreement can be entered into in connection with the rights associated with a bank or brokerage account. Notice must be given to the bank or brokerage entity holding the account.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Shares of a Venezuelan corporation may be pledged. In addition to executing a pledge agreement, a transfer as security interest note should be inscribed in the shareholders registry book of the corporation. Share certificates are commonly issued (Article 293 of the Commercial Code). However, the transfer of the rights of a shareholder is done by a note in the shareholders registry book (Article 296 of the Commercial Code). The agreement must be governed by Venezuelan law (Articles 20, 27 and 37 of the International Private Law Act).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security interest can be taken over inventory by way of a chattel mortgage (Article 30 of the Chattel Mortgage and Pledge Without Transfer of Possession Act) or pursuant to an arrangement with an authorised general warehouse and delivery of warehouse certificates (in accordance with the General Deposit Warehouses Act).

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A security interest can be granted to several creditors and for different transactions. However, if different creditors are receiving a security interest with respect to different transactions, ranking of the security interest and inter-creditors agreements may be necessary.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The notarisation charges for documents creating security interest are not calculated based on the type or value of the assets but rather on the particulars of the document (e.g. number of pages). Registrations of security interests, however, generate fees which are calculated based on the value assigned to the security interest. The registration fees will be calculated pursuant to a progressive rate of up to 0.60% (Article 83 of the Public Registry and Notary Act).

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

When authorisations are required, the procedure may be a lengthy one. Registration of complex transactions may also require extra time. When the assets are located in different jurisdictions, the security interest document may need to be registered in all of the registries with jurisdiction over the different locations, which may prove to be a long process.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Chattel mortgages and pledges without transfer of possession can only be created in favour of qualified secured creditors, including foreign banks authorised by the Superintendency of Banks (Article 19 of the Chattel Mortgage and Pledge Without Transfer of Possession Act). To request such an authorisation, a draft of the security interest document must be presented.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There is no problem in creating a security interest with respect to a revolving credit facility. Priority of mortgages will be set by the date of registration.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Mortgage documents must be registered. Registration must be done in the registry office with jurisdiction given by the location

© Published and reproduced with kind permission by Global Legal Group Ltd, London

or the type of asset. Pledges are to be executed before a notary, or a counterpart of the pledge agreement must be filed with a notary soon after.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Guarantees and security interest can be provided to support financing for the acquisition of shares, except that there is a prohibition on making loans or giving security interest for the acquisition of its own shares. The prohibition originates from the provision regarding Treasury shares, which establishes that the company cannot purchase its own shares but with amounts corresponding to retained earnings (Article 263 of the Commercial Code). A more evolved and far reaching provision is found in the Securities Market Act of 2015 (Article 72).

(b) Shares of any company which directly or indirectly owns shares in the company

Case law has expanded the above-mentioned prohibition to preclude transactions that pretend to bypass the prohibition by using interposed persons.

(c) Shares in a sister subsidiary

The comment for (b) above applies here as well.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

