ICLG

The International Comparative Legal Guide to:

Lending & Secured Finance 2017

5th Edition

A practical cross-border insight into lending and secured finance

LSTA

Morgan Lewis

global legal group

Contributing Editor
Thomas Mellor, Morgan, Lewis & Bockius LLP

Sales Director
Florjan Osmani

Account Director
Oliver Smith

Sales Support Manager
Paul Mochalski

Editor
Sam Friend

Senior Editors
Suzie Levy, Rachel Williams

Chief Operating Officer
Dror Levy

Group Consulting Editor
Alan Falach

Publisher
Rory Smith

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 2017

Copyright © 2017
Global Legal Group Ltd.
All rights reserved
No photocopying

ISBN 978-1-911367-46-8
ISSN 2050-9847

Strategic Partners

Editorial Chapters:

1	**Loan Syndications and Trading: An Overview of the Syndicated Loan Market** – Bridget Marsh & Ted Basta, The Loan Syndications and Trading Association	1
2	**Loan Market Association – An Overview** – Nigel Houghton, Loan Market Association	7
3	**Asia Pacific Loan Market Association – An Overview** – 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 the Leveraged Loan Market in 2016** – Joshua W. Thompson & Caroline Leeds Ruby, Shearman & Sterling LLP	20
6	**Escrow Funding in the Term Loan B Market** – Meyer C. Dworkin & Samantha Hait, Davis Polk & Wardwell LLP	26
7	**Commercial Lending in a Changing Global Regulatory Environment: 2017 and Beyond** – Bill Satchell & Elizabeth Leckie, Allen & Overy LLP	30
8	**Acquisition Financing in the United States: 2017… Uncertainty!** – Geoffrey R. Peck & Mark S. Wojciechowski, Morrison & Foerster LLP	33
9	**A Comparative Overview of Transatlantic Intercreditor Agreements** – Lauren Hanrahan & Suhrud Mehta, Milbank, Tweed, Hadley & McCloy LLP	39
10	**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	46
11	**The Global Subscription Credit Facility and Fund Finance Markets – Key Trends and Forecasts** – Michael C. Mascia & Wesley A. Misson, Cadwalader, Wickersham & Taft LLP	56
12	**Recent Developments in U.S. Term Loan B** – Denise Ryan & David Almroth, Freshfields Bruckhaus Deringer LLP	59
13	**The Growth of European Covenant Lite** – James Chesterman & Jane Summers, Latham & Watkins LLP	65
14	**Yankee Loans – What You Need to Know** – Alan Rockwell & Denise Gibson, Allen & Overy LLP	68
15	**Debt Retirement in Leveraged Financings** – David A. Brittenham & Scott B. Selinger, Debevoise & Plimpton LLP	76
16	***In re Motors* Expands Future Claimants' Rights at Expense of 363 Purchasers** – George E. Zobitz & Omid H. Nasab, Cravath, Swaine & Moore LLP	82
17	**The Continuing Evolution of Middle Market Lending** – Sandra Lee Montgomery, Proskauer Rose LLP	87
18	**An In-house Legal Team's Views on the Roles and Responsibilities of External Deal Counsel on Lending Transactions** – Clifton Prabhu & Charles Bronowski, HSBC	93
19	**The Section 363 Sale Process: Key Considerations for the Prepetition Secured Lender** – Zachary H. Smith, Moore & Van Allen, PLLC	97
20	**Distributed Ledger Technology, The Internet of Things (IoT) and Artificial Intelligence and Cognitive Analytics: The Future of Trade Finance is Rapidly Approaching** – Josias Dewey, Holland & Knight LLP	102
21	**Marketplace Lending** – Vanessa Spiro & Edward Dartley, K&L Gates LLP	108
22	**Overview of Sanctions Programs Affecting the Lending Market in the United States** – Joseph F. Giannini & Adrienne Sebring, Chadbourne & Parke LLP	114

Country Question and Answer Chapters:

23	**Andorra**	Montel&Manciet Advocats: Audrey Montel Rossell & Liliana Ranaldi González	119
24	**Argentina**	Marval, O'Farrell & Mairal: Juan M. Diehl Moreno & Diego A. Chighizola	125
25	**Australia**	King & Wood Mallesons: Yuen-Yee Cho & Elizabeth Hundt Russell	134
26	**Belgium**	White & Case LLP: Hadrien Servais & Nathalie Colin	142
27	**Bolivia**	Criales & Urcullo: Andrea Mariah Urcullo Pereira & Daniel Mariaca Alvarez	149
28	**Botswana**	Khan Corporate Law: Shakila Khan	156

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	**Brazil**	Pinheiro Neto Advogados: Ricardo Simões Russo & Leonardo Baptista Rodrigues Cruz	164
30	**British Virgin Islands**	Maples and Calder: Michael Gagie & Matthew Gilbert	172
31	**Canada**	McMillan LLP: Jeff Rogers & Don Waters	179
32	**Cayman Islands**	Maples and Calder: Tina Meigh	188
33	**Chile**	Carey: Diego Peralta	195
34	**China**	King & Wood Mallesons: Jack Wang & Stanley Zhou	202
35	**Cyprus**	E & G Economides LLC: Marinella Kilikitas & George Economides	209
36	**Denmark**	Nielsen Nørager Law Firm LLP: Thomas Melchior Fischer & Brian Jørgensen	217
37	**England**	Allen & Overy LLP: Darren Hanwell & Temi Esho	224
38	**Finland**	White & Case LLP: Tanja Törnkvist & Oona Lilja	233
39	**France**	Orrick Herrington & Sutcliffe LLP: Emmanuel Ringeval & Cristina Radu	240
40	**Germany**	King & Spalding LLP: Dr. Werner Meier & Dr. Axel J. Schilder	250
41	**Greece**	KPP Law Firm: George N. Kerameus & Ilianna Sotiria Koraki	262
42	**Hong Kong**	King & Wood Mallesons: Richard Mazzochi & David Lam	270
43	**Hungary**	Lakatos, Köves and Partners: Szabolcs Mestyán & Andrea Spisák	277
44	**India**	HSA Advocates: Anjan Dasgupta & Harsh Arora	285
45	**Indonesia**	Ali Budiardjo, Nugroho, Reksodiputro: Theodoor Bakker & Ayik Candrawulan Gunadi	295
46	**Ireland**	Maples and Calder: John Breslin & David Burke	303
47	**Italy**	Chiomenti: Giulia Battaglia & Gregorio Consoli	310
48	**Ivory Coast**	IKT & associates: Annick Imboua-Niava & Osther Henri Tella	319
49	**Japan**	Anderson Mori & Tomotsune: Taro Awataguchi & Yuki Kohmaru	325
50	**Korea**	Lee & Ko: Woo Young Jung & Yong-Jae Chang	333
51	**Mexico**	Gonzalez Calvillo, S.C.: José Ignacio Rivero Andere	341
52	**Norway**	Advokatfirma Ræder DA: Kyrre W. Kielland & Anne Christine Wettre	348
53	**Peru**	Estudio Saco-Vertiz & Landerer: Carlos Saco-Vertiz Tudela & Jaime Sabat Pancorvo	357
54	**Russia**	Morgan, Lewis & Bockius LLP: Grigory Marinichev & Alexey Chertov	366
56	**Singapore**	Drew & Napier LLC: Valerie Kwok & Blossom Hing	373
55	**South Africa**	Allen & Overy LLP: Lionel Shawe & Lisa Botha	382
57	**Spain**	CUATRECASAS: Manuel Follía & María Lérida	391
58	**Sweden**	White & Case LLP: Carl Hugo Parment & Tobias Johansson	401
59	**Switzerland**	Pestalozzi Attorneys at Law Ltd.: Oliver Widmer & Urs Klöti	408
60	**Taiwan**	Lee and Li, Attorneys-at-Law: Hsin-Lan Hsu & Cyun-Ren Jhou	417
61	**UAE**	Morgan, Lewis & Bockius LLP: Ayman A. Khaleq & Amanjit K. Fagura	425
62	**USA**	Morgan, Lewis & Bockius LLP: Thomas Mellor & Rick Eisenbiegler	437
63	**Venezuela**	Rodner, Martínez & Asociados: Jaime Martínez Estévez	448

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

Bridget Marsh

Ted Basta

The Loan Syndications and Trading Association

In the past 30 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 2016, total corporate lending in the United States nearly reached $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 stood at approximately $860 billion in 2016. 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 approximately $875 billion.[2] Leveraged loans are typically made to companies seeking to refinance existing debt, to finance acquisitions or 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 2016, middle market lending totalled approximately $245 billion, with $105 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 30 years. Attracted by the higher returns of the loan asset class, the investor base expanded significantly starting from the mid-1990s and has grown increasingly more diverse. This, in turn, fuelled demand for loans, leading to a commensurate rise in loan origination volumes in the primary market which peaked in 2013 at more than $1 trillion. For the loan market to grow successfully, for the loan asset class to mature, and to ease the process of trading and settlement, the new entrants to the market in the 1990s needed uniform market practices and standardised trading documentation. In response to these needs, the Loan Syndications and Trading Association ("LSTA" or "Association") was formed in 1995, 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 since the Global Financial Crisis to meet new market challenges, assuming more prominence in the loan market generally and regularly engaging with the U.S. government and its regulatory bodies on 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.

Now in the second phase of its regulatory outreach programme, the LSTA is maintaining a dialogue about the loan market with regulators and promoting 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 about 30 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

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

(LBOs), which required larger loans with higher interest rates. This had two significant consequences for the loan market. First, because 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 propel 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 are 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 most 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 such as collateralised loan obligations or "CLOs". Between 1995–2000, 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.

Source: LSTA

© 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 stalled 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. Once again, this growth was driven by M&A activity and large LBOs. Increasing by nearly 200% from 2003–2007, 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 had only been possible because of the emergence of CLOs. This structured finance vehicle changed the face of the leveraged loan market and was also responsible for its revival after the Global Financial Crisis.

The 2008 Global Financial Crisis 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 the investment tools put in place years earlier and the standardisation of legal and market practices helped the market to expand further during its next phase which began in 2013.

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. Loan trading volumes in 2014 reached a new high of $628 billion and the size of the loan market grew to an all-time high of $831 billion. It was surprising then that 2015 proved to be disappointing for loan investors. Portfolio managers had not anticipated the contagion that would spread as the price of oil plummeted and global economies weakened. LLI returns were negative 0.7% on the year, marking the first time since 2008 that annual returns were in the red. Annual secondary loan trade volumes, however, totalled $591 billion in 2015 – just a 6% decline from 2014's all-time high of $628 billion. Fortunately, disappointment with the market's performance was short-lived. In 2016, risk assets and commodities rallied, lifting loan returns above 10% for only the third time in the past 20 years. Although the tale of 2016 did not start on a high note, by March the market had begun a record-setting rally where loan prices in the secondary market ran higher through December. By year's end, the secondary market's V-shaped recovery was complete as the median trade price pushed back above par to 100.25. This "risk-on" recovery was the product of both favourable technicals (demand outstripped supply for most of the year) and stronger fundamentals.

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. The LSTA is active in the primary market, where agent banks originate syndicated loans, and 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 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 benefited 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

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

trading, significantly contributed to a more liquid loan market, for 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. In 2016, the *LSTA's Complete Credit Agreement Guide* was published; this textbook is a comprehensive resource for understanding the complexities of today's syndicated credit agreements, providing in-depth explanations of credit terms, market trends, and global forces that impact the negotiation of each new deal. This year, the LSTA plans to finalise Model Credit Agreement Provisions for Investment Grade Revolving Credit Financings and its first complete Form of Investment Grade Credit Agreement.

Regulatory Challenges

2016 saw continued heightened regulatory scrutiny of the US loan market while a new regulatory focus on loans emerged in Europe. For the last three years, institutions regulated by the US banking regulators have been at times frustrated as they competed for European deals hamstrung by the Interagency Guidance on Leveraged Lending ("US Guidance").[11] The US Guidance is not a rule but has been largely applied as such by the US banking regulators. In addition to rigorous reporting and monitoring requirements, the US Guidance indicates certain criteria to be considered in developing an institution's "leveraged lending" definition, including whether a loan's leverage exceeds 3× senior debt to EBITDA or 4× total debt to EBITDA. It further restricts banks from originating – defined broadly to include amendments and refinancings – a non-pass credit. In the years following the US Guidance's release, the banks endeavoured to comply and as the paths to conformance became clearer, the market saw US banks retreat from deals for which there was market demand, but which would not pass regulatory muster. At the same time, US banks watched their non-US counterparts able to participate in these deals. That trend may very well have ended now that the European Central Bank ("ECB") has published draft guidance of its own in November 2016 ("Draft Guidance").[12] The ECB's Draft Guidance applies to all "significant credit institutions" supervised by the ECB under the Single Supervisory Mechanism, but, like its US counterpart, would not apply to nonbank lenders. Even though the Draft Guidance's goals are aligned with the US Guidance, institutions that did not have significant business in the US may be facing painful change. Moreover, because of the market dynamics in Europe, as Fitch Ratings recently pointed out, because banks represent a significant share of the European leveraged credit markets and European leveraged credit investors rely more heavily on supply from private equity sponsors, the potential impact in Europe may be particularly significant.[13] On the other side of the coin, for European banks with businesses already subject to the US Guidance, these entities may welcome the ECB's actions as a step toward a more level playing field globally.

Substantively, the US Guidance and the ECB's Draft Guidance are very much aligned: both recommend banks' definitions of leveraged transactions include loans where the borrower's post-financing leverage exceeds 4× EBITDA; both note that underwriting transactions presenting a total debt to EBITDA ratio in excess of 6× raise concerns for most industries; both recommend that borrowers should show the cash-flow ability to repay at least half of its total debt in five to seven years and both question weak covenant features, such as the absence of, or where there is significant headroom in, financial covenants. In some ways, however, the Draft Guidance goes even further. The Draft Guidance does not have any of the comforting language granting latitude for workouts and troubled credits found in the US Guidance, and critically, EBITDA in the Draft Guidance refers to "*unadjusted* EBITDA".[14] The use of unadjusted EBITDA would not only be a novel regulatory move, but also one that is totally at odds with the metrics used in financings. In the US, where the guidance uses adjusted EBITDA which permits some assumptions, recent data showed the average leverage level of M&A deals goes up roughly a turn when non-adjusted EBITDA is used.[15] That being said, EBITDA addbacks may be the next frontier of regulatory scrutiny. At the beginning of 2016, anecdotal feedback indicated that the US banks had largely determined how the bank examiners were interpreting and applying the US Guidance and were well on their way to conformance. In July, the regulators "found the incidence of non-pass originations ha[d] reduced to a de minimis level",[16] meaning that banks were conforming with the requirement to only originate loans to companies that show the ability to repay all senior debt or half of total debt in five to seven years from base cashflows. That same SNC Review flagged several areas of continued concern, but overall, the banks received a good report card and "examiners noted continued progress toward full compliance with underwriting and risk management expectations".[17]

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

In only a matter of months, however, the spectre of noncompliance again loomed. Rumblings that the regulators were concerned that US banks were again originating non-pass credits were picked up in the financial headlines as at least three deals were flagged as problematic due to inappropriate and unsupported EBITDA adjustments. It is likely this focus will continue in 2017, even as industry comments to the ECB have argued against incorporating unadjusted EBITDA in the final guidance. Finally, as the US and Europe's regimes are converging, it should be noted that the Bank of England (BOE) in the UK has decided that no regulatory action is required to address risks in the UK market.[18] The BOE has indicated that they will continue to monitor this space; for now, it seems there may be a competitive advantage for these institutions. How meaningful any regulatory arbitrage will prove to be is unclear. And, of course, the BOE may certainly decide in time to revisit releasing guidance of its own, but in light of an eventual Brexit, that may be a complicated decision.

As 2017 unfolds, the regulatory landscape for leveraged loans continues to move. Europe will soon begin the odyssey of figuring out what the ECB's guidance says, does and means for the loan business. Unfortunately, three years after the US Guidance was released, it seems US banks, who thought they may have concluded their journey, may still be *en route*. It is true that many US market participants have allowed themselves to hope that the post-crisis regulatory *status quo* is in for a shake-up. With the election of Donald Trump and conservative majorities in both houses of the US Congress, regulatory change in the finance sector is at the very least possible and likely probable. However, at the time of writing, it is early days in the Trump administration, so speculation is still the name of the game. There have been beacons of hope for financial regulatory reform, such as Trump's February 3rd executive order outlining core principles for the regulation of the U.S. financial system. These principles include making regulation efficient, effective, and appropriately tailored. Although this may seem like music to the ears of many, it is still a long road to regulatory change. Look at the US Guidance, for instance, the reality is that the professional staff at the banking agencies will not change overnight and that the staff seems happy with the impact the US Guidance is having. Trump will eventually appoint new heads to the OCC, the Fed and FDIC (as well as a Vice-Chair for Supervision at the Fed). Once these appointments are confirmed, the tone at the top may begin to change, but that is still in the distance.

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 Michael Bellucci and Jerome McCluskey, THE LSTA'S COMPLETE CREDIT AGREEMENT GUIDE, 2nd ed., 541–542 (McGraw-Hill 2016).
9. For further information on the structure of assignments, see *id*. at 543–561.
10. For further information on the structure of participations, see *id*. at 561–567.
11. Interagency Guidance on Leveraged Lending, 78 Fed. Reg. 17766 (Mar. 22, 2013) issued by the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC") and the Board of Governors of the Federal Reserve System ("Federal Reserve").
12. ECB Supervisory Authority's Public consultation on the draft guidance on leveraged transactions", dated Nov. 23, 2016, *available at* https://www.bankingsupervision.europa.eu/legalframework/publiccons/html/leveraged_transactions.en.html.
13. Fitch Ratings, "European Leveraged Credit May Suffer If US-Style Guidelines Introduced", Sept. 23, 2016, *available at* https://www.fitchratings.com/site/dam/jcr:64c72ed0-0115-47a1-8581-169c8d785850/European%20Leveraged%20Credit%20May%20Suffer%20if%20US-Style%20Guidelines%20Introduced.pdf.
14. Draft Guidance, footnote 7.
15. CR Trendlines published by Covenant Review on Dec. 13, 2016, *available at* https://covenantreview.com/samples/download/29.
16. Shared National Credits Program, 1st Quarter 2016 Review, July 2016, *available at*: https://www.federalreserve.gov/newsevents/press/bcreg/bcreg20160729a1.pdf ("SNC Review"), p. 3.
17. *Id.*
18. Bank of England News Release, "Financial Policy Committee statement from its meeting, 24 March 2015", dated Mar. 26, 2015, *available at* http://www.bankofengland.co.uk/publications/Pages/news/2015/021.aspx.

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

Bridget Marsh

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

Tel: +1 212 880 3000
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 leads the legal projects for the development and standardisation of the LSTA's documentation, is responsible for addressing secondary loan market trading disruptions, and ensures that the LSTA's legal products reflect current market practices. Bridget regularly speaks on the loan market at American Bar Association events and is a Fellow of the American College of Commercial Finance Lawyers.

Prior to joining the LSTA, Bridget practised as a corporate finance attorney at Milbank, New York, and as a lawyer in the corporate 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, 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

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

Tel: +1 212 880 3000
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

Founded in late 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 late 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 654 in 2017, including banks, non-bank institutional investors, law firms, ratings agencies and service providers from 60 countries.

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.
- Regulation 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. 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 was published in August 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.

2015 saw the publication of a term sheet for use in pre-export finance transactions, a secured single currency term facility agreement governed by South African law and a real estate finance German law facility agreement. Later that year, 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.

Recent documentation initiatives include a new security agreement and contractually subordinated intercreditor agreement for use in real estate finance, a German language German law facility agreement and term sheet for multi-property real estate transactions and an insurance broker letter also for use in real estate finance. Most recently, in early 2017 a leveraged finance mezzanine facility drafting guide was published.

While the UK referendum vote in June 2016 to leave the EU will have a major impact on the future financial landscape in the UK and Europe, in the vast majority of cases it does not bring about any immediate legal or contractual change. It is too early to speculate on the implications for the syndicated loan market of the UK's withdrawal from the EU and much will depend on the form of negotiated exit. Needless to say, the LMA is closely following developments and will, in due course, address any documentary changes. In the meantime, however, a note has been published addressing a number of considerations for LMA facility documentation.

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 & 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 subsequently agreed including, *inter alia*, clarification of treatment of notary fees. In late 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, anti-trust amendments were incorporated into mandate letters and the confidentiality and front running letter for primary syndication. In 2016, French, German and South African law investment grade templates were updated and general updates were published to the suite of documents to reflect legal and market issues, such as changes in the accounting treatment of leases (IFRS 16) and the new ICE LIBOR submission methodology. Leveraged documentation was also recently revised to include, among other things, an optional incremental facility.

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

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 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, a Guide to Agency Protections, a Guide to Secondary Loan Market Transactions and a Guide to Improving Liquidity in the Secondary Market. A Comparison of Private Placement Debt Products was published in July 2016 and most recently a Guide to Dealing with Request for Amendments was released.

Regulation and Lobbying

The LMA seeks to maintain a dialogue with regulators and government bodies wherever new or revised regulatory proposals 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. Responses to regulatory bodies across the globe are too numerous to list.

Notable dialogue over recent years includes submissions *re* the impact of the EU Capital Requirements Directive (CRD IV) on bank financing, to the OECD consultation *re* Base Erosion and Profit Shifting (BEPS), the EC consultation on European Capital Markets Union and submissions to the EC, PRA and FCA *re* the Article 55 bail-in directive. Also to highlight are 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 deductibility of loan interest payments and lobbying the EU on its framework for simple, transparent and standardised securitisations. The LMA had previously successfully lobbied for lower risk retention requirements for new CLOs in the post-crisis era.

Anti-money laundering and counter-terrorist financing measures have been the subject of several recent submissions to the ESA and HM Treasury. Most recently, a submission was made to the FCA in September 2016 on the potential impact of Brexit on the loan market and in January 2017 to the ECB on its draft leveraged lending guidelines.

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 into 2017 and beyond. The LMA remains committed to playing 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, Amsterdam, Brussels, Dubai, Dublin, Frankfurt, Istanbul, Johannesburg, Lagos, Madrid, Milan, Moscow, Munich, Nairobi, New York, Paris, Stockholm, Vienna and Zurich.

In September 2016, over 900 delegates attended the LMA's 9th 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 17,000 delegates have attended LMA events in the last three years.

In 2005, the inaugural LMA Certificate Course was held in London. Consistently oversubscribed, the course is now entering its 12th year and will be run four times in 2017. 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.

A Loan Documentation Certificate Course was launched in 2016, affording professionals a more in-depth understanding of LMA primary documentation. In 2017, a Real Estate Finance Certificate Course will be launched, aimed at junior professionals in that sector.

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. Over 10,000 copies of The Loan Book have been distributed 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 recognition of the 20th anniversary of the LMA, the latest book – 20 Years in the Loan Market – was published in November 2016. Again the result of contributions from leading practitioners from across the market, the publication looks back at the last two decades of the syndicated loan market, analysing its evolution over that period.

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 expanded in terms of coverage in 2016 to include sessions in French, German and Spanish.

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

Working in close collaboration with the LMA Operations Committee (see below), in October 2016 the LMA launched its first e-learning programme. Aimed at practitioners across the market, be it from a legal, financial or operations background, the course seeks to create a knowledge benchmark for the asset class. The course will consist of ten modules in total with six already available at the time of writing. The course is free of charge for LMA members and to date over 2,300 delegates from 60 jurisdictions have registered on the dedicated e-learning portal.

Loan Operations

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 administrative "quick-wins" have been implemented across top agency houses since 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 2016, the LMA held its 2nd 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 2016 and the LSTA reciprocated at the LMA event in June to underline the global nature of the issues involved.

Financial technology ("fintech") is high on the agenda at most major financial institutions and the LMA is engaged with banks, lawyers and vendors alike to understand the potential implications of innovative technology such as Blockchain, in particular as it may impact operational processes in the medium term.

Maintaining the spotlight on secondary settlement and operations in general is a core strategic aim for the LMA into 2017 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 detailed reference guide, as does the LMA's latest publication 20 Years in the Loan Market. 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 2015 EMEA loan market volumes reached $1,400bn for the first time since the crisis. 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. Overall volume in 2016 dipped to $1,000bn, including $56.9bn to support the acquisition of Monsanto by Bayer AG.

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 now have a much larger foothold than previously. 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 reached a post-crisis high of €17bn in 2016 and analysts predict similar volumes in 2017.

Institutional investors have also become more visible in other loan asset classes, such as real estate and infrastructure finance. A multitude of funds have also 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 larger institutions are now established participants. Many more managers have raised dedicated loan funds over the last few years and competition for assets is becoming intense, especially as several banks have again become more active in the sector (many would argue that they never left).

The Way Forward

Results from a survey of LMA members at the end of 2016 suggest that market participants are cautiously optimistic about prospects into 2017. Some 52% of respondents expect loan market volumes across EMEA to be flat year on year, with 25% expecting growth of 10% or more, *versus* only 17% predicting lower volumes. Global economic and/or geopolitical risks (including Brexit) were cited as the single biggest potential influence on the market in 2017 with 51% of respondents on board, competitive pressure was a distant second with 19% of the vote. Respondents saw new corporate M&A and refinancing volume on an equal footing. Asked how much financial regulatory change has impacted their business over the last five years, some 69% have seen a significant or material impact.

Indeed, regulatory issues remain high on the agenda and the LMA's focus on lobbying and regulation will continue unabated. Other trends will also determine the focus of the LMA's work into 2017 and beyond. The institutional investor base has continued to grow and non-bank finance has increased 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 to expand its work in these markets to promote the acceptance of regional standards. We expect the focus on operational efficiency to continue to grow and the LMA is fully engaged with partners and practitioners across the market to identify issues, find solutions and broker change. Fintech will undoubtedly evolve to reshape the financial services industry and it will be increasingly important to trade ideas and knowledge in this area. Asked about the biggest single impact on the loan market in the next 20 years, the LMA member survey scored highest in "technological innovation".

The LMA's principal objective some 20 years ago was to promote greater liquidity and efficiency 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 over 650 organisations covering 60 countries, 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

Asia Pacific Loan Market Association – An Overview

Janet Field

Katy Chan

Asia Pacific Loan Market Association

About the APLMA

Founded in 1998, the APLMA is a pan-Asian trade association that represents the common interests of the many different institutions active in the syndicated loan markets of the Asia-Pacific region. The APLMA's primary objective is to promote growth and liquidity in the primary and secondary loan markets and works in tandem 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.

Standard Documentation

One of the core objectives of the APLMA is to produce standard primary documentation for syndicated loan transactions in the Asia Pacific markets. These documents, covering English law, Hong Kong law, Australian law and Singapore law, have become the market standard for Asia.

The APLMA has also developed a number of templates to provide alternative wording for use by members. These include: sample wording relating to the Contracts (Right of Third Parties) Ordinance which became effective under Hong Kong law in 2016; a sample Asia arbitration clause with a litigation option for a hybrid dispute resolution process; and a full suite of standard term sheets, mandate letters and confidentiality letters, including templates for primary syndication and for sale/sub-participation under both English and Hong Kong law.

Documentation Updates

In 2016, the APLMA published a rider relating to the Hong Kong Contracts (Rights of Third Parties) Ordinance (Cap. 623) effective 1 January, 2016. The rider contains sample wording to be inserted into the Hong Kong law facility agreement templates. The sample wording reflects the changes required to be made to the current APLMA facility agreement templates to expressly allow or exclude third party rights. The form of expanded Third Party Rights clause set out in the latest LMA templates has been incorporated as part of the current APLMA template update exercise.

Other revisions include:

- interest rate fallback and slot in provisions which follow the LMA approach;
- legal updates, such as the FATCA lenders risk option, Article 55 of the BRRD, and Hong Kong Contracts (Rights of Third Parties) Ordinance (Cap. 623); and
- LMA operational updates, including Agency protection, reference bank protection and disruption to payment systems.

These revisions have been made to both the English law and Hong Kong law templates. The Singapore law documents will be revised accordingly and launched in 1Q2017.

In Australia, the APLMA has published for the first time an investment grade syndicated facility agreement with letter of credit based on the LMA equivalent agreement but with a number of modifications to comply with Australian market conventions. In addition, the APLMA has completed a new secured syndicated facility agreement for the sub-investment grade corporate segment. The facility agreement is based on the APLMA's investment grade term and multicurrency revolving syndicated facility agreement with letter of credit, and the secured provisions are based on the LMA's leveraged facility agreement.

Major Projects 2017

In light of the plethora of new regulations over the past few years, the APLMA is drafting a new Asia Pacific Regulatory Guide to assist members on some of the key regulatory changes and the implications for the syndicated loan market. The new guide, which aims to provide members with an analysis of some of the key regulatory changes and how they impact on the syndicated loan market in Asia, including sections on FATCA, Basel III, sanctions and Brexit, will be posted on the APLMA website in 1Q2017.

With the increase in complexity of bank on-boarding processes and KYC requirements on investors, the APLMA is drafting a new KYC note which sets out the KYC requirements under the APLMA documentation templates.

The APLMA is also finalising a general update to the suite of six investment-grade syndicated facility agreements based on recent LMA updates and a number of other drafting issues identified in the April 2016 update to the two main investment grade agreements and the secured syndicated facility agreement. The APLMA will publish updates to the two bilateral facility agreements as well as a new secured version in 2017, along with an update to the APLMA security trust deed and term sheets. The multicurrency loan note deed poll and subscription agreement (for facilities under $100m) will also be updated.

In Taiwan, the APLMA has agreed a timeline for the launch of a new APLMA Taiwan Law template to promote the use of standardised documentation in Taiwan. The new template will be synchronised with the standard APLMA form and will be produced in dual language.

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

Agency Issues

In 2016, the APLMA published a new guidance note on conditions precedent confirmation which provides general guidance on the issues which need to be agreed beforehand by the relevant parties (Arranger, Borrower, etc.) and how and within what timeframe the confirmation of each CP is to be communicated.

A new agents' administrative details form was also published. The form, which is based on the LMA template, seeks to provide a standardised check list for agents to enable the collection of administrative details from the lenders in the syndicate more efficiently.

In 4Q2016, the APLMA hosted its inaugural Agency Seminar in Singapore following the success of the Hong Kong Agency Seminar in September. The seminar covered the role of Agents in a debt restructuring, KYC issues, best practices in respect of confidentiality, payment delays and information covenants, and the roles and rights of Agents, including the multiple roles of agents in the same transaction.

Market Practices and Regulatory Issues

The APLMA continues to monitor and address key market and regulatory issues raised by members through the Market Practices and Regulatory Committee. The last committee meeting addressed a number of key issues raised by the market including the new Hong Kong Competition Ordinance and how it impacts on the syndicated loan market, negative interest rates in Japan, standard KYC practices in both primary and secondary loan markets in the region and skim fees. Other market issues reviewed included front-running practices and the HKMA's Supervisory Policy Manual on media procedures for high-profile syndicated deals.

Education and Training

The APLMA held over 100 seminars, conferences, training courses and networking events in 2016 as part of its commitment to enhancing industry education and providing a vibrant pan-Asian professional network. The APLMA hosts events in all the major financial centres in the region, the majority of which are free of charge for Members.

The event programme will continue to expand in terms of coverage for 2017 to include seminars and conferences in fast-growing cities in China and South East Asia such as Qingdao and Myanmar.

APLMA China

Recognising the potential opportunities to fund projects and investments under China's One Belt One Road initiative, the APLMA established stronger links with the Hong Kong Trade Development Council (HKTDC) in 2016 and has been invited to act as one of their advisors on the HKTDC Belt and Road Portal.

On the ground, the APLMA China Committee hosted its annual full-day conference in Beijing in October 2016. The conference, which was held in dual language in association with the China Banking Association (CBA), addressed a number of topical issues including One Belt One Road, the recent relaxation of inbound RMB remittances, onshore acquisitions in China and challenges for foreign banks.

In September 2016, the APLMA Shanghai Committee hosted a Fintech Seminar in Shanghai in conjunction with the Shanghai Banking Association (SBA), which focused on opportunities and challenges presented by the "New Normal, New Industrial" internet and technology industry, including a detailed overview of the different financing structures seen in the internet and technology sector.

The APLMA is seeking to continue to strengthen cooperation with the CBA and the SBA in respect of future events to diversify the reach of each association, including an inaugural educational seminar in Qingdao in 1Q2017.

Sustainable Finance

To facilitate growth and development of sustainable finance in Asia, a new APLMA Green Loans Committee was formally established in December 2016. The first task that the committee will be working on includes a review of the ICMA green loan principles to assess applicability to the loan market and the practicability of drafting a clear and robust definition of what constitutes a green loan in view of the difference in green standards under each jurisdiction in Asia.

Looking Ahead

With the regulatory landscape constantly changing, the APLMA will continue to monitor fiscal and regulatory developments in the region and publish market guidance notes to assist members in assessing the extent of the potential impact on the loan market.

In light of the differing regulatory regimes in Asia Pacific, the APLMA will shortly be launching a new Asia Pacific Regulatory Guide. We will also be hosting regular seminars and conferences in the major cities and financial centres across Asia on topical issues, whilst at the same time expanding the APLMA's presence in frontier markets in the region.

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

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 the operations of the APLMA across Asia Pacific. She is also responsible for expanding the APLMA's presence in new markets across Asia. She heads up a team responsible for the development of standard primary and secondary loan documentation for multiple 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 is a Director of the APLMA, 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 in 2014, Katy was with Standard Chartered Bank in Hong Kong where she managed a portfolio of large international and local corporates. 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 primary objectives include:

- providing standard loan documentation templates;
- formulating guidelines on market practices;
- organising seminars, training and networking events;
- monitoring legislative, regulatory and market changes for 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 with a branch in Australia and a management committee in Singapore, as well as offshore committees in China, India, Malaysia, New Zealand and Taiwan. Currently the APLMA has over 290 institutional members from Asia Pacific, Europe, North America 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

Marcus Marsh

Morgan, Lewis & Bockius LLP

1 Introduction: The Rise of Cross-Border Lending

Increase in Cross-Border Lending. For lenders and lawyers who practise 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 has increased from approximately $1.7 trillion in 1995 to over $7 trillion today. 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.

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

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 (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 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 titled 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 1st being the best score and 185th the worst (see http://doingbusiness.org/rankings). Each country is rated across 11 categories, including an "enforcing contracts", "resolving insolvency" and "protecting investors" category. 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 2016 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 worth 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. 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

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

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 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 to 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.

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

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 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 & 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, and is co-chair of the firm's Latin America Practice. 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*.

Marcus Marsh
Morgan, Lewis & 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 30 offices in the US, Europe, the Middle East and Asia, including financial centres such as New York, London, Paris, Moscow, Frankfurt, Dubai, Singapore, Hong Kong, Shanghai, 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 the Leveraged Loan Market in 2016

Joshua W. Thompson

Shearman & Sterling LLP

Caroline Leeds Ruby

1 Introduction

The year 2016 was a game of two halves, starting slowly and ending strongly – the mirror image of 2015. The credit markets were affected by a number of factors, expected and unexpected, including:

- US interest rates rising but staying very low in Europe (often below zero);
- demand exceeding supply for most of the year;
- geopolitical risk and volatility in the commodity markets;
- the Chinese economic slowdown and capital controls;
- ECB and Bank of England interventions reducing investment grade bond yields;
- the Brexit vote and nationalist populism in Europe and increased political uncertainty;
- the Trump campaign and election;
- improving economic performance in the US; and
- hopes of deregulation and anticipated tax reform in the US under President Trump.

Thomson Reuters reported that leveraged loan issuance in the US grew slightly last year but fell slightly in Europe. Both US leveraged loan market returns and European leveraged loan market returns increased to multi-year highs and secondary market prices recovered with secondary market rates increasing slightly in the US and by over 10% in Europe. In both the US and European markets, excess demand exceeded supply with an increase in CLO issuance in Europe ahead of implementation of the US risk retention rules and a material fall-off in CLO issuance in the US but strong flows into mutual funds. Excess demand and loan trades increasing above par provided favourable conditions for borrowers to reprice and refinance and achieve very borrower-friendly terms. Around two thirds of deals were opportunistic refinancings and repricings.

In Europe, the big story was the pace of change. Excess demand and hot competition for deals, together with low M&A levels and sponsors often losing out to trade buyers, rapidly increased the rate of convergence of loan terms to high-yield terms. Competitive tree processes, limited investor pushback, unfamiliarity with terms and a lack of consensus on which terms to push back on has led to acceptance of more aggressive terms in the European market than the US in some cases as the market has adapted to the new pro-borrower terms. There are European examples of high-yield bonds in disguise (term loans with only high-yield bond covenants in a loan wrapper), but this approach has not been accepted in the US market. Whilst European flex rights now extend to documentary terms as well as price terms (as in the US), flex rights and transferability remain more restricted in Europe.

The impact of weaker covenants will depend on how aggressively borrowers use the increased flexibility and the approach of regulators; in 2017, we have seen US regulators take a more commercial and facilitative approach to the leveraged lending guidelines. At present, the approach of borrowers and sponsors does not appear to have materially changed and directors and officers of European companies remain subject to potential liability risks under local laws for aggressive actions if their company is in financial distress.

However, the particular risk in Europe is that if a restructuring only occurs on a payment default because there is no earlier trigger, such as a financial covenant breach, then the options (and recoveries) may be limited. European local bankruptcy laws are less likely to preserve enterprise value than Chapter 11.

Whilst investor demand has been strong in the US and Europe, high-yield investors have been focused on credit quality with most issuances having ratings of B or above. There was a rise in European PIK issuances, which is usually a sign of a frothy market.

The Asian leveraged finance market has remained a small proportion of the global market. However, there have been a number of large acquisitions by Chinese investors using leveraged finance, including ChemChina's acquisition of Syngenta for $43bn. Chinese investors are using both internationally syndicated debt and high-yield bonds and funding from Chinese banks.

2 US Companies Borrowing More in Europe

As a result of low interest rates and favourable pricing in Europe, many US companies (with offshore operations) chose to raise debt in Europe, particularly as European terms grew ever closer to US terms. European high-yield issuances by US companies fell slightly as US companies opted for loans.

As widely anticipated, the US Fed raised its target federal funds rate by a quarter point to 0.75% with at least three more rate hikes forecasted for 2017 for a median rate centred at 1.375% and median long-term rate projections increased to 3%. With imminently rising interest rates, US business demand for floating rate debt is highly likely to become more desirable as a protection against rising rates and for easier refinancing opportunities.

3 Refinancings and Repricings Rule

The majority of transactions in both the US and Europe were refinancings and repricings as borrowers locked into the record low prices before the end of 2016. Big European deals included the EUR 4.97bn refinancing/repricing and new money loan for Jacobs

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

Douwe Egberts, the EUR 2.589bn refinancing for Ziggo, and the refinancings for Altice, Telenet and Virgin Media. Repricings included those for SIG Combibloc, First Data Group, Axalta and Catalent.

M&A activity slumped and private equity sponsors found it hard to compete with trade buyers. There were fewer jumbo deals but the AT&T and Dell deals were notable. Financing of M&A transactions by private equity firms and leveraged company acquisitions represented just over a third of all European leveraged lending. LBOs included Kuoni, Hotelbeds, Tipico, Solera, Euro Garages, Morpho and Veritas.

As most deals were refinancings and repricings, this meant that the banks earned fewer financing fees in 2016.

The default rate has remained low at 2% in the US and 2–3% in Europe, although certain sectors faced more financial stress such as retail, shipping, energy (e.g., in the US, the energy default rate at the end of 2016 was approximately 14%), metals and mining, service companies and healthcare.

4 Covlite TLB Takes Over as Debt Instrument of Choice in Europe

In Europe, term loans overtook high-yield bonds as the debt instrument of choice due to favourable pricing, limited call protection and covenants continuing to converge with high-yield bond covenants. There were several bond-to-loan refinancings. Covlite loans (with no financial maintenance covenant) became increasingly common in Europe other than for certain sectors such as retail and small deals finally representing the majority of deals towards the end of 2016. Other facilities had only one maintenance covenant, commonly a leverage covenant.

Revolving credit facilities in most covlite loans in the US and Europe included only a springing net leverage covenant; with the term lenders only having a remedy if the revolving facility lenders accelerate. These net leverage covenants are commonly tested at the end of a quarter (i.e. only on four days in a year) if the facility is drawn over a threshold amount (excluding letters of credit and sometimes other available facilities) and is set with a headroom of up to 35% (which headroom may even assume the facility is fully drawn). This covenant test has become easier to satisfy in many facilities as:

- the borrower may be able to do a pre-emptive equity contribution and round trip the cash afterwards;
- a covenant breach may be deemed cured if the lenders do not take action before the next covenant test and the borrower satisfies the next test (a European feature but not one seen in the US);
- the borrower can pay down the revolving facility and/or hoard cash just before the quarter end test;
- EBITDA add-backs often provide flexibility; or
- letters of credit are often excluded (in whole or in part) from the threshold, so the borrower can borrow under letters of credit to avoid a covenant test.

High-yield bond issuances fell over 10% both in Europe and in the US year on year. Although year-over-year high-yield issuance fell in the US, the financial, media and entertainment and energy sectors led in industry performance and the markets demonstrated a marked preference for credit quality with over half of high-yield bonds rated BB- or higher. Larger European deals included the EUR 9.5bn bonds and EUR 6.1bn loans for Altice, the EUR 3.16bn Ziggo bond, the EUR 3.6bn Schaeffler PIK notes and EUR 1.5bn Ardagh PIK notes.

5 Flex Rights

The scope of European flex rights is broadening to become closer to the scope of typical US flex rights, which would generally include flex on: pricing; extending the soft call protection period from six to 12 months after closing; extending the period during which most MFNs yield protection on incremental facilities; the proportion of excess cashflow that must be prepaid; the leverage tests applicable to restricted payments and restricted debt payments; interest coverage ratio-based covenants; freebie baskets; EBITDA add-backs and time periods; and amortisation (for amortising debt). A key difference is that arrangers can usually exercise flex rights reasonably freely in the US market to sell down to zero whereas, in Europe, sponsors tend to include many more hurdles on the exercise of flex rights which may impact the economics for arrangers as well as potentially increasing their underwriting risk. Arrangers may only have a flex right to sell down to 10–30% of their participation and the arrangers may need to pay away a minimum amount of their arrangement fees (which may be based on 100% selldown even if the arrangers retain some of the debt before exercising a flex); flexing terms rather than pricing may still require a fee pay away. The size of the facility may also be increased to fund OID or upfront fees with a corresponding adjustment to covenant headroom. Arrangers may need to show they cannot achieve a successful syndication without flexing which would be difficult in a tough market where arrangers will only at best achieve a partial selldown.

6 Transferability in Europe Reduces

European facilities typically provide that borrower approval is required for transfers unless they are made to existing lenders, affiliates or related funds, following an event of default or to lenders on an agreed whitelist. However, transferability is becoming more restricted in Europe:

- the event of default trigger for free transferability may now be replaced by only insolvency or payment events of default;
- the whitelists have become shorter and the borrower may be able to remove a few names a year;
- transfers to lenders which are industrial competitors with the borrower or are on a blacklist may be restricted even after an event of default; and
- a lender taking a revolving credit facility commitment may need to be a bank or financial institution with a minimum credit rating.

Lenders that breach the transfer provisions may be disenfranchised and transferability is likely to be a key focus for lenders in 2017. Some documentation has tripped up lenders. Blacklists may include generic descriptions such as loan-to-own investors or distressed debt or vulture funds so no transfer can be made to such entities even after an event of default. "Industrial Competitors" may be defined to include affiliates without excluding affiliates and controlling shareholders which are financial institutions and debt funds and which may end up disenfranchised. Also the restriction may apply to other types of debt transfer such as credit default swaps and total return swaps and a bank may enter into a swap and disenfranchise itself inadvertently.

Selectively, we have seen certain credits benefit from travelling structures, e.g., where a pre-engineered pathway to permit a change of control is allowed in circumstances that would normally give rise to an event of default. These are relatively rare structures and lenders need to be convinced of the specific story in order to accept this unusual flexibility.

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

7 Equity Cures – Cherry Picking Between the US and European Markets

Where loans do include financial covenants, the covenant cures have become more borrower-friendly, even as their relevance falls, because the financial covenants are less meaningful due to large headroom and EBITDA add-backs. It has become standard for a borrower to be able to inject equity (or, in certain circumstances in Europe, permitted subordinated debt) and add this cash to EBITDA to satisfy its financial covenant (an EBITDA cure) in the US for several years and an EBITDA cure is now becoming standard in Europe. However, European cures are more borrower-friendly than US cures in some respects. There is very often, in Europe, no limit on overcures, so the limit on the number of cures possible over the life of the loan (often five) can be side-stepped (although cures in successive financial quarters are usually not permitted) and if the borrower breaches its financial covenant but then meets the financial covenant when next tested, the earlier breach may be deemed cured if the lenders have not accelerated. Some borrowers have been looking to get the best of both markets for their equity cure.

8 More Incremental Debt

Increasingly, European facility agreements provide for incremental facilities to be incurred secured on the collateral as has been standard in the US for some time.

In both the US and European markets, negotiation revolves around the size of the freebie basket, reclassification of debt which has been incurred, the MFN sunset and, in Europe, flexibility to structurally senior debt as discussed below.

Debt can now often be incurred subject to the quantum of debt:

(a) meeting a *pro forma* net leverage ratio test;

(b) falling within a general "freebie" basket based on the greater of a hard cap and 50–100% of the borrower's EBITDA over the most recent 12 months;

(c) the amount of voluntary prepayments and debt buybacks of debt having the same security priority (the reload); or

(d) certain other additive components (e.g., other equity contributions and returns on investments in unrestricted subsidiaries).

The net leverage ratio incurrence test has become more flexible:

(i) the test often requires little or no de-leveraging from closing date leverage;

(ii) only senior debt secured on the collateral may be included in the test (thereby allowing structurally senior debt at non-guarantor restricted subsidiaries even though cash in all restricted subsidiaries can be netted off); and

(iii) the test may be at the borrower's election on the date the documentation is signed rather than when it is subsequently incurred even if the funds are not raised on a certain funds basis.

Borrowers may be able to use capped dollar baskets and then, once they can meet the leverage ratio test, reclassify the debt as having been made under the ratio basket. This reclassification then frees up the dollar baskets. Lenders generally resist the ability of borrowers to do this in relation to junior debt payments and other restricted payments. Although the new debt must generally mature on or after the maturity of the existing loan, a capped amount may be permitted to mature inside the maturity of the existing loan, but this is rarer in Europe and is often subject to flex in both the US and Europe. Due to the differences in European bankruptcy laws to US Chapter 11, there is more risk of holdouts by lenders of such early maturing debt. Hand in hand with the ability to incur more debt, including debt in acquired companies, borrowers have more flexibility to make acquisitions subject to a leverage test.

Repricing protection has weakened in Europe. The requirement that the yield on the incremental facility does not exceed 0.5–1.0% of the yield on the existing term loan (the "MFN") is limited to a sunset period of six to 12 months or sometimes dropped altogether or the requirement may only apply to the margin and/or the initial term loan. In the US, the survival of MFN limitations (whether the MFN sunset or the scope of application of the MFN) through syndication has depended on prevailing market conditions given that such limitations are commonly subject to flex.

Also, MFN protection may only apply to incremental facilities over a certain threshold or incurred under the free and clear basket or the reload basket but not the ratio test or which mature within a specified time after the latest maturity of the original term loan.

Alternative debt to an incremental facility under other debt instruments may be permitted (side car, or incremental equivalent, debt). Some facilities allow a borrower to retain debt in a company it acquires subject to *pro forma* net leverage not becoming worse post-acquisition than pre-acquisition or meeting a *pro forma* net leverage ratio.

In the US, incremental equivalent debt would usually have to be incurred by a credit party and secured only on collateral for the existing facility but European facilities have varied. The ability of a borrower to incur structurally senior debt has been a hot topic in Europe in 2016 due to the potential impact on recoveries. Under European bankruptcy laws it may not be possible to sell pledged shares in a company if the company's subsidiaries are borrowers of structurally senior debt unless the holders of that debt are party to an intercreditor agreement under which they have agreed to standstills and to release their claims on an enforcement sale of the pledged shares subject usually to fair market value protections. This is because holders of such debt may not be subject to a creditors' freeze on a bankruptcy and local bankruptcy laws may not give a route to release of their claims. Also, upstream guarantees by European companies are often subject to significant legal limitations. Some European facilities now include a limit on debt in non-guarantors and/or require the borrower of an incremental facility to be the same as the borrower of the existing term loan and/or not only limit the borrowing of debt to secure on collateral but also unsecured debt over an agreed threshold unless the lenders are party to an intercreditor agreement.

9 More Restricted Payments Out

Borrowers can increasingly pay dividends and other restricted payments from a basket which builds based on 50% of cumulative consolidated net income (rather than cumulative retained excess cash flow) plus various additions such as a starter basket with an EBITDA-based grower component, capital contributions and the fair market value of non-cash additions provided that a net leverage test is met; albeit the foregoing is commonly also subject to flex. In Europe, there is also increased ability to make restricted payments from the proceeds of certain asset sales. The net leverage test may require little or no de-levering from the closing date and, in the US, the net leverage test condition may only apply to restricted payments from the builder basket. Where a capital contribution can increase restricted payments capacity then a sponsor may be able to inject equity, net the cash off to meet a net leverage test and then, subject to meeting the ratio test, round trip the cash by paying a dividend (however, typically, a borrower cannot round trip the proceeds of an equity cure).

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

10 EBITDA Add-backs Keep Expanding

More US deals featured aggressive EBITDA add-backs using future company growth to increase EBITDA highlighted in the repricing of UFC's $1.375bn term loan. EBITDA add-backs continued to expand in Europe with add-backs for synergies and cost savings from acquisitions and also group initiatives and restructurings sometimes capped to a percentage of EBITDA per transaction or even, in some cases, uncapped. Periods to realise these have increased – sometimes to 24 months – and the periods may apply from when the relevant cost saving actions were taken. The previous requirement for independent verification may be replaced by a requirement that the realisation is achievable in the good faith determination of the officers of the company. There will probably be more focus in 2017 on whether add-backs are justifiable and supportable given the regulators' increased interest in add-backs. The EBITDA add-backs have a significant effect on covenant protection impacting not only financial covenants but also the incremental debt capacity, grower baskets, margin ratchets, capacity to incur debt or make restricted payments or acquisitions and the cash sweep. Investors have pushed back on add-backs that are not reflected in sponsor financial models or which are significantly inconsistent with peer credits and which may result in one-time artificial boosts to EBITDA (e.g., accelerated revenue recognition).

11 Softer Prepayment Requirements and Weaker Call Protection in Europe

European covenants restricting disposals may now allow a borrower's asset base to shrink without prepayment. A borrower may now be able to dispose of assets so long as it receives 75% of the consideration in cash (subject to certain exceptions) and the disposal is for fair market value. Any proceeds over a threshold may be permitted to be reinvested within 12–24 months or used to prepay *pari passu* debt with any surplus over a threshold being applied in prepayment until leverage has been minimally reduced. Thresholds have increased and thresholds may be per transaction with an annual aggregate threshold (excluding the per transaction limit). In addition, excess cash flow prepayments may be less due to longer cash sweep payment holidays and a higher threshold. Following limited de-levering, the percentage of excess cash flow required to be prepaid may step down and the requirement to prepay disposal proceeds may switch off. These step-downs are commonly subject to flex.

For first lien term loans, a borrower may only have to pay a soft call prepayment premium of 1% of the principal amount of the loan if it prepays the loan within the first six months and then only if the primary purpose is repricing subject to certain exceptions. No prepayment premium may be payable if the borrower is doing a "transformative transaction" or there is a change of control or IPO listing.

Recently, some European facilities have followed US facilities by permitting the borrower to designate some companies as "unrestricted subsidiaries" to which the covenants do not apply but are subject to ring fencing-type restrictions on dealings with the rest of the group. The uncapped ability to make disposals may mean that companies may make disposals of key collateral (such as intellectual property) to a subsidiary which has been designated an unrestricted subsidiary as long as the unrestricted subsidiary pays cash and any fair market value requirements are complied with depending on the conditions for the release of collateral. A borrower's ability to transfer value and asset strip from the restricted group to unrestricted subsidiaries has received increased scrutiny in the US and, in certain industries, lenders have started to push back.

12 Brexit

Brexit continues to dampen the European M&A market and lenders are wary of being long in sterling following the 20% drop in the value of sterling against the dollar. The uncertainties of Britain's future deal with the EU make forecasting difficult. UK businesses have remained robust but are expected to face the challenges from reduced inward investment and inflation and possibly an interest rate rise in the UK in response to inflation. Disruption to London as a financial centre remains uncertain. Any loss of passporting rights to the EU financial services market will be, initially, perceived as negative for London and questions around the scope of these post-Brexit privileges will remain a focus for financial institutions in 2017 and their contingency planning.

There are some potentially stormy waters ahead. The UK faces the risk of the imposition of WTO rules and trade tariffs if it does not agree to a trade deal with the EU.

With upcoming elections (at the time of writing) in France, Germany and the Netherlands, there could be further unexpected results in Europe.

13 European Regulation Increasing and US Regulation Decreasing?

In November 2016, the European Central Bank issued draft guidance on leveraged lending. The ECB guidance will apply to all significant credit institutions supervised by the ECB under the single supervisory mechanism including eurozone branches of non-eurozone-based credit institutions, which are, in each case, supervised by the ECB. The proposed ECB guidance will not apply to direct lenders or other unregulated non-traditional credit providers.

The draft guidance is similar to the US Interagency Guidance on Leveraged Lending issued by the US including the guidance that loans to borrowers with a total debt to EBITDA ratio exceeding six times are likely to raise concern and the requirement to monitor whether the borrower can repay over 50% of the total debt within five to seven years. The key ways the ECB guidance differs from the US guidance are:

(a) control of a borrower by a sponsor may make a loan a leveraged loan for the purpose of the ECB guidance whatever the leverage;
(b) whether the borrower's senior debt:EBITDA ratio exceeds three times is not a factor in determining whether the loan is a leveraged loan (unlike under the US guidance) although whether the total debt EBITDA exceeds four times is a factor (both for the US guidance and proposed ECB guidance);
(c) unadjusted EBITDA must be used;
(d) exposures in transactions with a settlement risk must be monitored such as "best efforts" transactions (including investment grade corporate bonds, although the ECB has since said that the draft Guidance was not intended to apply to bonds);
(e) it is not clear whether gross debt or net debt may be used;
(f) there is no carve-out for lending to borrowers in restructurings and workouts subject to risk mitigation whereas the US regulators have said that the US Interagency Guidance is not intended to discourage lending to borrowers in restructurings and workouts where the supervisory focus is on management actions to strengthen the credit; and
(g) loans to companies whose financial performance deteriorates and become more leveraged (fallen angels) will become leveraged loans; whereas under the US Interagency Guidance this does not happen until the loan has been modified, extended or refinanced.

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

When the US Interagency Guidance was introduced and leverage levels dropped as banks have become more comfortable with the US Interagency Guidance, the number of deals with leverage over six times has increased but the percentage of deals with leverage over seven times remains low; of course, leverage across different industries can vary dramatically.

Eurozone lending by banks may trend downwards whilst banks develop their policies. However, the ECB Guidance may have less impact than the US Interagency Guidance since the US banks lending in Europe are already subject to the US Interagency Guidance even though banks represent a higher proportion of investors in leveraged loans than in the US. Also, most European deals have a leverage close to 5.5 times, so the six times leverage test may not be a significant limitation, although the repayment capacity test may prove more restrictive for certain businesses. The proposed ECB guidance would not apply to a loan where the lender has a consolidated exposure under a threshold (currently proposed to be EUR 5m) so lenders would still be able to hold small participations in revolving credit facilities to support loans by direct lenders and bond deals. The use of unadjusted EBITDA would also be likely to have a greater impact on borrowers in sectors where *pro forma* adjustments are common, such as the tech sector. The rules relating to hung bridges may generate some secondary market opportunities for debt funds.

The heads of all three US regulatory agencies will change in 2017, which may result in a shift in approach. Broad regulatory reform is anticipated with the Trump administration in the US and President Trump issued an executive order directing the Treasury Department to consider revising the Dodd Frank rules – setting the tone for "business friendly" policies expected during his administration. It is unclear whether this will result in a relaxation of risk retention rules or leveraged finance guidance and any potential effects on the debt markets. Moves to revise Dodd Frank may lessen regulatory and compliance burdens for banks and other depository institutions but might also not translate to a materially increased appetite for incurring risk and entering new markets or products. However, changes in 2017 to risk retention provisions (e.g., moving from risk retention of 5% of fair value to 5% of the equity in a CLO) could boost CLO issuance and more CLO-favourable measures are anticipated under a Trump administration. A boost to securitisation in 2017 could help smooth some of the technical bumps that have unsettled the markets from time to time in 2016 and would permit for a further deepening of the syndicated lending market. European CLO issuance remains relatively weak, in terms of relative total volume, to USD-based CLOs; this remains an ongoing limitation in non-USD markets and an area of ongoing scrunity by European regulators in 2017. The ECB may wait until it is clearer whether there are likely to be changes to the US Interagency Guidance before issuing the final ECB Guidance. The Bank of England has declined to issue guidance for the time being.

US non-bank lending institutions continued to benefit from the ability to lead and sell aggressively termed deals traditional arrangers are unable to provide. Increasing investor demand for US leveraged loans has allowed entities not subject to regulation to take over in arranging and repricing deals significantly over regulators' six times leverage test and additional scrutiny – pushing US average leverage ratios higher.

Although the US has had anti-tying rules for many years, this has not been the case in the UK. In 2016, the UK Financial Conduct Authority proposed a prohibition on clauses containing rights of first refusal and clauses which prevent clients from sourcing future services from third parties regardless of the terms. The prohibition covers corporate finance services carried out from an establishment in the UK in investment and corporate banking engagement letters and contracts. Exceptions would apply to rights to pitch, rights to match and bridge loans with a term of less than 12 months.

14 Direct Lending Remains Robust

Direct lending continued to grow in Europe, although it fell slightly in the US, where yields were more volatile. Direct lenders have benefited from increased regulation of banks both restricting underwriting and causing banks to sell loan assets to meet regulatory capital requirements. Direct lending has become an important source of capital for mid-market deals and, increasingly, for larger deals particularly in Europe. European deals included Are's EUR 250m loan for Eurazeo's acquisition of Fintrax and ICG's EUR 155m loan for Caledonian Investment's acquisition of Gala Bingo by Caledonian.

The direct lenders still have strong competition from banks. Banks have the ability to fund much larger loans at lower pricing and on terms that are generally not significantly less favourable than those on offer from direct lenders. Direct lenders have so far largely resisted covenant-lite lending, but they may not be able to hold out on larger deals in a competitive market. In the US, there is a divergence between direct lenders in the lower middle market and those doing larger deals. The larger deals have attracted sponsors which have needed to fill the gap when banks have retreated e.g., when technical volatility in 2016 has caused the market to back up. As technicals improved in 2016, those direct lenders who pushed to expand their market share during technical market turbulence were rewarded with strong returns.

If Brexit causes market dislocation, this may favour direct lenders but many do not want to be long in sterling. The ECB has also indicated that it is reviewing whether to regulate non-banks which could result in the loss of a key competitive advantage for direct lenders over banks.

15 US Tax Reform

While a coherent and integrated tax reform package has not yet crystallised in the US at the time of writing of this article, it is noteworthy that US tax reforms are also being considered which would potentially reduce corporate income tax rates to 15% and allow companies to elect to forego interest expense deductibility in favour of immediately expensing capital investment. The deductibility of interest expense would also be limited to interest income. This would reduce the advantage of leverage in acquisition structure and increase the cost of debt so US borrowers may start to structure deals using less debt. Proposals to tax carried interest as ordinary compensation at a top rate of 33% would also reduce returns to sponsors. The impact of such a radical overhaul of deductibility will be significant. It is hard to immediately see how current US dollar debt liquidity (and the underlying structures that create such debt liquidity) will be rapidly transformed into increased equity funding.

However, a successful plan could provide a boost to M&A activity and provide a tax holiday for an estimated $2.6 trillion in overseas funds held by domestic businesses and provide the capital for increased M&A activity, capital expenditures and stock repurchases.

Other governments have introduced restrictions on corporate tax-based erosion and profit shifting that has reduced tax deductibility on sponsor shareholder loans and PIK debt.

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

16 Syndicated Lending

Overall in the US, syndicated lending remained broadly flat and in Europe dropped slightly with the focus being on refinancing. Many higher grade investment grade companies in Europe had already refinanced with low-priced loans so there was a drop in European refinancing activity and also a drop in large M&A activity. Lafarge, ZF Friedrichshafen, Glencore, Nestle and Orange all did large European IG refinancings.

Surges in market appetite have driven loose covenant packages in the US in 2016. Strong credits have attracted over-subscriptions and top-tier sponsors have taken advantage of investor demand to drive terms. If these credits perform during future downturns, then investors will be rewarded. On the other hand, investors will likely face materially weaker recoveries and be punished for their excessive optimism if these credits do not stand the test of time. Credit discipline among loan-to-own investors, credit opportunity funds and distressed investors represents the other end of the spectrum. We have seen strict discipline among these investors, particularly in the energy and entertainment sectors in the US in 2016.

The middle market, especially among smaller underwriting clubs, has seen a deepening of liquidity among non-bank lenders. Leading underwriters have built internal syndication capacity that allows for deals to be sold down to internal vehicles and managed accounts, as opposed to external third-party buy-side shops. Liquidity has also been facilitated by banks financing these non-bank lenders through a variety of structures (e.g., warehouse lines). Deeper pools of capital have allowed these non-bank arrangers to offer unitranche and other credit solutions (e.g., second lien loans, unsecured loans and private high-yield) that are often attractive to borrowers, both in terms of yield and execution. Q4 2016 saw a decline in quality deal flow for these entities as pricing compressed and leverage was stretched. Strong deal flow for many of these entities has continued into Q1 2017.

17 ABL Lending

US asset-based loan issuance was down in 2016 although deal size increased, particularly in the $300–500m range. ABL carries a lower cost of capital to banks and higher recoveries. Around two thirds of the deals were refinancings and the larger deals attracted a lot of competition and occasionally pricing as low as 1.25% over LIBOR. Asset-based lending structures in Europe can be more complex and time consuming to implement due to local bankruptcy laws particularly if done on a cross-border basis but may become increasingly popular in response to the ECB Guidance. Servicing is also evolving with new technology and this is likely to facilitate more ABLs.

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, Head of Leveraged Finance and Head of Private Debt Capital, 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 is also 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, investment grade and corporate loans, 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*. "A range of impressed clients note that Caroline Leeds Ruby is 'really first-class', 'stays cool under pressure' and has 'excellent business acumen'" (2013). "Very diligent, extremely responsive, flexible and has deep technical knowledge" (2015).

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

Escrow Funding in the Term Loan B Market

Davis Polk & Wardwell LLP

Meyer C. Dworkin

Samantha Hait

Background – Escrow Funding

The concept of "funding into escrow" has long been familiar to participants in the high-yield bond market. Whether to bridge the uncertainty of a closing date (*e.g.*, awaiting satisfaction of a regulatory condition with a timeline outside of the parties' control) or to seize on favourable terms and pricing then available in the capital markets, companies have for many years issued bonds pursuant to escrow arrangements in advance of their actual need for the proceeds. Such escrow arrangements generally include the issuance by the issuer of the bonds (either the company or, as discussed below, a special purpose subsidiary used for the escrow period) against the deposit of the proceeds with an escrow agent, which proceeds are typically pledged to the bondholders. The issuer will usually be required to prefund the escrow with some amount of interest and, if relevant, any special redemption premium that might be due upon breaking of the escrow without closing. Upon the satisfaction of specified escrow release conditions, the escrow agent releases the proceeds to the issuer and, if the issuer was initially a subsidiary, the company merges with the issuing subsidiary or otherwise assumes all of the issuing subsidiary's obligations under the bonds, the indenture and any other issuer documents. If the escrow release conditions are not satisfied prior to the agreed outside date (or any other escrow termination event occurs), the escrow agent will return the proceeds to the bondholders on behalf of the issuer in the form of a special redemption. Whether the special redemption includes a redemption premium is the subject of negotiation, but importantly, any negotiated premium will be significantly less than a "make-whole" payment.

Escrow arrangements have proved to be especially useful, and have therefore become common, for high-yield bonds issued to finance an acquisition. In this case, the relevant considerations include: that a road show will often begin before the parties have certainty as to when the final conditions to closing the transaction will be satisfied, with investors expecting an issuance to occur promptly after the end of that road show; that pricing and availability in the high-yield bond market have historically proved to be volatile; and that the acquisition agreement will almost never include a true "financing-out" (*i.e.*, a condition to closing the acquisition that financing is, in fact, available to the Buyer). To eliminate the risk that a Buyer is required to close a previously agreed acquisition at a time the capital markets for bonds have deteriorated or even "closed", the Buyer may choose to strike while the proverbial iron is hot, taking advantage of favourable market conditions, even if the Buyer has a committed "bridge" financing to backstop any ultimate unavailability. Bondholders are generally willing to permit escrow fundings, as interest accrues on the bonds while held in escrow even though the issuer has no access to the bond proceeds (which, as noted above, typically collateralise the issuer's obligations to redeem the bonds upon escrow termination without closing).

The issuance of term B loans ("TLB") into escrow in the acquisition financing context is a more recent innovation and remains significantly less common. An increasing number of recent TLB acquisition financings with commitments of six months or longer, however, have provided the committing lenders with the right to demand the funding of the committed TLB into escrow no later than an agreed date if the related acquisition hasn't closed – and the TLB hasn't been funded to the borrower – prior to such date (the "Required Escrow Funding Date").

In contrast to the use of escrow funding in the bond context, which, as noted above, may be driven by uncertainty of timing for closing or an issuer's desire to take advantage of favourable market conditions, a TLB escrow funding is most typically intended to permit the initial committing lenders to, in effect, replace their funding commitments by syndicating a funded TLB to institutional and other investors prior to the closing of the acquisition and expiration of the long-dated commitment period. As in the capital markets context, the escrow approach creates little practical risk to the funding TLB lenders as, once funded, the TLB proceeds are held by the escrow agent in the escrow account (subject to the lien in favour of the lenders), and either released to the Buyer upon the closing of the acquisition or, if the acquisition is terminated or does not close by the agreed outside date, repaid to the TLB lender.

Despite the increasing frequency of escrow demand rights in commitment letters, TLB arrangers have in practice seldom had cause to use them. Given the relatively low usage of escrow arrangements in the TLB context, the precise mechanics of a TLB escrow funding (other than with respect to basic economic terms and, sometimes, conditionality) are not typically specified in the related commitments letters. Instead, such commitment letters most typically require that the TLB be funded into escrow on the Required Escrow Funding Date on "customary" terms and conditions to be reasonably agreed by the parties prior to such date. This article discusses several common issues that arise when parties seek to implement TLB escrow funding arrangements.

Issues to Consider in TLB Escrow Fundings

Fees and Interest

Instead of escrow funding, TLB acquisition financings with medium-dated commitments of three months or more most typically require that the borrower pay the committing TLB lenders a "ticking

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

fee" that accrues on the undrawn and unfunded TLB commitments. This fee permits the lead arrangers of such financings to syndicate the commitments to institutional lenders and other investors (at favourable pricing) in advance of closing and hold that syndicate together by compensating the TLB lenders for the period before the actual funding. Ticking fees usually begin to accrue 30–60 days following allocation of the TLB commitments to such investors[1] until the earliest of (i) the date the TLB is funded into escrow (at which point interest on the TLB accrues) (the "Escrow Funding Date"), (ii) the closing of the acquisition and the initial funding of the TLB to the borrower (the "Closing Date"), and (iii) the termination of the TLB commitments.[2] The ticking fee percentage generally steps up every 30–60 days from an initial percentage – often 50% – of the interest rate margin applicable to the TLB to 100% of such margin *plus* then-applicable LIBOR (sometimes inclusive of any applicable LIBOR "floor"). If the ticking fee begins before full allocation of commitments (and therefore before the pricing terms of the TLB have finally been determined), the calculation of the applicable margin may give effect to any potential increase in spread after application of any available "market flex" provided for in the fee letter. While such ticking fees apply to medium-dated commitments whether or not an escrow funding of the TLB is contemplated, in transactions where the escrow demand right exists, a possible consequence of a borrower's failure to comply with an escrow demand from the committed lenders on the Required Escrow Funding Date is that (i) the ticking fee is further increased to the maximum spread permitted pursuant to "market flex" provisions in the fee letter plus, to the extent not already included in the calculation of the ticking fee, any applicable LIBOR floor, and (ii) the borrower will be required to pay the TLB underwriting fee on such date.

A second fee payable to lenders in nearly every TLB is an upfront fee calculated on the principal amount of the TLB actually funded to the borrower. Upfront fees are generally reflected as "original issue discount" on the loan or documented as a fee paid by the borrower but, in practice, such fees are paid through "net-funding", whereby each lender reduces the amount actually advanced to the borrower by the upfront fee payable to it. In either case, the borrower owes the full stated principal amount of the TLB to the lender. In the escrow funding context, it is most typical that the TLB is net-funded into escrow, with each lender retaining any upfront fee payable to it. Assuming the acquisition closes and the escrow proceeds are released to the borrower, the usual rules apply and the borrower is liable for the full stated principal amount of the TLB. In contrast, where the escrow terminates and the escrow proceeds are instead returned to the lenders, the most common approach – reflecting the commercial understanding that upfront fees are payable solely upon the funding of the TLB to the borrower – is that the return of the net-funded escrow proceeds to the lenders (plus accrued interest) is deemed to be a repayment in full of the TLB. Of course, as with some bond escrow arrangements, the parties might decide to negotiate a premium payable to the lenders upon this "special prepayment".

In addition, TLB lenders expect interest – including both the applicable LIBOR or base rate and margin – to accrue on their loans from the Escrow Funding Date and throughout the escrow period. As a result, borrowers are required to either (i) pre-fund the maximum amount of interest payments that may accrue during the escrow period, or (ii) periodically pre-fund such additional interest payments to the escrow account, with a break of escrow and return of funds to the lenders if the borrower does not satisfy its pre-funding obligations.[3] Many escrow agreements permit the proceeds of the TLB and any pre-funded interest payments to be invested in United States treasuries or other short-term, high-grade investments during the escrow period to allow a minimum return to the borrower. If so, the related escrow agreement will require the borrower (or, in the case of a borrower that is a special purpose vehicle ("SPV") or unrestricted subsidiary, as discussed below, a creditworthy affiliate) to "top up" the amounts on deposit in the escrow account to account for any losses on investment. Accrued interest on the TLB held in the escrow account is then paid to the lenders upon the earlier of release of the escrow proceeds to the borrower in connection with the closing of the acquisition and the date the escrow terminates (if the acquisition terminates) and the TLB are repaid to the lenders.

Existing Indebtedness

The creation of a TLB escrow structure is relatively straightforward in the context of a private equity sponsored acquisition, in which the acquisition entity/borrower (the "Buyer") is a newly established entity formed solely for purposes of consummating the acquisition and related financings. Such SPV will generally have no existing indebtedness or other arrangements that would limit its ability to fund the TLB into escrow. In contrast, where the Buyer in an acquisition financing is a company with existing indebtedness ("Existing Debt"), the initial borrowing and funding into escrow must be permitted by the terms of such Existing Debt.[4] Especially if the Existing Debt is non-investment grade, with covenants strictly limiting the incurrence of new debt and liens, the Buyer may be prohibited from incurring such additional acquisition financing and is almost certainly prohibited from pledging the escrow account to secure its repayment obligations on the escrowed TLB.[5] To address this complication, and where available, the most common solution is for the initial "borrower" during the escrow period to be an "unrestricted" subsidiary of the Buyer (the "Escrow Borrower"), similar to the practice in high-yield bonds as described above. Such "unrestricted" Escrow Borrower is excluded from the "restricted group" that is governed by the debt, liens and other negative covenants in the Existing Debt and may, therefore, incur the escrowed TLB and pledge the escrow account to the TLB lenders without violating the terms of such Existing Debt.[6] To ensure that the TLB lenders are ultimately secured and guaranteed on a *pari passu* basis with the lenders under the Existing Debt of the Buyer, at the closing of the acquisition, the Escrow Borrower will generally merge with and into the Buyer, with the Buyer and its other restricted subsidiaries surviving as the obligors of the TLB.

Documentation and Conditionality

Where the Buyer is an SPV established solely for purposes of consummating a private equity sponsored acquisition and the relating financing, the borrower and lenders will generally enter into the definitive credit agreement on or prior to the Escrow Funding Date. Such credit agreement will include the agreed mechanics for the escrow funding, as well as the specific terms governing the TLB during the escrow period (which terms will include customary negative covenants and events of default with respect to the Escrow Borrower). In contrast, where the TLB is issued by an "unrestricted" subsidiary of the Buyer that is not subject to the Existing Debt of the Buyer (but that will later become subject to such Existing Debt via merger with and into the Buyer), the terms of the escrowed TLB may be evidenced pursuant to a short-form credit agreement or promissory note (the "Short Form Credit Documentation").

In utilising this latter approach, it is important to note that such Short Form Credit Documentation does not typically include the customary covenants and events of default found in a fully negotiated credit agreement. Nevertheless, TLB lenders have generally become comfortable with such lack of detailed and specific covenants and events of default on the basis that the Escrow Borrower is, during

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

the escrow period, simply a shell entity with no operations, assets or liabilities other than the escrowed funds. As such, so long as (i) the Escrow Borrower agrees to be subject to a customary "HoldCo" negative covenant prohibiting it from engaging in any activity other than performing its obligations under the escrow agreement and incidental activities, and (ii) the TLB proceeds are held in the escrow account pursuant to the escrow agreement, TLB lenders are adequately protected. Still, certain lenders have sought to have the Escrow Borrower become subject to some (if not all) of the covenants under the Existing Debt of the Buyer by incorporating such covenants into the Short Form Credit Documentation.

Whether the escrowed loans are evidenced by a credit agreement or pursuant to Short Form Credit Documentation, the conditions to escrow release should be identical to the conditions to funding the TLB directly to the borrower set forth in the commitment letter. The one notable exception is that, in the escrow context, the escrow agent will require a certification that the conditions to the release of the escrowed TLB to the borrower have been satisfied. To ensure lender control over the escrow release process, while such certification is in addition to what is required for customary "SunGard" limited conditionality, borrowers generally accept that this incremental conditionality is necessary to effect the escrow construct.

TLB Commitment Termination

Just as commitments under a credit facility terminate upon the funding of the TLB to the borrower, committing lenders in the escrow context likewise seek to ensure that their commitments to the borrower under a commitment letter terminate upon the funding of the TLB into escrow. If the TLB Commitments do not terminate upon escrow funding, the initial committing lenders will effectively have double exposure (and potentially be required to maintain excess regulatory capital) as the TLB has been funded into escrow (including by such lenders) but the initial committing lenders remain committed to fund the TLB on the Closing Date if the escrowed proceeds are for any reason unavailable to the Buyer. In contrast, Buyers in the escrow context may argue that the TLB commitments of the committing lenders should remain outstanding until the TLB proceeds are released from escrow to the Buyer. Such argument is based on the fact that the Buyer has contracted with the committing lenders for the TLB to be available to consummate the acquisition on the Closing Date and any risk around the escrow structure should be borne solely by the initial lenders. As a contractual matter, the best way for lenders to protect themselves against this "double counting" risk is to specify in the commitment letter that the TLB commitments thereunder are reduced on a dollar-for-dollar basis by the principal amount of the TLB funded into escrow. While many commitment letters are silent on this issue, Buyers have, where pushed, generally accepted such reduction language so long as the commitment letters also specify that the conditions to the release of TLB proceeds from the escrow account are identical to (or no more onerous than) the conditions precedent to the funding obligations of the TLB lenders under the commitment letters on the Closing Date. Buyers have, in most cases, been successful in resisting any incremental conditionality in the escrow context (with the one ministerial exception of certification to the escrow agent noted above).

Bankruptcy Considerations

While, as noted above, both Buyers and lenders benefit from the use of escrow fundings in the TLB context, such escrow arrangements do introduce additional risk to the committed acquisition financing arising from the Escrow Borrower's or even the escrow agent's potential filing of a Chapter 11 bankruptcy case.

In the event of a bankruptcy filing by the escrow agent, both the Escrow Borrower and lenders will seek to ensure that the TLB escrow structure remains in place. Under a valid escrow arrangement, upon deposit of funds into an escrow account, (i) legal title to the escrow remains with the grantor (here, the lenders) until the satisfaction of the release conditions specified in the escrow agreement, and (ii) the grantee (here, the Escrow Borrower) has only an equitable interest in the escrow arrangements, obtaining legal title only upon satisfaction of such conditions precedent.[7] Because, in such a valid escrow arrangement, the escrow agent does not hold a legal or equitable interest in the escrowed funds, such funds are not considered property of the escrow agent's bankruptcy estate[8] and, upon court order, should be released to the Escrow Borrower (upon satisfaction of the escrow release conditions) or returned to the lenders upon escrow termination.

In the event of a bankruptcy filing by the Escrow Borrower, the TLB lenders may seek to argue that the TLB proceeds never constituted property of the Escrow Borrower – that they remained property of the lenders subject to the escrow arrangements – and, as such, the escrow agent should immediately and directly return such proceeds to the lenders. Such a result would be extremely advantageous to lenders as they would receive a timely repayment of the TLB in full without having to navigate the lengthy and often contentious Chapter 11 process (as would be the case without an escrow arrangement, even for a creditor fully secured by cash). A potential challenge to such an argument is that a "valid" escrow arrangement for purposes of the bankruptcy code is one in which the proceeds are held in a "neutral" account in the name of an escrow agent (similar to an attorney's escrow account in the residential real estate context). In TLB fundings, in contrast, the escrow account is generally opened by the escrow agent in the name of the Escrow Borrower and subject to investment at its direction. While there is no direct case law on point, it is unclear whether a bankruptcy court would deem such arrangement to be a valid escrow arrangement or recharacterise this as a classic financing secured by a pledge of the Escrow Borrower's deposit account at the escrow agent.

Conclusion

Given that funding a TLB into escrow is a useful way for committing lenders to practically (or, ideally, contractually) reduce exposure with respect to long-dated commitments with little added risk for Buyers, we expect to see more committing lenders asking for escrow demand features to help defray or reduce their exposures. With the increasing frequency of TLB escrow arrangements, we can also expect further consensus among market participants on how to address the issues discussed in this article, including creative solutions addressing potential conflicts with existing debt documents – we have already begun to see the beginnings of a trend in credit documentation of including express provisions permitting future escrow arrangements – and final resolution of whether TLB commitments terminate upon escrow funding.

Endnotes

1. Note that some borrowers may seek to have the ticking fee begin to accrue only following allocation of all of the commitments (or following 30–60 days after allocation of all of the commitments). While less common, some lenders have addressed this request by (i) having the ticking fee begin to accrue upon the earlier of (x) the date on which all of the TLB commitments have been allocated to the market, and (y) an outside date, or (ii) allowing the ticking fee to accrue only on the allocated portion of the TLB commitments.

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

2. Note that in certain transactions, ticking fees, similar to commitment and upfront fees, are payable by the borrower solely to the extent the Closing Date occurs (or the TLB are funded into escrow).
3. Another, less common, approach is to permit the borrower to provide other satisfactory credit support for future interest payments (including, for example, equity commitment letters from a related private equity sponsor).
4. We assume for the purposes of this article that, as is often the case, the Existing Debt may not be amended to expressly permit the escrow funding.
5. Note that even where the Buyer has sufficient capacity under the debt and lien negative covenants of the Existing Debt to incur the escrowed loans and pledge the escrow account, there may be other limitations on entry into the escrow funding (e.g., if the Buyer is seeking to use "incremental" debt capacity to incur the escrowed loans, the customary requirement that incremental loans not be secured by any collateral that does not secure the Existing Debt would be violated by this structure).
6. The creation and designation of a subsidiary as "unrestricted" under Existing Debt may be subject to various conditions. Where there is no capacity under such Existing Debt to designate an "unrestricted subsidiary" for this purpose, a less common, but equally effective solution may be to use a sister company or other affiliate of the Buyer that is likewise outside the scope of the "restricted group", which upon closing similarly merges with and into the Buyer.
7. *See* In re TTS, Inc., 158 B.R. at 585–88. *See also* 28 Am. Jur. 2d *Escrow* § 18 (2007).
8. In re Dreier LLP, 527 B.R. 126, 132 (S.D.N.Y. 2014).

Meyer C. Dworkin
Davis Polk & Wardwell LLP
450 Lexington Avenue
New York, New York 10017
USA

Tel: +1 212 450 4382
Email: meyer.dworkin@davispolk.com
URL: www.davispolk.com

Mr. Dworkin is a partner in Davis Polk's Corporate Department, practising in the Credit Group. He advises lenders and borrowers on a variety of credit transactions, including acquisition financings, asset-based financings, debtor-in-possession financings and bankruptcy exit financings and structured financings.

In addition, Mr. Dworkin regularly represents hedge funds and corporations in negotiating prime brokerage agreements, ISDA and BMA-standard agreements and other trading and financing documentation and other complex structured financial products.

Mr. Dworkin's clients have included many major financial institutions and corporations across various industries, including Emerson Electric Co., Facebook, Ingram Micro, Noble Group and V.F. Corporation.

He joined Davis Polk in 2005 and became a partner in 2013.

In 2002, Mr. Dworkin received his B.S., *magna cum laude*, in Engineering Management from Columbia University School of Engineering and Applied Science, and in 2005, he received his J.D., *cum laude*, from Harvard Law School.

Samantha Hait
Davis Polk & Wardwell LLP
450 Lexington Avenue
New York, New York 10017
USA

Tel: +1 212 450 4556
Email: samantha.hait@davispolk.com
URL: www.davispolk.com

Ms. Hait is an associate in Davis Polk's Corporate Department, practising in the Credit Group. She advises financial institutions and borrowers on a variety of secured and unsecured corporate finance transactions, including acquisition financings, asset-based financings and fund financings.

She joined the firm in 2011.

In 2008, Ms. Hait received her B.A., *summa cum laude* and Phi Beta Kappa, from Brandeis University and in 2011, received her J.D., *magna cum laude* and Order of the Coif, from Fordham University School of Law.

DavisPolk

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

Commercial Lending in a Changing Global Regulatory Environment: 2017 and Beyond

Bill Satchell

Elizabeth Leckie

Allen & Overy LLP

The political changes of 2016, with the Brexit referendum in the UK and election of Donald Trump in the November 2016 US election, herald changes for the world of financial services regulation. For the past few years, regulators globally have been focused on a prescriptive approach to supervision and oversight in response to the 2008 financial crisis. Both nationally and internationally, regulators have been implementing a wide range of rules intended to mitigate systemic risk with an emphasis on capital requirements, stability, the risks posed by failure of a big financial institution and the desire to protect taxpayers from the burden of bailouts. The international coordination of these efforts has been aided by the work of the Financial Stability Board (FSB) and the Basel Committee for Banking Supervision (BCBS) of the Bank for International Settlements and a faith in a collective response to shared global problems.

A Change in Tone for Financial Services Regulation

While the developing political landscape makes prediction a treacherous game, it is clear that there will be a change of tone for financial services regulation going forward. Certainly, in the US, the new administration has made clear its desire to ease the regulatory burdens it sees as hampering business generally and to free banks to lend. It has indicated that it views financial services regulatory reform as a priority and that repealing or amending Dodd-Frank will be at the centre of those efforts. In addition, new appointments to the federal agencies which regulate financial services will also have an effect in the nearer term on how regulations are enforced and may be an important practical means of easing regulatory burdens. In addition to major political appointments such as the Treasury Secretary, there are several key appointments in the agencies which will become vacant during 2017 as the terms of the current incumbents expire, including the Comptroller of the Currency and changes in the composition of the Board of the Federal Deposit Insurance Corporation (FDIC). In an era when less deference to the international order is clearly part of the political zeitgeist, a movement away from harmonising global financial regulation is also likely, and the administration has already made clear that it shares concerns that the Basel Accords and other international initiatives may not be consistent with the best interests of US financial institutions.

In February 2017, President Trump issued an Executive Order announcing steps to revisit the rules enacted after the 2008 financial crisis and giving the Treasury the authority to restructure major provisions of Dodd-Frank. Specifically, the order directed the Secretary of the Treasury to report within 120 days on the extent to which existing laws, treaties, regulations, guidance, reporting and recordkeeping requirements and other government policies inhibit federal regulation of the US financial system in a manner consistent with the goals of the new administration.

Dodd-Frank Revisited

The signature provisions of Dodd-Frank included:

- the creation of the Financial Stability Oversight Council (FSOC) to serve as an inter-agency body charged with identifying and responding to emerging threats to financial stability, together with the authority to designate a non-bank financial firm as a systemically important financial institution (SIFI) and to designate financial market utilities (FMUs) and certain payment, clearing and settlement activities as systemically important, as well as the authority to provide recommendations for resolution of supervisory jurisdictional disputes among member agencies;
- the creation of the Orderly Liquidation Authority (OLA), that enables the FDIC to serve as receiver for any financial institution (not just banks), with authority to transfer assets and liabilities to newly organised "bridge" entities to help avoid taxpayer bailouts and maintain the ability to continue critical services;
- the "Volcker Rule", which sharply limits most kinds of proprietary trading and affiliation with private funds by US banking organisations, restricting banks from engaging in proprietary trading or sponsoring or holding ownership interests in private funds and applies also to both domestic and (to a limited extent) international activities of foreign banks that have branches, agencies, commercial lending subsidiaries or bank subsidiaries in the US;
- the introduction of clearing, trading, reporting, margining and business conduct requirements on swap market participants, including requirements for certain over-the-counter swaps to be centrally cleared and traded, for swap dealers and major participants to be registered and subject to regulation, and for initial and variation margin to be posted for non-cleared swaps; and
- the introduction of credit risk retention rules requiring originators or sponsors of asset-backed securities (ABS) to retain risk with respect to securitisations. These initiatives recognised the moral hazard associated with originating assets and securitising them, and sought to align the interests of sponsors or originators and investors by requiring sponsors or originators 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. These retained interests – particularly horizontal interests (such as an equity tranche) – could be

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

particularly costly in capital terms for banks as a result of provisions that (especially under US rules) penalise the holding of equity. 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 selected them in the open market, a measure that is thought to be adversely impacting new CLO offerings.

Prospects for Legislative and Regulatory Reform

Addressing any of these rules would require new legislation, and much of the speculation around Dodd-Frank reform has centred on proposals contained in the Financial CHOICE Act, introduced to Congress by the House Committee on Financial Services Chairman Jeb Hensarling in 2016. Whether a modified version of the CHOICE Act is reintroduced to Congress in substantially the same form in 2017 or whether a new bill is introduced instead, it is viewed as giving some insight into the likely financial regulatory framework going forward.

The CHOICE Act would have significantly amended several provisions of Dodd-Frank, replacing them with what were described as simpler and more market-based measures. They included: affording broad regulatory relief to banking organisations that maintain an average leverage ratio of 10% or more and are well-managed, which would permit electing institutions to avoid complex capital requirements and systemic risk oversight; stripping FSOC of its power to designate non-bank SIFIs; eliminating FMUs; repealing the Volcker Rule; removing risk retention for all asset classes except mortgages; restructuring the Consumer Financial Protection Bureau (CFPB) and restricting its authority to regulate consumer financial services and products; eliminating OLA and in its place creating a new chapter of the Bankruptcy Code to address financial institution insolvencies; and other proposals which would change the manner in which financial regulatory agencies would be organised and likely impose greater accountability, including significant changes to some established administrative law doctrines regarding a regulatory agency's ability to interpret statute.

However, in practical terms, even though the Republicans have control of both houses of Congress at the beginning of 2016, it may be difficult in the near term to pass the legislation necessary to reform Dodd-Frank. There are other legislative priorities which may take precedence, such as healthcare and tax reform, but in any event it will not be easy to get any proposed legislation through the Senate, as Democratic Senators can use the filibuster to obstruct the progress of bills they oppose, and there is strong political sentiment against certain of the changes likely to be included in any proposed bill relating to financial services regulatory reform. Unless they are willing to take steps to change the filibuster rules, in order to pass legislation the Republicans must be able to muster the 60 votes necessary to end a debate of the bill in the Senate. Currently that would require some Democratic support, which in turn would require potential modification of the proposals to make them more palatable to moderate Democrats. If there is a willingness to defer any legislative solution until after the 2018 elections, there is the possibility that by then the Republicans will have increased their majority by winning some contested seats from the Democrats.

While it has yet to be fully articulated, there is also some suggestion that a movement to return to restrictions similar to Glass-Steagall that would have the effect of separating the lending business from other capital market activities of financial institutions could have some political traction.

Even Representative Hensarling now acknowledges that any legislative action with respect to the yet-to-be-introduced Financial Choice Act version 2.0 faces obstacles in the current legislative environment. Indications are that version 2.0 would retain the key features of version 1.0, such as capital relief for electing banking organisations that maintain an average leverage ratios of 10% or greater and are well-managed, that might allow affected institutions greater capacity to lend. Even without legislative change, over the first half of this year the Administration will be able to appoint key leaders across the financial services agencies, including the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, and the Commodity Futures Trading Commission, that could result in a significant liberalisation of rules implementing the Volcker Amendment, the Risk Retention requirements, Title VII (relating to derivatives), and Basel III. Such leadership changes might also prompt greater supervisory flexibility in applying the Leverage Lending Guidelines and the application of discretionary capital surcharges, as well as increased diffidence in exercising the authority of the FSOC and the criticism of living wills.

Other legislative changes, while not specifically focused on financial services regulatory reform, could have an effect on the loan market. The most significant of these is the new administration's proposals for tax reform. While the details are yet to become clear, it is possible that any new legislation might significantly reduce the interest expense deduction with a view to eliminating purely tax-driven incentives for leverage. If adopted, these proposals could impact more highly leveraged transactions and prompt more highly leveraged borrowers to reevaluate their capital structure and decrease their debt load.

The Administration's focus on national security and the vigorous administration of immigration and criminal laws suggests that there may be little respite from intense regulatory pressure for compliance by financial institutions with respect to AML, OFAC Sanctions and cybersecurity. While the Administration may be open to initiatives to seek greater efficiencies in the performance of KYC/CID with respect to institutional counterparties and improvements in SAR reporting, it is more difficult to know whether the Administration will embrace enhanced beneficial ownership requirements imposing mandatory reporting of beneficial ownership of newly organised business organisations. Whether such measures can potentially streamline some of the administrative burdens surrounding the syndication process remains to be seen.

A Change in Attitude Toward International Regulatory Initiatives

Over recent years, the Basel Committee on Banking Supervision has moved closer to finalising its framework of banking reforms under the Basel accords, steadily working through implementation of the requirements for a new global liquidity framework and higher capital requirements contemplated by Basel III. Significant elements included a capital conservation buffer, a countercyclical buffer, a standardised approach to measuring counterparty credit risk exposures, and an approach to strengthen the capital standards for securitisation exposures held by banks. These have been steadily implemented over the last few years. In January 2017, the BCBS announced it would need more time to finalise its framework on schedule and needed more time to work through the enhancements that have become known as "Basel IV". This retreat seems, at least in part, to reflect concerns of European member countries about the economic impact of further capital constraints on their major domestic financial institutions, many of which are still struggling

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

with portfolio credit issues and other legacy challenges as well as current competitive demands. Further, in the US, the new administration has signalled its scepticism of US participation in multilateral international bodies such as the FSB and the BCBS and the extent to which those bodies influence US regulatory measures. This is another area in which new leadership at the applicable agencies might signal a different, more domestically focused supervisory approach to liquidity and capital requirements in the US as well as globally.

The near-term uncertainty surrounding the terms of the UK's impending exit from the European Union and how that will affect the European-wide regulatory landscape compounds these issues. Prior to the Brexit referendum, the UK had taken a leading role in the development of a unified European regulatory approach and was a primary advocate for the liberalisation of markets. The prospect of parallel or overlapping regulatory regimes and a number of open questions about the practical implementation of Brexit in the world of European financial services and the logistical burden of responding to those challenges will preoccupy most of the financial institutions operating across those markets for several years to come.

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 US 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 specialises in cross-border issues.

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

ALLEN & OVERY

Our ambition at Allen & Overy is to help the world's leading businesses both maximise the opportunities that globalisation presents and meet the potential challenges. Our teams across the world work together in a highly integrated manner to leverage their expertise and experience for our clients' benefit. We foster creative, independent thinking within a collaborative culture and, as a result, our lawyers are involved in many of the most influential cutting-edge commercial transactions, and are known for providing our clients with transformative solutions to the toughest legal challenges.

Allen & Overy's market-leading New York and English law global leveraged finance practice (comprising an integrated loans and high-yield bonds practice) operates in all of the main financial centres throughout the world. 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. Our practice is supported by pre-eminent Private Equity, Equity Capital Markets, Debt Capital Markets, Securitization and Restructuring teams. This collective expertise combined with in-depth sector insights makes us one of very few firms with the ability to advise on complex cross-border leveraged finance transactions across the full spectrum of the capital structure, as well as on all types of "crossover" and emerging markets loan and bond transactions.

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

Acquisition Financing in the United States: 2017… Uncertainty!

Morrison & Foerster LLP

Geoffrey R. Peck

Mark S. Wojciechowski

Global M&A was sluggish in the beginning of 2016, but ended strong with a fourth quarter burst of activity. While aggregate 2016 deal volumes dropped 16% from the highs of 2015, Thomson Reuters reports that 2016 global deal volume hit US$3.7 trillion, the second highest since the financial crisis. US deal volume, at US$1.7 trillion, reflected a corresponding 17% decline. A significant part of the turnaround from the start of year came in the last quarter of 2016, which had US$1.2 trillion of global deal volume and seven of the top ten deals by size.

Corporate strategic buyers were significantly more active in 2016, often winning competitive M&A bids over private equity funds. Large corporate balance sheets and the difficulty of the regulatory environment for lending were likely factors. Many corporate deals were 2016's largest deals, including AT&T's announced US$107 billion acquisition of Time Warner. Other mega deals included the US$63 billion acquisition of US's Monsanto by Germany's Bayer and the US$30 billion acquisition of UK's ARM by Japan's Softbank.

2016 M&A activity was fairly balanced across industry sectors, with the exception of energy and power, with a 15% increase from 2015, and technology, with a 15% decrease. While 2016 saw many mega deals, global middle market deal volume remained strong at US$931 billion; only a 1.2% decrease from 2015.

Whether 2017 proves to be another strong year for M&A and the lenders that finance deals may be impacted by the uncertainty of global politics. The global economy saw two unexpected political developments in 2016: Brexit in the United Kingdom and President Trump in the United States.

The United Kingdom's vote to exit the European Union was a shock, but the impacts on M&A activity are likely to be first seen in 2017 when Prime Minister Theresa May formally begins the process of exiting the trade union. Intense negotiations between the UK and the EU on the meaning of "exit" are expected. These negotiations will give the corporate sector the first insight to whether Brexit will result in the UK remaining a loose, but unofficial, member of the EU or whether the exit will be more severe and disruptive. 2017 elections in France, Germany, Italy and the Netherlands have the potential to create more uncertainty for the EU and possibly result in additional countries leaving the union. M&A activity involving Europe may slow while the uncertainty of Brexit's impacts is analysed.

The United States, not to be outdone by the uncertainty created by Brexit, upped the ante by electing Donald Trump as its 45th President. In just the first few weeks as President, Mr. Trump has signalled his intent to make major change in many areas that impact M&A deal-making decisions: trade, tax and regulation. Mr. Trump's proposed changes may ultimately result in a US M&A boom. In 2017, however, with the contours of the proposed changes undetermined, there will be uncertainty which could result in slower deal-making, particularly in certain industries.