A security agent could be created, empowering such agent to act on behalf of all the secured lenders. However, the secured interest must be created in favour of the secured lenders. The security agent may also serve as payment agent and be authorised to receive payments and to make distributions of such payments among the secured lenders.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable. See the answers above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Notice must be given to the debtor and the guarantor if an assignment of a loan takes place (Article 1550 of the Civil Code and 150 of the Commercial Code). The transaction documents may establish additional conditions for the transferability of a loan.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest payments are subject to withholding tax when made to foreign lenders (Article 9 (3) of Decree 1808 of 1997). Interest payments to local banks are not subject to withholding (Article 10 of Decree 1808). Guarantee and proceeds of enforcing a security interest are not subject to withholding, unless deemed allocated to the payment of interest.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Currently, there are no tax incentives for foreign lenders. From time to time, exonerations are given to induce the financing of projects in certain economic sectors. Interests on loans made by foreign financial institutions are taxed at the rate of 4.95% (Article 52 of the Income Tax Act). Other rates may apply because of tax treaties. The stamp taxes and fees that are to be paid for the documentation of a loan or a security interest are the same for local and foreign lenders.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Income originated from loans made to Venezuelan borrowers is subject to Venezuelan income tax at a rate of 4.95% (Article 52 of the Income Tax Act). The borrower is to withhold the tax when making the interest payments. If the guarantor or the owner of the security interest is a Venezuelan corporation, no Venezuelan tax will apply to the loan solely because of such circumstance.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are no significant costs associated with the execution of documentation related to a loan, guarantee or security interest, except that the registration of the security interest will entail the payment of registration fees based on a progressive tariff of up to 0.60% of the value of the security interest (Article 83 of the Public Registry and Notary Act).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are none.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Venezuelan courts will recognise a foreign governing law if selected to be the governing law of a contract (Article 29 of the International Private Law Act). Venezuelan courts will enforce such a contract in Venezuela. However, there may be some exceptions for national interest contracts and public policy reasons (Article 151 of the Constitution and Article 5 of the International Private Law Act).

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Passing of a foreign judgment requires a procedure before the Supreme Court (*exequatur*), which excludes the examination of the merits (Articles 53 of the International Private Law Act and 850 of the Civil Procedure Code). For arbitral awards, the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards will apply.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

A procedure for collection of amounts due may take up to approximately two years, depending on the defences and appeals that the defendant raises during the court procedures. An *exequatur* procedure, for the passing of a foreign judgment, may take between one and two years, and the enforcement against assets of the defendant in Venezuela may take between six months and one year.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Venezuelan enforcement procedures will require a public auction (Articles 550 to 584 of the Civil Procedure Code). Notices to the Attorney General's Office will be required, if there is a risk of interruption of a public service (Article 99 of the Attorney General Organic Act). The existing exchange control is one of the major obstacles to effectively realise the proceeds of the security interest being enforced.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

This is not applicable. In non-commercial litigations, the foreign plaintiff may be required to post a bond (Articles 36 of the Civil Code and 1102 of the Commercial Code).

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

If the debtor has a positive network but has liquidity problems, it may apply for a moratorium (Article 898 of the Commercial Code). While in moratorium or in a bankruptcy procedure, the enforcement of rights against the debtor would be suspended, except that the suspension would not apply to the enforcement of security interest (Articles 905, 942 and 964 of the Commercial Code).

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Venezuela is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The secured lender would be limited in its ability to collect from the bankruptcy assets, other than the collateral, if the collateral is not sufficient to satisfy its claims (Article 1047 of the Commercial Code). If the collateral is not sufficient to satisfy the debt, the bankruptcy effects will apply to the remaining debt, including that interest stop accruing on the bankruptcy declaration date (Articles 943 and 944 of the Commercial Code).

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

There are debts that are preferred by law (privileged creditors, Article 1867 of the Civil Code; labour debts, Article 151 of the Labour and Workers Act), even above the preference corresponding to secured creditors. Security interest granted during the so-called suspicious period may be set aside. A suspicious period may be up to two years and 10 days (Articles 936 and 945 of the Commercial Code). The suspicious period begins 10 days prior to the date on which the court establishes that the insolvency commenced. Payments on unmatured debt or in kind made during the suspicious period may be annulled (Article 945 of the Commercial Code).

© Published and reproduced with kind permission by Global Legal Group Ltd, London