On trade, Mr. Trump indicates a protectionist policy future that could disrupt established trade channels in the global economy. It is uncertain how far the Republican-led Congress, which is generally pro-free trade, will go to implement a protectionist trade policy. Many large-cap and middle market companies have long worked in the complex global economy and any disruption of these markets could impact M&A activity.

On tax, Mr. Trump and the Republican Congress are in agreement on cutting corporate taxes, including changes to the US tax code that currently discourage US companies repatriating non-US source revenue back to the US. Tax planning is a key to any successful M&A deal, and the uncertainty on corporate tax rates and rules will need to be considered by M&A deal-makers.

On regulation, Mr. Trump and the Republican Congress are in strong agreement to roll back corporate regulations. "We are cutting regulations massively for small business and for large business," said Mr. Trump at the time he executed an order calling for a "two for one" regulatory requirement; for each new regulation, two existing regulations need to be terminated. Mr. Trump has also signed an order indicating a roll back of Dodd-Frank, the post-financial crisis regulation of the finance industry, and Obamacare, the national health insurance law. Uncertainty about the regulatory environment in any given industry may hamper M&A activity.

While "uncertainty" will be a key word for 2017, deal-making should be high, particularly in industries less impacted by political uncertainty. 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 includes 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

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

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 sizable 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.

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 has been met but the lenders' obligation to fund the loans has 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 sizable contractual breakup 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 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.

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

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 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 certain agreed-upon terms of the financing without the 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.

At times of financial and market uncertainty, 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 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

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

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.

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 lenders could inherit the indemnities 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 breakup 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 has 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 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.

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

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. While 2017 promises to be a hard-to-predict year, expect M&A volumes to remain high, with sponsors exercising greater leverage over their lenders to further loosen acquisition-lending 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 10019-9601
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 10019-9601
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 major domestic and international banking institutions, as well as alternative lenders such as private equity funds, hedge funds, asset managers and finance companies, as well as emerging growth, mid-cap, and large public and privately held companies. With over 1,000 lawyers in 16 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. *IFLR1000*'s 2016 guide ranked MoFo as a leading firm for Banking in the U.S., U.K and Japan. Please 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

Lauren Hanrahan

Suhrud Mehta

Milbank, Tweed, Hadley & McCloy LLP

Introduction

The intercreditor frameworks applicable to a given financing structure in a particular market are often fairly settled, but in cross-border financings for European borrowers or other financings involving practitioners and business people in different parts of the world, deal parties may have 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 different assumptions, which therefore results in significant intercreditor 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 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. 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 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.

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

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, it has become fairly common for refinancing and incremental debt to be permitted in European deals. European intercreditors typically 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 traditional feature of U.S. credit facilities, although we do now see them included in transatlantic financings. 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 66⅔% 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) and lien 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, principally because there is no pan-European equivalent of the Chapter 11 stay. 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 has traditionally run 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. However, the enforcement standstill period is now often subject to negotiation. 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 (subject to the Chapter 11 stay) 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 150 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 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 is of limited relevance where (as is now common on top-tier sponsor deals) it 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. European second lien intercreditors now tend to follow this U.S. approach.

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 requirement to buy out 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 any shared collateral free and clear of their liens or other claims

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

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 remain varied. 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;
- claim subordination of the second lien debt 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, primarily to ensure it can be released upon an enforcement of this group.

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 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 at lhanrahan@milbank.com, or Suhrud Mehta at smehta@milbank.com. 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 ⅔% 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.	Similar to the U.S. approach.	Similar to the U.S. approach.
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.
Material Unsecured Debt	Not included.	Often included (above a threshold).	Similar.

© 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

Mark L. Darley

Skadden, Arps, Slate, Meagher & Flom LLP

While there are many broad similarities in the approach taken to 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) dominating documentation trends, there remains a number of significant differences in commercial terms and overall market practice. The importance for practitioners and loan market participants to understand the similarities and differences of both markets has grown 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 (or, to give it its formal title, the Loan Market Association) unless exceptional circumstances merit a more bespoke approach. 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 (which comprises more than 600 member organisations, including commercial and investment banks, institutional investors, law firms, service providers and rating agencies) 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. Formed initially with the objective of standardising secondary loan trading documentation, the LMA 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, developing market and commodity 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, regulatory and political developments (indeed, most recently in the context of the outcome of the United Kingdom's referendum to leave the European Union): its influence and authority 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, financial covenants, 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

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

"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.

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, 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, so there is only one set of loan documents, one agent, one interest rate and one set of lenders. A separate agreement among lenders ("AAL") governs 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 implicitly recognised the court's ability to interpret and enforce an AAL.

In Europe, driven by the rising prominence of debt funds and alternative capital providers, unitranche and direct loan facility structures are playing a much more significant role in the debt market, particularly in the sub £250m deal bracket. Similarly to U.S. unitranche structures, European unitranche structures also utilise an AAL, which typically the borrower will not be party to. In a restructuring context, European unitranche structures have also raised their own issues – in particular, questions around whether the first out and last out creditors comprise a single class for the purposes of an English law scheme of arrangement under Part 26 of the Companies Act 2006, notwithstanding the various creditors' distinct economic positions and interests as set out in the AAL. Whilst unitranche structures and the rights of unitranche creditors in a scheme of arrangement have not been directly considered by the courts, recent cases suggest that unless creditors can demonstrate that their distinct economic rights are also accompanied by corresponding legal rights enforceable against the borrower (which will not typically be the case where the borrower is not party to the AAL), it is likely to be difficult for junior creditors to maintain that they should form a separate class in a scheme of arrangement (and, as such, forfeiting the potential hold-out value that may entail during the course of a borrower's restructuring).

In the case of European borrowers with both high-yield bond debt and bank debt (usually revolving credit facilities) in their capital structures, so called "super senior" structures are also very common. In such structures, both the lenders under the revolving credit facility and the high-yield noteholders rank equally in regards to payment and the security package (where the notes are secured). However, the lenders under the revolving credit facility are "super senior" in that they take priority over the noteholders in relation to the proceeds of recovery from any enforcement action.

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 in the United States 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 investors who also participate in high-yield debt instruments and so 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 to compensate for these more "relaxed" terms.

Whilst in the past European sponsors and borrowers unable to negotiate sufficiently flexible or desirable loan terms with their usual relationship banks had to resort to U.S. Term B loans and the U.S. high-yield bond market in order to achieve the flexibility they desired, the growth of debt funds, direct lenders and U.S. institutional investors in the European loan market – (who now vigorously compete with banks and other traditional lending institutions) has led to the evolution of the English law "European TLB" market. Indeed, the European TLB market is now an established and attractive funding option for borrowers in larger leveraged transactions (£250m of debt or greater), albeit that some terms are not yet quite as flexible as those seen in the U.S. Term B loan market. For example, most European TLB instruments are still likely to contain guarantor coverage tests, higher lender consent thresholds, more expansive events of default and mandatory prepayment provisions and generally have smaller permitted baskets when 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

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

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 (in practice) required to demonstrate the same level of funding commitment as if they were making a public bid, albeit that this is not a legal or regulatory requirement in a private 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 and the New York law principle of dealing in good faith, 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 the dominant 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 still remain many 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 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. Borrowers are negotiating for more flexibility with respect to unrestricted subsidiaries but lenders have been pushing back due to recent attempts by borrowers to use these unrestricted subsidiaries to consummate transactions not intended to be permitted.

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. A recent trend in U.S. loan agreements is for reclassification provisions in lien covenants in addition to indebtedness covenants, permitting borrowers to reclassify transactions that were permitted under a fixed basket as permitted under an unlimited leveraged-based basket after the borrower's financial performance improves.

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 or secured indebtedness ratio (if the new debt is to be secured) 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 ratio 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. Borrowers have also become more creative with provisions that allow for increases to the free-and-clear basket over the life of the loan, including *pro rata* increases in free-and-clear baskets upon voluntary prepayments of existing loans and/or voluntary reductions in revolving commitments and free-and-clear baskets with an EBITDA grower providing for an increase in the amount of the free-and-clear basket in tandem with increases in the borrower's EBITDA.

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

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

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 (although the average duration of the "sunset" has been decreasing). Recently, such sponsor-friendly agreements have incorporated further provisions aimed at eroding MFN protection, including (i) limiting MFN protection to incremental term loans borrowed using the free-and-clear capacity, refinancing incremental term loans or incremental term loans that mature within a certain period (say, two years) of the latest-maturing existing term loans, and (ii) setting a threshold amount of incremental term loans that may be borrowed without triggering MFN protection.

U.S. loan agreements also typically include an exception to the debt covenant for refinancing debt. Historically, refinancing debt was subject to limitations as to principal amount, maturity, weighted average life to maturity, ranking and guarantees and security. The trend of looser terms in U.S. loan agreements is evident in some recent innovative tinkering with the concept of refinancing debt, though. Traditionally borrowers could incur at most refinancing debt in a principal amount not to exceed the principal amount of the old debt plus accrued interest, fees and costs. But creative drafters have changed that limitation so that the principal amount of the refinancing debt can exceed the principal amount of the old debt (plus interest, fees, etc.) by up to the amount of any unused commitments. Borrowers can obtain commitments that they cannot immediately use because there is no capacity under any of their debt baskets, so this formulation can result in problems – e.g., consider a first lien loan agreement that permits second lien refinancing debt in an amount equal to the old debt plus incremental debt permitted by the second lien loan agreement. The borrower could obtain commitments for second lien refinancing debt exceeding the principal amount of its old second lien debt and then refinance and fully borrow under all the commitments it obtained, sidestepping its incurrence test and any need for first lien lender consent.

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). A notable recent trend in the European loan market (particularly in larger leveraged transactions) has been the relaxations around the ability of borrowers to incur additional debt. There is now a definitive 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 (or incremental) 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 (demonstrated in the fact that the LMA now includes incremental facility language in its standard form documentation). Indeed, uncapped, leverage ratio-based incremental debt capacity is now a common feature of many recent large-cap European loan agreements. As in the case of U.S. loan agreements, the vast majority of European loan agreements with incremental facility provisions will also contain MFN protections, and in most cases, such MFN protections will usually be expressed to sunset (or expire) after 12 to 18 months.

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 on a flexible "builder basket" growth concept.

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. Another new borrower-friendly development is the use of adjusted EBITDA to determine the seeded amount of the builder basket. 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

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

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 was not commonly seen in European loan agreements, it is now common for borrowers to be permitted to make acquisitions subject to satisfying a *pro forma* leverage ratio test (with fewer additional conditions on acquisitions generally). For stronger borrowers, it is becoming more common for there to be no restrictions on their ability to acquire entities that will become wholly owned subsidiaries (as opposed to acquisitions of interests in joint ventures and other investments). Soft-capped baskets for acquisitions and investments (where the monetary limit is based on the greater of a fixed amount and a percentage of earnings or asset value) are also now more commonplace in the European market.

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, although this is changing in the context of large-cap deals and the increasing role of the European TLB market. Whilst strong sponsors have typically been able to negotiate provisions permitting payments or distributions from retained excess cash flow, subject to satisfying a certain leverage ratio, deal trends over the last year have revealed that the U.S. approach towards allowing restricted payments is now being accepted in Europe: in particular, consolidated net income-based "builder baskets" are now commonly seen in larger transaction, as well as uncapped upstream payment ability, subject to satisfaction of a *pro forma* leverage test, further illustrating the convergence of terms between the U.S. and European markets.

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 in connection with any transaction that would constitute an initial public offering, a change of control, or a transformative acquisition.

While call protection is relatively rare in the European market for senior (bank held, term loan A) debt, soft call protections are not unusual in European loans that have been structured to be sold or syndicated to institutional investors (for example, TLBs). 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

Although debt buybacks have been less frequent in recent years, the provisions allowing for such prepayments are typically found in both U.S. and European 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), 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

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

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, term debt not permitted to be incurred under the applicable loan agreement 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.

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. 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 (after a poor showing in late 2014 and fiscal year 2015, the volume of covenant-lite middle market deals increased again in 2016). 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 other financial ratio incurrence tests – 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 historically included a full suite of ongoing financial maintenance covenants. However, in the first half of 2016, only around 10% of European deals were "fully covenanted". With the influx of institutional investors and increased demand generally affording borrowers increased bargaining power, "covenant-lite" and "covenant-loose" deal structures are much more prevalent, especially where it is intended that the loan will be syndicated to an institutional investor base. European deal activity in 2016 revealed that just over 40% of loan transactions were "covenant lite", meaning that the facility contained only a single financial covenant for the revolving facility lenders (usually a leverage ratio covenant tested on a springing basis) or contained no maintenance financial covenant at all.

In the United States, the leverage covenant historically measured consolidated debt of the Borrower and all its subsidiaries. Today, leverage covenants in U.S. loan agreements frequently apply only to the debt of the Borrower and its 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-levering 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 revealed that nearly half had a fixed capped 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. Although, in 2015, lenders were more resistant to uncapped netting, a survey of leveraged loans issued in 2016 found that 80% of such loans had uncapped netting, even higher than the 2014 sample.[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 (excluding intra-group debt). Unlike the cap on netted cash and cash equivalents in some U.S. loan agreements, European borrowers net out all free 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. Add-backs have also become increasingly vague and flexible – for example, addbacks 'of a type' similar to those in the model delivered to arrangers during syndication or cost savings addbacks without a requirement relating to when the savings materialise. 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

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

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 by reference to a fixed amount or a certain percentage of EBITDA, typically around 15–20% in the United States (although in 2016 one study found that an increasing number of loans had a 25% cap) and 5–20% in Europe (although uncapped add-backs are becoming more common both in the U.S. and European markets in spite of regulatory scrutiny).

In Europe, the European Central Bank (the "ECB") has published draft leveraged lending guidelines (discussed further in Part D). Whilst still in the consultation process (as at the time of writing), the ECB guidelines (unlike its U.S. counterpart) currently intend to test leveraged transactions by reference to "unadjusted" EBITDA, meaning "*realised EBITDA over the previous 12 months with no adjustments made for non-recurring expenses, exceptional items and other one-offs*".

Equity Cures of Financial Covenants

For a majority of sponsor deals in the United States, loan agreements that contain a financial maintenance covenants 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) 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 for many years. As in the United States, the key issues for negotiation relate to the treatment of the additional cure equity; for example, whether it should be applied to increase cash flow or earnings, or to reduce net debt (and, if so, whether it should also be applied in prepayment of the facilities). While historically, it was restricted to the latter, European deal activity over the last couple of years has revealed a definitive trend towards "EBITDA cures" – that is, cure amounts being treated as an increase in earnings rather than as a reduction in net debt. In 2016, over half of all loan agreements with equity cures allowed for such EBITDA cures. 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). Another key difference between the U.S. and European approaches to equity cures is that, unlike in U.S. loan agreements, "over-cures" are typically permitted in European loan agreements (that is, the ability to inject more equity proceeds than is actually required to cure any financial covenant non-compliance). Such an ability is advantageous to some borrowers by allowing them to obscuring any possible future underperformance. 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 are often 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 does not typically provide for amend and extend provisions that permit borrowers to extend their loan's maturity with only the consent of the extending lenders (which is not unusual in the U.S.). 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.

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

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

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 and trigger events. 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 commitment is ignored 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). Restrictions on transferring commitments to "competitors" of the borrower are also now common in European loan agreements. 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 U.S. 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.

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 "US Guidance") issued in March 2013 by the Federal Reserve, the OCC and the FDIC. The U.S. Guidance provides, among other things, that a leverage level in excess of 6× total debt over EBITDA will raise regulatory concern for most industries and may result in the loan being criticised (as discussed further in in Part B). In addition, the U.S. 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 U.S. 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 U.S. 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 U.S. Guidance could result in more borrowers electing to use non-regulated institutions as agents and lenders, and, as predicted, since 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 a liquidity problems in a few years when borrowers seek to refinance (regulators have indicated that the U.S. Guidance may be applied to a refinancing). Regulators are considering regulations to address the non-regulated financing sources loophole.

The federal regulators noted in a 2016 review that the banks have made progress in compliance with the U.S. Guidance as the number of non-pass loan originations in the U.S. market reached *de minimis* levels. But the regulators cautioned that some weaknesses in underwriting practices still exist, including liberal repayment terms, structures with "ineffective or no covenants", incremental debt provisions that allow for debt to a level that inhibits deleveraging capacity and dilutes senior secured creditors and unreasonable addbacks to EBITDA. Further part of the decrease in non-pass originations is attributable to the liberal use of

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

addbacks that increase EBITDA substantially, thereby decreasing the leverage ratio below 6×. For example, when the Ultimate Fighting Championship put itself up for sale recently, addbacks to its EBITDA increased its earnings from $170,000,000 in the initial calculation to $300,000,000 in the presentation given to debt investors (which decreased its leverage ratio to 6×). This large increase in EBITDA would permit substantially more debt to be incurred in connection with the sale. Regulators caught on and cautioned Goldman Sachs, the arranger. When Bain Capital decided to buy online jeweller Blue Nile, addbacks increased Blue Nile's EBITDA from approximately $19,000,000 to approximately $45,000,000, dropping its leverage ratio from 9× to 4×. The concern of regulators is that, regardless of the decrease in non-pass originations, this type of creative accounting does not represent true progress toward tighter underwriting practices.

Similar leveraged lending regulation is likely to be introduced in Europe shortly. On 23 November 2016, the ECB published (for consultation purposes) an initial draft guidance to banks regarding leveraged transactions, which is intended to apply to all "significant credit institutions" supervised by the ECB under the Single Supervisory Mechanism (the "ECB Guidance"). The ECB Guidance will not apply to "credit institutions" based in member states outside the Single Supervisory Mechanism and not directly supervised by the ECB (such as the United Kingdom, although the Bank of England has itself from time to time considered leveraged lending levels). Although the ECB Guidance will not be legally binding, affected institutions are expected to incorporate the ECB Guidance as part of their internal lending policies, which will undoubtedly affect credit and lending decisions once the ECB Guidelines are finalised and implemented.

For the purposes of the ECB Guidance, a "leveraged" transaction will include all types of loans or credit exposures where the borrower's post-financing level of leverage (i.e. the ratio of total debt to EBITDA) exceeds 4.0× as well as all types of loan or credit exposures where the borrower is owned by one or more financial sponsors. Under the ECB Guidance, affected credit institutions are expected to ensure that transactions which have a "high level" of leverage – meaning transactions where the ratio of total debt to EBITDA exceeds 6.0× at the time of deal inception, remain "exceptional" (in similar vein to the U.S. Guidance). As mentioned above, the ECB Guidance proposes to test leveraged transactions by reference to "unadjusted" EBITDA, unlike the U.S. Guidance which acknowledges adjustments to EBITDA. At the time of writing, the ECB Guidance was still in the consultation phase and far from being finalised, and so whilst it will be certainly significant from a compliance and risk perspective, the real impact on deal levels and loan terms cannot be meaningfully determined at this stage.

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, and as a wider range of alternative and non-bank investors are attracted to the investment opportunities presented by both the European and U.S. loan markets, 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.

Acknowledgment

The authors would like to acknowledge the assistance of their colleagues Emily Stork 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

Bibliography

1. *When a Permitted Refinancing Definition Magically Creates a New Debt Basket*, Xtract Research, North America Special Reports, November 9, 2016.
2. *CR Trendlines: Loan Terms Loosen in Q4,* Covenant Review, January 2017, available at https://covenantreview.com/samples/download/35 (accessed February 17, 2017).
3. *What's Market: 2016 Mid-Year Trends in Large Cap and Middle Market Loan Terms*, Practical Law Company, July 1, 2016.

Endnotes

1. *What's Market: 2015 Year-End Trends in Large Cap and Middle Market Loan Terms*, Practical Law Company, January 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. October 14, 2014).
3. *Credit: Just the Stats (Well, Maybe a Little Commentary*), Loan Syndications and Trading Association Week in Review, November 7, 2014, available at http://www.lsta.org/news-and-resources/lsta-newsletter (accessed February 26, 2015).
4. *Trends in Acquisition Finance*, ABA Business Law Section – Syndications & Lender Relations Subcommittee, September 18, 2015, available at http://www.lsta.org/uploads/ArticleModel/218/attach/paul-weiss_trends-in-acqusition-finance.pdf (accessed January 22, 2016); *Debt Financing From a Borrower's Perspective: From Healthy LBO to Distressed Debtor*, ABA Business Law Group – West Coast, April 17, 2015, available at http://apps.americanbar.org/dch/thedl.cfm?filename=/CL190035/relatedresources/2015spring_debtfinancing_041715.pdf (accessed January 22, 2016); *State of the U.S. Loan Market*, Xtract Research, North America Deal Data, October 18, 2016.

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.

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 leverage financing work. She also has been included in *IFLR1000* (2013 and 2014), *The Legal 500 U.S.* (2013) and *The International Who's Who of Banking Lawyers* (2014). 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 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 22 offices and 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 percent 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 Forecasts

Michael C. Mascia

Wesley A. Misson

Cadwalader, Wickersham & Taft LLP

Introduction

The Subscription Credit Facility (each, a "Facility") and related Fund Finance markets continued their expansion in 2016, extending the long-standing industry trend. Mirroring our recent experience both during and after the financial crisis, Facility credit performance remained pristine, with no monetary defaults having become public last year. This chapter summarizes the key trends in the Facility and Fund Finance markets in 2016 and forecasts developments for the coming year.

Credit Performance

To our knowledge, there were again no payment events of default in the Facility or related Fund Finance markets in 2016. Similar to the past three years, 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 Investors ("HNW Investors"). This positive credit performance again extended to our hybrid and asset-level facilities, which have ticked upward (slightly) as a percentage of our overall deal portfolio. Interestingly, we have for the first time been consulted on a pre-default analysis for a Facility facing uncertainty as a result of real credit and liquidity deterioration of the key Investor. While the details of this Facility are of course confidential, we are comfortable that the underlying factual circumstances are highly unique and isolated and not reflective of any systemic issue or risk.

Resilient Growth

Despite the Brexit vote and the unexpected result in the United States presidential election, 2016 was another healthy year for private equity generally and the Facility markets specifically. According to Preqin research, private capital raised in 2016 hovered around the $600 billion mark for the fourth straight year and private equity dry powder climbed to an all-time high.[1] Coupled with increased interest and acceptance of the Facility product in the buyout and venture capital asset classes, many of the major lending institutions in the market (each, a "Lender") again report portfolio growth in excess of 20% last year, exceeding our forecasts. While there are certain Lenders that have reached their institutional lending limits for particular Fund sponsors (each, a "Sponsor") and even for the Facility product itself (and even a small handful of Lenders that exited the market in 2016), this self-imposed constraint has done little to slow industry-wide growth.

Structural Evolution

Last year was very muted in terms of structural evolution in the Facility market. Frankly, very little changed. At the 7th Annual Global Fund Finance Symposium on March 14, 2017 in New York (the "2017 Global Conference") hosted by the Fund Finance Association (the "FFA"), panelists had to stretch a bit to come up with concrete examples of how Facility structures evolved in the last year. For sure, from a Lender's viewpoint, private equity fund (each, a "Fund") limited partnership agreements ("Partnership Agreements") continued to improve, which has led to a reduction in asset-level mitigants such as periodic clean downs or net asset value ("NAV") floors. Facility borrowing bases ("Borrowing Bases"), while holding remarkably stubborn to the traditional Included Investor/Designated Investor structure (particularly in the United States), have inched upward incrementally. Advance Rates moved slightly higher in the last year and concentration limits were relaxed moderately, at least for high credit quality Investors. But these changes were really at the fringe; Facility structures remain quite consistent with where they have been in recent years.

Industry Developments and Press Coverage

The Facility and Fund Finance markets and industry continue to mature and 2016 was very active in this regard. Over 700 people registered for the 2017 Global Conference, with 55 different market participants formally sponsoring. Despite a major snow storm, over 400 people actually attended. The FFA also formed a Women in Fund Finance subgroup, which had a very successful inaugural event in March in New York that was followed by a companion event in London the following week. The events included a screening of the movie Equity and a discussion panel with several of the producers and actresses in the film. Global Legal Group Ltd., the publisher of this Legal Guide, published the inaugural edition of *Global Legal Insights – Fund Finance 2017*, a comprehensive legal guide on the Fund Finance markets. The guide includes 14 product-oriented chapters and 17 jurisdictional updates contributed by many of the world's preeminent Fund Finance law firms.[2] Fund Finance has clearly matured from a product category into an industry in its own right.

The Facility market was also covered more extensively in both mainstream and private equity press in 2016, sometimes fairly and sometimes frankly in an alarmist and inflammatory way. On October 20, 2016, the *Financial Times* published an article about the Facility market titled "Financing 'trick' boosts lucrative private equity fees".[3] While the article begins by quoting a professor that characterizes Facilities as a "trick" to enhance Sponsor fees, it does go on to provide

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

some balanced reporting, explaining that Facilities offer utility to both Funds and Investors and in actuality are unlikely to materially impact Sponsor fees over the entirety of most Fund lifecycles. The article also goes somewhat astray paraphrasing another purported expert who indicated that Facilities could be adding "inappropriate leverage" into buyout transactions and that as a result, in the event of a financial crisis, it could "force fund managers to sell their liquid equity and bond holdings first, exacerbating market instability". Of course, Facilities are not leverage at all in the traditional sense, in that they do not allow a Fund to invest a single dollar more than the Fund's committed equity capital from Investors. Further, with Facilities' expected source of repayment being Investor Capital Calls, suggesting Facilities are likely to lead to forced liquidations of Investments also seems somewhat off the mark. Private Equity International also published two articles on Facilities early this Spring, both casting a somewhat negative light on Facilities from the vantage point of the Investor. Both articles, however, did note many of the benefits of Facilities as well and pointed out that many Investors are benefitted by, and are supportive of, Facilities.[4] Investment advisor TorreyCove Capital Partners also recently published a thoughtful academic analysis of the Facility product, which provided mathematical examples of the interplay between Facility usage, IRR and Sponsor fees. This press attention, while new to the Fund Finance market, is further evidence of the industry's maturation.

2017 Market Forecast

From a Facility structural perspective, we expect evolution to continue to be limited to the margins in 2017. Credit performance of Facilities during the financial crisis validated current structures and Lenders have expended significant institutional resources the past several years developing their Facility product programs and policies. We believe wholesale revisions and exceptions to these programs and policies are quite unlikely and thus, structural change will be incremental. Outside of the Facility space, we do note discussions in the market about Funds structuring NAV-based facilities in the form of preferred equity. While non-tenured leverage certainly has an inherent appeal to Funds seeking to optimize their financing options, we think this new product offering will only expand slowly in 2017. Sponsors are highly focused (rightfully) on thorough Investor disclosure at present, and many older vintage Partnership Agreements were of course unable to foresee this financing innovation. So while in many cases Sponsors may be comfortable going to Investors for amendments to Partnership Agreements to permit the innovations, our expectation is that growth in this product segment has a longer term horizon. One area where we do think NAV-based and hybrid structures are likely to grow significantly in the coming year is with private debt Funds. Over the last few years, the number and size of private debt Funds has grown significantly. And Investors are widely forecasted as likely to increase their allocations to debt Funds in 2017.[5] This asset class is in many cases seen by Investors as entirely appropriate for traditional leverage, and the Fund's strategy may simply require leverage to meet the expected return targets. Further, levering at the Fund level makes complete sense for a debt Fund, as Investment-level financing is unlikely to be attractively available in most cases. Further, debt, of all asset classes, is where Lenders are going to be the most comfortable (and most competent) adding NAV to a Borrowing Base. Hence, we have seen, and expect to continue to see, growth in this area.

While we do expect the rate of Facility growth to slow in 2017 as compared to the 20+ percent of the past few years, we forecast 2017 growth in Lender portfolios in the 10%–15% range year-over-year. The historical factors supporting expansion remain sufficiently pronounced. The number of Funds in the market is at an all-time high at 2,965.[6] Cash distributions made to Investors in 2015 and 2016 again meaningfully exceeded Capital Calls, requiring Investors to re-up with Funds at current or greater levels to maintain their asset allocations. As a result, we forecast a healthy 2016 for Fund formation. Dry powder (i.e., Borrowing Base availability) again increased meaningfully in 2016. And interest rates have remained low and pricing margins have trended downward. We also think there is additional market growth from new Sponsors; we continue to work on transactions for a Sponsor's first Facility despite having multiple prior Funds. Thus, market growth, while perhaps somewhat more modest than that sustained in recent years, is likely to exceed double digits once again in 2017.

Hot Button Issues

Two issues we see drawing increased attention in 2017 involve anti-terrorism provisions in Facility credit agreements and "Know Your Customer" documentation and information requests. While Lenders are optimistic that the new presidential administration in the United States will be helpful at reducing or at least improving the regulatory environment generally, there is near universal agreement amongst Lenders that terrorism is one area where regulation is likely to intensify. As a result, virtually every Lender is closely examining their sanctions, anti-money laundering, anti-corruption and KYC policies and provisions. Updates are coming. And the combination of greater use by Funds of alternative investment vehicles with heightened KYC deliverables is likely to lengthen the new borrower onboarding process.

Upcoming Events

On June 19, 2017, the FFA is hosting the inaugural Asia-Pacific Fund Finance Symposium at the Four Seasons Hotel in Hong Kong. This will be the first industry-wide event held in Asia and it will be exciting to see the level of interest and attendance. The 3rd Annual European Fund Finance Symposium is scheduled for October 11, 2017, this year moving to a new venue, the Landmark Hotel in London. And the 8th Annual Global Fund Finance Symposium has been scheduled for March 21, 2018, again at the Grand Hyatt Hotel in New York City.[7]

Conclusion

The Facility market appears poised for another solid year in terms of portfolio growth in 2017. While Facility structures have been trending ever so modestly 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.

Endnotes

1. See *Private Capital in 2017, Key Findings from the 2017 Preqin Global Alternatives Reports*, Preqin, Christopher Elvin, Head of Private Equity Products, presentation at the 7th Annual Global Fund Finance Symposium on March 14, 2017 in New York, New York ("Preqin FFA Presentation"), pages 6 and 8.
2. An electronic copy of *Global Legal Insights – Fund Finance 2017* can be accessed at https://www.globallegalinsights.com/practice-areas/fund-finance/global-legal-insights---fund-finance-2017-1st-ed.

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

3. A copy of the article is available at https://www.ft.com/content/c5c24c58-953c-11e6-a80e-bcd69f323a8b.
4. Copies of the two Private Equity International articles can be accessed at http://link.privateequityinternational.com/view/582073023f92a457f5e281815c7yb.7k5/a7760b76 and https://www.privateequityinternational.com/news/europe/2017-03-09/walking-the-line/.
5. *Preqin* research shows that 57% of surveyed Investors report planning to invest more money into private debt in 2017 and that 62% report expecting to increase their asset allocation to private debt going forward. See *Preqin FFA Presentation*, pages 22–23.
6. See *Preqin FFA Presentation,* p. 21.
7. Information on these events is available at the FFA's website, http://www.fundfinanceassociation.com/.

Acknowledgment

The authors would like to thank Jeremy Cross, Partner at Cadwalader, Wickersham & Taft, for his invaluable assistance in the preparation of this chapter.

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 recognized 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 totaling 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

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 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 Developments in U.S. Term Loan B

Denise Ryan

David Almroth

Freshfields Bruckhaus Deringer LLP

Introduction

If you don't like the weather, wait an hour. The same could be said for the U.S. leveraged loan market in 2016. Investors navigated a slow start to the year. Hung deals from a challenging second half of 2015 took time to clear the market and made for strong headwinds during the first quarter. Yet sunnier skies prevailed by springtime, even as investors weaved choppy waters caused by various geopolitical events – Brexit, increasing regulatory scrutiny and the U.S. election among them.

In the end, global syndicated loan volume during 2016 fell by 10% from 2015 levels. The U.S. loan market, however, was strong. Volume in the U.S. during 2016 dropped only 4% from 2015, and lending in the U.S. loan market accounted for 58% of global syndicated lending, its highest proportion since 1999. 'Yankee' loans issued by European borrowers in the U.S. market exceeded 'reverse-Yankee' loans issued by U.S. borrowers in European markets, with a score of €29bn to €12bn. The number of cross-border deals that included both dollar and euro or sterling tranches continued to increase. By the second half of 2016, demand in the U.S. market had far outstripped supply, and borrowers approached the market opportunistically. Over $40bn of dividend recaps were issued. Repricings surged by 44% in the fourth quarter, making 4Q the best quarter for repricings since 2014, and issuer-friendly pricing flexes on the whole exceeded those of lender-friendly pricing flexes (although lenders were able to win concessions on certain terms).

With such an outlook, loan documentation in the U.S. market continued its trend towards ever-more friendly waters for Term Loan B (***TLB***) borrowers, which has been a consistent theme for the last few years. This article examines some of those developments.

Market Fundamentals

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 TLBs 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 TLB holders are more likely to be non-bank lenders, i.e. institutional investors such as hedge funds and issuers of collateralised loan obligations.

Institutional investors take a different approach to their participation in a loan syndicate when compared to traditional banks, viewing loans as liquid, tradable and impersonal investments, rather than part of a broader institutional banking relationship with that borrower. Individual investors buy and sell loans opportunistically instead of holding them to maturity, meaning that they are less reliant on the protection that a more traditional term loan covenant package affords. An institutional investor's overall portfolio will include high-yield bonds as well as loans and, accordingly, they have gotten comfortable with high-yield incurrence-based covenants for both bonds and leveraged loans in their portfolio. Sponsors and borrowers have been able to use this shift in composition of the lender base, as well as the strong demand for the TLB product, to their advantage in order to push for greater flexibility in terms, in the knowledge that investors will continue to tolerate weaker covenant packages and '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.

Leveraged Lending Guidance

The Leveraged Lending Guidance (***LLG***) jointly issued in 2013 by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency (the ***OCC***) and the Federal Deposit Insurance Corporation (collectively, the ***Agencies***) continued to influence deals in the market. Under LLG, 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. LLG states that the Agencies will apply additional scrutiny to transactions where leverage levels exceed 6.0× and the borrower is not able to repay all senior debt or half of total debt within five to seven years.

LLG provides guidelines and not bright-line tests for banks to follow, and the scope of LLG has been expounded upon by the Agencies in public statements. Since the guidelines were issued, the market for TLB continues to evolve in response – in particular, in order to justify higher debt quantums while keeping headline leverage levels down, sponsors and arrangers have relied on more adjustments and add-backs when determining the "adjusted EBITDA" number presented to TLB investors. In October 2016, responding to these practices, the Agencies notified arrangers of two large, well-publicised transactions that aggressive adjustments and add-backs to the reported EBITDA number were problematic and would receive extra scrutiny. The Agencies have also focused more

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

on borrower models and documentation terms that affect them, including financial definitions, cash netting and permitted debt provisions (all explained in more detail below).

Due to the uncertainty created by LLG and the limitations on leverage that LLG requires, borrowers have sought alternative forms of capital or additional leverage from unregulated market participants who can afford to be less cautious when underwriting highly leveraged transactions. Preferred equity and mezzanine debt fill gaps in senior capital structures that are hampered by LLG. Unregulated , non-bank lenders have increased their volume of syndicated loans, and direct lending and unitranche borrowings continue to grow, particularly in the middle market. One analysis noted that first lien leverage ratios in loans issued by non-banks typically run as high as 7.5×. Despite LLG, market commentators have noted that even regulated banks will still commit to deals with leverage above 7.0× in certain circumstances.

Given all this, there are mixed opinions whether the goal of LLG – to reduce overall leverage for corporate borrowings in a heated U.S. loan market – is really being achieved. While large banks have reduced their leveraged lending, unregulated non-bank lenders have picked up where the large banks left off and many participants suspect that large banks will take on more highly-leveraged deals in 2017 in anticipation of a more relaxed regulatory environment under the new U.S. presidential administration. The OCC recently stated it is less concerned about total leverage in the system, which may mean there has been a shift in thinking at the Agencies as well.

Economic Terms

Pricing

Borrowers taking advantage of the strong demand in the second half of 2016 squeezed loan margins with a glut of repricings. In years past, lenders have relied on LIBOR and other base rate ‘floors’, typically set at 1%, to prop up low margins in an era of historically low interest rates. In 2016, however, borrowers in the U.S. market began to obtain lower LIBOR floors as well, either at 0.75% or 0.0% or with no floor at all, which had been more standard in the European market. Now that the Federal Reserve has increased the federal fund borrowing rate in December and signalled more increases to come, LIBOR is expected to exceed the LIBOR floor in more and more credit agreements, so more and more commercial interest rates will begin to float, just as they had before the financial crisis.

Optional Prepayments

Unlike bonds, investors still generally accept that TLB is prepayable without penalty or premium. With the increase to the depth and liquidity of the TLB investor base in 2016, borrowers took 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) and looked to do so even fairly quickly after initial issuance.

As a result, investors continue to demand that some limited pricing protection be included in TLB facilities from the outset. Typical protection is a 1% prepayment premium for refinancings within an agreed period of time (known as ‘soft call’ protection). In 2016, the majority of soft call protection provisions included a ‘sunset’ of six months, while a minority lasted for a full year after initial issuance. While soft call protection as a concept remained, borrowers in 2016’s hot market continued to press for broader exceptions to the requirement to pay a prepayment premium, including when prepayments are made in connection with another transaction, such as from the proceeds of a change of control or an IPO. The broadest formulation of such a carve-out permits a prepayment without a premium where the repricing of the loan is not the ‘primary purpose’ of the transaction. In 2016, nearly half of smaller TLB (less than $300m) and more than half of large TLB ($300m or greater) included such a ‘primary purpose’ carve-out.

Mandatory Prepayments

Mandatory prepayment requirements became less onerous in 2016, continuing the trend in TLB that lenders have pulled back from requiring borrowers to de-lever with excess cash. Many loan agreements no longer require prepayments from issuance of new equity proceeds. Excess cash flow (***ECF***) sweeps have continued their absence from some sponsored deals and, where they remain, are often undermined by borrower-friendly carve-outs to the definition of ECF.

For asset dispositions, where TLB lenders once required 100% of the proceeds from asset dispositions to be applied to pay down debt, TLB borrowers in 2016 typically may reinvest proceeds during a period of up to 18 months or longer – and the criteria for qualified reinvestments continue to expand to the point that nearly anything the borrower believes to be used or useful to its business is permitted. Moreover, TLB borrowers typically may utilise the asset sale proceeds to pay down debt from other secured lenders on a *pro rata* basis together with the TLB and, if certain leverage thresholds are met, the percentage of asset sale proceeds which is required to be used to pay down the TLB may step down (a concept borrowed from the ECF sweep provision). Even where a TLB requires the borrower to pay down debt with a percentage of proceeds from an asset sale, some borrowers have obtained changes to the asset sale covenant that permit asset sales to be made without a minimum amount of cash consideration. As one market commentator noted, “100% of net cash proceeds isn’t worth very much if a permitted asset sale does not generate any cash!”

Restrictive Covenants

Although TLB terms continued to loosen in 2016, the structure of the covenants in TLB remained stable. For the most part, TLB facilities have resisted incorporating the form of high-yield covenants – with stronger resistance in the U.S. market than in Europe. Yet the substance of the covenants continued to become more akin to high-yield bond incurrence covenants, where many corporate actions are permitted subject to the meeting of certain ratios on the date of such action. For example, most TLB facilities keep payments to shareholders (also known as ‘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 more and more to enter into strategic transactions and incur or refinance debt without seeking the consent of their lender syndicate and without incurring the associated consent fees otherwise required to be paid.

As in high-yield bond indentures, TLB facilities also 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, but their EBITDA and earnings (and debt) are excluded from the calculation of financial definitions and ratios.

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

Financial Covenants

The prevailing trend over the last few years toward 'cov-lite' TLB continued in 2016 overall, although the pendulum between maintenance covenants and 'cov-lite' varied greatly depending on market conditions quarter to quarter. On larger deals, more than three quarters of deals in 2016 were 'cov-lite' with no maintenance covenant protection available to the transaction's term lenders.

Even if a financial covenant is not included for the benefit of TLB lenders, a facility may include a 'springing' financial covenant. Springing covenants are typically tested only when the relevant revolving lending facility is drawn above a certain threshold and are applicable only to, and for the benefit of, the revolving lenders. In 2016, springing maintenance covenants made headway in smaller deals when conditions were favourable to borrowers, being entirely absent from smaller TLB in some fiscal quarters and in other fiscal quarters included nearly a quarter of the time. For large deals, if a springing maintenance covenant was included, the maintenance covenant was 'sprung' when the revolver was drawn by more than 30% or 35% of commitments in most cases. For smaller deals, there was no common threshold figure, and many springing covenants had no minimum drawing threshold.

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. TLB facilities typically still include more stringent parameters around the terms of secured debt than unsecured debt, including limitations on the borrowing entity, final maturity, weighted average life, prepayments and, sometimes, more restrictive terms (for example, requiring an 'MFN' in the case of the inclusion of a financial covenant in any *pari passu* debt).

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 (including incremental facilities), which are subject to similar parameters but also to *pro forma* compliance with a financial ratio.

Additional Debt (Including Incremental Facilities)

TLB facilities in 2016 continued the ever-widening variety of approaches to providing borrowers flexibility to incur additional debt, and most loan documents will contain more than one overlapping means by which a borrower may incur additional debt. Permitted additional debt baskets can be grouped into those that will be governed by the borrower's original credit agreement and those governed by separate documentation.

Incremental Facilities. Additional debt incurred under a particular credit agreement is typically referred to as an incremental facility. For years, TLB credit agreements have included a right to add one or more new tranches of TLB (or increase the size of an existing tranche) on a *pari passu* basis within the framework of the original credit agreement. This ability is usually subject to both (i) a restriction on the aggregate amount of new debt that can be issued, and (ii) the protection of a 'most favoured nations' (***MFN***) provision that ensures any newly incurred debt will be issued with an all-in-yield no more than a threshold amount (customarily 50 bps) in excess of the all-in-yield on the original TLB facility. The MFN will automatically adjust the margin of the original debt to ensure the variance is no greater than the threshold, and as a result, MFNs provide an economic disincentive for a borrower looking to incur debt under an incremental facility at a higher price. For this reason, borrowers typically push for an MFN provision to expire (or 'sunset') after a certain period has passed since the initial closing.

MFN Sunset Provisions. The details of MFN were again heavily negotiated in 2016 and varied depending on market conditions. In underwritten financings, MFN sunsets remained a focus of flex provisions. Arrangers demanded (and regularly exercised) the flex right to remove or extend the MFN sunset period that the borrower pushed for in order to complete syndication in variable market conditions. Although the majority of deals done in 2016 still had no sunset on the MFN protection, the incidence of sunsets increased and the duration has varied from anywhere between six and 24 months, with the most commonly agreed period being 12 months.

Exceptions to MFN for Incremental Facilities. Some more recent TLB facilities also incorporate new and varied exceptions under which the borrower may incur additional debt that is not subject to the MFN provision. A significant minority of MFN provisions in the market are not triggered by additional debt with a maturity date that is later than the maturity date of the original term loan by an agreed period (typically more than two years). Other deals include a new basket for additional debt that is not subject to the MFN, either for the 'freebie' basket of additional debt discussed below or another agreed fixed amount. A few very recent deals have also cleared market with a permitted spread of 75 bps (e.g., the new debt can have an all-in-yield up to 75 bps higher than the existing debt), which could become a trend in 2017. Finally, with an increasing number of cross-border facilities, it is becoming more common for TLB facilities to specify that the MFN will apply only to the original loans incurred in the same currency as the new incremental facility.

Amount of Incremental Debt. The total amount of incremental debt that TLB borrowers were permitted to incur also evolved. Size was typically determined by one or more of the following three components: (1) a 'freebie' amount that may be incurred irrespective of *pro forma* compliance with a financial ratio; (2) a ratio amount limited only by such *pro forma* compliance; and (3) an add-on amount equal to voluntary prepayments of the existing debt. While 'freebie' baskets typically are a fixed dollar amount, nearly a quarter of 'freebie' baskets in large TLB loan agreements included a 'grower' concept that set the size of the 'freebie' basket at the greater of a fixed amount and a percentage of EBITDA, providing greater flexibility to the borrower to incur debt without the limitations of *pro forma* compliance. The ratio used to determine *pro forma* compliance is a point of negotiation as well. A first lien leverage ratio (often set at first lien leverage on the closing date) is the most common of late, but overall secured leverage is common as well, and a small number of TLB will determine the size of the ratio amount by reference to total leverage.

Incremental Equivalent Debt. In recent years, TLB facilities also include a right to incur additional debt within the same parameters negotiated for incremental facilities under documents other than the original credit agreement that meet certain pre-agreed criteria – called 'incremental equivalent debt' or a 'side-car facility' – on the theory that the economic effect is the same as an incremental facility. Lenders typically permitted borrowers to incur incremental equivalent debt under bond offerings, but some TLB include a right to incur side-car facilities in the form of term loans. These typically do not trigger MFN protections for the incurrence, although there has been some push by investors for the MFN to apply to side-car facilities that are incurred in the form of *pari passu* secured term loans.

Reclassification. Other debt that TLB credit agreements permit a borrower to incur includes capital expenditure-related debt, acquisition-related debt and permitted ratio debt, among others, with basket sizes typically comprised of an initial 'seeded' amount plus an amount that can be incurred subject to a *pro forma* ratio

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

compliance test. An increasing number of TLB facilities now allow the borrower to reclassify debt that was initially incurred under the initial 'seeded' amount as debt incurred under the ratio amount when capacity becomes available under the ratio (a concept borrowed from high-yield bonds). These 'reclassification' provisions have been incorporated into the additional debt baskets as well as the incremental facility amount. In practice, reclassification permits a borrower to refresh the initial 'seeded' amount it can borrow without complying with the ratio tests whenever capacity under the ratio amount or another additional debt basket later becomes available. Such provisions will also now typically provide that additional debt is deemed to be incurred first under any ratio capacity before the 'seeded'/'freebie' basket in order to preserve the amount that may be borrowed without being subject to the ratio cap.

Acquisition Debt. To facilitate using incremental facilities to finance acquisitions, it is now common to allow the testing of the conditions to incurring an incremental acquisition 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 (and an acquisition counterparty) with more certainty around the availability of their financing to close the acquisition. TLB facilities have not settled, however, on whether a borrower must calculate and comply with ratio thresholds while the acquisition is pending by reference to financials assuming the acquisition has not occurred, by reference to *pro forma* figures that assume closing of the acquisition or both. We expect further market developments on this point during the course of 2017.

Replacement Debt

As it became increasingly difficult during the Great Recession to replace debt under a new loan agreement, TLB borrowers and lenders created alternative ways to restructure loans within the framework of an existing credit agreement. Typical TLB facilities provide the flexibility to borrowers to incur debt pursuant to provisions that permit refinancings, repricings, rights to 'amend and extend' outstanding loans and rights to add tranches of debt, in each case, typically subject only to the consent of the lenders participating in such debt and the agent. Each form of replacement debt is accompanied by a list of requirements of the form that the replacement debt may take, generally limiting the final maturity, weighted average life, and otherwise requiring that the replacement debt be on terms no more favourable to the new lenders than the old debt being refinanced.

Typically, the principal amount of replacement debt that may be incurred is limited to the actual outstanding principal amount of the debt being refinanced plus fees and expenses for the transaction. While undrawn commitments are not typically considered debt "incurred" for purposes of the additional debt restrictions until they are drawn, some recent TLB facilities now include undrawn commitments under a facility in calculating the maximum principal amount of permitted refinancing debt which can be refinanced. Since permitted refinancing debt is not subject to the *pro forma* compliance ratios that apply to additional debt, including undrawn commitments in the maximum amount of permitted refinancing debt effectively permits a borrower to incur additional debt it would otherwise have been unable to draw without complying with the *pro forma* ratio.

Other Covenants and Covenant Exceptions

Permitted acquisitions, investments, restricted payments and junior debt prepayments

The conditions to making acquisitions, investments, restricted payments, junior debt prepayments and similarly restricted transactions continue to loosen. One typical condition to such transactions has traditionally been an absence of either (i) any continuing event of default, or (ii) any event which, after the giving of notice or passage of time, would give rise to an event of default if not cured (i.e., a 'Default'). It is becoming more common for conditions to be limited to events of default only (so a restricted transaction may be permitted while a Default is continuing) and in some cases such transactions are permitted even while an event of default has occurred or is continuing so long as the event of default does not arise as a result of a nonpayment or an insolvency proceeding.

For acquisitions, borrowers are increasingly permitted to acquire entities that are not required to accede as guarantors. Similarly, it is not unusual, particularly where a borrower has significant non-U.S. operations or a non-U.S. growth strategy, for investments in subsidiaries that are non-guarantors (which most often are non-U.S. entities) to be uncapped. The borrower generally remains subject to the overriding requirement that material subsidiaries contributing an agreed percentage of the group's EBITDA (typically somewhere between 80 and 90 percent) must become guarantors and grant security. This requirement will often not include excluded subsidiaries, which usually include all controlled foreign corporations (or in some cases, all foreign subsidiaries). EBITDA calculations to determine the guarantor threshold may also have specific exclusions that further reduce the number of subsidiaries that must become guarantors.

Ratio-based Permissions and Available Amount Baskets

There is no dominant approach as to which financial ratio should govern ratio-based covenant exceptions, including those for debt incurrence – first lien leverage; total secured leverage; total leverage; and a fixed charge cover ratio are all used. For incurrence of *pari passu* debt, for example, first lien leverage remains the most common formulation, accounting for nearly two thirds of large syndicated TLB facilities in 2016, but the total secured leverage ratio accounts for nearly a quarter. A number of TLB facilities now permit the incurrence of an unlimited amount of unsecured debt subject to satisfaction of a minimum fixed charge cover ratio (in many cases set at 2×) instead of a maximum total leverage ratio, aligning the standard to incur unsecured debt with that commonly found in high-yield bonds. Similarly, restricted payments may be permitted in unlimited amounts subject to satisfaction of a leverage ratio, which may be total, total secured or first lien.

Borrowers are also now sometimes permitted to reclassify prior transactions among dollar baskets so that they are deemed to have been incurred under another exception within a particular covenant (such as the restricted payment covenant or the investments covenant) in the same manner as discussed above with respect to debt baskets. Some TLB will also permit reclassification across certain covenants, such as, for example, reclassifying a fixed dollar basket for restricted payments to be used to make a junior debt prepayment. TLB rarely specify that a borrower must give notice or justify a reclassification (as reclassification is a borrowed concept from high-yield bonds, which do not require notice or explanation of reclassification), and we expect that investors will begin to push for greater transparency around reclassifications generally in 2017 as they become more widely used.

As with the 'freebie' basket for incremental facilities, it is also typical for TLB loan agreements to provide flexibility to borrowers to undertake acquisitions, investments, restricted payments, junior debt prepayments and similarly restricted transactions that would otherwise require *pro forma* ratio compliance up to a total maximum amount. This maximum amount, called the 'Available Amount' or the 'builder basket', has traditionally been pegged to earnings which were not swept as ECF, with the result that the basket's size built up over time. Now, instead of retained earnings, nearly a

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

third of large TLB facilities peg the size of the Available Amount to a percentage of consolidated net income (usually 50%), which permits the borrower to build the basket faster. In addition, the 'Available Amount' now typically includes a fixed 'seeded' amount that is available immediately, and an increasing number of large TLB provide that the seeded amount is the greater of a fixed dollar amount and a 'grower' amount equal to a percentage of borrower's total assets (or, more aggressively, EBITDA). Seeded amounts permit borrowers to do investments, restricted payments and other restricted transactions from day one. Grower baskets like those that are now being used for seeded amounts remain a generally accepted TLB concept for many covenant baskets, including restricted payment baskets, and there is an increasing trend towards pegging the size of these baskets to EBITDA rather than total assets (which is often more beneficial to the borrower).

Financial Definitions

With the increased scrutiny by the Agencies on permitted debt incurrence has also come increased scrutiny on how borrowers are permitted to calculate the ratios that permit additional debt incurrence. The Agencies specifically criticised regulated banks in 2016 for the leeway granted to borrowers to make discretionary accounting determinations that have the effect of decreasing the leverage ratio. Leeway has increased on both the cash flow side and the net debt side of the typical leverage ratio equation.

On the cash flow side, EBITDA definitions historically permitted borrowers to add back to EBITDA prospective cost savings from synergies arising from reorganisations and acquisitions, but such savings historically needed to be expected to be realised within a period of time (traditionally 12 months) and the amount of the add-back was capped to a percentage of total EBITDA (typically 20%). More recently, however, borrowers have pushed for more flexibility in several ways. First, more recent definitions expand the scope of what qualifies as a reorganisation transaction. Some TLB facilities now even permit add backs for expected synergies arising from any 'cost savings initiative' (i.e., not in connection with a specific acquisition or in connection with an overall reorganisation plan) and leave it to borrowers to determine what initiatives qualify. Second, the period of time within which cost savings must be expected to be realised has increased. While 12 months used to be typical, 12, 18 and 24 months now are each found in approximately a third of large TLB facilities and a majority of smaller TLB facilities have a period of 18 months or longer. Some TLB no longer require the cost savings to be expected to be realised within the agreed period but rather require only that the reorganisation or acquisition that will give rise to the expected cost savings be completed within the agreed period. Finally, the cap on the amount of EBITDA add-backs has either increased (most commonly to 25% but sometimes higher) or been removed. Nearly half of large syndicated TLB facilities in 2016 permitted such add-backs without a cap, although add-backs without a cap in smaller TLB facilities are much rarer. Where a cap is present, it will still generally apply to all add-backs over a four-quarter period as opposed to some recent TLB in Europe that have begun to cap add-backs only in relation to individual transactions.

On the debt side of the ratio, TLB facilities have for some time permitted borrowers to calculate debt net of unrestricted cash held by the borrower and its subsidiaries. Cash netting was traditionally capped to a maximum dollar amount, but the number of TLB facilities that permit cash netting without any cap has ebbed and flowed over time. In 2016, the number of large TLB facilities with uncapped cash netting increased to more than three quarters of all large TLB facilities in the market, and nearly 40% of smaller TLB facilities also had this feature.

Assignments and Amendments

Some constraints on assignments of TLB 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 non-payment and insolvency) are continuing. Generally, consent will also be deemed to be given if the borrower fails to respond within a specified period. The length of such period continues to be a point of negotiation, with borrowers pushing for periods longer than the LSTA recommended position of five business days. Assignments to disqualified institutions (i.e. competitors and other identified institutions) are also typically prohibited. A 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). Many TLB facilities now state that the list will be provided to individual lenders upon request instead of posted generally, making it more difficult for a lender to market a loan generally to secondary purchasers who do not know whether a trade will ultimately be permitted and settle. Finally, assignments to the borrower and its affiliates are generally permitted, although the total amount of loans that may be held by affiliate lenders is generally capped to an agreed percentage, typically falling around 20 to 25%.

The thresholds for amendments have historically been set at a simple majority of lenders. Fundamental rights (including economic rights and release of substantially all guarantees and security) require the consent of all lenders. These thresholds now typically permit partial refinancings of TLB and incurrence of additional debt with consent only from 'each affected lender' so that lenders who do not agree to participate in the change do not have any blocking right. In practice, some amendments (e.g. the release of all or substantially all guarantees and/or collateral) will still require unanimous consent. Agents are typically permitted, however, to agree to consequential amendments (such as those to security documentation) that implement permitted additional or replacement debt without any further lender consent.

Conclusion

Although the U.S. TLB market faced difficult periods at the start and at various points throughout 2016, TLB covenant packages continued to move away from the traditional bank model of covenants that require deleveraging and consistent engagement with lenders. TLB borrowers simply weathered slow months and moved opportunistically to market when strong buy-side demand swelled. Waves of hot markets throughout the year, especially in the second half, permitted creative borrowers to push through any drag caused by regulatory pressures and continued to erode the traditional covenant model in favour of increasing bond-like flexibility.

Looking ahead, borrowers and lenders alike are expecting smoother sailing. Interest rates are expected to increase slowly throughout the year and all signs point to less regulatory pressure. It will be particularly interesting to see the extent to which U.S. TLB investors accept even more borrower-friendly provisions that are proposed by aggressive sponsor and corporate issuers. Some of these provisions may be sparked by the creativity seen in the European TLB market in light of the increasing number of cross-border transactions. While geopolitical events threaten a few dark clouds on the horizon, market participants appear to expect a sunny 2017 for the U.S. TLB market.

Acknowledgment

The authors would like to acknowledge the assistance of finance associates Kyle Lakin and Leon Daoud in the preparation of this chapter.

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

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.

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 B.A. from Wheaton College.

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 Growth of European Covenant Lite

James Chesterman

Jane Summers

Latham & Watkins LLP

In 2016, global sponsors and their advisers were successful in continuing to export their experiences from financing transactions in the US leveraged loan and global bond markets to the European leveraged loan market, and this continues apace in 2017. Momentum behind the continued adoption of US covenant-lite terms into European loans is strong as there is now a growing source of European "cov-lite" precedents, in turn strengthening the argument for cov-lite, in the absence of a market correction. This convergence brings a number of documentation issues to consider.

Covenant-lite Loans

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. The covenant benefitting 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. Associated provisions customary in US covenant-lite structures are also now being adopted in Europe. For example, the US-style equity cure, with amounts being added to EBITDA and no requirement for debt pay-down, is now being accepted by some lenders in Europe on some deals. The European market generally permits over-cures, whereas the US market does not.

Documentation

In the past there was a 'battle of the forms' in relation to documenting European covenant-lite loans, with the first covenant-lite loans emerging in Europe in 2013 being documented under New York law. 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 for covenant-lite deals. We now have 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 often have 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 increasingly separate "sidecar" financings. This style of covenant leads to far greater flexibility for a borrower to raise additional debt as pari secured, junior 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. In some cases there may be no limit to distributions if a lower leverage ratio test is met. 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 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, including cross acceleration rather than cross default, with longer remedy periods, which regarding bankruptcy defaults is unusual in Europe).

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

Other Provisions

There are a few other provisions we are seeing migrate from the US covenant-lite (or high-yield) market to Europe and becoming well-established, including:

- "Permitted Acquisitions" controlled by a leverage test rather than by imposing absolute limits – and generally 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.
- Guarantor coverage ratios are trending towards an EBITDA test only (at 80–85%).
- 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).
- Use of the concept of a "Restricted Group" and ability to designate subsidiaries as "Unrestricted" and therefore outside the representations and covenants.

Economic Adjustments

Economic adjustments such as a 101% (or 100.50%) soft call for six months, a EURIBOR floor, and nominal (0.25%) quarterly amortisation are also often 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 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 more flexibility to incur third party debt, 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 (including unsecured 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 is not structured for in European bond transactions.

These provisions become even more important to structure appropriately given the new trend is to seek to adopt "lifetime" intercreditor agreements which remain in place for future debt structures.

What Does This Mean for the Rest of 2017?

It seems likely that ultra-low interest rates may well 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. Further loosening of terms will likely continue if this environment continues. Experience suggests that it is only where a particular credit generates surprising losses upon a default that investors will push back on terms.

Acknowledgment

The authors would like to thank Daniel Seale for his 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 2016*.

Tel: +1 212 906 1341 / Email: daniel.seale@lw.com.

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

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 European leveraged finance and other structured and special situations lending. He is also a leading restructuring and workout lawyer. 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 2017*.

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 major financial institutions in leveraged finance transactions, principally acquisition financings including cross-border, 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, speaks frequently on market trends and serves as an expert witness and consultant involving questions critical to market practices.

Ms. Summers has been active in the syndicated lending market since its infancy in the mid-1980s, including 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.

LATHAM & WATKINS LLP

Latham & Watkins is a global law firm of more than 2,400 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

Yankee Loans – What You Need to Know

Alan Rockwell

Allen & Overy LLP

Denise Gibson

Introduction

This chapter discusses what you need to know about Yankee Loans:

- What is a Yankee Loan?
- Evolution of the Yankee Loan market.
- Look back at the Yankee Loan market in 2016.
- Outlook for the Yankee Loan market in 2017.
- Summary of key structuring considerations for Yankee Loans.
- Comparison of certain key covenant provisions that differ between the US and European and Asian leveraged finance markets (and related credit documentation) which need to be taken into account for Yankee Loans.

What is a Yankee Loan?

"Yankee Loans" are term loans (typically, although not always, denominated in US dollars) 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.

Evolution of the Yankee Loan Market

Prior to 2010, European and Asian borrower groups sourced most of their financing needs through local European and Asian leveraged finance markets, based on English law LMA- or APLMA-based credit documentation, and would only seek to raise financing in the US loan markets either to match US dollar-denominated financing against the US dollar portion of their 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 first became a key source of financing liquidity to such borrowers in the early years following the 2008–2009 financial crises, when financial conditions at the time in local markets affected availability of financing for borrowers in Europe and Asia. However, even as liquidity returned to the European and Asian loan markets, the US Term Loan B market remained an attractive proposition for many non-domestic borrowers because Yankee Loans were typically seen as delivering more flexible terms often at similar or in some cases better pricing (even after factoring in currency hedging costs).

A Look Back at 2016

Total Yankee Loan issuances in the US market decreased in 2016. Full year issuance by volume (as a percentage of all leveraged loans on the US market) was down by 7% compared with the previous year. 2016 saw 68 Yankee Loans hit the loan market (including 53 Yankee Term B Loans and six Yankee Term A Loans).[1] Of those deals, 39 Yankee Loans were done on a covenant-lite basis,[2] meaning that covenant-lite Yankee Loans as a proportion of total Yankee Loan issuance brought to market was unchanged compared with the previous year, holding steady at 57%.[3] Yankee Loans also continued to be available to non-domestic borrowers in a broad number of jurisdictions (including Australia, Austria, Belgium, Canada, the Czech Republic, France, Germany, Grenada, Hong Kong, Ireland, Luxembourg, the Netherlands, New Zealand, Singapore, Switzerland and the United Kingdom).

So, why the slow-down in Yankee Loans volume in 2016?

In the first instance, it is worth considering the factors at play in the US loan market. The US loan market had a slow start to 2016, with many key players starting the year "long" on underwriting positions that had been carried over from the second half of 2015. Against this backdrop, the appetite of lenders generally to underwrite any new deals was very low, even for domestic US borrowers. Although the US loan market recovered strongly by the second half of 2016, the uptick in non-domestic borrowers looking to tap this market was not as sharp. This is likely a function of recent developments in local markets since the beginning of 2015, which accelerated strongly in 2016.

In recent times, the European loan market has developed a much greater acceptance of and appetite for covenant-lite loans. As terms in the US Term Loan B market and European covenant-lite market have converged, unless there is a pricing arbitrage to be had at the relevant time by going to the US Term Loan B market or a particular need for US Dollars, European borrower groups may be more likely to raise their capital closer to home.

For Asian borrowers, the current high levels of liquidity available from local lenders makes local pricing too hard for the international institutional markets to compete with. It seems that the arbitrage on covenant and terms flexibility offered by the international institutional markets has not been enough to overcome the pricing differential which has arisen. In addition, it has also been the case that some strong borrower groups have been able to access the improved pricing offered by local banks whilst eliciting some of the "bells and whistles" on covenant and terms flexibility that would be available from international institutional investors.

Outlook for 2017

Market views on the outlook for Yankee Loans in 2017 continue to be varied. On the one hand, the significant growth in depth and liquidity in the European Term Loan B market, the current low interest rate environment in Europe and the current high levels of liquidity in the Asian loan markets, coupled with a rising interest rate environment in the US loan markets, point to the likelihood of a further drop in overall Yankee Loan issuance volume in 2017. On the other hand, the impact of the introduction of the ECB guidance on leveraged transactions in Europe (scheduled to take effect later in 2017), the potential uncertainty that may arise during Brexit negotiations between the UK and the EU and the anticipated (or perhaps, more accurately, hoped for) change in US financial regulatory oversight following the start of the new President Trump administration in the US, all could potentially negatively impact capacity and liquidity in the European and Asian loan markets while at the same time boosting capacity and liquidity in the US loan markets.

Regardless of where this shakes out in terms of volumes for 2017, one thing remains clear. Yankee Loans are on the "menu" to stay. In part this is because it makes sense for non-domestic borrowers to consider this option when deciding on the right capital structure. Depending on underlying market "technical" conditions at the relevant time, a Yankee Loan may well be the product that delivers the best fit for the underlying business plan. However, there is also a sense that certain US headquartered global asset managers simply have a preference for conformity across their portfolio and so, in the absence of any clear reason to deviate, they may default to a US Term Loan B solution.

Summary of Key Structuring Considerations

When looking at "Yankee Loan" transactions, it is important to understand the key drivers for properly structuring a deal involving senior secured debt. The likely insolvency regime that would apply in an enforcement scenario as a result of the location of the borrower(s) and guarantors of any senior secured debt is of paramount importance and requires the consideration of some important issues which may not be relevant in domestic US transactions.

Why the applicable restructuring regime matters

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 in any transaction is one which minimises enforcement risk by ensuring that senior secured lenders have the ability to control the restructuring process, and this is achieved differently in the US and in Europe and Asia.

United States Chapter 11

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 money" junior secured or unsecured creditors and release their debt claims, guarantee claims and collateral 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.

Europe and Asia – Out-of-court process

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; 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 can very often be 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 (less commonly) Asia, they traditionally rely on contractual tools contained in an intercreditor agreement (principally enforcement standstills and release provisions). The enforcement standstill and release provisions in an intercreditor agreement are designed to enable a borrower group to be sold at the direction of the senior secured lenders as a going concern.

An enforcement standstill operates to limit or prohibit junior creditors from taking any enforcement action including taking any steps to accelerate their debt claim or to enforce (or instruct the security agent to enforce) the transaction security. An enforcement standstill is designed to prevent junior creditors from obtaining leverage through threatening to force a borrower group into a value-destroying local insolvency proceeding and to allow the senior secured lenders time to implement a controlled disposal of the borrower group through enforcement of transaction security.

Release provisions apply upon a "distressed" disposal of the borrower group, i.e. a disposal following an acceleration event or when transaction security has otherwise become enforceable. The release provisions in an intercreditor agreement will operate to allow senior secured lenders to sell a borrower group free of the claims of the junior creditors that are party to the intercreditor agreement. Such release provisions provide that the borrowing and guarantee liabilities of, and the collateral granted by, the borrower group entity being sold (together with the borrowing and guarantee liabilities of, and the collateral granted by, any of its subsidiaries) will be released upon a distressed disposal.

It is worth noting that because the release provisions give senior secured lenders the right to wipe-out the debt claim of a junior creditor, there has been an evolution of so called "value preservation

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

protections" which would now be included in a typical intercreditor agreement to given the junior creditors some degree of comfort that the senior secured lenders have obtained a fair price for the borrower group. This "value preservation protection" attempts to emulate the comfort that junior creditors have in a Chapter 11, court-supervised process which ensures oversight on the actions on senior secured creditors during any restructuring of a borrower group.

This intercreditor practice on enforcement standstills and release provisions 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 (or otherwise bound by) it. Typically, the universe of creditors who are subject to an intercreditor agreement would be limited to the group's primary creditors who share common collateral and/or common guarantees together with intercompany lenders and shareholder lenders. Trade and other non-finance creditors are never party to an intercreditor agreement and this is an accepted market position. However given the debt incurrence flexibility in covenant-lite structures, there is a growing focus on the extent to which other types of third party creditors should be subject to similar enforcement standstill and release provisions outlined above. For example, for transactions which allow the incurrence material "unlimited" incremental debt, incremental equivalent debt, "incurred" acquisition debt or "ratio" debt subject to compliance with a financial ratio to be raised on a senior secured basis, a junior secured basis or an unsecured basis (whether or not the collateral is part of a common pool of security), if the relevant creditors are not subject to appropriate intercreditor arrangements it is easy to imagine how a structure intended to deliver control of a restructuring process to the senior secured creditors class can quickly unravel.

Europe and Asia – *an alternative – the English court-based Scheme of Arrangement*

As an alternative to an out-of-court process (but still not a formal insolvency procedure), creditors in Europe and Asia who document their transactions under English law may be able to take advantage of a scheme of arrangement – a statutory procedure under the U.K. Companies Act, which allows a company to enter into compromises and arrangements with its creditors which is then sanctioned by an English court.

Notwithstanding that a European or Asian centric transaction may have no substantive nexus to England, the scheme of arrangement option may still be available, as the English courts have determined that a sufficient connection will exist to enable an English court to sanction a scheme of arrangement so long as the primary finance document contains an English choice of law and exclusive jurisdiction clause.

The key principle of a scheme of arrangement is to allow an arrangement or compromise in respect of debt claims of a (solvent or insolvent) company to be made, and to be binding on all creditors, if the scheme is agreed by a majority in number and 75% by value of all creditors (or each class of creditors) including secured creditors – effectively allowing a 'cram-down' of minority creditors. The statute is not prescriptive and so the types of arrangements that can be made are flexible.

US: The US Term Loan B market is a mature and sophisticated market. Where a loan to a borrower group which is predominantly domestic in terms of its business and assets is to be syndicated in the US loan market, the credit documentation is universally New York law-governed and structured on the expectation that any restructuring would be effected in the US through Chapter 11 proceedings.

Europe and Asia: Deals syndicated in the European or Asian loan markets were traditionally those where the business or assets of the group were mainly in Europe or Asia, respectively, and such deals adopted a traditional European or Asian approach to structuring – the credit documentation was typically English law-governed (based on the LMA or APLMA form of senior facilities agreement and LMA leveraged intercreditor agreement), and drafted on the expectation that any restructuring would be effected through an out-of-court restructuring relying on contractual tools set out an intercreditor agreement (as described above).

So what happens to documentation when a predominately European or Asian business wants to tap the US Loan market?

Yankee Loans: Given that the US Term Loan B market is so well established, US Term Loan B institutional investors are very familiar with the US loan market-style credit documentation and therefore, most Yankee Loan deals syndicated in the US loan markets have been done using New York law credit documentation. Whilst it is not unprecedented for a foreign issuer to tap the US loan market using LMA-style English law credit documentation, this approach has been very much the exception rather than the rule.

When adopting US loan market-style credit documentation for borrower groups which are predominately non-US, it is important to consider whether the terms of such documentation (which presume a US bankruptcy process) are appropriate. Whilst it is entirely possible that 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), this has not, for the most part, been the approach taken where a borrower group has substantial operating assets and businesses located outside the US. Against this backdrop, a US-style approach to automatic acceleration of loans, whilst an important structural feature in a domestic deal (due to the automatic stay applicable upon a US bankruptcy filing), may not result in the right outcome in the context of a non-US borrower group. Such a provision could tip that non-US borrower group into a local insolvency process which may be value-destructive and which may derail the manner in which a senior secured creditor is trying to organise a restructuring process.

Given the limitations under many local insolvency regimes, European and Asian restructurings have tended to occur outside of any local insolvency process, either pursuant to an out-of-court transaction security enforcement process (relying on a contractual intercreditor arrangement) or pursuant to an English law scheme of arrangement. Given the limited circumstances in which an English law scheme of arrangement is likely to be available in the context of a Yankee Loan documented under New York law credit documentation, it is very important when structuring Yankee Loans to implement a more European/Asian-style approach to the intercreditor arrangements (as described above).

So how did the European market respond to the rise in Yankee Loans?

European Covenant-Lite: In 2016 there was a significant uptick in the volume of covenant-lite loans in Europe as a percentage of overall leveraged loan issuance. As this market began to evolve, there was a sense that, in addition to the approach to financial covenants, the market was also converging with the US Term Loan B market in relation to covenant and terms flexibility (in particular,

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

the approach in documentation in relation to matters such as debt incurrence, restricted payments and acquisitions).

However, throughout 2016, the evolution of European covenant-lite documentation became less predictable because of the adoption of a "pick and mix" approach by strong borrower groups: some deals featured wholesale adoption of a high yield bond covenant package (without any material modification to reflect a secured bank loan); others imported provisions substantially equivalent to those in US Term Loan B credit documentation; and in many cases, deals featured a combination of these two approaches **plus** a sprinkling of terms which are not commonplace in either a high yield bond covenant package or a US Term Loan B package but which had been seen to clear the market during syndication in another European loan market deals.

The covenant and terms flexibility and competitive pricing now available in the European covenant-lite market and the Asian local markets has undoubtedly dulled the enthusiasm of some non-US borrower groups to look at the option of a Yankee Loan, since they may now be able to access the same or better terms in their home market.

What's next: As US, European and Asian loan markets continue to evolve and mature, it can be expected that credit documentation in each market will continue to be impacted. The globalisation of the leveraged finance market and the dominance of global assets managers suggest that, as terms become customary in one region, there will be an expectation that equivalent terms should be available in other regions. Lenders will need to consider carefully whether it is appropriate in all cases to import terms "across the pond" in either direction.

With that being said, there are differences between the US and European loan markets that mean that for at least some deals, loan terms and structures may never fully converge. The key reasons for this are (1) banks remain an important source of liquidity in several European jurisdictions (especially where the underlying credit needs significant local currency which is not be readily available in the institutional market) and banks generally have not been willing to buy significant amounts of covenant-lite debt on a take and hold basis, and (2) as outlined above, the restructuring regime underlying the documentation is fundamentally different in the European market and this needs to be addressed through certain contractual protections not customarily included in New York law credit documentation.

From an Asian perspective, whilst local loan markets continue to develop, the expectation is that it will be some time before US Term Loan B or European covenant-lite terms are viewed as acceptable (or, in fact, appropriate) for the majority of transactions in Asia. This is primarily a function of (1) the high levels of liquidity available from local banks (including domestic champions that provide very competitive pricing) meaning that international institutional investors (who require higher yield in exchange for lighter terms) are not as prevalent, and (2) the structuring issues noted above that often occur in transactions involving developing jurisdictions. A space to watch, however, is the Australian market. The first Australian dollar Term Loan B governed by Australian law was executed in September 2016. It will be interesting to see whether the institutional investor market in Australia will demonstrate sufficient growth to support more substantial (by size and number) covenant-lite transactions.

Why the location of the borrower(s) and guarantors matters

Jurisdiction of Borrower – some issues to consider

In US secured 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.

Lender licensing rules: Many European and Asian jurisdictions impose regulatory licensing requirements for lenders providing loans to borrowers organised in that particular jurisdiction.

Withholding tax on interest payments: 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). In addition, some European jurisdictions may impose limits on the number of creditors of a particular nature that a borrower organised in that jurisdiction may have without triggering additional withholding tax obligations.

Foreign Debt restrictions: In certain jurisdictions in Asia, there are restrictions on foreign debt (i.e. debt that is either provided by a non-resident lender and/or debt that is not denominated in the borrower's local currency) being borrowed by local borrowers.

Foreign Exchange restrictions: In certain jurisdictions in Asia and Latin America, foreign currency exchange rules mean that there are limitations – or in some cases, prohibitions – on expatriating cash and, to add to the complexity, these rules in some cases can be vague, untested and can change frequently.

Need for a US Co-Borrower: 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, some Yankee Loans have included US co-borrowers in an effort to ensure that a maximum number of US Term Loan B institutional investors can participate in the financing. However, 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 liability between US co-borrowers and non-US co-borrowers.

Comparing guarantees and collateral in different jurisdictions

US: The value of collateral and guarantees from borrowers and guarantors located in the US in secured 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 value leakage concerns for senior secured lenders.

Europe and Asia: 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 value leakage is a material concern because lenders either do not get the benefit of a guarantee for the full amount of their debt or collateral in amount equal to the full value of the assets

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

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) or be given at all in support of obligations owed to financial institutions outside the jurisdiction of incorporation of the relevant security provider; (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 guarantee and security principles should operate in those jurisdictions to reflect local market requirements.

As a result, when structuring a Yankee Loan, careful consideration should be given to the jurisdiction of borrowers and guarantors to assess the quality and value of credit support and collateral 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 also be paid to the inclusion of provisions which ensure that a senior secured lender can require a borrower group to provide any updated financial information needed to produce or deliver any market valuation required in connection with the operation of any release provisions in an intercreditor agreement at or shortly before the time of enforcement of any SPE share pledge.

A Comparison of Key Terms

When considering what changes should be made to a typical negative covenant package for a Yankee Loan, lenders need to understand both (1) the difference in drafting styles between New York law credit documentation and European and Asian LMA and APLMA credit documentation, and (2) why the substantive terms of credit documentation in the US and European and Asian markets have traditionally differed, based on the expected outcome under different applicable restructuring regimes (see under "**Structuring Considerations**" above). Below is a summary of recent market developments in credit documentation in the different loan markets and issues to watch out for.

US Covenant-lite

In 2016, Covenant-lite deals in the US accounted for 75% of leveraged loan issuance.[4] In a covenant-lite deal, 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 rapid and continuing convergence between the Term Loan B and high yield bond markets in the US.

Incurrence-based covenants typically provide permissions (for example, to incur additional debt or to undertake an acquisition of a third party) 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 senior secured bank loans by testing compliance against a projected business plan or base case financial model.

European covenant-lite/covenant-loose

Traditionally, European leveraged loans were structured with a suite of four maintenance financial covenants testing leverage, interest cover, cashflow cover and capex spend.

As noted previously, in recent times there has been a significant uptick in the volume of covenant-lite deals in Europe. For the most part, the fundamentals of this product have adopted a similar approach to their US equivalent (i.e. in terms of the "springing" RCF covenant and the incurrence-based permissions).

However there have also been significant developments in the Europe loan market even for those transactions which perhaps cannot support a full "covenant-lite" approach. It is very unusual for a lender in the current European market to benefit from the full suite of financial maintenance covenants. The so-called "cov-loose" market in Europe began by cutting two of the four traditional maintenance financial covenants (leaving investors with (typically) a leverage ratio and an interest cover ratio) and has evolved such that most of today's "cov-loose" transactions would only benefit from a leverage ratio.

The other development in the European "cov-loose" market is that increasingly the financial maintenance leverage covenant will be static (or to the extent it does step-down, there is likely to be only one step before the covenant flat-lines). In the absence of the leverage covenant requiring de-levering, "cov-loose" loans in Europe will now often include similar incurrence-based permissions to those in a "covenant-lite" structure.

***Asian leveraged loan terms*:** Asian leveraged transactions are traditionally conducted out of the established hubs of Singapore and Hong Kong, which will typically cover acquisitions of assets across the region. Unlike in Europe, leveraged loans transacted in the region still often include a full set of maintenance financial covenants, with typical LMA- or APLMA-style covenant protections that are not incurrence-based in nature.

However, "strong" borrowers continue to push for more "covenant-lite"- or "covenant-loose"-style terms and can achieve these in big ticket transactions when there is liquidity and competitive enthusiasm amongst the large domestic banks and international banks. The push for these terms is predominantly coming from "strong" European and US sponsors, as well as their legal counsel.

Issues to watch out for

For the most part, for a US-only borrower group, the additional flexibility in covenant-lite transactions does not result in any material additional risk to senior secured lenders because enforcement will still occur, for the most part, through a US bankruptcy process under Chapter 11.

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

However, when agreeing to increased flexibility in negative covenant packages in the case of a borrower group where material credit support will be provided by non-US borrowers and/or guarantors (or where there is no US credit support at all), senior secured lenders need to consider the impact of this additional flexibility very carefully and in particular should spend some time focusing on the reason why such flexibility was traditionally not allowed in European or Asian credit documentation (which in most cases ties back to the very different way in which non-US borrowers and guarantors would be treated in a restructuring or insolvency process under local law compared to a Chapter 11 process).

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 financial 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, "incurred" 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) or junior secured, subordinated or unsecured debt. In each case, such debt is incurred outside of the credit agreement, and usually can be incurred by any "restricted" group member subject to a non-guarantor cap. The same "MFN" protection that applies to incremental debt usually also applies to incremental "equivalent" debt, "ratio" debt or "incurred" acquisition debt incurred in the form of so-called "sidecar loans", although certain "strong" borrowers negotiate for exceptions to one or more of these baskets and some deals in the US market have now 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 and 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 and 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 debt, incremental equivalent debt, ratio debt or "incurred" acquisition debt, even if junior secured or unsecured, may rank equally, or in some cases structurally senior, to the guarantee claims of the senior secured lenders who provided the main senior secured credit facilities.

This may be because incremental debt, incremental equivalent debt, ratio debt or "incurred" acquisition debt is not incurred for acquisition purposes and is therefore subject to less stringent guarantee limitations or prohibitions than the guarantee limitations or prohibitions applicable to the senior secured credit facilities incurred as acquisition debt to finance the acquisition of the applicable non-US borrowers and guarantors or it may be because the collateral provided by the applicable non-US borrowers and guarantors 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 borrowing and guarantee claims, providers of incremental debt, incremental equivalent debt, ratio debt or "incurred" acquisition debt may not be subject to the contractual enforcement standstill or release provisions provided under a customary European-style or Asian-style intercreditor agreement.

This had led to an increasing number of European covenant-lite and "cov-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 the 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). Since 2015, an increasing number of Yankee Loans have started to follow the same approach (especially in deals that include a second lien facility).

"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). General "grower" baskets are still rarely seen in the Asian loan market; however increased baskets following growth as a result of permitted acquisitions are more common.

It is worth noting that, historically, a "grower" component did not apply to the "fixed" or "free and clear" components for incremental debt baskets or Available Amount baskets but "strong" borrowers have now successfully negotiated for this in many top-tier sponsor deals in both the US and Europe – while you do sometimes see flex protection to eliminate the grower component from these baskets in US deals this flex protection is very rare in European deals.

Investments and acquisitions

Consistent with high yield bond covenants, US Term Loan B deals now usually do not include a fixed cap on acquisitions and investments (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

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

coverage test requirement, more similar to European or Asian deals, or a combination of the two concepts), although some recent top-tier sponsor deals involving a "build and grow" strategy have been successfully syndicated without any cap protection.

"Available Amount" (or "Builder") basket for third party investments, distributions and junior debt repayments

In US deals (including Yankee Loan deals), 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, and is used for (among other things) third party investments, paying distributions and repaying junior debt. Use of the basket is usually subject to a "no Event of Default" condition. Use of the basket is also usually subject to *pro forma* compliance with a leverage-based incurrence ratio condition (which often may only require minimal or no de-levering from opening leverage levels), but some deals may not include this protection for third-party investment baskets (or, in very limited cases, junior debt prepayment baskets) and other deals limit the scope of the protection solely to the "builder" component of the basket.

The European market is more disparate in its approach to Available Amount/"builder" baskets. It is not uncommon for European covenant-lite loans to limit the payment of distributions and repayment of junior debt to payments from retained excess cashflow (i.e. post sweep) and where the *pro forma* leverage is at least 2.0× inside opening leverage levels. However, in the last quarter of 2016 there was increasing convergence with the restricted payments regime in a high yield bond package or the Available Amount basket regime in a US Term Loan B package.

Available Amount/builder baskets are still rarely seen in the Asian loan market.

Additional unlimited baskets for third-party investments, distributions and junior debt repayments

In US deals (including Yankee Loan deals), it is now common for there to be uncapped ability to make third-party investments, pay distributions and to repay junior debt subject to a "no Event of Default" condition and *pro forma* compliance with an incurrence ratio condition (the level varies but would typically be set 1.5× to 2.0× inside closing date total net leverage).

The same is increasingly common for a European covenant-lite transaction although lenders may insist that there is greater degree of additional deleveraging before this basket becomes available.

This is not a feature that has been adopted in deals sold in the local Asian market.

Asset disposals

In US deals (including Yankee Loan deals), this is now commonly an unlimited basket, subject to an Event of Default blocker condition (although even this protection is excluded in some deals), and provided that 75% of consideration is cash (plus a basket for designated non-cash consideration), the sale is for fair market value and the net sale proceeds are applied and/or reinvested in accordance with mandatory prepayment asset sale sweep provisions. In some more recent top-tier sponsor deals, the percentage of net sale proceeds that must be applied in prepayment steps down from 100% to lower percentage levels (based on meeting a specified first lien net leverage or total net leverage financial ratio).

For European deals, there is not yet conformity in the approach to the asset disposals covenant. It is not uncommon to still see some form of general disposals baskets with an annual or life-of-deal cap combined with a fairly extensive list of carve-outs for certain identified assets. However increasingly, European loans (particularly where they are structured as a hybrid to incorporate certain high yield bond covenants) will adopt the US approach.

In Asian deals, one would expect to still see a fixed cap and a more tightly defined list of additional carve-outs to the disposals covenant.

Unrestricted subsidiaries

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 US 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 credit 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 transaction security enforcement, by blocking a distressed disposal of the borrower group as a going concern through foreclosure or share pledge enforcement.

Conclusion

Yankee Loans look a lot like a normal US Term Loan B loans (and increasingly a lot like European covenant-lite loans). 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 may occur in a default situation, greater care should be taken when structuring a Yankee Loan under New York law credit documentation so that it includes certain contractual protections customarily included in European and Asian credit documentation.

Endnotes

1. Source: S&P Leveraged Commentary & Data.
2. Source: S&P Leveraged Commentary & Data.
3. Source: S&P Leveraged Commentary & Data.
4. Source: Survey by Xtract Research (based on a survey of 216 US credit agreements with term loan facilities >$300 million).

Acknowledgment

The authors would like to thank their partners Fiona Cumming, Allen & Overy Hong Kong and Jake Keaveny, Allen & Overy London, and Associates Sarah Cantwell, Allen & Overy London, Madeleine de Garis, Allen & Overy Hong Kong and Anneka Dabo, Allen & Overy New York who helped with the research for this chapter.

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

Alan Rockwell
Allen & Overy LLP
1221 Avenue of the Americas
New York, NY 10020
USA

Tel: +1 212 610 6384
Email: alan.rockwell@allenovery.com
URL: www.allenovery.com

Alan Rockwell is a partner in Allen & Overy's Global Banking and Finance practice, based in New York, and a senior member of the global Leveraged Finance practice. He is recognised as a leading practitioner in the Banking and Finance field by *US Legal 500 2016*. 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 in over 30 jurisdictions 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, DIP and exit financings and restructuring/workout transactions under both New York law and English law.

Denise Gibson
Allen & Overy LLP
One Bishops Square
London E1 6AD
United Kingdom

Tel: +44 203 088 4231
Email: denise.gibson@allenovery.com
URL: www.allenovery.com

Denise Gibson is a partner in Allen & Overy's banking practice based in London specialising in leveraged finance. Her practice also covers other event-driven and structured finance transactions for which clients recognise her aptitude for dealing with complex structuring and execution challenges. From 2011 to 2013, Denise was an executive director in the debt underwriting group at Goldman Sachs with a responsibility for execution across leveraged loans (including US financings for European issuers) as well as high yield bonds.

Denise is recognised as a leading practitioner, having been listed as one of the "40 Under 40 Rising Stars in Legal Services" by *Financial News* in 2014. She is described by *Chambers UK 2017* as a "highly respected" presence in the market. Her experience includes advising leading financial institutions, borrowers and debt funds on a wide range of transactions.

ALLEN & OVERY

Our ambition at Allen & Overy is to help the world's leading businesses both maximise the opportunities that globalisation presents and meet the potential challenges. Our teams across the world work together in a highly integrated manner to leverage their expertise and experience for our clients' benefit. We foster creative, independent thinking within a collaborative culture and, as a result, our lawyers are involved in many of the most influential cutting-edge commercial transactions, and are known for providing our clients with transformative solutions to the toughest legal challenges.

Allen & Overy's market-leading New York and English law global leveraged finance practice (comprising an integrated loans and high yield bonds practice) operates in all of the main financial centres throughout the world. 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. Our practice is supported by pre-eminent Private Equity, Equity Capital Markets, Debt Capital Markets, Securitization and Restructuring teams. This collective expertise combined with in-depth sector insights makes us one of very few firms with the ability to advise on complex cross-border leveraged finance transactions across the full spectrum of the capital structure, as well as on all types of "crossover" and emerging markets loan and bond transactions.

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

Debt Retirement in Leveraged Financings

David A. Brittenham

Scott B. Selinger

Debevoise & Plimpton LLP

A company borrows money. It would like to avoid any requirements to mandatorily prepay the debt before its maturity, such as on the occurrence of some event or contingency, in order to retain the economic benefits of that arrangement and avoid the need to raise or deploy cash to meet a required prepayment. At the same time, it would like to maximise its flexibility to voluntarily prepay the debt before its maturity, such as to refinance at a cheaper cost of capital, or to obtain less restrictive terms.

An investor lends money. It would like to ensure that it can have the debt prepaid if an event or contingency affecting the credit occurs, such as an asset disposition or change of control. At the same time, it would like to protect itself against an unexpected prepayment of the debt at the company's election, forcing the investor to redeploy its capital and lose the benefit of its investment.

The interplay between these competing goals of a borrower and its creditors shapes the prepayment requirements and protections in financing agreements. These provisions further evolve over time with changes and developments in financing markets and products. This article will discuss prepayment requirements and protections in leveraged financing agreements, as well as prepayment and refinancing techniques employed by borrowers, focusing principally on custom and practice in the United States leveraged financing markets for large cap transactions.

Mandatory Prepayment Requirements[1]

Syndicated Term Loans. Traditionally, syndicated term loans in leveraged financings have had a number of mandatory prepayment requirements. Like other features, these requirements have evolved over the years as the syndicated term loan product and debt capital structures have changed and become more complex. The syndicated term loan market has changed fairly dramatically over the last three decades, moving from a market characterised by relatively modest sized loans made and held by commercial banks to one dominated by sizable loans arranged and sold to institutional investors. Given these changes, this article will focus principally on current market practice and recent developments with respect to common mandatory prepayment requirements for syndicated term loans.

Syndicated term loans typically require prepayment with the net proceeds of specified asset dispositions and recovery events with respect to property, commonly after a period during which the borrower is entitled to apply the proceeds to reinvest in its business or repair or replace property, and subject to monetary thresholds. Over the years, the feature has evolved to provide the borrower with greater flexibility to reinvest in its business and to exclude various types of transactions from the prepayment requirement. Its basic purpose, however, remains the same: to protect the investor against substantial changes in the assets of the business that may negatively affect the credit.

Term loans also commonly require a percentage of "excess cash flow" to be applied to prepay the loans, with the percentage varying with a leverage-based financial ratio, commonly beginning with 50%, and declining to zero when an agreed ratio is met. Excess cash flow is calculated for each fiscal year and any prepayment is made annually. The excess cash flow calculation can start either with net income and add back non-cash deductions, or with EBITDA and subtract non-cash additions. The former approach has become more common in recent years. The calculations have become increasingly complex, particularly for larger and more complex businesses. In addition, excess cash flow calculations now commonly take into account and deduct not only prior prepayments during the measurement period on the term loans themselves, but also on other debt secured with equal priority by the same collateral package, further adding to the complexity of the calculation. The excess cash flow prepayment requirement allows an investor to share in the cash flow generated by the business's performance in a good year, as a hedge against performance in a bad year. For a borrower, on the other hand, the excess cash flow prepayment requirement presents potential risk: if the calculation formula has missed something significant, the borrower could be facing a prepayment requirement that it is not anticipating or prepared for. In addition, paying out cash after a good year may result in a leaner cushion if performance declines in a future period. A borrower thus has a substantial incentive to try to shape the excess cash flow formula in a way that minimises the amount calculated. Term loans traditionally have offered a countervailing incentive, by allowing the borrower to increase "basket" capacity to make dividends and investments and take other actions by the amount of excess cash flow retained by the borrower. More recently, term loans have evolved to increase basket capacity by other means – for example, a percentage of consolidated assets, or 12-month EBITDA – and in some instances have moved entirely away from the retained excess cash flow construct.

A third common prepayment requirement relates to the incurrence of debt: A borrower must prepay its term loans if it incurs debt other than debt that is permitted by the term loan credit agreement. The evolution of debt incurrence features in credit agreements in recent years, providing enhanced flexibility to incur debt, including adding additional secured debt to the same collateral package, has made this prepayment requirement in many cases largely meaningless, and as a practical matter merely a way of refinancing the term loans without resorting to the voluntary prepayment features.

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

Syndicated term loans commonly give the investor the option to decline mandatory prepayments from the proceeds of asset dispositions and recovery events, or from excess cash flow. If the investor is happy with the investment and comfortable with the continuing credit, it may want to keep the investment and decline the prepayment. If, on the other hand, the term loan is trading at a significant discount, the prospect of a prepayment at full principal amount can create an incentive for investors to closely scrutinise a borrower's calculation of amounts subject to mandatory prepayment and enhance the need for the borrower to exercise care in that calculation.

Although not structured as a prepayment provision, syndicated term loans effectively require prepayment on the occurrence of a change of control, which typically constitutes an event of default entitling the lenders to require prepayment. How a change of control is determined, and what constitutes a change of control, has evolved over the years. Some term loans deem the change of control default to be waived or otherwise not to occur if the borrower has offered to prepay the term loans and has done so for all term loans tendered for prepayment, a construct that in effect is similar to the option to decline prepayment from asset proceeds or excess cash flow.

High-Yield Bonds. Since the early days of the high-yield bond market, high-yield bonds have required the borrower to offer to prepay bonds from the proceeds of specified asset dispositions, typically after complying with any requirement to prepay any more senior debt, and after a period of time to reinvest the proceeds in the business. For high-yield bonds, the prepayment requirement is coupled with the covenant restriction on asset dispositions. This provision requires that, if a specified asset disposition occurs, the borrower must receive fair value, the consideration must largely consist (commonly, 75%) of cash or the equivalent, or other specified types of consideration, and the net proceeds must be applied to reinvest in the business or to prepay more senior debt, and after a period of time to make an offer to prepay the bonds. As with the similar requirement for syndicated term loans, the bond prepayment requirement has evolved over the years to take into account increased business complexities and to provide the borrower with greater flexibility to make changes in its business without being required to prepay debt. The range of transactions excluded from the asset disposition restriction, the items that count toward the consideration percentage requirement or are deducted in calculating net proceeds, and the time period in which the borrower can otherwise apply the net proceeds, have all expanded substantially over the years. The application of proceeds "waterfall" has become more complex to take into account the potential for multiple bond and other financings with similar application and prepayment requirements. Recently, a feature has begun to appear that is reminiscent of the early days of high-yield bonds, providing that under certain circumstances, the application of proceeds requirement does not apply to a specified portion of the net proceeds of an asset disposition. In the early days, the provision might only cover 80% of the net proceeds absent default. Under the modern construct, the percentage steps down from 100% to a lesser percentage or to zero if a financial ratio is met. This provision thus can effectively suspend the operation of the asset disposition covenant restriction and prepayment requirement so long as the borrower meets a specified ratio. In addition, the asset disposition provision, including the proceeds application and prepayment requirements, is often one of a number of high-yield bond covenant restrictions that are suspended upon achievement of investment grade ratings.

A second prepayment provision that has long been a feature of high-yield bonds requires the borrower to offer to prepay the bonds, typically with a 1% premium, if a change of control occurs. As with syndicated term loans, how a change of control is determined, what constitutes a change of control, and the range of permitted transactions and equity holders, have evolved considerably over the years, in part to account for the complexity of the "beneficial ownership" concepts under US federal securities law that underlie the typical change of control test in high-yield bonds. The so-called "portability" construct that has become common in European high-yield bonds, permitting an acquirer to assume the bonds if specified financial or other requirements are met, has not gained traction in the US market. However, some US high-yield bonds, particularly those that are higher rated, require that a ratings downgrade occur in addition to a change of control, before the prepayment offer is required to be made. While offering an additional measure of protection to the borrower, the additional ratings downgrade requirement does not necessarily make things easier for an acquirer: the downgrade often can occur during a period of time after the change of control and still trigger the prepayment offer requirement, which may complicate an acquirer's financing plans.[2]

Other Leveraged Financing Products. Other leveraged financing products include such financing types as second lien term loans, as well as so-called "mezzanine" debt, which may be subordinated contractually in right of payment to other senior debt, or subordinated structurally by having been borrowed by a parent of the borrower of other debt. These products generally will provide for prepayment requirements similar to those for syndicated term loans and high-yield bonds. Second lien term loan provisions commonly will parallel those applicable to the syndicated term loans having first lien priority. Mezzanine debt may follow either a term loan or bond construct or a mix of both.