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Banks, insurance companies and brokerage houses are excluded from bankruptcy and subject to a similar procedure carried by the Superintendency of the Banking Sector Institutions (Articles 240, 247 and 257 of the Banking Sector Institutions Act), the Superintendency of Insurance Activity (Articles 98, 101 and 107 of the Insurance Activity Act) or the National Securities Superintendency (Article 135 of the Securities Market Act), respectively.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No (Articles 1844 of the Civil Code and 542 of the Commercial Code), except for retention rights (Articles 122 and 148 of the Commercial Code) and the collection of credits given as collateral (Article 538 of the Commercial Code).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, provided that it is a commercial transaction and the exceptions of national interest contract (Article 151 of the Constitution), Venezuela real estate or public policy (Article 47 of the International Private Law Act) do not apply.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, subject to the same conditions mentioned in question 9.1.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no eligibility requirements for lenders. However, the nature of the lender may be relevant for the purposes of determining the applicable income tax regime (e.g. a 4.95% tax rate applies to foreign financial institutions and a 40% tax rate applies to local financial institutions). There is no need for the lenders to be licensed or authorised to do business in Venezuela. They do not need to be a licensed bank in the jurisdiction of incorporation.

There are differences on the authorisations required to be a beneficiary of a chattel mortgage and pledge without transfer of possession, depending on the type of lender. No authorisation is required if the lender is a local bank. Authorisation from the Superintendency of the Banking Sector Institutions will be necessary if it is a foreign bank. Authorisation from the Ministry of Agriculture or the Ministry of Communications may be needed for certain security interests in favour of other type of lenders.

For trusts created in Venezuela, the trustee must be a local bank or insurance company, authorised to operate as such and to serve as trustee, by the Superintendency of the Banking Sector Institutions and by the Superintendency of Insurance Activities.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Special consideration must be given to the existing exchange control.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Jaime Martínez Estévez

Rodner, Martínez & Asociados
Avenida Venezuela, Torre Clement, Piso 2
El Rosal, Caracas
Venezuela

Tel: +58 212 951 38 11
Fax: +58 212 951 77 07
Email: jmartinez@rodnermartinez.com
URL: www.rodnermartinez.com

Jaime Martínez Estévez is a senior partner of the firm, who holds a Law Degree (*cum laude*) and a Commercial Law Specialist Degree from Universidad Católica Andrés Bello (UCAB), and an LL.M. from the University of Michigan Law School, and was admitted to practice in 1983. He teaches International Trade Law in the Post-graduate School of UCAB (since 1988) and is the author of multiple articles published in various domestic and international law reviews. He has been speaker on conferences and seminars on foreign investment, international contracts and arbitration.

Rodner, Martínez & Asociados is a Venezuelan law firm specialised in international finance, banking and investments in Venezuela. For over 30 years it has represented major international banks, export credit agencies and multilateral entities in project, commercial and export financing transactions, being local counsel for the largest and most complex transactions and investments in Venezuela, including the setting and operation of Venezuelan branches of foreign banks. Its expertise in securities law has been sought for the discussion of the 1998 Capitals Market Act and the issue of regulations by the former National Securities Commission, and for the design and implementation of new products for the domestic market. It has been consistently ranked as a leading Banking and Finance firm by *Chambers and Partners*, *IFLR 1000* and *Latin Lawyer*.

© Published and reproduced with kind permission by Global Legal Group Ltd, London

Other titles in the ICLG series include:

- Alternative Investment Funds
- Aviation Law
- Business Crime
- Cartels & Leniency
- Class & Group Actions
- Competition Litigation
- Construction & Engineering Law
- Copyright
- Corporate Governance
- Corporate Immigration
- Corporate Recovery & Insolvency
- Corporate Tax
- Data Protection
- Employment & Labour Law
- Enforcement of Foreign Judgments
- Environment
- Franchise
- Gambling
- Insurance & Reinsurance
- International Arbitration
- Litigation & Dispute Resolution
- Merger Control
- Mergers & Acquisitions
- Mining Law
- Oil & Gas Regulation
- Outsourcing
- Patents
- Pharmaceutical Advertising
- Private Client
- Private Equity
- Product Liability
- Project Finance
- Public Procurement
- Real Estate
- Securitisation
- Shipping Law
- Telecoms, Media & Internet
- Trade Marks

glg global legal group

59 Tanner Street, London SE1 3PL, United Kingdom
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255
Email: sales@glgroup.co.uk

www.iclg.co.uk