Protections Against Voluntary Prepayment by Borrower

Syndicated Term Loans. Traditionally, syndicated term loans have generally been prepayable without premium, on relatively short notice. This relative lack of prepayment protection is coupled with the variable interest rate nature of this financing product, which provides the investor with a rate of return that continually adjusts to the current interest rate environment.

In recent years, the syndicated term loan market has evolved, with institutional investors dominating the buy side, and opportunistic repricings and refinancings becoming more common. Prepayment protections too have evolved, with a relatively modest premium (typically 1%) being payable in connection with refinancings and amendments aimed at achieving a lower interest rate and thus a cheaper cost of capital. This so-called "soft call" protection will commonly fall away after a period of time, giving the investor some period in which it has some assurance that it will realise the benefit of its investment, while at the same time preserving for the borrower the flexibility to refinance or reprice on better terms after the soft call expires.

High-Yield Bonds. Traditionally, debt securities such as bonds have provided investors with a substantially greater degree of prepayment protection, corresponding to the generally fixed interest rate nature of this financing product. The fixed rate provides the investor with a predictable rate of return over a period of time, and the prepayment protection provides a degree of assurance that the investor will continue to receive that return over time, or an enhanced return in the form of a premium payable on prepayment of the investor's bond investment.

Investment grade bonds commonly have relatively long maturities, few covenant restrictions, and if they are prepayable at all, are prepayable only at a premium calculated at a so-called "makewhole" formula that typically results in a very expensive, if not prohibitive,

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

refinancing cost. The effectively permanent nature of this capital is acceptable to the borrower because the covenant restrictions on the operation of its business are few and relatively benign.

In contrast, below investment grade, or high-yield, bonds typically have a maturity not exceeding 10 years – eight years is very common in the current market – and a significantly broader array of covenant restrictions aimed at protecting the investor against a wider scope of possible changes to the business and its creditworthiness that may be of greater concern given the lower credit quality of the borrower. The greater potential for these covenant restrictions to interfere with the evolution of the borrower's business and its owners' goals for their investment give the borrower a greater interest in being able to prepay its high-yield bonds at a reasonable cost: the more restrictive the contract, the more the borrower is incentivised to have the flexibility to terminate the contract and free itself from those restrictions.

High-yield bond prepayment protections have evolved over the years. In the early days of the high-yield bond market, bonds commonly were not prepayable at all for a period of time, and thereafter would become prepayable at a fixed premium that declined to zero over time. That prepayment feature has remained a common term, but has undergone some changes. For many years, the so-called "call schedule" would begin at the midpoint of the life of the bond – for an eight-year bond, after four years; for a 10-year bond, after five years – and the initial "call" premium would be one-half the interest rate, scaling down ratably to zero for repayments made within two years of maturity. More recently, as the market has moved to an eight-year senior unsecured bond paradigm, the call schedule has moved to begin three years out instead of four, with an initial "call" premium that at first was set at three-quarters of the interest rate, but now may be seen beginning at one-half the interest rate as in the earlier call schedule construct.

New prepayment features have appeared over the years, principally aimed at mitigating the impact of the absolute prepayment, or "noncall", protection during the early life of the bond. First, high-yield bonds came to incorporate a provision permitting the borrower to prepay up to a specified percentage of the outstanding amount of bonds using proceeds of a new equity issuance received by the borrower at a premium lower than a makewhole-based premium, so long as a minimum amount of bonds remains outstanding to assure sufficient liquidity for secondary trading. Initially the feature was focused on public equity offerings, on the theory that going public and paying down debt would be a credit enhancing event and accordingly one that merited allowing the borrower to make a partial prepayment at a lower premium than a makewhole. The feature now commonly applies to any equity issuance by or contribution to the borrower. Typically the so-called "equity claw" can only be exercised during the first three years of the life of the bond, at a premium equal to the interest rate – more expensive than the premium payable when the call schedule becomes available, but less expensive for most if not all of the first three years than the makewhole feature now common in high-yield bonds, as discussed below.[3] For many years, the equity claw typically was exercisable for up to 35% of the outstanding amount of bonds, so long as 65% remained outstanding thereafter. More recently, the feature increasingly has permitted up to 40% to be prepaid, so long as 50% or sometimes 60% remains outstanding.

A second prepayment feature that has become common permits prepayment during the "noncall period" at a premium calculated at a makewhole formula, similar to the feature found in investment grade bonds. Early versions of the provision were commonly limited to voluntary prepayment upon a change of control, but it evolved to permit prepayment at the makewhole premium without restriction. The refinancing cost using the makewhole feature, while still substantial, is less prohibitive than for an investment grade bond, initially because of the shorter maturity of a high-yield bond, and later because the makewhole formula became tied to the prepayment amount payable at the first date on the call schedule rather than at maturity; that significantly reduces the makewhole premium because the amount payable at that first call date is significantly less than what would be payable at that date using a makewhole formula.

A third prepayment feature that has gained some currency is typically seen only in a secured bond context. It permits the borrower to prepay up to 10% of the outstanding amount of bonds in any 12-month period at a 3% premium, and again typically can only be exercised during the first three years of the life of the bond. The feature is based on the theory that secured bonds are incurred as a substitute for secured term loans, which as previously noted are generally prepayable without any premium, and accordingly the borrower should have some enhanced flexibility to prepay this alternative type of secured debt.

A final prepayment feature that has appeared more recently permits the borrower to prepay any bonds remaining outstanding after a tender offer has been made for the bonds in which at least 90% of the bonds have been tendered for payment, at the same price as paid in the tender offer. Thus, if for example the borrower has made an offer for its bonds following a change of control as required by their terms, typically at a 1% premium, and at least 90% have been tendered, the borrower can prepay the remaining bonds at the same premium.

Other Leveraged Financing Products. Prepayment protections for alternative lending products, such as second lien term loans and mezzanine debt, can vary to a greater extent than for syndicated term loans or high-yield bonds, but generally tend to be fairly modest in comparison to high-yield bond protections. These products often can be prepaid immediately or after a short period of time at modest premiums that decline fairly quickly to zero. The relatively benign prepayment cost involved makes these products attractive to borrowers.

Prepayment and Refinancing Techniques

The preceding section, in describing prepayment protections, also summarised a number of features permitting a borrower to voluntarily prepay its debt. This section will discuss the ways in which these provisions can be used by the borrower, as well as other features of the financing agreement and approaches external to the agreement that can be deployed to prepay, reprice, extend or otherwise retire debt.

Syndicated Term Loans. Syndicated term loans typically can be voluntarily prepaid on short notice, generally three business days in the case of loans bearing interest at a rate based on LIBOR. Traditionally, that notice was irrevocable, but when lending syndicates were relatively small and made up of commercial banks, it was generally feasible and accepted practice to obtain a so-called "payoff letter" that waived the notice requirement. In addition, in the case of a complete refinancing, the requirement to mandatorily prepay the term loans with the proceeds of a debt financing not otherwise permitted could be used to effectively sidestep the notice requirement. As term loans and lending syndicates became larger and the market moved to an institutional investor base, it became increasingly important to the borrower that it have the ability to revoke its prepayment notice if some contingency did not occur, such as the closing of a refinancing or of an acquisition of or by the borrower. It is now common for term loans to allow the borrower to give prepayment notice on a conditional basis, permitting the notice to be withdrawn if a given condition does not occur.

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

Modern syndicated term loans commonly provide a number of other options for prepaying, repricing, extending or otherwise retiring that debt, which have generally appeared over the last decade or so. One of the earliest features to appear is a set of provisions providing a fairly elaborate mechanic for the borrower to make an offer to prepay some or all of its term loans, open to all lenders, at a stated price or range of prices, similar to a tender offer for bonds or other securities. While this feature remains common in syndicated term loans, it has fallen into disuse as other debt retirement options have developed. In particular, syndicated term loans now often allow the borrower and its affiliates to acquire loans in open market purchases from individual lenders, without the need to make a prepayment offer to all lenders. Loans acquired by the borrower are generally required to be retired, while loans acquired by an affiliate such as a private equity sponsor are generally subject to certain restrictions, such as a limit on the amount of loans the affiliate can hold and on what voting rights the affiliate can exercise. The open market purchase option is generally faster, cheaper and more efficient than resorting to the prepayment offer mechanics.

Syndicated term loans now often allow for partial or full prepayment from a permitted refinancing facility created under the same term loan agreement. This feature will often impose a number of requirements that the permitted refinancing will have to meet. Perhaps in part as a result, the feature has not proven as popular in the context of a complete refinancing as another option, the uncommitted "incremental facility" feature. This provision allows the borrower to add new term loans under the existing term loan agreement subject to a monetary limit or compliance with a leverage-based financial ratio, the calculation of which will give *pro forma* effect not only to the incurrence of the new incremental term loans but also to the prepayment of the existing term loans with the proceeds. The new term loans often will be offered first to existing term lenders, and then to new investors. Some existing lenders for internal reasons may want to exchange their existing term loan for a new term loan, rather than fund cash and then be repaid, in a so-called "cashless rollover". The cashless rollover raised complications under some older term loans, but more recent term loans often expressly allow for it. The incremental refinancing may be used simply to "reprice" the borrower's term loans – that is, to obtain a lower interest rate but make little or no other changes – or it may be used to extend the maturity of the borrower's term loans and make other changes to the agreement.[4]

A simple term loan repricing can also be done by an amendment to the term loan agreement that just changes the interest rate. While such an amendment requires all lenders to consent, term loans today typically permit the borrower to require non-consenting lenders to assign their loans to another party once a majority of lenders have consented to the amendment – the so-called "yank a bank" mechanism – which will allow the borrower to obtain the necessary consent. However, the repricing amendment approach tends to be disfavoured by financial institutions engaged by borrowers to assist in effecting the repricing, because it makes arranging and allocating the repriced loans more complicated in practice than an incremental refinancing to effect the same repricing.

Syndicated term loans commonly allow for an amendment to extend the maturity of the existing term loans, instead of incurring new debt with a longer maturity to refinance the old debt. The extension amendment can be effective for only a portion of the outstanding term loans. It can also make other changes to the agreement that would otherwise be permissible with necessary lender consent, and the yank a bank mechanism can be deployed once a majority of lenders have consented. Again, however, arranging financial institutions favour using the incremental option to effect a complete refinancing or repricing, because the latter facilitates bringing in new investors more easily.

High-Yield Bonds. As discussed in the previous section, high-yield bonds give the borrower a number of options to prepay, or "redeem", the bonds at varying costs depending on when and how the prepayment is made. Traditionally, notice of prepayment had to be given at least 30 days and not more than 60 days in advance, and once given was irrevocable. The inability to revoke the notice once given meant that many transactions, such as those financing an acquisition of the borrower and the repayment of the bonds, had to be structured in other ways, often to provide instead for a tender offer for the bonds, or for a "redemption and discharge", as discussed below. In the late 1990s, our firm introduced a "conditional redemption" feature to the high-yield bond market, giving the borrower the ability to give the notice of prepayment of the bonds but subject to the satisfaction of one or more conditions. The prepayment still had to be made not less than 30 days and not more than 60 days after notice, but the borrower had the flexibility to delay the prepayment within that 30-day period to permit the specified conditions to be met. This innovation allowed the borrower to effect the prepayment with a relatively simple notice, without the cost and complexity of a tender offer. This feature has become increasingly common in the high-yield bond market, as borrowers have come to appreciate its efficiency and cost-effectiveness. It has further evolved in recent years, allowing notice to be given as little as 10 or 15 days in advance, and for the prepayment date to be extended beyond the traditional 60-day limit as needed to satisfy the specified conditions, in a manner similar to how a tender offer can be conducted. The ability to extend beyond 60 days makes it unnecessary to revoke the notice and issue a new notice, starting the clock over.

The tender offer is the traditional alternative to the voluntary "redemption", or prepayment, of high-yield bonds. Because bonds are securities, the tender offer is subject to rules governing debt tender offers under the US federal securities laws. These rules among other things require the offer to be held open for 30 days, but as a matter of interpretation allow the party making the offer to begin to accept tendered bonds for payment after 15 days, facilitating completion of the prepayment of the bonds more quickly than the 30-day minimum for a traditional voluntary prepayment discussed above. The tender offer also can be extended as necessary for any specified condition to be met, and is not subject to a set maximum limit on extensions similar to the 60-day maximum for a traditional voluntary prepayment discussed above. Holders of the bonds are not obligated to participate in the tender offer. However, the tender offer is typically coupled with a solicitation of consents to eliminate, or "strip", essentially all the restrictive covenants with majority consent, as an inducement to participate in the tender offer. Once a majority have consented, the remaining investors must either tender or be left without covenant protections, and typically a very high percentage of the bonds wind up tendered. Pricing can be set, and later adjusted if need be, to achieve sufficient market acceptance. Equal treatment may be required contractually for consent payments, but tender offers can provide for differential consideration to different series of bonds based on differing bond values. The principal drawbacks to a tender offer are that the documentation is more complex and the costs greater for a tender offer than for a voluntary prepayment, making the modern "conditional redemption" feature discussed above an attractive alternative in many cases.

High-yield bonds commonly provide two other features that can be deployed in retiring that debt. First, high-yield bonds typically provide for the "satisfaction and discharge" of the bond agreement, or "indenture", on payment in full of the bonds. Many high-yield bonds also allow satisfaction and discharge if the bonds will mature or can be "redeemed", or prepaid, within the next year: the company simply deposits funds with the bond trustee to cover all future

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

payments due through maturity or prepayment, together with a notice of prepayment if the bonds will be prepaid prior to maturity. The discharge is then effective, and all covenant restrictions under the bonds terminate. A satisfaction and discharge can be coupled with a voluntary prepayment, or "redemption". A "redemption and discharge" is fairly straightforward, and need not involve substantial out-of-pocket costs. But it may be more expensive than a simple redemption, because the company must deposit funds for a period of time prior to the redemption occurring, potentially increasing its interest expense or other cost of capital. In addition, the contractual conditions required to be met to effect the discharge need to be carefully assessed for practical concerns; for example, a requirement that no default exist could present an obstacle to a transaction should a default come to light at the last minute. Bonds called at a makewhole premium, or bearing interest at a variable or "floating" rate, may raise calculation issues with respect to determining the amount to be deposited, if the bonds have not expressly addressed that calculation in advance.

Second, high-yield bonds typically also provide for "defeasance" of bonds, by depositing funds with the trustee to cover all future payments through maturity or redemption. Defeasance is not limited to the one-year look forward limitation applicable to the discharge option – bonds can be defeased at any time. "Legal" defeasance terminates all substantive obligations, but is typically not possible as a practical matter because a common condition to legal defeasance requires delivery of a tax opinion that cannot be given under current US federal tax law. "Covenant" defeasance only terminates specified covenants and related defaults. It may be unattractive economically, and again the contractual conditions to covenant defeasance, such as absence of default, may pose practical concerns. Bonds called at a makewhole premium, or bearing interest at a "floating" rate, again may raise calculation issues with respect to determining the amount to be deposited.[5]

Endnotes

1. Financing products use differing terminology for similar things. A company that incurs debt as a term loan is a "borrower", but is an "issuer" if it incurs debt as a bond. A company "prepays" a term loan, but "redeems", "repurchases" or "calls" a bond. Term loans are "borrowed" under a "credit agreement", while bonds are "issued" under an "indenture". For simplicity and clarity, this article will generally use the same terms regardless of which product is being discussed.
2. The requirement to make a change of control prepayment offer has made some inroads in the investment grade bond market, responding to investor pressure for an option to exit in the event of a leveraged acquisition or similar credit changing event.
3. For an eight-year bond that becomes prepayable after three years at half the interest rate (known as "8 noncall 3"), a makewhole prepayment may be less expensive during the final six months of the three-year period than an equity claw prepayment.
4. One constraint on the incurrence of incremental term loans is that, to the extent that existing term loans remain outstanding and the effective interest rate on the new loans exceeds that on the old loans by more than a stated differential (typically 0.5%, or 50 basis points), a "most favored nations" or MFN provision will typically require the old loans to be repriced to that differential. The MFN provision may be subject to a so-called "sunset", and expire after a period of time. It would not in any event apply in the case of an incremental financing in which the old loans are repaid in full.
5. Under case law, an issuer cannot impose "in substance" defeasance absent a provision permitting defeasance. See *Rievman v. Burlington Northern Railroad Company*, 618 F. Supp. 592 (S.D.N.Y. 1985).

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

David A. Brittenham
Debevoise & Plimpton LLP
919 Third Avenue
New York, NY 10022
USA

Tel: +1 212 909 6347
Fax: +1 212 909 6836
Email: dabrittenham@debevoise.com
URL: www.debevoise.com

David Brittenham is a corporate partner and the co-chair of the Finance Group at Debevoise. He focuses his practice on complex leveraged and acquisition financings, such as the $15 billion acquisition of Hertz by The Carlyle Group, Clayton, Dubilier & Rice and Merrill Lynch Private Equity and the $5.9 billion acquisition of King Digital by Activision Blizzard.

Mr. Brittenham is a contributing author of the *Debevoise & Plimpton Private Equity Report* and regular co-author of articles covering a range of finance-related topics, including alternative leveraged lending structures, high yield bond financings and financial restructurings. He has been a co-chair for PLI's Leveraged Financing and Private Equity Acquisition Financing Summit programs since 2006.

Mr. Brittenham is listed as a leading finance lawyer in *Chambers Global* (2016), *Chambers USA* (2016) and *The Legal 500 US* (2016).

Scott B. Selinger
Debevoise & Plimpton LLP
919 Third Avenue
New York, NY 10022
USA

Tel: +1 212 909 6191
Fax: +1 212 909 6836
Email: sbselinger@debevoise.com
URL: www.debevoise.com

Scott Selinger is a corporate partner and a member of the Finance Group and Private Equity Group at Debevoise, and focuses his practice on complex acquisition and leveraged finance transactions.

Mr. Selinger has extensive experience in syndicated bank loan and high yield bond transactions and regularly advises the firm's private equity and corporate clients in connection with the financing of acquisitions, investments and restructurings, including the $2.73 billion acquisition of Local TV Holdings by Tribune Company, the $2.5 billion joint acquisition of Brand Energy & Infrastructure Services and the infrastructure division of Harsco Corporation by Clayton, Dubilier & Rice, and the $3.2 billion acquisition of Emergency Medical Services Corporation by Clayton, Dubilier & Rice.

Mr. Selinger is recognised as a leading finance lawyer by *Chambers USA* (2016) and is also recommended by *The Legal 500 US* (2016).

Debevoise & Plimpton

Debevoise offers clients unsurpassed expertise on a global scale. The firm has extensive experience in domestic and international leveraged and investment grade finance, including syndicated loans, asset-based loans, high yield issuance, investment grade issuance, acquisition finance, private equity finance, structured finance, and corporate debt finance. Debevoise also represents clients in credit derivatives, fund formation, mezzanine financing, restructuring and bankruptcy, and regulatory matters. The firm provides clients with creative solutions in complex financing transactions. In a market where cross-border transactions are commonplace, our clients benefit from the firm's considerable international presence.

Debevoise is a premier law firm with market-leading practices, a global perspective and strong New York roots. Our clients look to us to bring a distinctively high degree of quality, intensity and creativity to resolve legal challenges effectively and cost-efficiently. Deep partner commitment, industry expertise and a strategic approach enable us to bring clear commercial judgment to every matter.

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

In re Motors Expands Future Claimants' Rights at Expense of 363 Purchasers

George E. Zobitz

Omid H. Nasab

Cravath, Swaine & Moore LLP

I Introduction

In the six years since the bankruptcy filing of General Motors Corporation (herein "Old GM"), most commentators have explored Old GM's novel use of section 363 of the Bankruptcy Code, rather than the Code's more elaborate chapter 11 plan process, to accomplish a reorganisation. Indeed, the novelty of the 363 sale of Old GM's most profitable assets to the newly formed "General Motors LLC" (herein "New GM") elicited across-the-spectrum reactions from the bankruptcy bar.[1]

In the wake of New GM's admission that certain Old GM-manufactured cars suffer from ignition switch defects, and reports that Old GM knew about the defects prior to the 363 sale, several plaintiff classes have emerged to challenge the finality of the sale order and impose successor liability on *New* GM – the good-faith purchaser. These plaintiffs won a major victory in July when the Second Circuit in *In re Motors Liquidation Company*[2] reversed the bankruptcy court's decision to block their claims and held that New GM could be liable.

This article discusses the ramifications of the Second Circuit's decision for the certainty of the sale order's "free and clear" provisions – those provisions that allowed for New GM to take the assets free and clear of any liens or interests, including successor liability claims. The article also explains how the principles underlying the decision could affect the integrity of large-scale 363 sales more generally.

In this article, we do three things. First, we provide background on the 363 sale, including describing the interaction of state-law successor liability claims and the sale order's "free and clear" protections for 363 purchasers. Second, we describe how the revelation in 2014 of ignition switch defects that were known to Old GM prior to giving notice of the 363 sale gave rise to the current litigation between a series of plaintiff classes and New GM over the enforceability of the free and clear protections. Finally, we analyse the Second Circuit's recent ruling, which narrowed their enforceability based on an expansive procedural due process legal theory. This article is intended for bankruptcy M&A practitioners involved in 363 sales generally, and we seek to provide practical observations and insights relevant to that group throughout.

II Background

Old GM's decision to sell its assets under section 363 represented the "zenith" of a trend toward large-scale 363 sales.[3] Although the trend has subsided recently, section 363 is still commonly used for sales of significant assets, such as subsidiaries or business lines.[4] Some background on the typical structure is helpful.

First, prepetition, a soon-to-be debtor typically negotiates a stalking horse agreement with a potential acquiror for the sale of its assets. Next, the soon-to-be debtor simultaneously files a chapter 11 petition in bankruptcy court and moves for approval of the asset sale to the stalking horse, subject to marketing the assets and providing notice of the proposed sale order to all stakeholders. The proposed sale order commonly includes protections for the proposed acquiror to enhance the marketability of the assets to be sold, including provisions ordering that the assets be transferred "free and clear" of all "interests" therein, such as liens or other claims. Finally, once notice has been provided, objections have been heard and resolved and the marketing process has been concluded, the bankruptcy court approves a sale to the highest bidder. At that point, the winning bidder closes the transaction, takes the assets free and clear and begins operating the acquired assets or line of business. In contrast to a traditional chapter 11 plan process – or even a "prepack" plan process – a 363 sale can be completed in a matter of days, not months or years.

a. Road to Old GM Bankruptcy Filing

Old GM chose the 363 sale process for its speed. By the close of 2008, Bear Stearns, Lehman Brothers, Merrill Lynch and AIG were either sold, liquidating or very close to liquidating. The financial markets were in disarray, with commercial credit markets frozen. Consumer credit markets froze up as well, sending car sale revenue into a prolonged free fall. Old GM's financial statements later revealed it had lost $30.9 billion in 2008, and the deterioration was only accelerating in 2009.

During the crisis, the U.S. Treasury provided Old GM with emergency cash infusions to keep it afloat. In March 2009, however, Treasury conditioned any further cash infusion on the submission by Old GM of a viable out-of-court restructuring plan within 60 days. But it quickly became apparent that no out-of-court solution would be forthcoming. Instead, Old GM and Treasury opted to move forward with an unprecedented bankruptcy approach: a 363 sale of Old GM's most profitable assets and brands to a new Treasury-owned entity (*i.e.*, New GM).[5] On June 1, 2009, Old GM filed a chapter 11 petition in the Southern District of New York and simultaneously moved for approval of the 363 sale, proposing a sale order containing free and clear provisions that would allow the assets to be transferred to New GM free and clear of any liens, claims or other interests (including successor liability claims) that it did not voluntarily assume. Around the same time, the federal government announced that it would backstop all warranty obligations of Old GM.

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

b. Successor Liability & Sale Order Free and Clear Protections

Paragraph 7 of the sale order proposed by Old GM set forth these "free and clear" provisions, granted pursuant to section 363(f):

> "Except for the Assumed Liabilities . . . , the Purchased Assets . . . shall be free and clear of all liens, claims, encumbrances, and other interests of any kind or nature whatsoever . . ., including rights or claims based on any successor or transferee liability. . ."[6]

Some background on section 363(f) is helpful.

Although the general rule under state law is that an asset purchaser takes assets free of the seller's liabilities, there are several important exceptions that provide for imposing "successor liability" on asset purchasers. These exceptions include, among others, situations where the asset purchaser is a mere continuation of, or continues essentially the same operations or product lines as, the asset seller. For any large-scale asset sale of business lines or manufacturing operations, these exceptions present a significant concern for a potential purchaser uncertain of whether it might constitute a successor and, if so, what liabilities it might unknowingly assume. The allure of the "free and clear" 363 sale is here: in circuits and districts that allow it, 363(f) displaces applicable state law by eliminating the successor liability exceptions to the general rule and enabling debtors to transfer assets without risk of later successor liability. (Although courts across the U.S. are split on whether 363(f) can cleanse assets of successor liability claims, the Southern District of New York and many others have held that it can.)

Given that the sale from Old GM to New GM was to be a sale of substantially all its assets, there was considerable risk that New GM would constitute a successor to Old GM under applicable state law. Accordingly, New GM sought and obtained a sale order that contained broad 363(f) "free and clear" protections and only a limited carve out of liabilities that it voluntarily agreed to assume, leaving all residual liabilities exclusively with Old GM. It is worth noting, despite frequent reports to the contrary, that New GM voluntarily assumed liability for claims relating to post-sale accident-related deaths, personal injuries and property damage caused by Old GM cars.

c. Notice and Objections

Following submission of the proposed sale order to the bankruptcy court, Old GM proceeded to notice it to relevant stakeholders. Actual notice was provided to 25 categories of parties, including those parties known to have asserted any lien, claim, encumbrance or interest in the assets to be transferred, those parties who were vehicle owners involved in actual litigation with Old GM and all other parties whom Old GM considered "known" creditors. Publication notice was provided to all other parties by a notice published in six major American newspapers and four major Canadian newspapers.

After the sale motion was noticed, the bankruptcy court heard over 850 objections, including to the free and clear provisions' elimination of successor liability, all of which were overruled or otherwise resolved. On July 10, 2009 – merely 40 days after Old GM's bankruptcy filing – the court entered the sale order with the free and clear provisions intact, and New GM received the assets and took over operation of the company.

III Ignition Switch Defect & Emergence of the Plaintiff Classes

In early 2014, New GM informed the National Highway Traffic Safety Administration that it would be recalling vehicles under a number of models dating back to 2005 on account of an ignition switch defect. The defect was a low torque threshold on the ignition switch: only a small amount of force, such as the bump of a knee, could move the switch from "on" to "accessory" or "off". The problems this defect caused were manifold. If the switch moved while the vehicle was in motion, the vehicle could stall, the engine could shut off, the power steering and braking could cut out and/or the airbag deployment system could be deactivated.

Because New GM agreed at the time of the sale order to assume liability for death, personal injury and property damage actions arising post-sale from defects in Old GM-manufactured cars, New GM's liability to plaintiffs injured or killed as a result of the ignition switch defect after the sale was never in question. After the New GM's announcement of the recall, however, numerous other class action plaintiffs filed suit against New GM, nearly all asserting economic damages based on successor liability legal theories.

IV Litigation

Nearly every suit filed rested on claims of the successor liability of New GM for Old GM's actions. Notably, neither the bankruptcy court nor the Second Circuit expressly held that New GM would in fact be a state-law successor to Old GM but for the 2009 sale order's 363(f) protection. But in light of the business and manufacturing continuity between Old GM and New GM, each court's silence more likely reflects that the assumption that New GM was a state-law successor. After the suits were filed in 2014, New GM moved to enforce the sale order's 363(f) protections to block the successor liability claims. The plaintiffs, meanwhile, argued that they were entitled to, but failed to receive, adequate notice of the sale order. Because of that failure, they argued, enforcing the sale order's 363(f) provisions to block their successor liability claims would violate their constitutional due process rights.

In the bankruptcy court, New GM first countered that, because a 363 sale does not extinguish the plaintiffs' claims but rather redirects them toward the proceeds of a value-maximising asset sale, the 363 sale does not result in a deprivation of property triggering procedural due process. The bankruptcy court dismissed this argument by holding that, at least here, "[t]aking away the right to recover from [an] additional defendant (where such a right otherwise exists under [state law])" – implicitly suggesting that New GM was a successor under state law – constituted a deprivation of a property right.[7] In so holding, the bankruptcy court distinguished 363 sales where the purchaser would be a successor but for 363(f) from those where the purchaser would not be a successor regardless of 363(f). The holding seems to leave open the possibility that 363 sales not involving state-law successor purchasers may not raise the due process concerns at issue in the GM litigation.

Next, New GM countered that Old GM had nonetheless fulfilled its procedural due process notice requirements. On this issue, though, the court made a key factual finding that undercut Old GM's procedural due process argument: Old GM, the court found, had knowledge of the ignition switch defect at the time of the sale order. The court found that at least 24 engineers, senior managers and attorneys knew that Old GM was required under the National Traffic and Motor Vehicle Safety Act to send recall notices to owners of vehicles affected by the defect and imputed the knowledge of

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

those 24 employees to Old GM as a whole. That finding rendered every owner of an affected vehicle (records of whom the Safety Act required Old GM to keep) a "known" claimant for procedural due process purposes, which meant that they were entitled to *actual* notice, as opposed to *publication* notice, of the 363 sale order. Because the plaintiffs did not receive actual notice, the court held that notice was inadequate.

Finally, New GM countered that, even if Old GM failed to provide sufficient notice, a notice failure did not ripen into a procedural due process violation unless it prejudiced the plaintiffs' claims. The plaintiffs could not establish such prejudice, it continued, because the bankruptcy court already heard and dismissed in 2009 the very same successor liability objections to 363(f) that the plaintiffs now raised; because the objections were heard, the plaintiffs were not denied an opportunity to be heard and therefore suffered no prejudice from the notice failure. We call this theory herein the "adequate representation" theory of prejudice.

In response, the plaintiffs asserted that no prejudice need be shown at all to prove a due process violation. Alternatively, if prejudice was necessary, showing it did not require challenging the "propriety as a matter of bankruptcy law" of the sale order's 363(f) injunction,[8] but rather required showing only that the plaintiffs could conceivably have defeated the injunction either through legal challenge *or through public pressure or otherwise*. We call this theory herein the "conceivable alternative" theory of prejudice.

Here, the bankruptcy court agreed with New GM, holding that prejudice was indeed required and here could not be shown. It analysed prejudice by determining whether any plaintiffs now asserted claims that had not already been argued and disposed of when the sale order was entered in 2009. With respect to most of the plaintiffs' claims, the court answered no. The plaintiffs not only failed to bring new legal attacks not previously represented at the sale hearing, the court said, they did not even "argue that when the Court barred successor liability back in 2009, it got it wrong".[9] As to the plaintiffs' more relaxed "conceivable alternative" theory of prejudice, it wrote:

> "[The plaintiffs] ask the Court to accept the likelihood that by reason of public outrage or public pressure, they could have required Old GM or Treasury to rewrite the deal to accede to their desires. . . . [T]hey know, or should, the fundamental principle of bankruptcy law that a buyer of assets cannot be required to take on liabilities it doesn't want."[10]

It thereafter dismissed all the plaintiffs' claims (except a certain small minority of claims that were based solely on New GM's actions independent of Old GM).

The bankruptcy court certified its ruling to be reviewed directly by the Second Circuit. That court heard the case in March of 2016 and entered its decision on July 13, 2016. Its decision overturned the dismissals, holding that the plaintiffs were permitted to bring suit against New GM on all their claims.

First, the Second Circuit affirmed that extinguishing a legal claim constituted a property deprivation triggering due process, implying once again that New GM was a successor under state law.

Next, on the sufficiency of the notice provided, the Second Circuit under deferential review affirmed the bankruptcy court's factual finding that the plaintiffs were "known" and therefore entitled to actual notice. In fact, the court held that actual notice was required for holders not only of "known" claims but also of claims that "reasonably should have been known".[11] On that record, it affirmed that the publication notice provided to the plaintiffs was not sufficient.

On whether the lack of prejudice cured the notice failure, however, the Second Circuit reversed. It held that, regardless of whether prejudice was a necessary component of a due process violation, the plaintiffs demonstrated prejudice here. It reasoned that 363 sales are "private transactions" concerning primarily business judgment matters controlled by the buyer and seller, not the court. For example, on objections to 363 sales in general, the court wrote:

> "A bankruptcy court reviews a proposed § 363 sale's terms only for some minimal 'good business reason'. [Citations omitted]. Many sale objections will thus sound in business reasons to change the proposed sale order, not by reference to some legal requirement that the order *must* be changed" [emphasis in original].

The preclusion (by virtue of notice failure) of these non-legal-based objections – objections from the plaintiffs sounding in business reasons, not in legal requirements – is where the Second Circuit found prejudice. It reasoned that if such objections could have altered the business dynamics of the sale – even if affording the plaintiffs only an opportunity to negotiate with New GM – then the notice failure that prevented the plaintiffs from lodging them caused prejudice. It wrote:

> "Opportunities to negotiate are difficult if not impossible to recreate. We do not know what would have happened in 2009 if counsel representing plaintiffs with billions of dollars in claims had sat across the table from Old GM, New GM, and Treasury. Our lack of confidence, however, is not imputed on plaintiffs denied notice but instead bolsters a conclusion that enforcing the Sale Order would violate procedural due process."[12]

Thus, the Second Circuit embraced the plaintiffs' relaxed "conceivable alternative" theory of prejudice. It ruled that, to assert successor liability on a 363 purchaser relying on 363(f), a notice-deficient plaintiff need only plead a "particular factual context" that gives rise to doubt that the sale would be "negotiated and approved exactly as it was" if notice had been provided. Concluding that insufficient notice prejudiced the plaintiffs, the court held the plaintiffs suffered a due process violation. To remedy it, the court "vacate[d] the bankruptcy court's decision to enjoin [the plaintiffs'] claims",[13] allowing the plaintiffs to proceed against New GM. Although the court provided no analysis to support it, this remedy would follow naturally from the assumption that New GM was a state-law successor to Old GM in the absence of the sale order's 363(f) protections.

The relaxation of the prejudice requirement will potentially touch all 363 sales relating to the sale of a business or business unit. If the Second Circuit intended that merely depriving a plaintiff of the opportunity to negotiate constitutes prejudice, that is a low bar – after all, multi-party negotiations (often in courthouse hallways) are a hallmark of nearly every corporate bankruptcy case. There are two takeaways from this observation. First, 363 purchasers should not assume that adequate legal representation for all contingent claimants at the time of the sale order will cure notice defects. Second, if the 363 purchaser would be a state-law successor but for 363(f), the remedy for the notice violation may be to impose successor liability on the purchaser, its good faith notwithstanding. The combined effect is that 363 purchasers should consider investigating the seller's factual history not only for known but also for reasonably knowable claimants prior to a purchase. Of course, there can be no certainty that this diligence will uncover the wrongdoing (if any) from which later claims spring. As such, large-scale 363 sales involving the sale of substantially all assets of a business may, depending on how the jurisprudence develops, require not only increased diligence costs, but also a new fixed quantum of risk that no amount of diligence can mitigate.

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

V Conclusion

Undoubtedly, *Motors* has myriad unusual facts that distinguish it from the normal 363 sale and may limit its reach. For example, the seller "knew" of the product defect pre-sale. It had the names and addresses of the potential claimants due to a regulatory requirement, so could provide actual notice. The purchaser was likely a successor under state law, so triggered heightened due process. The business sold was manufacturing costly, long-lived consumer products, so the court may have been uniquely disinclined to permit liability cleansing as to such products. The U.S. government may have agreed to assume the seller's liability pre-sale had it been disclosed (as it did other warranty obligations), so the non-disclosure arguably caused unique prejudice to the claimants. And the list could go on.

Even so, *Motors* introduces uncertainty that may chill the market for large-scale 363 sales. The depth of the chill will depend on how the case law develops from here.

Endnotes

1. *See, e.g.*, Barry E. Adler, *Chapter 11 at the Crossroads: Does Reorganization Need Reform?: A Reassessment of Bankruptcy Reorganization after Chrysler and General Motors*, 18 Am. Bankr. Inst. L. Rev. 305 (2010); Robert M. Fishman and Gordon E. Gouveia, *What's Driving Section 363 Sales after Chrysler and General Motors?*, 19 J. Bankr. L. & Prac. 4 Art. 2 (2010); Daniel Keating, *Automobile Bankruptcies, Retiree Benefits, and the Futility of Springing Priorities in Chapter 11 Reorganizations*, 96 Iowa L. Rev. 261 (2010).
2. *In re Motors Liquidation Company*, 829 F.3d 135 (2d Cir. 2016).
3. *See* 3 Collier on Bankruptcy ¶ 363.02[3] (Alan N. Resnick & Harry J. Sommer eds., 16th ed. 2013).
4. *See, e.g.*, *In re SunEdison, Inc.*, Case No. 16-10992 (SMB) [D.I. 1002] (Bankr. S.D.N.Y. Aug. 16, 2016) (order authorising 363 sale of certain businesses).
5. *See In re Motors Liquidation Company*, 529 B.R. 510, 529–530 (Bankr. S.D.N.Y. 2014).
6. *In re General Motors Corp.*, Case No. 09-50026 (REG) [D.I. 2968] at ¶ 7 (Bankr. S.D.N.Y. 2009).
7. *In re Motors Liquidation Company*, 529 B.R. at 555.
8. *In re Motors Liquidation Company*, 529 B.R. at 567.
9. *In re Motors Liquidation Company*, 529 B.R. at 567.
10. *In re Motors Liquidation Company*, 529 B.R. at 568.
11. *In re Motors Liquidation Company*, 829 F.3d at 159.
12. *In re Motors Liquidation Company*, 829 F.3d at 165.
13. *In re Motors Liquidation Company*, 829 F.3d at 166.

Acknowledgment

The authors would like to thank Samuel P. Niles for his invaluable assistance in the preparation and finalisation of this chapter.

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

George E. Zobitz
Cravath, Swaine & Moore LLP
Worldwide Plaza
825 Eighth Avenue
New York, NY 10019-7475
USA

Tel: +1 212 474 1996
Fax: +1 212 474 3700
Email: jzobitz@cravath.com
URL: www.cravath.com

George E. Zobitz is the Managing Partner of Cravath's Corporate Department and Co-Head of the Firm's Financial Restructuring & Reorganization Practice. His practice focuses on complex syndicated loan transactions, including acquisition and leveraged finance and asset-based lending, as well as securities, mergers and acquisitions and general corporate representations.

Mr. Zobitz received a B.A. from Franklin & Marshall College in 1991 and a J.D. *cum laude* from New York University in 1995. He joined Cravath in 1995 and became a partner in 2003.

Omid H. Nasab
Cravath, Swaine & Moore LLP
Worldwide Plaza
825 Eighth Avenue
New York, NY 10019-7475
USA

Tel: +1 212 474 1972
Fax: +1 212 474 3700
Email: onasab@cravath.com
URL: www.cravath.com

Omid H. Nasab is a partner in Cravath's Litigation Department and a member of the Firm's Financial Restructuring & Reorganization practice. He has handled a wide variety of litigation cases, including intellectual property, mergers and acquisitions, environmental, securities and bankruptcy matters.

Mr. Nasab received a B.A. from Duke University in 2002 and a J.D. from Columbia Law School in 2006, where he was a Stone Scholar and was awarded the Whitney North Seymour Medal. After a clerkship with the Hon. Bruce W. Kauffman of the U.S. District Court for the Eastern District of Pennsylvania and a clerkship with the Hon. Deborah L. Cook of the U.S. Court of Appeals for the Sixth Circuit, Mr. Nasab joined Cravath in 2008 and became a partner in 2015.

CRAVATH, SWAINE & MOORE LLP

Cravath has been known as one of the premier U.S. law firms for nearly two centuries. Each of our practice areas is highly regarded, and our lawyers are recognised around the world for their commitment to the representation of our clients' interests.

Cravath's Financial Restructuring & Reorganization practice draws on our lawyers' experience handling our clients' most important and challenging cases and transactions, as well as a deep understanding of the business dynamics involved in finance and restructuring. Clients benefit from our role as a strategic, commercial partner in the face of issues triggered by financial distress or insolvency, receiving complete representation not only from our dedicated restructuring specialists, but also from the Firm's premier Finance, Board Advisory, M&A and Litigation teams.

Cravath's substantial experience with reorganisation, restructuring and bankruptcy matters includes debtor-in-possession and "exit" financing, advising independent directors and boards of directors, distressed and bankruptcy M&A and bankruptcy litigation. We also have extensive experience with municipal and sovereign restructuring.

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

The Continuing Evolution of Middle Market Lending

Proskauer Rose LLP

Sandra Lee Montgomery

Generally, the leveraged loan market is often bifurcated into two markets: the large cap market and the middle market. For the past five years, The Private Credit Group at Proskauer Rose LLP has tracked deal data for private, middle market loan transactions. The data reflects that, as those sponsors that have historically focused on large cap transactions have increasingly undertaken transactions in the middle market, the middle market has been forced to incorporate financing terms and conditions that were once only found in large cap financings. While middle market lenders have resisted the inclusion of the full slate of large cap financing terms, the increasing competition for deal origination has resulted in the selective inclusion of certain large cap financing terms, albeit with a middle market orientation. While large cap terms assume a profitable and durable business model, as deal sizes get smaller and business models less able to withstand adverse economic results, middle market lenders have reacted to the introduction of large cap term with incremental conditionality. Middle market lenders' appetite for certain of these large cap financing terms differ not only based on institutional biases, but also based on the size of the borrower's consolidated EBITDA. As a result, the evolution of these large cap financing terms can be traced, in certain respects, to the size of the borrower's consolidated EBITDA, resulting in the middle market becoming further fragmented into the "lower middle market", "traditional middle market" and the "upper middle market". The evolution of certain of these terms in the subdivided middle market is discussed below.

Debt Incurrence

One of the most transformative structural changes to make its appearance in the middle market is the flexibility given to sponsors to incur additional debt either within or outside the applicable loan facility.

Incremental Facilities and Incremental Equivalent Facilities

Leading the way in providing greater flexibility to sponsors is the evolution of incremental and incremental equivalent loan facilities. An incremental facility (also commonly referred to as an "accordion") allows the borrower to incur additional term loans or revolving loan commitments under the existing credit agreement within certain limitations and subject to certain conditions, without the further consent of the existing lenders. Incremental equivalent debt has the same features of an incremental facility except that the debt is incurred as a separate facility outside the existing credit documentation either pursuant to a separate credit facility or through the issuance of notes (which could be issued in a public offering, Rule 144A or other private placement).

The migration of these additional debt facilities into the middle market can be stated as follows: the upper middle market will generally accommodate both the incremental facilities and the incremental equivalent facilities, while the traditional middle market transactions will generally only accommodate incremental facilities (subject, however, to very strict conditions, as discussed below) but will rarely allow for incremental equivalent facilities. Lower middle market deals generally do not provide for incremental or incremental equivalent facilities.

Incremental amount

- In large cap transactions, the existing credit facility may limit the incremental facility to both a fixed amount (known as a "starter basket" or "freebie") and an unlimited amount subject to compliance with one or more leverage ratios. The fixed amount will generally be no greater than 1.0× of consolidated EBITDA and may even have a "grower" component (see discussion on Grower Baskets below). The unlimited amount will generally be subject to compliance with a leverage ratio and depending on whether the original transaction is structured as a first lien/second lien credit facility or senior/mezzanine credit facility and what type of incremental debt is being put in place (i.e. debt *pari passu* to the first lien or senior facility, debt that is subordinate to the first lien or senior facility but *pari passu* with the second lien/mezzanine facility, or unsecured debt), the type of leverage test will be different (i.e. first lien leverage test *vs*. secured leverage test *vs*. total leverage test). In these larger deals, the level of the ratios will often be set at the closing date leverage multiple. The upper middle market often follows the larger deals in terms of how the incremental amount is limited except that, originally, the leverage ratio for the incurrence of the unlimited incremental amount would sometimes be set at the closing date leverage multiple less a setback (often 0.25× of EBITDA). Our data has shown, however, that setting back the closing date leverage multiple has become rare.

  Unlike the upper middle market, the traditional middle market differs greatly in that it will rarely allow both the starter basket and the unlimited amount. In the traditional middle market, it is common for the incremental amount to be unlimited but subject not only to an incurrence leverage test but also to *pro forma* compliance with the maintenance financial covenants. In instances in the traditional middle market where the incremental amount is subject to a fixed cap amount, our data also shows that its incurrence will also often be subject to an incurrence leverage test and *pro forma* compliance with the maintenance financial covenants.

  The use of different leverage tests creates significant flexibility to the sponsors and the borrowers in that it allows the borrowers to incur multiple layers of debt in excess of the overall total leverage test originally used as the leverage multiple. For example, in computing total leverage, the

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

indebtedness included in such a calculation would typically include all funded indebtedness of the applicable credit parties and those subsidiaries included in the financial metrics of the credit parties. The indebtedness included in calculating first lien leverage would only be funded indebtedness subject to a first lien on the assets of the credit parties. As a result, a borrower could first incur unsecured indebtedness up to the required total leverage ratio and still incur additional first lien indebtedness even though such additional debt would bust the total leverage ratio because the test applied for the first lien leverage ratio would not include the unsecured indebtedness incurred by the borrower. This flexibility, although provided in the upper middle market, is often rejected in the traditional middle market transactions. Traditional middle market deals will usually only apply a total leverage test for all types of incremental loans.

- In large cap and upper middle market transactions, sponsors will also seek the ability to (i) use the ratio-based unlimited incremental amount first, (ii) reclassify (at their discretion or automatically) incremental debt which was originally incurred in the fixed amount as incurred under the ratio-based unlimited amount (thereby reloading the fixed amount), and (iii) in instances where an incremental loan is incurred based on both the fixed amount and the unlimited amount, not take the fixed amount into account when testing leverage. In the instances where a traditional middle market financing allows for both a fixed starter basket and a ratio-based unlimited incremental amount, the middle market lender will most likely require that the fixed amount be used first and reclassification would generally not be permitted.
- In large cap and upper middle market transactions, the incremental amount may also be increased by an amount equal to: (a) in the case of an incremental facility that effectively replaces any existing revolving commitment terminated under the "yank-a-bank" provisions, an amount equal to the portion of such terminated revolving commitments; (b) in the case of an incremental facility that serves to effectively extend the maturity of the existing facility, an amount equal to the amount of loans and/or commitments, as applicable, under the existing facility to be replaced with such incremental facility; and (c) all voluntary prepayments of the existing term loans, previously incurred incremental term loans and refinancings of the existing term loans and voluntary commitment reductions of the revolving facilities (except to the extent funded with the proceeds from an incurrence of long-term indebtedness (other than revolving indebtedness)). The incremental amount limitations will be the same for incremental equivalent facilities provided that the establishment of an incremental facility or the incurrence of incremental equivalent debt will result in a dollar-for-dollar reduction of the amount of indebtedness that may be incurred in the other facility. In this regard, the upper middle market is generally consistent with the larger deals. However, the traditional middle market will again differ in that if any additional amounts increase the incremental amount, it will be limited to the voluntary prepayments of indebtedness or commitment reductions of the revolving facilities. The traditional middle market will rarely allow the incremental amount to be increased as described above.

Rate and maturity

- Generally, incremental term loans: (a) cannot have a final maturity date earlier than the existing term loan maturity date; (b) cannot have a weighted average life to maturity shorter than the weighted average life to maturity of the existing term loans; (c) rank *pari passu* with the existing loans or junior in right of payment and/or security or are unsecured; (d) are not secured by any additional collateral or guaranteed by any additional guarantors than collateral securing or guarantors guaranteeing the existing term loans; (e) participate *pro rata* or less than (but not greater than) *pro rata* with the existing term loans in mandatory prepayments; and (f) have covenants and events of default substantially similar, or no more favourable to the lenders providing such incremental term loans than those applicable to the existing term loans, except to the extent such terms apply only after the latest maturity date of the existing term loans or (sometimes) if the loan agreement is amended to add or conform to the more favourable terms for the benefit of the existing term lenders. Some sponsors in larger deals have been pushing for a carve-out from the maturity requirement which would allow the borrower to incur incremental term loans with earlier maturities, up to a maximum amount governed by a fixed dollar basket.

  These terms have generally been adopted in the upper middle market. The traditional middle market does not contain significant variations with an exception, as the traditional middle market sometimes allows only the incurrence of incremental debt that is *pari passu* debt. Although it seems that allowing the borrower to incur either lien subordinated or unsecured subordinated debt instead of *pari passu* debt would be beneficial to the lenders, the traditional middle market's resistance to allowing different types of debt stems from a desire to maintain a simpler capital structure especially in credit transactions where there are no other financings.
- In large cap and upper middle market transactions, additional tranches of incremental revolving loan commitments are permitted whereas the traditional middle market allows only increases to the existing revolving loan commitments and may be combined with an extension of maturity of the existing revolving facility. If additional tranches of incremental revolving loan commitments are provided, these additional revolving commitments usually are required to have substantially the same terms as the existing revolving loan commitments, other than pricing, fees, maturity and immaterial terms that are determined by the borrower and the lenders providing such incremental revolving loan commitments.
- The interest rate provisions applicable to incremental facilities customarily provide some form of pricing protection that ensures that the all-in yield of the existing credit facility would be increased to match (less 50 basis points) any new incremental facility whose all-in yield was greater than 50 basis points above the existing credit facility. These provisions are generally referred to as the "MFN (most favored nations) provisions". In large cap and upper middle market transactions, the MFN provision is often no longer applicable after a period of 12 months to 18 months (some with sunset periods as short as six months). The sunset provision, however, may be eliminated altogether or flexed out, depending on marketing conditions. As the ability to designate incrementals with different payment and lien priorities (or as incremental equivalent debt) has become commonplace in large cap and upper middle market transactions, sponsors have been soliciting additional accommodations that have the effect of further eroding the MFN provisions, including (i) additional carve-outs to the calculation of all-in yield for amounts that do not clearly constitute "one-time" fees (for example, OID and upfront fees), thereby making it easier to remain below the MFN trigger threshold; (ii) applying the MFN provisions only to incrementals (or incremental equivalent debt) that is *pari passu* in claim and lien priority to the existing credit facility; and (iii) limiting the application of the MFN protection to the term loan facility originally issued under the credit facility.

  The traditional middle market takes a somewhat consistent approach to the upper middle market's treatment of the MFN provision. For the most part, *pari passu* debt issued in reliance upon the incremental provisions is subject to the MFN provisions. However, middle market lenders may also require that the impact of the MFN provisions apply to all debt outstanding under the credit facility, including incremental loans previously funded. Also, traditional middle market lenders rarely allow sunset provisions to apply to the MFN provisions.

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

- Finally, in large cap and upper middle market transactions, sponsors sometimes request that debt incurred in reliance upon the starter basket amount and other incremental incurrences used for specific purposes (i.e. permitted acquisitions) should be excluded from the MFN provisions. Without adding further protections, allowing the incurrence of an incremental loan based upon the starter basket amount to be free of the MFN protection has the potential of eliminating the MFN treatment altogether in deals where the borrower has the ability to redesignate starter amount incrementals as leveraged based incrementals because the borrowers are able to, in certain circumstances, reload the starter basket amount.

Use of proceeds

- In large cap and upper middle market transactions, proceeds from the incurrence of incremental and incremental equivalent debt may generally be used for any purpose not otherwise prohibited by the original credit facility. In contrast, the traditional middle market restricts the use of proceeds to very specific purposes such as acquisitions, or capital expenditures. Our data shows a clear migration of the large cap and upper middle market flexibility with respect to the use of incremental proceeds filtering down to the traditional middle market. Increasingly, middle market lenders are, in some deals, permitting incremental proceeds to be used for general purposes, including for restricted payments such as dividends and payment of junior debt but subject to stricter leverage tests.
- Sponsors have also been pushing to permit contemporaneous voluntary prepayment of existing debt with proceeds of an incremental. By permitting contemporaneous voluntary prepayment of existing debt, a borrower can use incremental debt to refinance existing debt, which may occur if the debt being incurred does not qualify as "refinancing indebtedness", or when the borrower is using the incremental to refinance non-consenting lenders in connection with an "amend and extend" transaction.

Ratio Debt

In addition to the incremental and incremental equivalent facilities described above, large cap and upper middle market transactions often include additional debt incurrence capacity through the inclusion of so called "ratio debt" provisions, provisions that can be traced back to the "high-yield" bond market. Ratio debt allows the borrower to incur additional indebtedness so long as the borrower meets the applicable leverage or interest coverage ratio test. Traditional and lower middle market transactions generally do not provide for ratio debt. To the extent ratio debt provisions appear in traditional middle market transactions, the incurrence of such debt is often conditioned on such debt being subordinated in right of payment to the credit facility (and is not otherwise permitted to be secured). Additionally, in those rare instances where the traditional middle market allows for ratio debt, it requires that any applicable MFN provisions be applied to any ratio debt that is *pari passu* to the credit facility obligations. Notably, this middle market term has migrated up market as upper middle market deals have increasingly adopted this protection in respect to ratio debt.

Acquisition Indebtedness

Generally, credit agreements will allow the borrower to incur certain indebtedness in connection with a permitted acquisition or investment. Not surprisingly, the larger deals will commonly allow the borrowers the most flexible formulation and permit the incurrence of any acquisition indebtedness to the extent such indebtedness was not incurred in contemplation of such acquisition or investment and is only the obligation of the entity or its subsidiaries that are acquired. The upper middle market takes a similar approach to the large cap market but will sometimes place certain restrictions by providing that after giving effect to the acquisition indebtedness, the borrower must be in *pro forma* compliance with the financial covenants and/or meet a leverage test (i.e. closing date leverage). Although it is not uncommon for this type of indebtedness to be permitted in the lower middle market, it will be subject to additional limitations. These limitations may be in the form of required subordination terms, dollar caps or require the assumption of debt incurrence exceptions otherwise provided for in the credit agreement. This formulation neuters the acquisition indebtedness exception because, generally, there will be no other form of permitted indebtedness (such as ratio debt) other than the general basket that would be applicable in the lower middle market or traditional middle market deals.

Limited Condition Transactions

One of the best known outcomes of the loosened credit markets in 2005 was the "certain funds provision" technology instigated by sellers who gave preference to those potential buyers who had financing locked down. Certain funds provisions (also commonly known as the SunGard provisions) provided that, except as expressly set forth in a conditions annex, there could be no conditions precedent in the definitive loan documentation to the close and funding of the credit facility, and it limited the representations required to be true at closing to material representations set forth in the acquisition agreement and a narrow set of additional "specified representations". It also limited the actions required to be taken by the borrower pre-closing to perfect security interests in the collateral. These limits were designed to assure buyers and sellers that so long as the conditions to closing under the acquisition agreement were met, the lenders would not have an additional "out" beyond the narrow set of conditions in the conditions annex.

Acquisition financings in general, regardless of the market, have generally adopted the SunGard provisions which require that the only representations at closing that are conditions to funding are specified representations and the representations set forth in the acquisition agreement. All other representations and warranties in the credit agreement are made at closing, but are not conditions to close, so even if such representations and warranties are not true, the lender will still be required to close the financing with a default immediately following the closing. In some more aggressive deals, the sponsor will seek to limit the representations and warranties made only to the specified representations and the acquisition agreement representations so that even if the other representations are not true, the borrower will not have a default post-closing. The upper middle market has generally followed the larger deals in this respect but not without objection especially in first lien and second lien financing transactions where the second lien lenders will not benefit from a regular bring down of the representations through advances made under a revolver. The traditional middle market, for the most part, continues to resist the requirement that only specified representations and acquisition agreement representations should be made at close.

As borrowers and sponsors continued to push for greater flexibility in credit documents, the certain funds provisions continued to evolve, widening its applicability to include future acquisitions contemplated by the borrower financed from the proceeds of incremental loan facilities. Through the broader applicability of the certain funds provisions, the limited condition acquisition provisions were developed where sponsors have succeeded in limiting conditionality for incremental debt incurred primarily to

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

finance an acquisition, thereby diminishing financing risk for follow-on acquisitions. In larger deals, sponsors have been successful in extending this "limited condition acquisition" protection to all acquisitions using an incremental, regardless of whether there is a financing condition in the underlying acquisition documentation.

Customarily, as noted above, conditions to incremental debt incurrence have included material accuracy of representations and warranties, absence of default or event of default, and in certain areas of the market, either a *pro forma* compliance with the existing financial covenant (if any) or meeting a specific leverage test, each tested at the time of incurrence of the incremental debt. The limited condition acquisition provisions debuted in the larger deals enabling the borrower to elect the date of the acquisition agreement ("acquisition agreement test date") as the relevant date for meeting the required conditions. As a result, if the borrower made such an election then the combined conditions to accessing the incremental loans and making a permitted acquisition (which may have included accuracy of representations and warranties, no events of default, and leverage tests) would be tested at the time the acquisition agreement is executed and the borrower would have the ability to include the financial metrics of the target entity (i.e. EBITDA) at the time of such testing. Although the middle market was not able to fully resist the introduction of the limited condition acquisition protections, the middle market was nonetheless able to counter the effect of limiting the conditionality of the incremental debt by requiring that the acquisition close within a specified time frame (usually not longer than 120 days (the "120 Days Limitation")). As a result, in the event the acquisition does not close within the agreed upon time frame, the limited conditionality is eliminated and the borrower would have to comply with all the conditions at the time of the incurrence of the incremental loan. The lower middle market has generally resisted the limited condition acquisition provisions.

The representations and warranties, events of defaults and leverage tests are treated and limited as follows:

- Representations and Warranties: In the larger deals and in upper middle market deals, for the most part, the incremental debt incurred primarily to finance an acquisition is conditioned on a bring-down of only the acquisition representations and the specified representations (see discussion above) at the time of signing the acquisition agreement.

  In the traditional middle market, the alternative approach is to require a full bring down of the representations and warranties at the time of signing the acquisition agreement and require only the acquisition representations and the specified representations at the time of closing the acquisition. This alternative is becoming harder to impose even in traditional middle market deals especially in light of the fact that the 120 Days Limitation may be in place which sponsors argue should be sufficiently protective to the lenders.
- Events of Default: In the larger deals and in upper middle market deals, the absence of the defaults condition is, for the most part, limited to the absence of payment or bankruptcy default at the time of signing the acquisition agreement.

  As an alternative, in the traditional middle market, some incremental facility provisions provide for testing of the absence of all defaults condition at the time of signing the acquisition agreement and an absence of payment or bankruptcy default at closing of the acquisition.
- Leverage Test: The limited conditionality provision permits a borrower to elect the date of the acquisition agreement (instead of the closing date) as the date of determination for purposes of calculating leverage ratios in order to test ratio-based incremental debt capacity. Testing of the leverage ratio at signing eliminates the risk of a decline in EBITDA of the borrower and the target between signing and closing (the period between execution of the acquisition agreement and closing date referred to as the "Intervening Period"), when the ratio otherwise would be tested. This risk is of special concern in deals involving a lengthy delay between signing and closing due to regulatory approvals.

  As the leverage test is intended to include the financials of the acquisition target on a *pro forma* basis, sponsors have further requested that any other incurrence-based leverage test (required in connection with any other investment, incurrence of debt, restricted payment, etc.) that is tested during the Intervening Period include the financials of the acquisition target on a *pro forma* basis. Generally, the markets have responded to this request in three different ways:
  - Most sponsor-favourable: In very large deals, any leverage test required during the Intervening Period will be tested after giving *pro forma* effect to the acquisition. In the event the acquisition does not close, any leverage test applied during the Intervening Period will be deemed to be valid regardless of whether the borrower would have failed to meet the leverage test without giving effect to the acquisition target's EBITDA. The upper middle market has not yet fully embraced this calculation of the leverage test.
  - Most lender-favourable: Any leverage test required during the Intervening Period will be tested on a stand-alone basis. The traditional middle market and the upper middle market (but less frequently) will generally take this approach.
  - Compromise: The maintenance financial covenant and any incurrence leverage test pertaining to the payment of restricted payments are tested on a stand-alone basis but the remaining incurrence leverage tests are tested giving *pro forma* effect to the acquisition. Another compromise is to test all maintenance financial covenants and incurrence leverage tests on both a *pro forma* or stand-alone basis. This application of the leverage test is often seen in the upper middle market.

Available Basket Amount

Once the leveraged financing markets revived following the downturn of the financial markets in 2009, the concept of builder baskets or the "available basket amount" seen in "high-yield" bond deals migrated into, and became prevalent in, the middle market. It is worth noting, however, that the lower middle market is still resistant and often rejects the inclusion of available basket amounts. An available basket amount is also commonly referred to as a "cumulative amount" or a "builder basket". The purpose of an available basket amount is to give the borrower the ability to increase certain baskets in the negative covenants (i.e. investments, dividends and payment of junior indebtedness) without asking for a consent from the lender. The rationale behind lenders conceding to an increase in certain baskets in the negative covenants was an attempt to recognise and reward an increase in the borrower's profitability by permitting the borrower to not only deleverage its debt, but also to permit the borrower the ability to increase baskets in the negative covenants that generally restrict cash outflow.

The available basket amount will be generally constructed to be the sum of the following:

- Starter Basket Amount: a starting amount (commonly referred to as a "starter basket amount") which, unlike the incremental starter amount, is not necessarily based on a percentage of the borrower's EBITDA but is, instead, generally determined on a case-by-case basis (which amount may be further increased by a grower basket in the larger deals). Upper middle market deals and traditional middle market transactions (but less frequently) will often include a starter basket amount.

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

- Retained Excess Cash Flow or a Percentage of Consolidated Net Income: typically in larger deals, the available basket amount will include a percentage of consolidated net income over the retained excess cash flow because the borrower will have quicker access to the consolidated net income especially in those transactions that close in the first half of a fiscal year since the borrower will not be able to build retained excess cash flow until the end of the following fiscal year. Upper middle market transactions will often use either retained excess cash flow or a percentage of consolidated net income. In contrast, the traditional middle market deals will more often include retained excess cash flow which, in addition to having limited accessibility, will most likely be defined in a manner that results in as little actual excess cash flow as possible since the borrower will be required to make a mandatory prepayment in an amount equal to a percentage of such excess cash flow. As a result, the borrower is incentivised to minimise the amount of excess cash flow generated.
- Contributed Equity: if the available basket amount is included in the financing, then having it increased by the amount of equity contributions will be common regardless of the size of the deal. It is also commonly accepted that equity contributions made in connection with equity cures will be excluded from the available basket amount.
- ROI on Investments Made With the Available Basket Amount: larger deals and upper middle market deals will commonly increase the available basket amount by the amount of returns in cash, cash equivalents (including dividends, interest, distributions, returns of principal, profits on sale, repayments, income and similar amounts) or investments. However, not all traditional middle market deals will include returns in cash, cash equivalents or investments in the available basket amount. If included, they will only be permitted to the extent such investments were initially made using the available basket amount.
- Declined Proceeds: declined proceeds from mandatory prepayments required to be made by the borrower will commonly be included in the calculation of the available basket amount regardless of the size of the deal.
- Debt Exchanged for Equity: in larger deals, to the extent that any debt owed by the borrower is converted into equity, such amount will be included in the available basket amount. The upper middle market will often adopt this formulation while the traditional middle market has, for the most part, resisted the addition of debt exchanged for equity in the calculation of the available basket amount.
- Redesignation of Restricted Subsidiaries: in larger deals and often in the upper middle market transactions, in the event an unrestricted subsidiary is redesignated as a restricted subsidiary, the fair market value (generally determined in good faith by the borrower) of the investments in such unrestricted subsidiary at the time of such redesignation will increase the available basket amount so long as such investments were originally made using the available basket amount. The traditional middle market continues to resist this component of the available basket amount.

The conditions around the usage of the available basket amount vary greatly and the traditional middle market takes a very different approach than its larger counterpart, the upper middle market. As noted, the purpose of the available basket amount was to increase the basket pertaining to cash leakage such as investments, dividends and junior debt payments. The upper middle market deals often place few conditions around the usage of the available basket amount. Such conditions may be further distinguished as follows. In very aggressive upper middle market transactions, conditions for accessing the available basket amount will usually apply in respect to a dividend or junior debt payment basket to the extent such amount is being increased from the component of the available basket amount pertaining to the starter basket amount or retained excess cash flow or a percentage of consolidated net income. More specifically, these conditions will typically be no payment or bankruptcy events of default as well as a specific leverage or fixed charge coverage test. It is important to note, however, that the leverage or fixed charge coverage test will generally apply only in instances where the component of the available basket amount pertains to the retained excess cash flow or a percentage of consolidated net income. In the more conservative upper middle transactions and the traditional middle market deals, the approach will be to place conditions for the usage of the available basket amount irrespective of which component of the available basket amount is being accessed. For the most part, these conditions may include a *pro forma* leverage ratio test as well as a no events of default condition. In the traditional middle market, it is also not uncommon for the available basket amount permitted to be used to be subject to an additional capped amount. Additionally, in respect to the payment of dividends or junior debt, there will be an additional leverage ratio test that will be well within the closing date leverage (by as much as 1.0× to 2.0×).

Grower Baskets

Akin to the available basket amount, the "grower basket" is intended to provide the borrower with the flexibility of automatically increasing certain basket amounts based on the growth of the borrower's EBITDA or total assets. As the larger deals adopted the grower baskets with ease and in light of the sponsors' continued demands on the lenders, the middle market was forced to respond in kind. While the upper middle market and, to a lesser extent, the traditional middle market have generally adopted the grower basket provisions, the lower middle market continues to resist the inclusion of grower baskets as much as it continues to resist the available basket amounts.

Grower baskets are intended to be utilised at any time a hard capped amount is implemented by formulating it as being the greater of a capped amount and a percentage of either the total assets or EBITDA of the borrower. As such, grower baskets will be used in connection with the free and clear amount in incremental debt provisions, the starter basket amount in the computation of an available basket amount and other amounts set out as exceptions to negative covenants.

Unlike the available basket amount, which represents an additional level of flexibility within the investments and restricted payment covenants by providing for an additional performance-based covenant exception, a grower basket is the addition of a growth component based on a percentage of EBITDA or total assets that corresponds to the growth of company. Utilisation of the grower basket will not be subject to any conditions such as there being no events of default or a leverage ratio test unless the exception for which the hard capped amount relates originally included any such condition.

Choosing between EBITDA or total assets is not exclusively beneficial to either the lender or the sponsor. While EBITDA is better to measure the performance of companies that are not asset rich but are instead cash flow-centric, the downsides are that it can be volatile and, depending on the industry, very cyclical. Total assets, on the other hand, are better suited for companies that are asset rich. However, the downside is that there may be certain assets that are difficult to value such as intellectual property and goodwill.

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

Unlike available amount basket, which will uniformly build with a percentage of consolidated net income or retained excess cash flow, there is no established rate by which particular grower baskets are set. Instead, the parties will negotiate the hard capped amount and set the percentage of either the closing date EBITDA or total assets to the equivalent hard capped amount.

Unlike the calculation of the available basket amount which, once increased, would only decrease to the extent utilised, because grower baskets are formulated based on a "greater of" concept, if the growth component fluctuates in size, the quantum of the basket will also fluctuate (but limited down to the hard capped amount). Note, however, that since grower baskets are generally included in incurrence-based exceptions utilisation, if a grower reduces in size, any prior usage of the basket at the higher level will not trigger an event of default.

Looking Ahead

With each passing year, The Private Credit Group data has shown that the terms relating to debt incurrence, limited condition transactions, available basket amounts and grower baskets as adopted in the middle market have continuously evolved due to sponsors' continuing success in obtaining greater flexibility in their transactions. Constantly evolving markets, economy and access to debt markets should, in certain instances, impact the sponsors' ability to continue pushing for flexibility in their transactions. However, as a particular sponsor-favourable provision is adopted in the middle market, the middle market lenders' ability to unwind such change is, for the most part, limited. The inability to back out of such provisions is due, in some part, to the growing use by sponsors and middle market lenders of credit documents for a prior transaction as the basis for the documentation of a new transaction. Although taking back a particular provision may be difficult to achieve, changes in the market will most likely still impact the dividing lines of where these issues fall in either the lower middle market, traditional middle market or upper middle market.

Acknowledgment

The author would like to thank Steven M. Ellis, co-head of The Private Credit Group at Proskauer, for his invaluable contributions to this chapter.

Sandra Lee Montgomery
Proskauer Rose LLP
2049 Century Park East
32nd Floor
Los Angeles, CA 90067-3206
USA

Tel: +1 310 557 2900
Fax: +1 310 557 2193
Email: SMontgomery@proskauer.com
URL: www.proskauer.com

Sandra is a partner in The Private Credit and Finance Groups. Sandra represents first- and second-lien senior lenders, mezzanine investors, and equity sponsors in senior debt, mezzanine and private equity financing arrangements, particularly those involving private sources of capital. Her areas of focus include acquisitions, recapitalisation and other leveraged financings, cash flow and asset-based financings, debtor-in-possession and exit financings, cross-border financings, unitranche and mezzanine financings, restructurings and other innovative, first-in-kind transactions.

Proskauer»

Proskauer is a leading international law firm focused on creating value. Our roots go back to 1875, when we were founded in New York City. With 725+ lawyers active in virtually every major market worldwide, we are recognised not only for our legal excellence, but also our dedication to client service.

The Private Credit Group is a unique middle market finance practice. The breadth and diversity of our practice is unmatched in the industry. The group was the first to dedicate its practice solely to representing providers of private credit. We represent over 50 clients, including private debt funds, business development companies, asset managers, finance companies and family offices. These lenders provide financings for transactions ranging from $10 million to more than $1 billion across a myriad of product types and industries.

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

An In-house Legal Team's Views on the Roles and Responsibilities of External Deal Counsel on Lending Transactions

HSBC

Clifton Prabhu

Charles Bronowski

1 Introduction

As the marketplace for the provision of legal services to financial institutions continues to evolve, in-house counsel is frequently asked by law firms how they can adapt their business models and relationships to better meet the needs of clients on lending transactions. As such, it can be helpful for law firms to understand some of the questions that are most frequently received by in-house counsel from external counsel, and to hear observations that in-house counsel have about the services provided by law firms on lending matters.

2 Question and Answer

(i) What factors are most important to you in selecting external counsel?

Broadly speaking, two factors come to mind: knowledge of the deal and knowledge of the client. While most law firms pride themselves on deal experience and substantive legal ability, the reality is that, absent a unique transaction requiring a very specific skill, these are not likely to be distinguishing features among the top law firms that have already made it onto a financial institution's "approved list" of firms. A financial institution will largely assume that its approved firms have the substantive experience and technical competence to complete most transactions; otherwise such firms would likely be removed from the approved list. So, it is often other factors that in-house counsel use when making the difficult calls in differentiating between law firms.

Perhaps the most important factor that distinguishes firms is the degree to which they invest the time and energy to get to know their clients. For example, most financial institutions have particular sensitivities around regulatory matters, tolerance levels for balancing legal risks, and preferences towards the structure of billing arrangements. Financial institutions organise their legal coverage in a variety of ways, such that understanding a bank's organisational structure is important. For example, is the in-house legal team working shoulder to shoulder in real time with the law firm or is there a deal execution team performing this task with the in-house team involved in select hot button issues? If the latter is the case, what are those issues that external counsel needs to flag for the in-house attorney?

To the extent that a relationship partner expresses his or her willingness to learn about a client's profile, that investment is likely to pay dividends down the road by creating a relationship built on mutual understanding of each party's interests. Internal counsel is often looking for more than just a document turner and deal manager. What they are really looking for is a trusted counsellor who can help shape and manage a financial institution's legal risk profile.

Taking a holistic approach to client management is also important: once a lead partner has had an initial conversation with a client, the client may properly assume that the messages conveyed to that lead partner will get cascaded within the law firm to the deal teams that run future transactions. Internal counsel will sometimes get frustrated if they need to keep repeating the same messages on sensitive deal touch points each time there is a new deal that arises and gets staffed by a different team at the law firm. In addition, it is appropriate for the relationship partner to have periodic follow-up discussions throughout the course of the relationship to learn how internal counsel's expectations may be evolving based on internal and industry developments.

(ii) What are the important attributes of effective external counsel?

By getting to know a financial institution's operations, objectives and challenges, and also understanding what role the bank's business side personnel plays on a deal, a law firm can add value by integrating itself into a client's legal risk management framework. In doing so, in-house counsel will gain trust that a law firm is focused on matters that are important to the financial institution.

An example of investing in a client is the degree to which a firm is willing to brief internal counsel and the relevant business personnel on market trends and conduct training sessions for the client. Law firms should be cognisant of the fact that most in-house legal teams do not have access to the breadth of training materials (such as voluminous knowledge management databases) or the wider breadth of current deal experience that law firms have. Therefore it is often helpful to be able to leverage a law firm's experience. The mass email client alert distributions on recent developments that many law firms prepare can sometimes be helpful, but it is the targeted advice and training that gets delivered that has the most impact. A well-timed phone call to an in-house counsel with targeted advice on a unique question may not only enhance a client's knowledge, but also lead to additional revenue-generating work for the firm. Similarly, being available to answer questions off the clock while a client is still in the exploratory early stages of deal development will be recognised by internal counsel and could give a law firm the inside track when it comes to landing work on the deal if it comes to fruition.

Another example would be the degree to which external counsel is willing to make recommendations or spot issues in a client's standard form documents. Any time that an external counsel can

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

lend a fresh pair of eyes to the work of internal counsel, it helps give internal counsel comfort that it is effectively addressing its key legal risks.

In terms of response times, clients understand that law firm attorneys are being pulled in many directions. However, clients do expect timely responses from their law firms, even if that initial response is simply that the message has been received and is under consideration. Clients are operating under tight time frames too, and are often competing with other financial institutions for business. When a law firm's response time is slow, that can slow the client's response time to its customer, and ultimately risk the expected compensation on a deal for both the client and law firm.

Lastly, law firms should not be afraid to seek out guidance after deals close for feedback on what they can do better. By asking for feedback, law firms will alert in-house counsel to the degree to which the external law firm values the financial institution as a client.

(iii) How have client expectations of external counsel changed over time?

Financial institution client expectations of law firms are largely reflective of the changing environment faced by clients themselves.

With financial institutions facing increased regulation and regulatory scrutiny, many financial institution clients have seen their compliance costs rise dramatically in recent years since the various financial crises. Law firms should be aware of the fact that they can have a positive role to play in assisting clients with compliance issues on both the front and the back end of transactions: the old adage that an ounce of prevention is worth a pound of cure has never been truer than it is today. When it comes to deal management, it is critical that law firms spot issues that could have compliance-related complexities and bring these issues in a timely manner to the attention of the proper personnel at the client.

It is equally important that the service be provided at a reasonable cost. As competitive cost pressures increase, financial institutions and their customers alike are increasingly scrutinising how deals are staffed by law firms. Financial institutions are more likely to use a law firm if they know that a dedicated partner will be overseeing all material documents and matters on a deal. It is understandable that partners lean on associates to do some of the heavy lifting on deals, but there is no substitute for having a partner or a very senior associate being the primary deal counsel. Clients also appreciate when the same external attorneys are staffed on the client's deals over time, which in the long run could lead to significant cost savings, because there will be no need to keep familiarising new attorneys with a bank's sensitivities.

Financial institutions and their customers are increasingly likely to refuse to reimburse a law firm for the billable hours of the very junior associates, where the value added is questionable (for example, simply being in the room for conference calls that the partner or senior associate are leading). One of the frustrations that financial institution clients and their customers have is when they see matters which appear to be over-staffed. Nowadays, there are too many cost constraints imposed on external legal spend to think that in-house counsel or a financial institution customer will be willing to pay billable hours to effectively train a junior associate.

(iv) How actively involved does internal counsel want to be on deals?

The degree to which in-house counsel wants to be involved with or cc-ed on routine daily deal matters varies from client to client, and as discussed above, the more effective law firms develop a thorough understanding of a client's organisational model and the role of its legal department in deal management. Financial institutions could have a variety of priorities when it comes to how legal coverage works on lending transactions. If a law firm has not developed a clear understanding of its client's legal coverage model, it is advisable when a deal first arises for the law firm partner to reach out to internal counsel and inquire as to in-house counsel's expectations. As part of that initial conversation, the law firm should find out what matters the in-house attorney expects to be escalated to him or her.

A law firm should understand that, regardless of the client's legal coverage model, it is being hired to be a deal leader and problem solver. In-house counsel is typically covering a much higher volume of transactions than external counsel, and when issues arise will typically expect the law firm to propose a solution and provide a rationale for an approach.

(v) What are examples of some of the key regulatory issues that external counsel should be monitoring for that might not always be obvious?

Remember that from a financial institution's perspective, identifying legal and regulatory issues posed by a particular transaction can be as or more important than any victories that an external law firm delivers to a client by, for example, drafting covenant definitions in a way more beneficial to the financial institution. The deal terms that could cause regulatory or legal issues for a bank need as much or more attention than those terms that have an effect on the pure economics of a transaction. It is important for deal counsel to occasionally step back from the deal documents that they are drafting and take a holistic view of the legal risks posed by a transaction.

When an external counsel identifies a previously unknown material legal or regulatory issue, it is important to get internal counsel involved in the matter as quickly as possible. Certain clients could have internal protocols and chains of communication that need to be involved in solving such matters, and it is always better to get the relevant client personnel involved in the matter at the front end rather than letting issues linger.

Examples of regulatory issues that are at the forefront for some financial institutions and that may not be immediately obvious to external counsel include: (1) knowing whether the consummation or enforcement of the transaction requires any bank licences to be obtained beyond those in the "home" jurisdiction of the client; (2) potential anti-tying issues if a financial institution is providing more services than simply a loan; and (3) the types of provisions that a financial institution needs to satisfy its sanctions, anti-money, or anti-bribery and corruption compliance burdens.

(vi) Please give examples of some key loan agreement provisions that are not regulatory in nature that are of particular focus to banks

There are a variety of provisions that in-house counsel prioritises that may not typically draw the most pointed attention from external counsel. The nature of these provisions is that they are focused upon changes over time in response to a client's changing priorities. Recurring themes in the financial services area revolve around balance sheet management, risk mitigation and information sharing. This means that loan agreement sections dealing with assignments, participations, and confidentiality provisions need particular focus. Generally speaking, provisions from the LSTA or the LMA are an appropriate starting point for New York or English law transactions, because they reflect current industry standards and the input of financial institution clients. A law firm should bring to the

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

attention of its client any material deviations from standard LSTA or LMA provisions. Given the dynamic nature of industry lending developments it is not advisable, absent a clear understanding, that a precedent document is the appropriate starting point for assignment, participations, and confidentiality provisions for a new transaction.

(vii) How have billing arrangements and pressures changed in recent years?

Financial institutions want the best legal counsel for their matter, not necessarily the cheapest option. Nevertheless, in the current environment, financial institutions and their customers are coming under increasing pressure to manage external legal spend budgets.

Law firms should be willing to explore alternative fee arrangements other than just billable hours. In addition, it is not uncommon for financial institutions to ask law firms to provide estimates or hard caps up front for work on lending transactions. When a client asks a law firm to provide an estimate or cap, the client will expect the law firm to remain true to its quotes. If the variables underlying the original quote change (the deal becoming more complicated than originally planned) it is important for law firms to give clients a warning that the deal will be more costly than previously assessed. One of the worst frustrations that can occur for internal counsel is hearing for the first time that there is an overage in legal expense after the deal closes and the final invoice is prepared. If the law firm needs to have a conversation with its client about its fees exceeding previous estimates, then those conversations should happen as soon as practicable.

Clients are increasingly likely to go through an invoice to look for duplicative work, especially by junior associates, for whom clients do want to be paying for training. Clients expect law firms to staff the deal properly so that there are not unexpected and unnecessary hours piling up.

Clients appreciate when law firms compile and send bills in a timely manner, particularly where the bill is being paid for by its customer. Sitting on bills before sending them to the clients will decrease timely payment efficiencies, as personnel changes and memories of what a great job the law firm performed fade away.

3 Conclusion

Law firms that invest the time and effort to get to know their financial institution client's preferences and touch points will ultimately develop deeper ties with those clients. A law firm should consider devoting one or two partners or counsel to be the primary points of contact for relationship issues. In an era when in-house legal teams are often expected to be risk managers for financial institutions' hot button regulatory and contractual touch points, it is particularly important for law firms to develop the types of relationships with their clients that foster plans to identify and reduce material legal risks.

In-house counsel is generally appreciative of targeted regulatory or industry updates that could have implications for the specific product that the financial institution provides. Law firms are generally exposed to a wider range of issues and have more robust knowledge management, which internal counsel can benefit from.

In the current environment, external counsel needs to be sensitive to the costs constraints that many clients have on external legal costs. If financial institutions are faced with competitive cost pressures in dealing with their clients, it is to be expected that financial institutions might exert those same costs pressures on their external counsel.

No matter how proficiently external counsel handles a deal and its relationships with its clients, inevitably there will be a deal or an issue that arises throughout the course of a relationship which poses a material legal risk to the client. When that happens, it is most important to keep the lines of communication between external and internal legal coverage as open and frequent as necessary to address the legal issues. Involving internal counsel early and often on issues that pose material legal risks is always better than silence, because internal counsel knows when to elevate issues internally within the institution.

As with many things in the financial services sector, candid, open and frequent communication will preempt the rise of and make easier the management of material legal risks on lending transactions.

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

Clifton Prabhu
HSBC
452 5th Avenue
New York, NY 10018
USA

Tel: +1 212 525 5000
Email: clifton.prabhu@us.hsbc.com
URL: www.us.hsbc.com

Clifton is a Senior Vice President and Associate General Counsel in HSBC's New York office. He is the Head of U.S. Legal for HSBC's Corporate Coverage & Lending and Commercial Banking units in the U.S. and provides legal advice across a broad spectrum of financing transactions. He also advises on the implication of regulatory issues to the bank's lending businesses.

Prior to joining HSBC, Clifton practised in the New York office of Milbank Tweed and the Toronto office of Smith Lyons (now Gowlings).

Clifton holds a law degree from the University of Toronto and a Bachelor's degree with honours in commerce from Queen's University at Kingston.

Charles Bronowski
HSBC
452 5th Avenue
New York, NY 10018
USA

Tel: +1 212 525 5000
Email: charles.p.bronowski@us.hsbc.com
URL: www.us.hsbc.com

Charles is a Vice President and Senior Legal Counsel in HSBC's New York office. He covers a variety of lending products across the project finance, export finance, and asset and structured finance businesses. He also advises on U.S. bank regulatory issues, renewable energy and green-incentivised financings, tax equity investments, and financing to BDCs (business development companies).

Prior to joining HSBC, Charles practised in the New York offices of Davis Polk and Latham & Watkins.

Charles holds a law degree from Harvard Law School, a Master's in economics from the University of Pennsylvania, and a Bachelor's degree from Rutgers College.

HSBC

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

The Section 363 Sale Process: Key Considerations for the Prepetition Secured Lender

Moore & Van Allen, PLLC

Zachary H. Smith

I. Introduction[1]

In modern chapter 11 practice, many complex restructurings appear on the surface to present a similar situation familiar to senior secured lenders to distressed borrowers:

- prior to bankruptcy, the borrower enters into a senior secured credit facility with an individual lender or lender syndicate (the "Lender");
- as of the filing of the borrower's chapter 11 petition, the credit facility is in default, and the Lender asserts a first priority blanket lien on substantially all of the borrower's assets including, without limitation, all of the borrower's cash and receivables;
- the borrower (the "Debtor") enters chapter 11 with an immediate need to use its existing cash encumbered by the Lender's lien, and/or to obtain additional liquidity through a new superpriority debtor-in-possession financing loan from the Lender (a "DIP Loan"), to fund the Debtor's business operations and chapter 11 administrative expenses such as estate professional fees;
- rather than seek to use chapter 11 to rehabilitate the Debtor's business and confirm a standalone plan of reorganisation, instead the Debtor, with the consent of the Lender, positions the chapter 11 case for a competitive auction process (an "Auction") and fast-track sale of substantially all of the Debtor's assets as a going concern pursuant to section 363 of the Bankruptcy Code;
- the Debtor and Lender negotiate procedures to govern the bidding and Auction process ("Bidding Procedures") and the bankruptcy court enters an order approving the Bidding Procedures, setting the Auction date and the date for a hearing to consider approval of the sale to the to-be-determined successful bidder;[2]
- shortly following the Auction, the bankruptcy court enters an order approving the sale to the "best or otherwise highest" bidder "free and clear" of all liens, claims, and encumbrances; and
- upon closing of the sale: (i) ownership of the purchased assets is transferred to the successful and court-approved purchaser "free and clear"; (ii) the Lender's lien transfers from the underlying collateral to the resulting sale proceeds with the same level of priority as of the bankruptcy filing; (iii) the purchaser is insulated from the debtor's pre-bankruptcy liabilities – and the sale transaction and purchaser are also insulated in the event of an appeal – by the protections of the bankruptcy court's order approving the sale transaction (the "Sale Approval Order"), in particular a judicial finding of the purchaser's "good faith" under Bankruptcy Code section 363(m); and (iv) the Debtor concludes its wind-down and dissolution process – importantly, the distribution of sale proceeds to stakeholders in accordance with the priority scheme of the Bankruptcy Code – under a subsequent liquidating chapter 11 plan confirmed by the bankruptcy court.

While the above paradigm appears straightforward, implementing a successful 363 process from the Lender's perspective, even in a generally consensual setting with the Debtor, is often anything but simple. This articles discusses: (i) the use of 363 sales by prepetition senior secured Lenders in modern bankruptcy practice as a means to pursue a consensual outcome with the Debtor and promote a competitive and value-maximising "going concern" sale of the Debtor's business; (ii) key considerations for the prepetition senior secured Lender when negotiating the terms of a 363 sale process with the Debtor and preparing to defend the validity of the process before a bankruptcy court; and (iii) an additional layer of complexity for the Lender when negotiating mechanisms for the distribution of value to creditors at the time of sale closing – particularly when the sale is, for all intents and purposes, the culmination of the chapter 11 process and confirmation of a subsequent liquidating plan appears remote or impossible.

II. Section 363 Sales, Generally

Chapter 11 of the Bankruptcy Code is the primary business reorganisation tool of federal bankruptcy law, providing a mechanism for companies experiencing some form of financial distress to effectuate needed operational and/or balance sheet restructurings while discharging the Debtor's fiduciary obligation to maximise value for the benefit of all stakeholders. Chapter 11 provides the Debtor (or "debtor-in-possession") with powerful tools to use in furtherance of these goals. These tools include, for example: (i) the "breathing spell" provided by the automatic stay under Bankruptcy Code section 362(a) (i.e., broad injunctive protection for the Debtor and the Debtor's property from creditor action on account of most prepetition liabilities, triggered by the filing of the bankruptcy petition); (ii) the exclusive right during the first 120 days of the chapter 11 case to propose a chapter 11 plan, and the exclusive right during the first 180 days to attempt to confirm that plan, pursuant to Bankruptcy Code section 1121; (iii) subject to court approval, the ability to grant superpriority liens and administrative expense status and other meaningful protections to postpetition lenders as a means to incentivise lenders to provide liquidity to a distressed borrower; and (iv) the ability to pursue confirmation of a chapter 11 plan over the objection of an impaired and rejecting class of creditors and, subject to court approval, to bind dissenting hold-outs ("cramdown").

Given the powerful nature of the statutory tools available to chapter 11 debtors and the attendant delay and cost to stakeholders in realising on their respective interests as a result of a chapter 11 filing, bankruptcy courts as "courts of equity" generally look to objective indicia of the Debtor's good faith to support a chapter

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

11 filing – in essence, the presence of a "valid reorganisational purpose" consistent with the underlying purpose and policies of the Bankruptcy Code.[3] Depending upon the specific facts and circumstances of a given case, such a purpose may – and, in modern practice, increasingly does – involve an effort to preserve otherwise dissipating estate value through a competitive but expedited sale of the going concern outside of a chapter 11 plan pursuant to section 363 of the Bankruptcy Code, and attendant wind-down of the Debtor's estate in a manner that maximises recoveries and provides finality.

Indeed, section 363 of the Bankruptcy Code provides the Debtor with a mechanism to pursue a sale of all or substantially all of the Debtor's assets as a going concern outside of a chapter 11 plan, "free and clear" of existing liens, claims, and encumbrances. Specifically, the statutory framework is found in Bankruptcy Code sections 363(b) and (f), and provides in pertinent part:

(b)(1) The [Debtor], after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate . . .

(f) The [Debtor] may sell property under [section 363(b)] free and clear of any interest in such property of an entity other than the estate, only if (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest; (2) such entity consents; (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property; (4) such interest is in bona fide dispute; or (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.[4]

The 363 mechanism is thought-provoking and, sometimes, controversial, in its relationship to the primary purpose of chapter 11 – rehabilitation – and the claim priority-based structure of the Bankruptcy Code. As described by the Third Circuit as recently as 2015: "11 U.S.C. 363 allows a debtor to sell substantially all of its assets outside a plan of reorganization. In modern bankruptcy practice, it is the tool of choice to put a quick close to a bankruptcy case. It avoids time, expense, and, some would say, the Bankruptcy Code's unbending rules."[5]

A typical 363 sale process is initiated when the Debtor files a motion (a "363 Motion") with the bankruptcy court seeking two separate hearings and the entry by the bankruptcy court of two separate and often heavily negotiated orders: one, a "Bidding Procedures Hearing" where the Debtor seeks entry of an order approving bidding procedures for a competitive bidding and Auction process for the determination of a successful bidder ("Bidding Procedures Order"); and two, a "Sale Approval Hearing" where the Debtor seeks entry of an order approving the sale to the successful bidder. When the 363 process has been negotiated and agreed with the Lender prior to the bankruptcy filing, the Bidding Procedures will have been extensively negotiated with the Lender and its advisors before the 363 Motion is filed with the bankruptcy court. In addition, if the Debtor and Lender have selected a proposed "stalking horse bidder" prior to the bankruptcy filing, the stalking horse also will have extensive involvement in the negotiation of the Bidding Procedures before the filing.

Bidding Procedures in complex chapter 11 cases typically include terms such as: (i) the deadline for the submission of bids; (ii) factors to be taken into account in evaluating bids and determining whether a given bid is qualified to participate in an Auction; (iii) the date, time, and location of the Auction; (iv) who may attend the Auction; (v) the rules of the Auction, such as minimum bidding increments, the ability to aggregate bids from multiple bidders to form one qualified bid, and the process for the determination of the "highest or otherwise best" offer and, thus, the successful bidder; and (vi) the date of the subsequent hearing before the bankruptcy court to consider approval of the sale to the successful bidder and entry of an order approving the same.

At the hearing to consider the Debtor's request for entry of the Sale Approval Order, the Debtor bears the evidentiary burden of demonstrating to the bankruptcy court that the proposed sale satisfies applicable statutory requirements and is supported by a valid exercise of the debtor's business judgment. As a chapter 11 debtor is a fiduciary of the debtor's estate for all stakeholders, demonstration of sound business judgment often translates to a showing through evidence, briefing, and argument that the proposed sale process and sale transaction maximise asset value of an otherwise "melting ice cube",[6] and serve the best interests of the debtor's estate and creditors as a whole.

III. Lender Expectations – and Questions – in 363 Sale Process Negotiations

Returning to the paradigm set forth at the outset, often a financially distressed borrower approaches its existing secured Lender pre-bankruptcy while in the process of evaluating strategic alternatives, to explore the possibility of the Lender providing a DIP Loan, or the consensual use of the Lender's cash collateral, to fund a 363 sale process and subsequent wind-down in chapter 11. As a general matter, this dialogue often presents an opportunity for the Lender to bargain for significant rights and influence in the borrower's subsequent chapter 11 case – including in connection with the contemplated 363 sale and liquidating plan processes – as part of a proposed DIP financing arrangement or consensual use of the Lender's cash collateral. As a practical matter, however, effective negotiation and structuring of the terms of a smooth 363 sale process requires appreciation of the anticipated case dynamics from the debtor's fiduciary perspective, and an awareness of areas for possible "pushback" in the 363 process – even when there is general consensus between Lender and Debtor before the chapter 11 petition is even filed.

The list below highlights just a few of the often-encountered considerations for the Lender and its advisors in considering and negotiating a potential 363 sale process structure, and in preparing to support a 363 process in court:

- Speed of Sale Process; Sufficiency of Prepetition Marketing. While the 363 process is often fast, is it overly so such that the speed of the process is likely to raise due process concerns from the Court, or objections from the United States Trustee or stakeholders? As a related matter, how is the bankruptcy court likely to view the sufficiency of the debtor's prepetition marketing process? Was the prepetition marketing process sufficiently robust and open such that the proposed expedited timeline is reasonably calculated to maximise estate value? What is the nature and credibility of the evidence that the Debtor is prepared to submit to the court to support a finding that the prepetition marketing process was sufficiently robust? What is the nature and extent of the Lender's involvement, if any, in the prepetition marketing process, and how is that involvement, if any, likely to be viewed by the court and other parties in interest? Is any party in interest likely to contend that any such Lender involvement skewed the prepetition process in some fashion, and if so, what is the Lender's anticipated response to such an argument?
- "Paying the Freight". Does the consensual financing arrangement between the Lender and the Debtor for the use of the Lender's cash collateral, or the provision of DIP financing, commit the Lender to fund the chapter 11 case after the closing of the 363 sale, and if so, to what extent and on what terms? Put differently, has the Lender committed

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

to "pay the freight" of the chapter 11 wind-down process, for the benefit of all stakeholders, once the 363 sale has closed? Is the Debtor at risk of administrative insolvency and therefore potential conversion to chapter 7 upon closing of the 363 sale, and if so, is the Lender prepared to address administrative insolvency concerns? Does the proposed financing arrangement play into an argument that the purpose of the case is to accomplish a *de facto* foreclosure within the context of a chapter 11 case, and nothing more? What is the view of the Lender's local counsel in the particular case jurisdiction as to the court's expectation of such a commitment from the Lender at the bidding procedures approval stage?

- Bidding Procedures and Consent Rights for the Lender. To what extent does the proposed Bidding Procedures Order provide the Lender with consent rights with respect to the debtor's determination of qualified bids entitled to participate in the Auction? To what extent does the proposed Bidding Procedures Order require the debtor to consult and/or coordinate with the Lender regarding modifications or amendments to the Bidding Procedures once the Auction is commenced? Given the debtor's status as fiduciary, are the negotiated levels of Lender oversight likely to raise concern with the court, the United States Trustee, or stakeholders? Additionally, if the Lender and the debtor have agreed in the Bidding Procedures Order that the Lender may exercise its right to credit bid at the Auction under Bankruptcy Code section 363(k) (or if the Lender is the stalking horse bidder on account of a credit bid), to what extent is the Lender entitled under the Bidding Procedures to consult with the Debtor with respect to the conduct of the Auction, including the determination of whether to modify any of the Bidding Procedures once the Auction has commenced if determined to be in the best interests of the Debtor's estate, or even the determination of the successful bidder?
- Sensitivity to, and Anticipating, Frequent 363 Sale Objections. At least three relatively recent reported decisions in high-profile chapter 11 cases highlight the potential for wide-ranging objections from a variety of stakeholders when a Debtor pursues a going concern 363 sale.[7] While the nature of any such objections plainly depends upon the facts of a given case and the interests at issue, effective 363 process negotiations require awareness of the general nature of these often-seen objections and the chapter 11 case "landscape" generally, such as: (i) is the proposed "free and clear" language contained in the draft Sale Approval Order overbroad; (ii) does the Sale Approval Order purport to impact the rights of stakeholders who may not be susceptible to receiving actual notice of the sale and, if so, on what basis;[8] (iii) does the Sale Approval Order purport to impact the ultimate treatment of any prepetition claims asserted against the debtors' estates and/or otherwise pre-ordain the terms of a subsequent chapter 11 plan, and if so, is the order likely to raise objection on the basis that the 363 sale constitutes an impermissible *sub rosa* plan; and/or (iv) is there a junior lienholder and/or intercreditor agreement in the mix that might seek to thwart the sale process and/or otherwise cause difficulty or delay?
- Sale Order Terms Regarding Distribution of Proceeds and Other Non-Traditional Sale Provisions. To what extent does the proposed Sale Approval Order provide for the distribution of sale proceeds to the Lender upon closing of the 363 sale, as opposed to under a subsequently confirmed liquidating plan? If the Sale Approval Order does contain terms authorising immediate distribution of sale proceeds, how does such distribution of proceeds (which are estate property) square with the Debtor's cash position as of sale closing and ability to continue to administer the chapter 11 case? Does the proposed Sale Approval Order contain other non-sale-related terms that may draw objection from the U.S. Trustee or other parties in interest – terms which may be viewed as more traditionally appropriate in the context of a chapter 11 plan – such as releases for officers and directors of the Debtors, and releases for parties other than the Debtors such as the Lender and the successful bidder? Does the proposed Sale Approval Order include other terms that may be viewed as extraordinary or unnecessary to the consummation of the sale itself, and if so, what is the necessity and basis for inclusion of such terms? What do the local rules of the particular case jurisdiction provide with respect to permissible terms in a Sale Approval Order, and what is the view of the Lender's local counsel with respect to the same?

IV. Payment of Certain Claims at the 363 Stage, and Outside of a Chapter 11 Plan

One of the areas noted above – creative 363 structures involving the distribution of value to certain creditors as part and parcel of the sale, and, importantly, when a chapter 11 plan has not been and may never be confirmed – continues to touch upon tensions between going concern 363 transactions and the claim priority structure of the Bankruptcy Code. Lenders involved in 363 sale structure negotiations must be mindful of the tensions and grey areas evoked by these situations.

For example, in a 2015 decision In re ICL Holding Co., Inc.,[9] the United States Court of Appeals for the Third Circuit upheld a 363 sale order providing, upon closing of the sale, for the purchaser's direct cash payment to certain creditors of the debtors' estates – even though those creditors' claims were junior to other claims that received no payment in connection with the sale.

Prior to its chapter 11 filing, acute care hospital operator LifeCare Holdings, Inc. and 34 subsidiary entities (collectively, "LifeCare") entered into a senior secured $355 million credit facility with a syndicate of lenders, pursuant to which LifeCare granted the lenders a first priority security interest in substantially all of its assets, including its cash. Eventually faced with liquidity problems and defaults under the secured credit facility, LifeCare sought to attract new capital sufficient to satisfy its secured debt in full, which proved unsuccessful. Subsequently, LifeCare and the lenders reached agreement to pursue a 363 sale of the going concern in chapter 11, with the lenders proposing to acquire LifeCare's business through a stalking horse credit bid in the amount of $320 million, and, in addition, to fund certain escrows necessary to pay fees of estate professionals and post-sale estate wind-down expenses. LifeCare and the lenders entered into an asset purchase agreement memorialising the proposed credit bid transaction and, the next day, LifeCare filed its chapter 11 cases together with a 363 Motion requesting approval of bidding procedures and an Auction process. Following the bankruptcy court's approval of the bidding procedures, LifeCare undertook an expedited postpetition marketing process that failed to yield a viable alternative bid. Ultimately, LifeCare selected the lenders' credit bid as the successful bid in accordance with the bankruptcy court-approved bidding procedures, and requested bankruptcy court approval of the transaction.

Two significant parties – the official unsecured creditors' committee and the United States Government – stood to receive nothing from the sale and objected to the transaction on various grounds. Subsequently, LifeCare and the committee reached a settlement resolving the committee's sale objection; under the settlement, the lenders (as purchaser) agreed to deposit $3.5 million of its own cash in trust to be paid directly from the trust to unsecured creditors, in exchange for the committee's agreement to support the sale. The United States Government, however, pressed its objection, arguing that that the $3.5 million set-aside for general unsecured creditors amounted to an impermissible "bypass" of the Government's senior administrative tax claim in the amount of approximately

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

$24 million, "disturbed the Code's priority scheme for the payment of creditors", and "attempts to distribute estate property to junior creditors over the objection of a senior creditor in violation of the absolute priority rule".[10]

The bankruptcy court approved the 363 sale, finding that the direct payments from the purchaser occurred outside of the bankruptcy estate (i.e., did not involve any distribution of estate property) and therefore the transaction did not implicate the priority distribution scheme of the Bankruptcy Code. On appeal, the Third Circuit affirmed, holding that the Court "cannot conclude here that when the secured lender group, using that group's own funds, made payments to unsecured creditors, the monies paid qualified as estate property . . . [T]he settlement sums paid by the purchaser were not proceeds from its liens, did not at any time belong to LifeCare's estate, and will not become part of its estate even as a pass-through".[11] With respect to the escrowed funds for payment of professional fees, the Court looked to the "economic reality" that the lenders received all of LifeCare's assets in exchange for the $320 million credit bid, and that the escrowed funds were at all times lender funds, not estate property.

The careful structuring of the 363 transaction in ICL was critical to the Court's assessment as to the lack of any interplay between the transaction and the priority scheme of the Bankruptcy Code. Ultimately, the ICL cases reached their formal conclusion through a series of dismissal and structured dismissal orders; no chapter 11 plan was confirmed in the case, nor did the case convert to chapter 7 – a concept that, itself, may be impacted by a case currently before the United States Supreme Court involving the use of "structured dismissals" as a means to exit chapter 11.

V. Conclusion

In complex chapter 11 practice, navigating the 363 process as Lender from beginning to end – even, as is the main focus of this article, a 363 process premised upon general consensus between Debtor and Lender – is often anything but linear. Indeed, depending upon the specific facts and circumstances of a given case, as well as differing expectations and practices across jurisdictions, the Lender is likely to encounter numerous instances of legal grey area and practical nuance along the way, necessitating constant assessment of strategic considerations in furtherance of a smooth sale process and certainty of outcome. Even where the Lender and Debtor are in general agreement regarding the 363 process, familiarity with key issues and tensions that may arise, and awareness of recent case law developments in 363 jurisprudence, is essential – for effective participation in the sale process, anticipating and avoiding pitfalls, and taking all possible steps to ensure that the sale process is an achievable and cost-effective exit strategy for the Lender.

Endnotes

1. The views provided herein are for general discussion and education purposes only and not attributable to any particular situation, individual, client, or otherwise.
2. Depending upon many factors, Bidding Procedures may or may not provide for the Lender's ability to participate at the Auction by "credit bidding" up to the face amount of the Lender's claim under the prepetition facility (i.e., the full amount of the debt owed to the Lender). 11 U.S.C. § 363(k). While briefly mentioned in this article, controversies and litigation surrounding the specific issue of credit bidding – such as, for example, attempts by a Debtor to limit the ability of the Lender to credit bid at the Auction due to allegations of potential bid chilling and/or inequitable conduct by the Lender – are a topic in and of themselves and not the focus of this article.
3. See, e.g. In re SGL Carbon Corp., 200 F.3d 154, 165 (3d Cir. 1999). ("It is easy to see why courts have required Chapter 11 petitions to act within the scope of the bankruptcy laws to further a valid reorganizational purpose. Chapter 11 vests petitions with considerable powers – the automatic stay, the exclusive right to propose a reorganization plan, the discharge of debts, etc. – that can impose significant hardship on particular creditors.")
4. 11 U.S.C §§ 363(b), (f).
5. In re ICL Holding Co., Inc., 802 F.3d 547, 549 (3d Cir. 2015).
6. In re GSC, Inc., 453 B.R. 132, 165–166 (Bankr. S.D.N.Y. 2011).
7. See, e.g. In re Chrysler LLC, 405 B.R. 84 (Bankr. S.D.N.Y. 2009); In re GMC, 407 B.R. 463 (Bankr. S.D.N.Y. 2009); In re Boston Generating, LLC, 440 B.R. 302 (Bankr. S.D.N.Y. 2010).
8. Indeed, this issue is alive and well in the ongoing and widely publicised "ignition switch plaintiff" litigation stemming from the General Motors 363 sale. See, e.g. In Matter of Motors Liquidation Company, 829 F.3d 135 (2d Cir. 2016).
9. ICL, 802 F.3d at 549.
10. ICL, 802 F.3d at 552.
11. In re Jevic Holding Corp., 787 F.3d 173 (3d Cir. 2015).

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

Zachary H. Smith
Moore & Van Allen, PLLC
100 North Tryon Street, Suite 4700
Charlotte, NC 28202-4003
USA

Tel: +1 704 331 1046
Fax: +1 704 378 1909
Email: zacharysmith@mvalaw.com
URL: www.mvalaw.com

Zachary H. Smith is a partner on Moore & Van Allen's Bankruptcy & Financial Restructuring team, based in Charlotte, North Carolina. He concentrates his practice in the areas of distressed situations and bankruptcy, representing institutional lenders, hedge funds, strategic investors, and debtors in in-court and out-of-court restructurings. Zach's recent representations include: (i) FirstBank Puerto Rico as senior prepetition secured lender to retail and real estate company Gatsby Stores in chapter 11 cases in Puerto Rico; (ii) international technology company Filip Technologies, Inc. in chapter 11 cases in Delaware; (iii) the United States Department of Treasury with respect to the restructuring of General Motors; (iv) the purchaser of the largest Caribbean marina, Marina Puerto del Rey, in a chapter 11 case in Puerto Rico; and (v) various stakeholders in connection with the Puerto Rico fiscal crisis. In 2013, Zach was recognised nationally by Law360 as one of five Bankruptcy "Rising Stars", and by *Turnarounds & Workouts* as one of twelve "Outstanding Young Restructuring Lawyers". He is an Advisory Board Member of the American Bankruptcy Institute's annual Caribbean Insolvency Symposium, a Lecturer in Law at Boston University School of Law, and a Senior Lecturing Fellow at Duke University School of Law.

Moore&VanAllen

Moore & Van Allen PLLC is a full-service law firm and one of the largest and most preeminent law firms in the Southeast United States, with nearly 300 attorneys and offices in Charlotte and Research Triangle, North Carolina, and Charleston, South Carolina. Founded in 1949, MVA has a long history of civic service and noted international and national clients, including 110 Fortune 500 companies. MVA's business and corporate work is organised into more than twenty practice groups, including Bankruptcy & Financial Restructuring, Finance, Corporate, Litigation, Intellectual Property, and Real Estate. Moore & Van Allen is the only Charlotte-based law firm identified in the prestigious "Am Law 200" list. U.S. News & World Report and Best Lawyers recognised Moore & Van Allen in their 2017 "Best Law Firms" rankings, both regionally and nationally.

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

Distributed Ledger Technology, The Internet of Things (IoT) and Artificial Intelligence and Cognitive Analytics: The Future of Trade Finance is Rapidly Approaching

Holland & Knight LLP

Josias Dewey

1 Traditional Trade Finance

The Primary Driver of Global Economic Growth

Trade finance, also known as export finance, is a critical component of the global economic engine. With approximately 80–90% of global trade reliant on trade finance, it is estimated that the industry is worth nearly $10 trillion a year.[1] The evolution in trade finance is being driven by greater efficiencies and novel capabilities resulting from advancements in the underlying logistics of the global supply chain, all of which are being made possible by the combination of three powerful technologies: (1) blockchain and distributed ledger technology; (2) the Internet of Things ("IoT"); and (3) powerful machine learning capable cognitive tools (e.g., IBM's Watson) that are capable of analysing vast amounts of data that humans simply can't do.

The transformation occurring in supply chain management and trade finance is not simply about converting from paper documents, such as letters of credit and bills of lading, to electronic documents. To the contrary, as we will discuss in detail, the changes that are occurring are about new ways that participants in supply chains can share information in a very granular and controlled manner, utilising novel technology that allows economic participants to trust the outcome of transactions without any need to trust the actual counterparties to a transaction. Equally important is the ability of distributed ledgers to accomplish the foregoing without the need for a trusted third party to act as an intermediary for the transaction – disintermediation has become a key theme of distributed ledger technology, and supply chains and the trade financing vehicles that keep them operating are not exempt from this phenomenon.

What is Trade Finance – Basic Mechanics

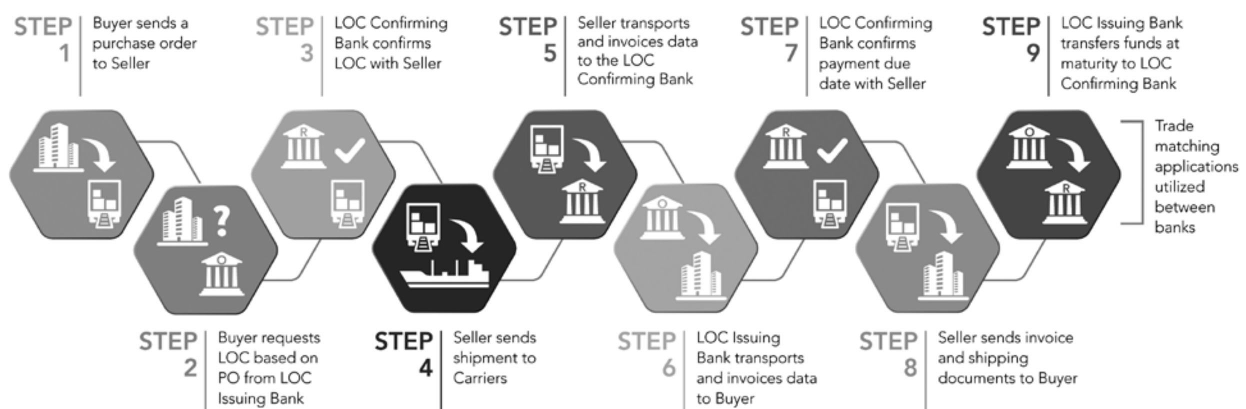
Before discussing the future of trade finance, it's important to understand the current mechanisms used to facilitate the movement of goods and commodities across the globe – much of which has remained static over the last few hundred years. It did not take human civilization long to discover the benefits of specialisation and trading resources that might be prevalent in one geographic region for other goods which are scarce in the same region. In the beginning, bartering ruled most forms of trade and even after stores of value, such as gold, allowed for the acquisition of goods for money, marketplaces were often static in terms of point of sale – thus requiring trading groups and companies to venture across long and often dangerous trading routes. With the advent of oceanic shipping, however, it became far easier to move large quantities of goods and commodities from one port to another far more efficiently. While a superior approach in terms of economic efficiency, "chicken and egg" situations soon arose when sellers did not want to place their goods on a ship for delivery to the purchaser without payment; and likewise, buyers did not want to pay for goods that they had not received – enter trade financing solutions. In its most simple form, trade financing addresses the "chicken and egg" dilemma by effectively creating an intermediary, such as a bank who issues a merchant letter of credit, who can assure the seller of payment if the seller performs and protect the buyer from ever paying for undelivered or non-conforming goods. In most circumstances, this is accomplished by the buyer causing its bank to issue to the seller a merchant letter of credit in the amount of the purchase price for the goods. The bank who issues the merchant letter of credit generally requires that the seller present, together with the merchant letter of credit, documentary proof that conforming goods were delivered to the buyer and that the seller has met the conditions to payment. One of those conditions will be the delivery of a properly executed bill of lading (a document of title) to the buyer, who with that and an opportunity to inspect to goods to ensure conformance, is never at risk of losing his or her capital in the event of the seller's non-performance.

It should be apparent that in many respect, the "finance" transaction described above has less to do with loaning money and extending credit and more to do with facilitating a transaction that might otherwise introduce to much risk for the buyer, seller or both. There are plenty of trade finance transactions that are akin to more traditional extensions of credit. For example, a farmer may need trade finance to acquire seeds and fertiliser, and is unable to repay such financing until the farmer harvests his crop. In that case, the transaction could be solely driven by credit considerations. In some cases, trade finance serves both as a transaction facilitator and an extension of credit necessary to provide a farmer or manufacturer with inputs necessary to generate the profits necessary to repay the extension of credit. In the case of the farmer, the seeds and fertiliser may be shipped from a foreign producer, such that the trade finance solution serves both purposes – the role of an intermediary with respect to the exchange between the farmer and the foreign producer and that of an extension of credit because the farmer lacks the liquidity to purchase the inputs necessary to grow his crop.

Trade Finance – Traditional Lifecycle

While there are several forms of trade finance, we have chosen to further illustrate, via graphical illustration (which the author admits is an oversimplification with respect to many transactions), the mechanics of this industry through one of the most conventional types of trade finance facilities – a merchant letter of credit:

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



As entire books are frequently written on trade finance, we can't analyse the above transaction from every participant's perspective in a single chapter. So, we will look at some of the most common pain points and areas of "friction" from the perspective of a bank or other financial institution providing trade financing in a transaction following the lifecycle depicted above. In any secured transaction, a trade finance lender will want to ensure that its position:

(i) is adequately collateralised (i.e., the seller has the goods it purports to have or will have when it is required to tender and the value of such goods is consistent with the assumptions made by the lender in underwriting the credit);

(ii) consists of a first-priority security interest (unless providing subordinate financing); and

(iii) is consistent with its understanding of risks posed by acts of god, casualty or other *force majeure* events, and that such risks have been mitigated by insurance or other means to the extent available.

To achieve the above three objectives, lenders often employ the following "controls":

(i) implementing relevant financial controls throughout the trade transaction lifecycle;

(ii) monitoring all material aspects of the transaction; and

(iii) ensuring that the collateral (i.e. the trade goods) are properly stored and transferred.

Using the Bill of Lading example illustrated above, implementing these controls can be a cumbersome and fragmented process for lenders, which often lead to the following "pain points":

(i) **Fraud**. Current methods of documentation, and documentation transfer, do not protect against the risk of parties, including lenders, relying on falsified documentation.

(ii) **Tracking and Reconciliation Costs.** Current fragmented trade lifecycles, which require human involvement and interaction throughout, require constant tracking and reconciliation by lenders and often require that such be done amongst several different platforms.

(iii) **Authenticity of Goods.** A lack of uniform tracking mechanisms from "source to sale" provides susceptibility for counterfeit goods to enter the trade lifecycle.

(iv) **Confidentiality.** The current necessity to (humanly) verify and reconcile points throughout the trade cycle make it difficult to ensure the confidentiality of the trading parties and terms.

It should come as no surprise that the above complexities often leave bank customers less than satisfied with the overall experience of obtaining the credit. To make matters worse, there has been a steady increase in transaction costs, in part, due to the increasingly difficult regulatory environment. Fortunately, all participants may soon be receiving relief from all of the above.

Trade Finance – Increasing Number of Stakeholders Means Growing Complexity

It is also worth noting that some of the additional friction in the market today is due to an increase in the overall number of persons involved in the process, including trade finance credit insurers, customs personnel and certification organisations who, depending on the existence of friendly trade arrangements, may be required to hold the goods at port or other locations for extended periods of time. This increase in participants has led to a corresponding level of complexity. Simply put, supply chain management and trade finance have become more complicated, while innovation was non-existent. Seemingly overnight, the paper documents that remained in use for decades are on the verge of extinction.

2 Emerging Technologies – Blockchain Technology

Blockchain technology is commonly defined as a decentralised peer-to-peer network that maintains a public, or private, ledger of transactions that utilises cryptographic tools to maintain the integrity of transactions and some method of protocol-wide consensus to maintain the integrity of the ledger itself. The term "ledger" should be thought of in its most simple terms; imagine a simple database (like an Excel spreadsheet) that can store all sorts of information (e.g., someone's name, age, address, date of birth). As you can write an entire book on the topic of blockchain technology and the law (I know because I did), set forth below is a very cursory review of the underlying technology. If you are not comfortable with the technology itself after reading the below, there are no fewer than a couple of hundred good descriptions available on the Internet (or you can find my book).

Blockchains tracking the transfer of virtual currency, such as Bitcoin, essentially maintain a ledger that tracks the transfer of Bitcoin from a transferor to a transferee. Perhaps most importantly, such ledgers are considered decentralised because transactions are stored on several thousand computers connected to a common network via the Internet. These computers are known as "nodes". Each node contains a complete history of every transaction completed on a blockchain beginning with the first transaction that was processed into the first block on that blockchain. This network of nodes is connected via the Internet, but in a completely decentralised manner (i.e., there is no single server to which all the nodes are connected). So, when we refer to the network, this describes all the peer-to-peer nodes operating under the same set of rules (commonly referred to as a "protocol"), which are embodied in computer code under which all participants in such blockchain operate. Thus, at the

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

heart of every blockchain is an agreed upon protocol that ensures that only information upon which the network reaches consensus will be included in the blockchain. In other words, a network of computers, all running a common software application, must come to agreement upon whether a change to the blockchain (again, think "ledger") should be made, and if so, what that change should be.

As a proposed transaction propagates throughout this peer-to-peer network, there is still one last step left to consummate the transaction – the transaction needs to be memorialised into a block on the given blockchain ledger. "Blocks" are simply a convenient way of aggregating transactions into larger groups (or batches) for processing purposes. The perceived immutable nature of the ledger is rooted in the aggregation of time-stamped transactions into linear sequenced blocks. It is the aggregation into blocks that permits us to create links between transactions – the proverbial "chain" in the blockchain. Each block contains a reference to the block before it. This resulting relationship between all the blocks makes it exponentially more difficult to alter a prior entry in the ledger. Recently, certain protocols have been developed which have all the character of a blockchain, but without the block structures – hence the reason all blockchains are distributed ledgers while not all distributed ledgers are blockchains (e.g., R3's Corda platform is not a blockchain). For the time being, the terms distributed ledger technology and blockchain are generally used interchangeably – the reader should recall the distinction, however, is dealing with the implementation of a distributed ledger system that requires a blockchain-style ledger.

While Bitcoin was the first implementation of blockchain technology (and the only implementation for several years), with the advent of the Ethereum protocol and the subsequent "Blockchain 2.0" protocols, the capability of the technology skyrocketed – as did the potential use cases. The reference to "Blockchain 2.0" generally refers to the development of smart contracts, which is executable computer code that is broadcast to all of the nodes connected to a distributed ledger – the resulting computation being what determines any changes to the ledger. While the term "smart contract" does not necessarily refer to a legally binding contract (but rather any snippet of code), some smart contracts do constitute legally binding agreements. The advent of smart contracts is critically important to its adoption for trade finance – without it, we would not be able to model the functionality and provisions of a letter of credit or bill of lading.

Another recent development that was necessary for distributed ledgers to play an active role in trade finance was the ability for parties to include all the details of a trade in the transmission of a transaction to a distributed ledger – but limit who can see which details with very fine control. For example, if a seller of crops experiences a liquidity crisis and must sell a portion of his crop for below market prices, the seller will want neither his competitors nor other buyers in the market to know the price for those crops. In this example, it is possible to broadcast the transaction with only the buyer and seller seeing the price and needing to validate the terms to the contract. Any other consensus on the network will be limited to the existence of the transaction itself (and most likely a time stamp as well).

While there are no fewer than a dozen protocols in regular use today, the two most public blockchains are Bitcoin and Ethereum. Anyone is free to connect to either of those protocols. Unlike public blockchains, most financial institutions and other enterprise users are not comfortable using public blockchains because of data security and privacy concerns, among others reasons. Instead, these institutions have or intend to deploy permissioned and/or private distributed ledgers, where each member of the distributed ledger knows with whom it is transacting. Again, there are many more protocols that are listed herein, but some of the more popular permissioned protocols are: (1) R3CEV's Corda platform; (2) Hyperledger Fabric (also hosted on IBM's cloud as its native blockchain solution); (3) Monax (formerly known as Eris); (4) Ethereum (permissioned versions available from Microsoft, JPMorgan and others); and (5) Ripple.

3 Emerging Technologies – The Internet of Things ("IoT")

Even alone, distributed ledgers would have a significant impact on supply chains and trade finance, but when coupled with two other technologies – IoT and Cognitive Analytics (including machine learning) – the impact will be nothing short of a paradigm shift. The Internet of Things (IoT) is one of the other technological advances that will have a major impact on the financial industries. IoT refers to the simple concept that more and more physical devices are becoming connected to the Internet (i.e., networked). Today, the types of devices being connected to the Internet is growing exponentially – both in terms of consumer and industrial products. For example, many transportation tracking systems, are connected to the Internet so that inventory and goods can be more effectively monitored.

This trend is expected to continue over the next several years, such that virtually all physical objects in the world will be (or at least have the capability to be) connected to the Internet. These connections will work both ways. Physical objects will transmit information about their internal state and/or information about environmental factors (e.g., temperature, humidity). Many objects will also have physical actuators (i.e., things that interact with physical world such as motors, locks, LEDs). Together with sensors, this means that many physical objects will be able to transmit real-time information over the Internet (whether by ZigBee meshes, cellular or satellite transmissions) to applications that can analyse that data and send commands back to physical devices to interact with the physical world. For example, if a storage container's internal temperature is too hot, that data will trigger an application monitoring that information over the Internet to send a signal back to the container's internal fans to cool it down again.

Blockchain technology will augment IoT in several positive ways. First, blockchains built in cryptocurrency payment protocols are perfect for interacting with automated payment systems, especially in the context of complex trade cycles that do not necessarily require human interaction. Second, and probably more importantly, the blockchain can add a level of security that no other existing technology can. The distributed ledger is perfect for ensuring that use and ownership rights are adequately tracked. For example, the generation of public/private keys is perfect for ensuring that only an authorised user can authorise the dispatch or delivery of goods.

4 Emerging Technologies – Artificial Intelligence and Cognitive Analytics

Artificial intelligence and cognitive analytics, including applications leveraging machine learning, are the final ingredients needed to radically transform supply chains and trade finance. By combining distributed ledger technology with IoT devices, such as sensors, real-time data is available to the parties to the transaction and can be recorded on an immutable, tamper-proof ledger. This capability alone significantly improves the overall supply chain and trade finance process, but what about data from one or more business processes that requires intensive calculations or analytics that the human brain can't do? Artificial intelligence, especially the subsets known as machine learning and natural language processing have

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

made significant advancements in just the last couple of years. These tools can receive the raw data from the IoT devices, process the data and format it into useful structured data that can be used to monitor contract compliance matters. These tools remove any limitation on human cognition and traditional computing devices that impair our ability to process complicated and voluminous data sets.

In addition to real-time compliance oversight, artificial intelligence is also helping sellers and purchasers with business decisions that impact their entire enterprise, especially with respect to supply chain management. For example, price discovery is made possible so that a purchaser can unleash sophisticated algorithmic tools on massive amounts of data available online or through private network data feeds. Price discovery, however, is just the tip of the iceberg – a purchaser's entire inventory management process can be run by artificially intelligent machines, which can contract for supplies when appropriate without any human interaction. Machine learning capabilities are particularly useful because as these systems are used and provided feedback on the decisions it makes, its performance or percentage of accurate decisions increases until it performs its function far better than its former human counterpart.

Of course, the real-time data feeds monitoring in-route products and the price discovery and inventory management are ultimately all part of one operation – to ensure the smooth and optimal purchase order and inventory life cycle. We must also keep in mind that these machine capabilities will continue to grow at a rapid pace, especially given the fact that Moore's Law appears to still have some run left in it before humans are no longer capable of fitting more transistors on smaller and smaller pieces of silicon. This assumes, however, that we do not discover entirely new ways to supply ever increasing computational power (e.g., quantum computing).

5 Trade Finance 2.0: Applying Emerging Technologies and Paradigm Shift

Any lawyer or professional who has practice transactional law for any length of time, knows that the more stakeholders involved in a transaction or series of related transactions, the more difficult it becomes and the more "friction" is involved in the form of higher transactional costs and lost efficiency and output. Often, trade finance and supply chain transactions involve several stakeholders, especially when there is a cross-border aspect to the transaction. The number of participants can grow fast. Possible participants include the buyer, the seller, a letter of credit issuer (i.e., a bank), one or more correspondent banks, customs and revenue (tariff) officials, warehouse owner, logistics companies and a host of other possible involved participants. It is for this reason that distributed ledgers when combined with IoT devices and cognitive analytics prove to be one of the most powerful uses of distributed ledger technology. The cost savings and reduction in transactional costs and friction in many cases are extreme. For example, the ability to model a merchant letter of credit in the form of computer code (e.g., Solidity, Java, Go); and more importantly, the ability of that code to execute on a distributed ledger using self-implementing conditions to, in the case of a letter of credit, release funds programmatically to the seller without any need for the seller to present a paper letter of credit to anyone. Consider the reduction in friction afforded by this mechanism. Rather than a paper letter of credit needing to work its way through a series of correspondent banks, each of which must be paid a fee, a digital letter of credit that is self-implementing executes automatically when the conditions to payment are met – resulting in a significant reduction of expenses.

The inverse is also true, and no less important – meaning that the bill of lading, which evidences the transfer of ownership to the goods to the purchaser, is also transformed into computer code where it resides on a distributed ledger until payment is released to the seller. Upon payment, the bill of lading will automatically be released to the purchaser in digital form. This removes any issues with respect to fraudulently procured or produced documents of title, such as a bill of lading. In addition to payments and documents of title, many more aspects (in fact, virtually all of them) can be converted to self-implementing code broadcast to a distributed ledger, together with corresponding, real-time contract administration and monitoring, including casualty insurance covering the goods during transit, foreign trade credit insurance and the coordination of any other logistics companies (e.g., last mile carriers).

In addition to what I will refer to as "core logistics", there are a host of other significant benefits to virtually all participants in the lifecycle of an average transaction, including integrity and providence matters. For the consumer, there is certainty that the product is what it says it is, whether that is assurances that a luxury brand is not a cheap counterfeit good, or that a non-GMO food product is in fact not made from genetically altered DNA. For governments, both taxation and import requirements are far easier to enforce when all of the data for products and manufactured goods flowing into and out of a country are monitored in real-time and stored in a tamper-proof, immutable ledger. Governments and regulators can easily require a "master key" with respect to goods and products over which they have some jurisdictional interest. For example, Walmart recently engaged in a pilot program to ensure the safety of produce sent to the U.S. from a foreign producer. It is for these reasons and many others that so much investment has been spent in supply chain and trade finance. The benefits gained by the number of parties involved in the supply chain far exceeds the potential cost to implement.

It's important to appreciate that the concepts described in this chapter are not mere academic discussions or the thoughts of a futurist. To the contrary, everything has been implemented in real world pilot programs, and some aspects are already in deployed, production systems. In fact, of all the potential use cases generally discussed as appropriate for distributed ledger technology, there is no other use case likely to reach critical mass in deployed, production-ready distributed ledgers. The world's largest participants in all aspects of trade finance and supply chain management are actively pursuing pilots and otherwise moving full speed ahead – these companies include Walmart, BNY Mellon, IBM, HSBC, Bank of America, Microsoft and Barclays, just to name a few. To be fair, the transition to Trade Finance 2.0 is not remotely finished and ninety-some percent of supply management and trade finance are accomplished in the same manner as described in the very beginning of this chapter. The feedback, however, received from all the companies involved in pilot or prototype programs has been unanimous – distributed ledger technology (as augmented by IoT and AI) will soon result in a complete paradigm shift.

While the promise land is in sight, there are still obstacles that must be overcome before all the world's trade is completed on distributed ledgers. Payment rails for the distributed systems currently under investigation are still not perfect. More specifically, unlike Bitcoin and Ethereum, Hyperledger Fabric (IBM Blockchain) and R3's Corda do not include a native cryptocurrency, and even if one were added (it's easy to model digital cash on either platform), there is no existing system to process the volume of exchanges of fiat currency and digital currency that would be generated by global trade. As such, it is more likely that payments made will be triggered by messages from the distributed ledger that instruct the payment from a traditional fiat account (e.g., messaging with SWIFT codes to release funds from the purchaser's account or its letter of credit issuer).

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

Maybe a more systemic hurdle to overcome is the lack of uniformity in the different distributed ledgers that are currently under active development. As discussed earlier, there are several different distributed ledger protocols under active development. These different ledgers cannot currently communicate with each other, but this may, however, be a temporary impediment. Several development shops are working on interfaces and other strategies to achieve interoperability between these different ledgers. In addition, systems are being developed to ensure backwards compatibility for each new distributed system with existing legacy systems since it's not possible to transition the world's information technology systems all at one time. Furthermore, given the rather nascent nature of the technology, many companies prefer to overlay their distributed systems atop their legacy system to maintain a level of redundancy (what I refer to as the "training wheels" approach, which I believe to be a prudent approach).

While no one is certain of the exact timing, based on the current pace of advancement, it seems likely that there will be several deployed, production systems in operation within five years. Be sceptical of anyone who suggests these systems are 15 or 20 years away from production. In fact, if these systems are not in production before 10 years, that means they are likely never going into production and a newer, better system has surfaced (e.g., quantum computing). The reason for such a statement is that the potential benefits are so fundamental and so enormous when scaled on a global basis, that most major players in every industry imaginable are in a sprint towards implementation. The growing number of pilot programs and proof of concepts appearing in the general news and economic journals is only further testament to the investment being made around the globe.

This rapid pace of development is likely to continue or even accelerate as industries reach critical mass – which triggers another key benefit of distributed ledgers, which is the mutualisation of the cost to implement new systems. Because distributed systems allow all participants to access a common truth, only one distributed ledger system needs to be designed and engineered to a common set of specifications and standards. Today, every participant maintains its own centralised database that is the subject of costly reconciliations with other counterparty records. For example, rather than 10,000 manufacturers in a province of China maintaining their own central database – as they do today – only one decentralised system must be operational; thus, resulting in each company paying 1/10,000th of the costs of such decentralised system. It's tempting to think distributed ledger technology is an area limited to the world's megabanks or largest retailers, like Walmart. The headlines certainly reinforce this perception.

For small to midsize banks, suppliers, manufactures and others involved in supply chain management and trade finance (or any other industry for that matter), distributed ledger technology is an opportunity to level the playing field and eliminate certain competitive advantages held by their larger competitors, especially with respect to the banking industry in the United States. Anti-money laundering (AML), OFAC and other compliance costs represent a disproportionate amount of expenses for small and midsize banks. Distributed ledger technology also can permit banks to mutualise the cost of compliance, and in doing so, improve the effectiveness of their overall programs. This is just one of the many potential benefits (others include participation trading platforms) available to small and midsize banks. The choice seems simple. For those institutions willing to be innovative and to take some risk, there is an opportunity to be a trailblazer with potentially market-changing innovative solutions. For those who remain complacent and willing to allow the world's largest banks to maintain a monopoly on the future, their own future does not seem bright.

Perhaps the one force that can derail the implementation of distributed ledger technology across the globe is regulations or other policy enforcement that is too restrictive, and ultimately smothers out the innovation needed to reform our existing and inefficient processes. Fortunately, many jurisdictions, including the United States, already have existing legislation that, while passed years before distributed ledger technology existed, is broad enough in scope because of their origins out of the original Internet revolution. So, electronic or digital signatures, including public key infrastructure, are already accepted practice. While there will almost certainly be a need to tweak commercial laws here and there, especially in the cross-border context, those efforts should be easy to accomplish given the mutual benefits for all involved, including governments. The policy decisions that will impede distributed ledger technology are those too myopic on counterbalancing issues, such as consumer protection. Any policy that says no to any risk, is a policy that will shutter innovation. Going forward, it is important that the regulators and policymakers both in the United States, the UK, continental Europe, China and the rest of the world's global trade powers, implement regulations and rules that foster innovation and encourage institutions to take chances to achieve potentially game changing results. That is not to say that financial institutions need a licence to engage in reckless activities, but rather enough flexibility to innovate by take calculated chances and risk. There is a balance that can be found where consumer safety and the soundness of the economic environment is maintained, while innovation fosters much needed economic growth and employment growth around the globe.

Endnote

1. https://www.tradefinanceglobal.com/finance-products/trade-finance/.

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

Josias Dewey
Holland & Knight LLP
701 Brickell Avenue
Suite 3300
Miami, FL 33131
USA

Tel: +1 305 374 8500
Fax: +1 305 789 7799
Email: joe.dewey@hklaw.com
URL: www.hklaw.com

Joe Dewey is a financial services and real estate partner in Holland & Knight's Miami office and is considered a thought leader on blockchain technology. Mr. Dewey regularly represents banks and other financial institutions across the entire spectrum as measured by assets and scale, from community to global money center banks. Mr. Dewey spends a considerable amount of time at the convergence of human prose legal contracts, as well as computational contracts, based primarily on computer code. This includes smart contracts that can be implemented on Hyperledger Fabric (or IBM's Blockchain service), Ethereum (both public and permissioned versions) and R3's Corda platform. Dewey spends a considerable amount of his practice in this space assisting clients in identifying optimal distributed ledger use cases and developing proof of concept applications. He can assist in the transition from proof of concepts (PoCs) to production systems built by our clients' primary technology solutions providers.

Holland & Knight

Holland & Knight is a global law firm with more than 1,200 lawyers and other professionals in 27 offices throughout the world. Our lawyers provide representation in litigation, business, real estate and governmental law. Interdisciplinary practice groups and industry-based teams provide clients with access to attorneys throughout the firm, regardless of location. With more than 130 members throughout the firm, Holland & Knight's Financial Services Team has the depth and experience to effectively serve borrowers and lenders in all of their legal needs, including where finance and technology converge. Holland & Knight helps clients understand distributed ledger technology and blockchain, how it may benefit their businesses and the emergence of related public policy issues. Our blockchain lawyers draw on substantive backgrounds in financial services and banking, real estate, gaming, taxation, intellectual property, mergers and acquisitions, data security, anti-money laundering, corporate law and insurance. These attorneys combine hands-on knowledge of technology – some are even active coders – with the business perspective that comes from decades of experience serving clients in the industries likely to be most affected by blockchain. Our professionals understand blockchain technology at the deepest level and can navigate clients through complex decisions such as which platforms to consider (e.g., Corda, Ethereum, Hyperledger), whether permissioned or public blockchains are best suited for their specific use cases, as well as the particular legal regime for compliance.

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

Marketplace Lending

Vanessa Spiro

K&L Gates LLP

Edward Dartley

Introduction

Innovations in financial technology ("fintech") are transforming the provision of financial services to consumers and small businesses in ways that are at once profound and mundane. The nascent online lending – or "marketplace lending" – industry is a key beneficiary and driver of this innovation. Marketplace lenders marry third party capital providers with potential consumer and small business borrowers via data-driven online platforms. Most online platforms focus on one market segment, such as consumer loans, small business loans, student loans, real estate loans or microfinance.

While the industry has enjoyed steady growth over the last several years, marketplace lending remains a relatively small part of domestic and global lending markets. The evolution of the online consumer lending industry can be traced in the bewildering array of names that have been used to describe it. Originally known as "peer-to-peer" or "P2P" lending, it began with a focus on facilitating lending by individual investors to individual consumer borrowers. Over time the terminology changed to reflect the increasing variety of financial products offered by online platforms, the evolution of their funding strategies and the growing involvement of institutional investors in the online consumer lending market, which in many ways crowds out the individual "peer" investors that originally supported the industry.

With the continued growth and evolution of marketplace lending, now is an opportune time for loan market participants to gain an understanding of marketplace lending and consider ways in which this new segment of the financial services industry may offer opportunities for loan market participants. In this article, we explain the mechanics of marketplace lending, provide an overview of the existing regulatory framework and explore whether marketplace lending may present opportunities for loan market participants.

What is Marketplace Lending?

Where Did It Come From?

Marketplace lending moves the timeless practice of individual lending to an online platform ("Platform") where algorithms and other technology are used to rapidly and efficiently match prospective borrowers seeking credit with prospective lenders seeking to invest capital. Early "peer-to-peer" Platforms provided an alternative to traditional banks by offering small loans to individuals that the banking industry could not profitably service and who might not otherwise have access to credit. Without the expenses associated with traditional banking establishments, such as maintaining and staffing brick-and-mortar branches and complying with regulatory capital and other prudential requirements, Platforms were able to minimise costs, thereby making smaller personal and business loans economically feasible. Following the financial crisis in 2008, many consumers were unable to obtain credit from traditional lenders on reasonable terms – or any terms at all. This, combined with the lack of applicable banking regulations and the speed with which tech-savvy non-bank Platforms could source borrowers online and use algorithms to automate credit determinations, made Platforms a viable and attractive alternative to financial institutions and marked a turning point in their popularity.

How Does It Work?

The structure and process of marketplace lending has evolved over the years. While there are variations, the following is a description of how many Platforms are typically structured. The lending process begins on the website of a Platform operator (an "Online Lender") where prospective borrowers and prospective lenders register to participate. Platforms typically allow prospective lenders to specify certain investment criteria, such as credit attributes, financial data and loan characteristics, which, together with the Platform's proprietary credit algorithms, help lenders model targeted returns and construct their loan portfolios. Investors typically also deposit funds in a segregated deposit account maintained by the Online Lender in amounts sufficient to cover any prospective loans they have expressed an interest in funding.

Prospective borrowers complete loan applications and the Online Lender uses that information to determine whether a prospective borrower and proposed loan meet the Platform's lending standards. If the standards are met, the Online Lender assigns a proprietary credit rating and interest rate to the loan. Those details, together with certain information, are posted on the Platform website (unless the Online Lender decides to fund the loan on its own balance sheet) and prospective lenders determine whether they would like to fund all or a part of the loan.

Once there are sufficient commitments from prospective lenders to fund the loan, the Online Lender either originates the funded loan directly or through an affiliated or third-party bank or licensed lender that advances the principal amount of the loan. The originating bank typically deducts an origination fee from the funded loan amount, and a portion of that fee is paid by the originating bank to the Online Lender as a transaction fee. The relationship between the Online Lender and originating bank is often governed by a loan account program agreement.

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

Next, the originating bank sells and assigns, and the Online Lender purchases and assumes, the funded loan from the bank at the face amount using lender funds on deposit with the Online Lender. As consideration for the originating bank's agreement to sell and assign the funded loan, the Online Lender typically pays the bank a periodic fee (usually monthly) in addition to the purchase price of the loan.

After the Online Lender purchases the funded loan, it may choose to hold the loan on its own balance sheet, but often the loan is transferred into a trust that will then issue "payment dependent notes" to lenders that meet eligibility requirements ("Platform Note"). Each Platform Note represents an allocated share of all principal and interest payments received by the Online Lender for a specific loan, net of service fees charged by the Online Lender. Platform Notes are typically non-recourse and entitle the holder to principal and interest payments to the extent paid by the borrower. Platform Notes may be unsecured obligations, secured obligations or structured as participation interests or payment intangibles that represent a beneficial ownership interest in a portion of a specific loan. In these circumstances, the lenders assume the credit risk on the loan and the Online Lender services the loan on behalf of the lenders.

The process described above contemplates multiple lenders funding a single loan and receiving fractional interests. Platforms may also offer whole loans. In the case of a whole loan, an Online Lender may sell entire portfolios of loans to lenders that want to hold loans on their own balance sheets either in a single portfolio or on a flow-through basis. Unlike Platform Notes, whole loans are sold through master loan purchase agreements, with the loan purchaser also executing a master servicing agreement with the Online Lender.

Overview of Regulatory Framework

Despite increasing attention from regulators, there is no comprehensive framework for the regulation of marketplace lending. Instead, industry oversight remains a relative patchwork of efforts by different agencies, both federal and state, acting directly and indirectly. Below we provide an overview of the regulatory framework that surrounds the marketplace lending industry.

Securities Act

Unlike the corporate loans that loan market participants are accustomed to, Platform Notes are "investment contracts" and therefore considered "securities" under the Securities Act of 1933 (the "Securities Act"). Platform Notes may be offered in public offerings made pursuant to a registration statement that has been filed with the Securities and Exchange Commission ("SEC"), but because registration is expensive and time consuming, Online Lenders may choose to offer Platform Notes in exempt transactions, typically in private placements under Regulation D. Alternatively, Online Lenders may choose to offer Platform Notes in unregistered public offerings pursuant to Regulation A, as amended.

Private Placements

Rule 506 of Regulation D provides issuers engaged in private placements with a "safe harbor" that ensures such offerings will be exempted from registration. Issuers have two options under the safe harbor: Rule 506(b) and Rule 506(c). Rule 506(c) was recently added to Regulation D pursuant to the Jumpstart Our Business Startups Act (the "JOBS Act") to broaden the scope of permitted private placement communications with prospective investors.

Both Rule 506(b) and 506(c) allow issuers to offer an unlimited amount of securities to an unlimited number of investors so long as they are "accredited investors" as defined in Rule 501(a) under Regulation D.[1] Both rules also require the issuer to undertake some level of review of the investor's status as an accredited investor, either before providing offering materials or before the ultimate sale.[2] However, a key difference between the rules is that Rule 506(b) prohibits the use of general solicitations and advertising, whereas Rule 506(c) does not include similar limitations. The effect of this difference is that an Online Lender engaged in an offering of Platform Notes under Rule 506(b) must limit its marketing communications to prospective investors to avoid being considered engaged in a general solicitation. This makes Rule 506(c) more appealing so long as issuers are able to adequately verify the accredited investor status of investors .[3]

Regardless of whether an offering is made under Rule 506(b) or Rule 506(c), a Form D must be filed in each state in which an offering is made pursuant to Regulation D. The cost of these multistate filings may lead an Online Lender to consider limiting each offering to purchasers in a discrete number of states.

Public Offerings Pursuant to Regulation A and A+

Regulation A was initially adopted to create an exemption for certain public offerings of limited sizes. However, due to the conditions it imposed, issuers more frequently used Rule 506. As a result, Regulation A was amended by the JOBS Act in 2015 and subsequently became known as "Regulation A+". Regulation A+ permits qualifying issuers to engage in public offerings of securities up to a specified annual limit that depends on whether the issuer is a Tier 1 issuer (up to $20 million) or a Tier 2 issuer (up to $50 million). As with a registered offering, Regulation A+ requires that the issuer provide specified disclosures to investors and file an offering statement with the SEC. Though Regulation A+ provides greater flexibility than Regulation D, the annual volume limits make it an impractical option for an Online Lender that intends to have continuous offerings. Accordingly, it is only a feasible option for smaller Online Lenders that are still in the process of increasing their volume.

Registered Offerings on Form S-1

In order for Platform Notes to be offered to the public without the volume restrictions of Regulation A+, they must be offered and sold pursuant to a registration statement that is filed with the SEC. The offer and sale may be registered on either Form S-1, for continuous offerings or Form S-3, for a securities shelf. Both approaches present significant limitations on the Online Lender's ability to offer multiple series of Platform Notes using a single base prospectus. In addition, issuers who file for continuous offerings are subject to ongoing requirements to monitor and update the prospectus. As a result, the registration process may be expensive and time consuming.

Blue Sky Laws

State securities laws ("Blue Sky laws") also require registration of publicly offered securities unless an exemption applies. In most states, the only exemption from registration available for Platform Notes is an exemption for sales of securities to certain classes of institutional investors, such as banks, insurance companies, investment companies, pension funds and similar institutions. Because Platforms tend to market offerings broadly, this will result in multiple state registrations.

Secondary Trading

Investors should also consider the resale restrictions that apply under the securities laws. The way in which the Online Lender originally sold the Platform Notes to the investor will dictate the applicable resale restrictions. Investors that purchase Platform Notes in a registered public offering or under Regulation A+ will be able to

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

resell them without restriction under the Securities Act. However, investors may encounter resale restrictions at the state level.

Platform Notes that are issued and sold in a private placement under Rule 506 are "restricted securities" as defined in Rule 144 under the Securities Act. Restricted securities may not be resold unless the offer and sale are registered under the Securities Act or are made in a transaction that is exempt from the registration requirements of Section 5 of the Securities Act. Registering an offering of Platform Notes is not practical because of the time and expense involved. The three main transactional exemptions under the Securities Act are Rule 144, Rule 144A and Section 4(a)(7). Unfortunately for those hoping to develop a broad trading market for unregistered Platform Notes, these exemptions come with significant restrictions. Rule 144 imposes either a six-month or one-year holding period on potential sellers,[4] and Rule 144A's requirements have the effect of limiting purchasers to large institutional investors.[5] In contrast, Section 4(a)(7) requires that securities only be outstanding for 90 days and allows for a broader universe of purchasers by specifying that they only need to be accredited investors. Section 4(a)(7) also requires that sellers not be subject to certain disqualifying events and not offer the securities through general solicitation or advertising. This latter requirement poses challenges for those seeking to develop online trading platforms for Platform Notes, but Section 4(a)(7) still presents the most feasible approach for secondary trading of Platform Notes. As with unrestricted securities, Blue Sky laws are also a consideration.

Exchange Act, Advisers Act and Investment Company Act

Exchange Act

Securities sold pursuant to an effective registration statement under the Securities Act also become subject to ongoing reporting requirements under Section 15(d) of the Exchange Act. These include annual (Form 10-K) and quarterly (Form 10-Q) reports that require significant effort to prepare.

Transaction-based compensation has long been regarded by the SEC as a hallmark characteristic of a broker-dealer under Section 15 of the Exchange Act.[6] Therefore, an Online Lender could potentially be required to register as a broker-dealer under the Exchange Act if it were to charge a sales commission or receive other transaction-based compensation upon the sale of Platform Notes. In order for an Online Lender not to be considered a broker-dealer, the compensation paid to it should be based on a spread between the amounts received on underlying loans and the amounts paid to investors on the associated Platform Notes. Origination and servicing fees related to the underlying loans also would not be considered transaction-based compensation in relation to the sale of Platform Notes.

Online Lenders considering establishing an online trading platform to facilitate secondary trading of Platform Notes should note that any such platform would need to be operated by a registered broker-dealer. The Exchange Act would likely also require such an electronic platform to register with the SEC as an "alternative trading system".

Investment Adviser Registration

The Investment Advisers Act of 1940 (the "Advisers Act") requires investment advisers to register with the SEC unless an exemption applies. Section 202(a)(11) of the Advisers Act defines an investment adviser as a person who, for compensation, engages in the business of advising others as to the value of securities or advisability of investing in, selling, or purchasing them. In order to avoid potential registration and regulation as an investment adviser under the Advisers Act and similar state laws, Online Lenders should not charge separate compensation for advice regarding, among other things, the advisability of investing in Platform Notes generally, which Platform Notes to purchase, or any other topic related to the value of Platform Notes.

Investment Company Registration

As described above, with the evolution of funding models for marketplace lending, Online Lenders have increasingly held loans on their balance sheets or in a subsidiary or other controlled entity. If those loans are deemed securities, the Online Lender (or any affiliate holding the loans) may be an investment company as defined in the Investment Company Act of 1940 (the "Investment Company Act"). This is because the Investment Company Act generally treats any company that holds more than 40% of the value of its total assets in investment securities as an investment company.[7] If the Online Lender or an affiliate were an investment company, it would be required to register as such with the SEC and it would be subject to regulation under the Investment Company Act. An Online Lender could not function under the Investment Company Act. Among other things, the Investment Company Act's restrictions on affiliated transactions would likely prohibit the Online Lender from issuing and/or acquiring the loans that serve as the basis for the Platform Notes.

Several exemptions from the definition of investment company are available to Online Lenders. The applicability of these exemptions in a particular case would depend on the precise model used and the types of loans the Online Lender holds. The Investment Company Act analysis applicable to a particular Platform would also depend on a wide range of facts and circumstances. These could include such matters as whether loans are made primarily to consumers or to businesses, the purpose of the loans, whether loans are secured and, if so, the nature of the collateral and the nature of the sponsor's business and balance sheet.

Other Issues

While the Securities Act, Exchange Act, Advisers Act and Investment Company Act impose significant requirements on marketplace lending activities, various other federal and state regulators and laws and regulations, including state usury and licensing laws, data privacy laws, anti-money laundering laws and consumer-protection laws, also have the ability to impact marketplace lending.

Prudential Regulatory Considerations

The fintech industry, and marketplace lending in particular, are receiving increased focus from the prudential regulators. While the marketplace lending industry is too small to give rise to systemic financial stability concerns, regulators have expressed concern about several areas where marketplace lending could be misused in dangerous ways. For example, the Federal Reserve has been concerned that Online Lenders' powerful algorithms and data crunching ability could lead to a gradual reintroduction of redlining practices that would be illegal for regulated financial institutions.

On the other hand, the prudential regulators and the United States Treasury have been open to the growth of online lending in principle. The Office of the Comptroller of the Currency (the "OCC") was particularly active in 2016,[8] concluding the year with a December announcement that it would consider fintech company applications for special purpose bank charters.[9] In May 2016, the U.S. Department of Treasury issued a white paper summarising the responses it received to its July 20, 2015 request for information on the marketplace lending industry and providing recommendations on how to promote "safe growth" of the industry.[10] Each of these

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

initiatives faces particular challenges, and state banking regulators have taken their own direction in important matters. For example, the Conference of State Bank Supervisors has questioned the OCC's authority to grant a fintech charter as proposed, and New York's anti-bank partnership legislation, described in more detail below, invites scepticism about the prospects for convergence of marketplace lending with traditional banking.

State Usury and State Licensing

While some Platforms originate loans through affiliated banks or licensed lending companies, many acquire the loans they originate from banks that act as lenders of record for the underlying loans. Using a federally insured depository institution to serve as lender of record, sometimes referred to derisively as "rent-a-charter", affords the benefits of federal preemption to subsequent assignees of the loan, including the Platform and its investors. Under federal preemption, a loan can be originated nationwide without the lender being licensed in any state, and the loan can bear an interest rate and fees that are permitted in the home state of the lender of record, regardless of the borrower's location. There have been some relatively recent challenges to this view of preemption in various jurisdictions, including West Virginia and New York. Consequently, there is a lack of clarity in certain jurisdictions as to whether federal preemption will protect assignees from running afoul of state usury laws.

Some states, including New York, Colorado, Vermont and West Virginia, seek to regulate the "bank origination" model of marketplace lending by introducing legislation to require state licensing of entities that merely market loans to their residents, even if those entities do not originate the loans. For example, the New York Budget legislation has recently proposed expanding lender licensing requirements by requiring that entities that solicit loans in state and also purchase or otherwise acquire from others the loans or facilitate financing those loans with respect to all loans of $25,000 or less (consumer) or $50,000 or less (commercial) bearing an interest rate above 16% be subject to licensing and possibly the same usury requirements that would apply to a non-licensed lender. Violation of the licensing requirements renders the loans void and unenforceable.

Privacy, Data Protection and e-Commerce

The nature of the business and the contractual arrangements of Platforms and Online Lenders raise a variety of issues that may be material to investors. Data privacy is an important issue for Platforms, and the disclosure of the applicable risks and compliance issues is relevant to the securities offering process. Privacy policies may be material, as well as whether the Online Lender provides its borrowers the privacy notices required under federal law. Another material area of concern may be seen in Platforms' terms of use, particularly to the extent that they are subject to rules governing electronic commerce. Platform users typically consent to electronically sign all agreements presented to them on the Platform, to be bound by their electronic signature, and to receive all documents and notices electronically.

Anti-Money Laundering and Bank Secrecy Act

The current political climate has focused attention on the intersection of the marketplace lending industry and regulatory concerns relating to counterterrorism and national security. Notably, marketplace lending is subject to anti-money laundering laws and regulations under the Bank Secrecy Act as amended by the USA PATRIOT Act. Non-bank Platforms may not be directly subject to these obligations, but depending on their structure and services offered, a Platform may be subject to regulation as a money-services business, a money transfer system, an investment company, an investment adviser, or a broker-dealer. These regulatory concerns indirectly affect investment managers and their investors.

Consumer Protection

To the extent that an online lending marketplace is involved with loans to consumers, the rules enforced by the Consumer Financial Protection Bureau are a material consideration for the companies and their investors. These include the Truth in Lending Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act and the Consumer Credit Protection Act. There may also be applicable state laws to the extent that federal law does not have preemptive effect. These affect disclosures, indemnifications and other material issues.

How Might Marketplace Lending Evolve to Attract Loan Market Participants?

Marketplace lending has greatly evolved from its early days of peer-to-peer lending driven by sheer necessity, and traditional banks and Platforms have since partnered in several different formats. These partnerships combine a bank's source of capital and its customer database with the time-saving technology and access provided by a Platform. Examples include partnering in the origination space such as the arrangement between WebBank and Lending Club, where WebBank originates loans that it sells to Lending Club, and the partnership between Regions Bank and Avant to leverage Avant's platform to offer unsecured loans to Regions Bank customers. Some large financial institutions have announced that they are building out their own Platforms to service retail customers and small businesses in a manner that mimics the partnership of Platforms and banks.

Do these connective partnerships and products provide an attractive opportunity for loan market investors? As currently constructed, these arrangements do not represent immediate opportunities for loan market participants. The underlying products, home mortgages, credit cards and auto loans, are not typically the kinds of loans in which loan market participants invest. Nor are the borrowed amounts for those kinds of loans generally sufficient for investors seeking to trade individual corporate loans, as each loan is often significantly less than $1 million, the minimum threshold for a debt trade in the corporate loan market. Another hurdle for Platforms with respect to building a product for the loan market investor is the role of the Online Lender or its servicer. Loans originated online are serviced by the Online Lender or, if funded pursuant to a notes issuance, by a servicer similar to those in other securitisation products. The Online Lender or servicer is contractually obligated to act in prescribed ways within set deadlines upon loan defaults. Accordingly, to the extent that asset class is interesting to loan market participants, it would more likely be pursued only by those loan market investors that pursue those kinds of assets or securitisation products. In the traditional corporate loan market setting, there is a loan agent who performs significant loan administrative tasks and duties, including those directed by the lender group, which has the ability to collectively agree to direct the loan agent to take, or not to take, actions and seek remedies in times of borrower distress.

However, if Platforms can deliver larger loan amounts efficiently and quickly, it is possible that marketplace lending could expand to service larger commercial business borrowers. This evolution could provide the impetus for building loan market investor demand for such loans, which demand, in turn, would fuel more lending opportunities for Platforms.

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

The logical next step for Platforms to increase commercial business borrower activity is to infiltrate the lower middle market lending market, conservatively defined as loans aggregating less than $100 million per borrower, and/or borrowers with an annual EBITDA of greater than $10 million or so. This market tends to be supported by club deals, a small group of lenders who often hold the debt to maturity; liquidity in the secondary trading market is not a focus. The loan structures are fairly conservative and the loan documentation contains significant protections in favour of the lenders, including the imposition of ongoing reporting obligations on the borrower. The club of lenders willing to participate in this process could select a manager for their Platform that is highly regarded and who could serve as loan agent for the club group. The loan documentation would include typical loan market reporting and other covenants and would need to grant the lender group, not the Online Lender, with its traditional and customary input on collective action matters. In addition, the tenor of these loans would need to be consistent with middle market expectations, typically five or six years, rather than the shorter Platform loan tenor currently in place. With these tweaks to the online platform loan structure, it is possible that lower middle market borrowers could find their capital needs well met by the online lending platform model. The benefits to both the borrower and the club participants would be the ease of execution in a highly cost efficient manner.

Success in the lower middle market could lead online marketplace lenders to consider expanding into larger corporate loans that are widely syndicated. The trading protocols of this market include a minimum trading threshold of $1 million, soft call protection, expectations of transparency into the market for such loans, rules regarding non-disclosure of confidential information and often the need for consents to trade, together with documentation requirements for such trades. The Online Lender or a selected servicer would need to serve the role of loan agent for purposes of addressing these trading protocols, and others, including the maintenance of a loan registry.

Additionally, the borrowers for whom these Platforms are available would likely impose eligibility requirements with respect to possible assignees of their debt, including outright prohibitions on competitors or specified others purchasing the debt or receiving information under the loan documentation. Would the Online Lender of a Platform be expected to police this? Such outcome seems unlikely, but there might be a perceived decrease in control over these matters if a Platform, rather than a traditional financial institution with a longstanding business relationship with the borrower, is responsible for these tasks.

The corporate loan market is a bespoke market, with its own protocols and idiosyncrasies that may prove challenging to marketplace lending's entry into the arena absent some modifications to online marketplace lending to address these matters. The functions performed by loan agents are not easily transferred to Platforms without a corresponding replacement in some form for the administrative and active role of the bank agent. Loan market participants expect certain rights in managing the credit, such as the receipt of ongoing reporting, measurement of financial performance and a vote on collective action matters, and borrowers expect the right to know the identity of their lenders and have consent rights over debt assignees, none of which is currently granted by Platforms. Platforms arose to meet specific capital needs of consumers and small businesses not met in the financial crisis or in the waning support from traditional banks in those markets thereafter. If Platforms build critical mass and overcome the burden and costs of regulatory overlay, it is conceivable that there will be opportunities to craft products that entice loan market investors to participate in loans originated online.

Endnotes

1. Generally, the term "accredited investor" includes companies with total assets of more than $5 million, companies in which all equity owners are accredited investors, natural persons with a net worth (alone or with a spouse) of more than $1 million, and natural persons with an individual income in excess of $200,000 in each of the two most recent years, or joint income with a spouse in excess of $300,000 in each of those years, and a reasonable expectation of reaching the same income level in the current year. Under Rule 506(b), an issuer may also offer securities to up to 35 non-accredited investors, but doing so imposes certain disclosure requirements.
2. An Online Lender that offers Platform Notes in reliance on Rule 506(b) must have a reasonable belief that each prospective investor who views offering materials for the Platform Notes are "accredited investors". An Online Lender that offers Platform Notes in reliance on Rule 506(c) must take reasonable steps to "verify" that all persons who ultimately purchase Platform Notes are "accredited investors". The staff of the Securities and Exchange Commission has indicated that the verification standards under Rule 506(b) and Rule 506(c) are not materially different. *See generally* SEC, Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, 78 Fed. Reg. 44771 (July 24, 2014) (discussing the factors to consider in determining whether a method constitutes "reasonable steps to verify", including: the nature of the purchaser and the type of accredited investor that the purchaser claims to be; the amount and type of information that the issuer has about the purchaser; and the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount).
3. The safe harbor methods for verification generally include reviewing Internal Revenue Service forms reporting income, reviewing certain statements of assets provided by regulated financial entities in conjunction with consumer reports describing liabilities, and obtaining written confirmation from certain registered entities that they have taken reasonable steps to verify accredited status.
4. Rule 144 allows a non-affiliate of the issuer to resell unregistered securities without registration if the investor has held the securities for either six months or one year, depending upon whether or not the issuer is a reporting company under the Exchange Act.
5. Rule 144A allows non-issuers to resell unregistered securities without registration if they are sold to a "qualified institutional buyer" (a "QIB") and certain other requirements are met. To qualify as a QIB, a purchaser must be an entity and, with few exceptions, it must hold at least $100 million in securities investments.
6. Brumberg, Mackey & Wall, P.L.C., SEC Staff No-Action Letter (May 17, 2010).
7. Investment Company Act, Section 3(a)(1)(C).
8. Office of the Comptroller of the Currency, Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective (Mar. 2016); Office of the Comptroller of the Currency, Recommendations and Decisions for Implementing a Responsible Innovation Framework (Oct. 2016).
9. Thomas J. Curry, Comptroller of the Currency Regarding Special Purpose National Bank Charters for Fintech Companies, Georgetown University Law Center (Dec. 2, 2016); Office of the Comptroller of the Currency, Exploring Special Purpose National Bank Charters for Fintech Companies (Dec. 2016).
10. U.S. Department of the Treasury, Opportunities and Challenges in Online Marketplace Lending (May 10, 2016).

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

Vanessa Spiro
K&L Gates LLP
599 Lexington Avenue
New York, NY 10022-6030
USA

Tel: +1 412 355 6355
Fax: +1 412 355 6501
Email: vanessa.spiro@klgates.com
URL: www.klgates.com

Vanessa Spiro is a partner at K&L Gates, focusing on banking and asset finance. She has substantial experience in leveraged finance and represents financial institutions and other creditor entities and borrowers (corporates, sponsors and other capital end-users) in connection with acquisition financings, cash flow and asset-based transactions and other finance matters. She also has significant experience in restructurings, workouts, distressed debt matters and debtor-in possession and exit financings. Ms. Spiro has been recognised for her work in both *The Legal 500* and *New York Super Lawyers*, and she has been listed in *Who's Who of American Women* and *Who's Who of American Lawyers*. She has been quoted by numerous media outlets and has appeared on Bloomberg Television to discuss loan market conditions.

Edward Dartley
K&L Gates LLP
599 Lexington Avenue
New York, NY 10022-6030
USA

Tel: +1 212 536 4874
Fax: +1 212 536 3901
Email: ed.dartley@klgates.com
URL: www.klgates.com

Ed Dartley is a partner at K&L Gates and concentrates his practice on all facets of the asset management industry, with particular focus on advising clients in the fintech and marketplace lending (peer to-peer). With over a decade of experience as in-house counsel and chief compliance officer with an asset management group of registered investment advisers and private equity fund managers, Mr. Dartley has deep in-house experience and a unique perspective on how asset management works from the inside. Mr. Dartley continues to utilise this experience by serving as general counsel to a number of clients of the firm. Mr. Dartley also is a founding member of the Bloomberg Alternative Marketing Council, an advisory board founded by Bloomberg to define best practices in marketing for the alternatives industry.

K&L GATES

K&L Gates comprises approximately 2,000 lawyers globally who practice in fully integrated offices located on five continents. The firm represents leading multinational corporations, growth and middle-market companies, capital markets participants and entrepreneurs in every major industry group as well as public sector entities, educational institutions, philanthropic organisations and individuals. As technologies and regulatory guidelines shape the burgeoning segment, lawyers in our Marketplace Lending Practice can assist sector participants in achieving their business and investment objectives, while managing risks. Whatever market niches, strategies, and algorithms our clients wish to develop, we work side by side with them to innovate and navigate the legal, regulatory, and commercial challenges of this evolving consumer debt market segment. We leverage our deep experience in consumer financial services regulation, e-commerce regulation, private equity, private fund formation, cybersecurity, finance and IP to provide holistic support to market participants and provide the legal underpinning to innovation in the delivery of financial services in marketplace lending.

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

Overview of Sanctions Programs Affecting the Lending Market in the United States

Joseph F. Giannini

Chadbourne & Parke LLP

Adrienne Sebring

I Introduction

In an effort to advance foreign policy and national security objectives, national governments and international bodies have developed sanctions programs designed to deter and punish countries, regions or persons that engage in practices and promote policies that are in contravention of international norms.[1] This article focuses on a brief sampling of sanctions programs enacted by the United States aimed at curtailing financial activities with such countries. These sanctions programs impose requirements and limitations on banks, financial institutions and other lenders within the United States (referred to herein as "***US Lenders***") in dealing with customers to whom they extend credit in order to help deprive access to capital to persons who have been added to the Specially Designated Nationals ("***SDNs***") and Blocked Persons list (the "***SDN List***").

Although they may overlap, there are more than 20 sanctions programs administered and enforced in the United States by the Office of Foreign Assets Control ("***OFAC***") that US Lenders must be familiar with. While the specific details of these sanctions programs are beyond the scope of this article, this article does aim to:

- explain the importance for US Lenders of ensuring compliance with sanctions programs;
- discuss certain sanctions programs which have recently changed or may be subject to review and potential change in the near future;
- explore the consequences to US Lenders for violations of sanctions programs and identify customary documentary protections and other steps that can be taken by US Lenders to avoid running afoul of sanctions programs; and
- consider the impacts of the current political climate on the possibility for changes to existing sanctions programs.

II General Background

A. Implementation, Oversight and Application of United States Sanctions Programs

In the United States, the use of sanctions dates back to the War of 1812 where the United States Department of Treasury imposed sanctions against Great Britain for the harassment of American sailors. With President Truman's declaration of a national emergency after China's entry into the Korean War over a century later, OFAC was formally established as a separate office within the United States Department of Treasury, specifically tasked with the administration and enforcement of economic and trade sanctions (although other departments including the Department of State and the Department of Justice also play a tangential role). OFAC acts at the direction of the President (through the enactment of executive orders) and pursuant to various federal laws that address sanctions programs including:

- The Trading with Enemy Act;
- The International Emergency Economic Powers Act;
- The National Emergencies Act;
- The Cuban Democracy Act; and
- The Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010.

The process of establishing sanctions programs most commonly begins with a Presidential declaration of a national emergency in response to a foreign threat. Often the foreign threat in question is centered on a determination that a sovereign state, individual, entity, organization or participants in a specified industry is (or should be) considered generally hostile to the national security of the United States. Once the President has made such a declaration leading to the imposition of sanctions, he or she has the power and authority, pursuant to the International Emergency Economic Powers Act, to regulate commerce with regard to that foreign threat for a period of one year, unless extended by an additional executive order or terminated by a joint resolution of Congress. This power is exercised by the President through OFAC.

Under the rules and regulations implemented by OFAC in furtherance of sanctions programs, "US persons" (including citizens, residents and companies organized in the United States and their foreign branches and persons actually located in the United States) are generally prohibited from engaging in transactions (such as making loans, investments or raising money) involving property or interests in property belonging to persons and entities included on the SDN List (wherever they are located) absent a specific exemption or authorization from OFAC. Where a target owns 50% or more of an entity, whether directly or indirectly, that entity is also blocked despite not being named on the SDN List. Furthermore, beyond directly entering into a transaction with these targets, there are also restrictions on "facilitating" actions of non-US persons or entities which may not be directly performed by US persons or entities regardless of whether they are legal for the non-US person or entity to perform. Although this article focuses on loan transactions, it is worth highlighting that the prohibition may apply to transactions and dealings generally with blocked persons/countries and is not limited to financing transactions.

B. Types of Sanctions

Generally speaking, there are two types of sanctions that the United States employs: (i) "comprehensive sanctions" and (ii) "list-based

sanctions." Comprehensive sanctions refer to sanctions that are typically broad in scope and apply to an entire state or territory. In short, comprehensive sanctions ban all activities conducted by US persons with a subject state or with individuals or entities within the subject state. Often, the activities that are most directly impacted by such a ban center on importing, exporting, transporting and engaging in financial transactions. List-based sanctions tend to be narrow in scope and apply to individuals specified on a list maintained by OFAC who are considered (i) committed to the support of terrorism, trafficking, piracy, narcotics and other criminal activities or (ii) related to certain former or current regimes that are committed to the support of terrorism, trafficking, piracy, narcotics and other criminal activities.[2]

In addition to comprehensive sanctions and list-based sanctions, there is a third category of sanctions that OFAC can impose but does so with less frequency – so called "sectoral industry sanctions." Sectoral industry sanctions prohibit US persons from engaging in certain specified activities with parties operating in a particular industry within a specified country or territory. Sectoral industry sanctions can allow the United States and OFAC to more precisely target problem actors in a narrow sector and geographic region.

III Future of Select Sanctions Programs

Under the Obama Administration, relations with certain countries that the United States had historically been at odds with improved or were re-evaluated in pursuit of achieving broader strategic goals. Either as a result of, or as the catalyst for, achieving these objectives, certain countries that were previously the target of sanctions programs by the United States were presented with a pathway towards easing, and ultimately ending, these sanctions programs. With the start of a new Presidential Administration in the United States, there is a degree of uncertainty and speculation as to the future evolution of United States foreign relations and how that evolution and change in foreign policy may result in an alteration of existing sanctions programs and the implementation of new sanctions programs. Currently, the sanctions programs that have garnered the most attention and appear susceptible to change through acts of the new Presidential Administration are those applicable to Russia/Ukraine, Iran and Cuba. These sanctions programs are illustrative of the ways in which a change in elected leadership, shifting political climates and current events can lead to a change in the scope and application of United States sanctions programs. These sanctions programs also demonstrate the unpredictability of change as well as the pace with which these changes can occur.

A. Russia/Ukraine

In 2014, pursuant to Executive Order 13662 (the "***Russia Executive Order***"), OFAC imposed sectoral sanctions (the "***Russian Sanctions***") in response to threats to the peace, security, stability and sovereignty of Ukraine. Included in these sectoral sanctions, and perhaps the primary target for their issuance, was Russia. The Russian Sanctions apply to certain Russian energy and defense companies and financial institutions, which OFAC includes on its "Sectoral Sanctions Identification List." The Russian Sanctions, as implemented by OFAC through directives issued pursuant to OFAC's delegated authority under the Russia Executive Order, prohibit US persons from transacting in, providing financing for, or otherwise dealing in (i) debt with a maturity of longer than 30 days or (ii) equity, in each case, if that debt or equity is issued on or after the effective date of the sanctions by, on behalf of, or for the benefit of persons (or their property or interests in their property) operating in Russia's financial sector named under a directive issued by OFAC. OFAC has also issued a directive that prohibits transacting in, providing financing for, or otherwise issuing new debt with a maturity greater than 90 days if that debt is issued by, on behalf of, or for the benefit of persons (or their property or interests in their property) operating in Russia's energy sector and named under a directive issued by OFAC.

The Russian Sanctions have garnered increased attention leading up to and following the 2016 Presidential election in the United States primarily as a result of Russian activities in the Ukraine and on the world stage. Although reports have indicated that the new Administration may be willing to consider easing and/or lifting the sanctions program against Russia, it is not clear whether that position will be maintained. Further, the Congressional position on the Russian Sanctions has not been clearly determined leaving the possibility for easing, maintaining or expanding the Russian Sanctions all as possible outcomes. Given this uncertainty, this situation is one that should be closely monitored by US Lenders and any organization that has operations in Russia that may seek access to the US lending market.

B. Iran

In 2014, the White House announced its intention to implement a Joint Plan of Action (an agreement among the US, UK, France, Germany, Russia, China and Iran) to halt Iran's progress on its nuclear program in part out of concerns that the program could lead to the development of nuclear weapons. Pursuant to the Joint Plan of Action, sanctions imposed by the States party to the Joint Plan of Action would be eased if Iran's nuclear program met specific benchmarks in accordance with certain milestones. By January of 2016, the International Atomic Energy Agency verified that Iran had implemented its key nuclear-related measures, and consequently the US lifted certain nuclear-related sanctions against Iran, including secondary sanctions against non-US persons relating to trade in the precious metals, energy, shipping and automotive sectors as well as certain underwriting and insurance and banking and financial transactions with Iran. Despite the relief afforded by the implementation of the Joint Plan of Action, certain other US secondary sanctions remain in effect in addition to primary US sanctions, which are comprehensive in nature, and generally prohibit US persons from engaging in transactions with or involving Iran.

Similar to the Russian Sanctions, the sanctions program against Iran has been in the spotlight but, in contrast, President Trump has expressed a view that the existing United States foreign policy with regards to Iran had been too tolerant and, as a result, strengthening of the sanctions program in Iran seems possible and perhaps even probable. In fact, new sanctions were issued in February 2017 to put Iran "on notice" about its ballistic missile tests. Under these circumstances, it does not seem unreasonable to suspect that further sanctions could be imposed by the current Administration.

C. Cuba

In December of 2014, President Obama announced in a press release his intention to begin the process of easing sanctions against Cuba. Following this announcement, OFAC published amendments to then-existing regulations in order to allow increased travel to and from Cuba, commerce with the Cuban private sector and flow of information to and from Cuba. Notwithstanding such amendments to ease the Cuban sanctions in certain respects as a means to further engage and empower the Cuban people, the Cuba embargo remains in place, and most transactions between the United States and Cuba continue to be prohibited. Despite the movement to ease sanctions against Cuba, the timing and pace of implementing such change remain to be seen.

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

IV Addressing Sanction Risks in Financing Transactions

A. Consequences of Violations

While the foreign policy position of the United States together with political considerations may indicate the possibility of increasing, easing or even ending various sanctions programs at any given time, the relative uncertainty on how and when this may happen underscores the importance of US Lenders taking steps to help ensure their continued compliance with sanctions programs. This is done primarily through due diligence and properly structuring and drafting credit protections in transaction documents. If these efforts are unsuccessful, there are a range of potentially dramatic and severe consequences US Lenders may face due to violations, which include the following:

1. Limitations on enforcement rights under the relevant agreement and/or collateral.[3]
2. Regulatory Enforcement Actions – Prosecution of banks by US federal and state authorities has become increasingly common, with at least 15 cases involving a fine in excess of $100 million since 2009 (including in one instance a fine of approximately $9 billion) as a result of violations of applicable sanctions programs.
3. Civil/Criminal Liability – OFAC may refer a case to the Department of Justice for criminal investigation if there is evidence of criminal intent on the part of the financial institution or its employees. In such instances, criminal fines ranging from $50,000 to $10,000,000 as well as imprisonment for a period of 10 to 30 years may be imposed. Civil fines and penalties may also be imposed.
4. Franchise/Reputational Risks – Beyond the substantial fines, criminal liability and damages that a US person can face for violating sanctions programs, violations can have an even more significant impact on the reputation of an institution. The reputational effect can, in some circumstances, be so dramatic that a finding of guilt may not even be necessary to do harm to the institution in question – merely becoming the subject of such an investigation and/or prosecution related to sanctions violations may result in significant negative publicity which can irreparably taint an institution's reputation leading ultimately to economic losses.

OFAC has published guidelines (the "***OFAC Guidelines***") which set forth its policy and procedures for enforcing violations of its sanctions programs, including potentially referring cases to the Department of Justice for criminal investigation, issuing civil penalties and/or warning letters. Notwithstanding the onerous consequences of sanctions violations, it is worth noting that OFAC does not prohibit US Lenders from undertaking a transaction if the *borrower* conducts a "de minimis" amount of business with a sanctions target subject to certain conditions, including that the financing in question does not relate to the borrower's business with the sanctions target and conducting due diligence to confirm the scope of the borrower's activities with the sanctions target. However, there is no official guidance from OFAC on what constitutes "de minimis" for these purposes so exclusively relying on this exception can be risky and should be closely scrutinized in light of the facts in question.

B. Risk Mitigation

Given the severity of the consequences a US Lender may face for violating the sanctions programs, it is important that US Lenders entering into financing transactions be well aware of (i) the sanctions risks that a particular borrower presents and (ii) what credit protection provisions (i.e., representations and warranties, covenants and events of default) can best assist the US Lender to ensure that actions on the part of the borrower do not result in a violation by the US Lender. Conversely, any borrower looking to access the US banking market today must understand the importance that US Lenders will place on ensuring their continued compliance with the applicable sanctions programs (and why borrowers will often find it difficult to negotiate the institutional and market adopted provisions relating to sanctions programs). Although foreign borrowers may be inclined to resist these provisions on the basis that the sanctions programs do not apply to them, US Lenders will likely reject this argument on the basis that violations of the sanctions programs can result in onerous consequences. In fact, the only means that a US lender may have to control the risks of borrower activities after a closing is through the inclusion of the documentary protections discussed below. The presence of a representation or covenant with respect to sanctions programs may not shield the US Lender from liability if the representation or covenant is breached, it does provide evidence of a US Lender's effort to comply with the sanctions programs (and could result in reduced penalties to the extent the violation was unintentional).

(1) General provisions

a. Compliance with Law Representations and Covenants

Credit agreements should include a traditional representation and covenant from the borrower regarding general compliance with applicable laws (which should generally be adequate to cover any sanctions programs). In light of the enhanced focus on sanctions related regulations, US Lenders may now also include specific representations and covenants in credit agreements related to sanctions compliance. It is important to note that the inclusion of such provisions is not a requirement for US Lenders to be in compliance with sanctions laws. Inclusion of such provisions can, however, help US Lenders to mitigate damages to the extent a transaction does violate sanctions programs by demonstrating an intent, on the part of the US Lender, to comply with sanctions programs as well as to form the basis on which such an intent and belief can be founded. As a secondary purpose, the specific inclusion of these provisions can also alert borrowers to the importance of compliance with such laws, particularly in the case of foreign borrowers (which may not be subject to US sanctions law but nevertheless may be their subject).

b. Illegality Mandatory Prepayment

Some credit agreements contain mandatory prepayment provisions to the extent that making or maintaining a loan under a credit facility by a US Lender becomes illegal. Such provisions, although perhaps not currently the market norm in the US, may become increasingly popular as a means to address risks associated with violations of sanctions programs. A mandatory prepayment of this nature permits a US Lender to avoid having to maintain loans where such loans result in violation of a future sanctions program. In addition, because sanctions-related provisions included in credit agreements by US Lenders are not only intended to address legal liability but also to avoid franchise and reputational damage, it is helpful for US Lenders to have the right and ability to exit a transaction if a situation arises where a US Lender could run afoul of a sanctions program by remaining in a credit facility.

(2) Specifically tailored provisions

a. Status under Sanctions

US Lenders should obtain a representation in credit documentation that neither the borrower nor any of its subsidiaries, directors, officers, employees, agents or affiliates is or is owned or controlled by persons that (i) are the subject of any sanctions programs imposed by OFAC, the US Department of State or other relevant sanctions

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

authorities outside the US or (ii) is located, operating or resident in a country subject of sanctions. Given the scope of the parties covered by such a representation, it would not be unusual for borrowers to seek to include a knowledge qualifier to limit the possibility of an unknown breach. Such a knowledge qualifier may be acceptable in certain circumstances with respect to directors, officers, employees, agents and affiliates but should not be accepted with respect to the borrower itself or its subsidiaries.

b. Use of Proceeds

US Lenders should include a use of proceeds representation and covenant from the borrower, which provides that the borrower will not, directly or indirectly, use the proceeds of any extensions of credit to finance activities in violation of sanctions laws. Borrowers often look to negotiate a knowledge qualifier in these provisions as well. In light of the strict liability nature of the OFAC regulations (which do not include a knowledge standard), such a qualification could undercut the protection that US Lenders seek to obtain by including these provisions and is therefore commonly resisted. Furthermore, to the extent the use of proceeds provision is included as a representation rather than a covenant, it is important to ensure that the representation is brought down at the time of each borrowing and not made only at closing to provide for continued protection during the life of the facility.

c. Compliance with Sanctions Programs

US Lenders have also begun to increasingly require, beyond the general compliance with law covenant or representation, a provision specifically requiring the borrower to maintain policies and procedures designed to promote and achieve compliance with applicable sanctions programs. Such a provision may provide comfort to US Lenders that the borrower understands and places a priority on sanctions compliance. Although this does not protect against the strict liability standard, it can help a US Lender avoid the reputational risks presented by engaging in a relationship with an entity that may have violated sanctions programs in unrelated transactions in the past.

d. Event of Default

Given the serious consequences facing US Lenders found in violation of sanctions programs, any breaches of the sanctions-related representations and covenants by the borrower should trigger an automatic event of default without a requirement for delivery of notice or an opportunity for the borrower to cure.

(3) Due diligence

In addition to more specifically tailoring representations, warranties and covenants to help ensure compliance with sanctions regulations, US Lenders should consider performing due diligence, particularly with respect to those credit transactions involving a borrower that is, or has affiliates who are, targeted by US sanctions programs or are located or operating in countries or regions that are the target of US sanctions programs. The documentary protections do not obviate the need for due diligence, but, rather, the two go hand in hand as due diligence can inform the necessary scope and coverage of the requested credit agreement provisions related to sanctions programs. The nature of the due diligence should focus on developing an understanding of what the activities in question are so that legal counsel can present informed advice on the true nature of the risks presented.

Type of Provision	Suggested Language	Points of Negotiation/Drafting Notes
Definition of "Sanctions"	Sanctions administered or enforced by the U.S. Department of the Treasury's Office of Foreign Assets Control, the US Department of State, [the United Nations Security Council, the European Union, Her Majesty's Treasury] or other relevant sanctions authority.	Non-US sanctions authorities that have jurisdiction over the borrower or any member of the borrower group should be specifically listed. The catch-all reference to any "other relevant sanctions authority" may be negotiated out by the borrower.
Representation relating to status under sanctions	None of the Borrower, any of its Subsidiaries or [to the knowledge of the Borrower] any director, officer [employee, agent, or affiliate] of the Borrower or any of its Subsidiaries is an individual or entity ("Person") that is, or is [owned] [owned 50 percent or more, individually or in the aggregate, directly or indirectly] or controlled by Persons that are: (i) the [subject/target] of any Sanctions, or (ii) located, organized or resident in a country or territory that is, or whose government is, the subject of Sanctions.	Lenders frequently seek greater protection by having the status under sanctions representation apply to directors, officers, employees, agents and affiliates, in addition to loan parties and their subsidiaries. In certain circumstances, such scope may encompass an extremely large number of entities and individuals, which may make it difficult for the borrower to make the representation without an appropriate knowledge qualifier. The knowledge qualifier should not be applied to the loan parties or their subsidiaries.
Use of proceeds representation/covenant	The Borrower will not, directly or indirectly, use the proceeds of the Loans, or lend, contribute or otherwise make available such proceeds to any subsidiary, joint venture partner or other Person, (i) to fund any activities or business of or with any Person, or in any country or territory, that, at the time of such funding, is, or whose government is, the subject of Sanctions, or (ii) in any other manner that would result in a violation of Sanctions by any Person (including any Person participating in the Loans, whether as underwriter, advisor, investor, or otherwise).	Borrowers sometimes seek to include a knowledge qualifier with respect to the use of proceeds but such qualifier should be resisted on the basis of the strict liability regime of the OFAC regulations. In certain circumstances, however, lenders may be comfortable including a knowledge qualifier limited to the "indirect" use of proceeds only. If the use of proceeds provision is included as a representation rather than a covenant, it should be a representation that is required to be brought down at each borrowing.
Maintenance of policies/ procedures representation/ covenant	The Borrower will maintain in effect policies and procedures designed to promote and achieve compliance by the Borrower, its Subsidiaries and their respective directors, officers, [employees, agents, and affiliates] with Sanctions.	Borrowers may try to negotiate to include "reasonably" designed and "compliance with Sanctions in all material respects."
Event of default	Misrepresentations and breaches of covenant of sanctions-related provisions should be included as an event of default not subject to a cure period.	Borrowers may try to negotiate for a cure period but given the severity of the consequences for the lender and the practical challenges associated with attempting to cure such a breach, it is not advisable for the lender to have to wait to pursue remedies in connection with such a breach.

V Conclusion

As sanctions can be such a powerful and effective foreign policy tool, their continued use by the United States is assured. What is less predictable, however, is how and when existing sanctions programs may be modified and when new sanctions programs may be implemented. An evolving foreign policy agenda, political considerations and current events all factor into this complicated equation. With a new Presidential Administration in Washington D.C., this uncertainty is amplified. Such uncertainty necessarily adds a layer of complexity for US Lenders to consider when evaluating new transactions and investments. The provisions included in finance documentation to protect US Lenders from potential violations of sanctions programs must be revisited and reviewed in light of the specific facts and circumstances of a transaction, as well as the sanctions programs and political landscape in effect at the time of the transaction. As such and because of the strict liability regime in which lack of knowledge does not provide a defense, it is critical that US Lenders have a robust framework in place to properly evaluate the sanctions-related risks presented by its customers and clients.

Endnotes

1. The purpose of this summary is to provide information relating to the sanctions-related rules and regulations that are applicable in the context of a US Lender providing a credit facility that has a possible cross-border element (i.e., a foreign borrower or US borrower with a foreign parent subsidiary or affiliate). We have not discussed the sanctions rules and regulations applicable in other jurisdictions but it is important to note that they can be extensive as well and should be considered when evaluating transactions that have funds emanating from a non-US source.
2. Although list-based sanctions tend to be more narrowly tailored than comprehensive sanctions, tracking and ensuring compliance by borrowers with list-based sanctions may prove to be more difficult for US Lenders due to the relative anonymity that may be associated with individuals identified on the list.
3. Transactions will not be deemed unenforceable to the extent that the person (i) did not willfully violate the rules, (ii) had no reasonable cause to know or suspect that the transaction violated the rules and (iii) the person promptly reported the violation to OFAC upon becoming aware of it. However, the elements of this defense may be difficult for US Lenders to prove as a practical matter.

Joseph F. Giannini
Chadbourne & Parke LLP
1301 Avenue of the Americas
New York, NY 10019-6022
USA

Tel: *+1 212 408 1137*
Email: *jgiannini@chadbourne.com*
URL: *www.chadbourne.com*

Joseph Giannini's practice focuses on representing domestic and international clients in banking, finance and related transactions. Mr. Giannini has extensive experience representing both borrowers and lenders in connection with secured and unsecured lending transactions, including syndicated credit facilities, working capital facilities, structured finance arrangements and cross-border transactions. He represents a diverse group of clients including national financial institutions, bank syndicates and various domestic and foreign companies. Mr. Giannini also represents clients in connection with restructurings and workouts as well as related enforcement and bankruptcy proceedings. Mr. Giannini received a B.A. from Drew University and a J.D. from Georgetown University Law Center.

Adrienne Sebring
Chadbourne & Parke LLP
1301 Avenue of the Americas
New York, NY 10019-6022
USA

Tel: *+1 212 408 2314*
Email: *asebring@chadbourne.com*
URL: *www.chadbourne.com*

Adrienne Sebring's practice concentrates on transactional work and general corporate matters, with a particular focus on financing transactions. Ms. Sebring represents borrowers, financial institutions, insurance companies and other institutional investors, lending syndicates, administrative and collateral agents and corporate trustees in a diverse array of financing transactions, including secured and unsecured loans, private placements and other debt offerings, workouts and restructurings, structured finance arrangements and cross-border transactions. She also advises clients with respect to exemptions from the Investment Company Act of 1940. Ms. Sebring received a B.A. from Duke University, *cum laude*, and a J.D. from Fordham University School of Law, *magna cum laude*.

Chadbourne & Parke LLP is an international law firm dedicated to providing practical business solutions to a diverse range of clients in virtually all areas of law. Our core practices include M&A, corporate/corporate finance, US and international tax, bankruptcy and financial restructuring, energy/renewable energy, project finance, insurance/reinsurance, intellectual property, private equity/fund formation, commercial and product liability litigation, international arbitration, securities litigation and regulatory enforcement and executive compensation and employment. In addition to the US and North America, major geographical areas of concentration include Latin America, Western Europe, Central and Eastern Europe, Russia, the Middle East and Africa.

Founded in 1902, Chadbourne is deeply committed to the success of our clients. We help them navigate the complexities of the global marketplace through collaborative cross-border practices. This multidisciplinary approach enables us to achieve optimal results for our clients in all areas of the world.

© 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 a conservative jurisdiction in terms of secured lending structures. There are no trends developments to consider.

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 no 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 contained 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.

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

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

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 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 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.

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

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

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 (a) above can be equally applicable in this scenario.

(c) Shares in a sister subsidiary

Please see point (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.

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

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

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, 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.

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 also 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 foreclosure proceeding is regulated by the Foreclosure Act, dated 18th December 2014.

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.

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 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 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; 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.

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

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. Please bear in mind that under the Andorran law for establishing a framework for the recovery and resolution of credit institution, the bankruptcy procedures applicable to such entities is subject to certain specificities.

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 resolutions, 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.

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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.

© 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 majority of the matters have been mentioned in the previous answers.

Audrey Montel Rossell
Montel&Manciet Advocates
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 Advocates 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 Advocates
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 Advocates 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 Advocates

Montel&Manciet Advocates 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 Advocates 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 significant development is the abrogation of the foreign exchange restrictions which have been adopted in Argentina since 2001, mainly affecting cross-border financing.

Since December 17, 2015, the new elected authorities in Argentina have implemented a series of measures to progressively deregulate and implement more flexible regulations. The new regulation removed the requirement for residents to transfer to Argentina and settle in the foreign exchange market the proceeds disbursed under any financial indebtedness incurred with a non-resident. Also, the minimum maturity term has been eliminated, and principal amounts can be repaid or voluntarily or mandatorily prepaid. Finally, the new regulation eliminated the 30% mandatory deposit for the inflow of certain funds to Argentina through the foreign exchange market.

These developments, together with other economic and political measures taken by the new administration, are starting to create a new investment environment that has begun to show an increase in cross-border financing.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

- In 2016, International Finance Corporation granted Adeco Agropecuaria S.A./Pilaga S.A. a US$ 50,000,000 loan.
- In 2016, ICBC, Dubai Branch granted Loma Negra Compañía Industrial Argentina S.A. a US$ 50,000,000 Medium-Term Facility.
- In 2015, HSBC BANK USA, N.A. granted Cargill SACI a US$ 50,000,000 Pre-Export Finance Loan.
- In 2015, Unicredit S.p.A., BNP Paribas, Italian Branch and GE Capital Interbanca S.p.A. granted AEB a €71,500,000 loan.
- In 2015, International Finance Corporation granted Arla Foods Ingredients a US$ 56 million loan.
- 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.

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 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. Nevertheless, certain jurisprudence resolved that if the by-laws do not include said prerogative, the irregularity may be fixed by a subsequent ratification of the shareholders.

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.

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

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 residents to make payments abroad without entering and settling the funds through the Argentine Foreign Exchange Market (the "FX Market"). Regardless of whether the funds are entered through the FX Market or not, the debt shall be registered in the survey of debt issuance of external debt and liabilities established by Communique A 3602, as amended. 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. airplanes). 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 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.

© 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?

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 guarantee 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 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 Registry of Pledges 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.

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 effect upon delivery of the amounts pledged to the pledgee. These guarantees are not usual, though.

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).

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

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; 1.8% 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. Registration Fees: 0.2% of the guaranteed obligation. 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.
Accounts Receivable/Debt Securities	Notary Fees: low, depending on the characteristics of the security. Registration Fees: 0.2% of the guaranteed obligation. 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.

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 between approximately one and six months, depending on the type of assets involved.

As to 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.

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

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

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. The matter is pending a final ruling from the Argentine Supreme Court of Justice.

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 guarantees on behalf of the lenders (as *apoderado*), provided that it is duly empowered to do so by a power-of-attorney and the guarantee 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*).

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?

As a general rule, 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 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, 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.

Foreign lenders will be taxed by income tax only on their profits from Argentina (Argentine-source income). When the lender is a banking or financial institution under the supervision of the relevant Central Bank or equivalent authority and is situated either in a jurisdiction that, in accordance with the regulations under the Income Tax Law, is considered as a "cooperative jurisdiction", or in a jurisdiction that is party to an exchange of information treaty with Argentina

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

and, as a result of the application of its internal regulations, cannot refuse to disclose information to Argentine authorities on the basis of bank or stock secrecy rules, 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 abovementioned. 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.

Under Argentine Income Tax Law, thin capitalisation rules apply only to interest in respect of loans granted by foreign related financial institutions (located in countries which are not considered non-cooperative jurisdictions) to Argentine residents. The Income Tax Law sets out a limit of a 2:1 debt-to-equity ratio, so interest paid with respect to debt above such ratio is deemed non-deductible and treated as a dividend while interest which does not exceed that ratio are fully deductible for tax purposes. 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.

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*).

© 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?

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 guarantees 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 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 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 (such as funeral or medical costs), etc.

© 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?

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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, whether they are residents or foreigners, from the licensing perspective. 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 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 882, 8th 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 at 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 882, 8th 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 a foreign associate at Cleary, Gottlieb, Steen & Hamilton during 2004–2005. He graduated in 2001 as a lawyer from the Catholic University of 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

King & Wood Mallesons

Elizabeth Hundt Russell

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The Australian loan markets have had a mixed year, driven, in part, by increasing capital costs for bank funding. Despite this, there have been a number of large corporate deals demonstrating that significant capital is still available for blue-chip borrowers who operate in strong sectors. This year has seen:

- the domestic banks' participation declining in certain lending products, giving rise to tighter liquidity, albeit partially offset by the increasing presence of non-bank lenders, such as senior or alternative debt funds, particularly in leveraged finance and other bespoke corporate financings and recapitalisations;
- an increased use of underwriting in certain mid-cap acquisition financings;
- the continuing trend of US/European Term Loan B financings for private equity/corporate acquisitions (including the Baring Private Equity acquisition of SAI Global and Iron Mountain's acquisition of Recall); and
- the continued popularity of 'mezzanine holdco' financings (often PIK-only) with an increasing number of institutions willing to provide this product and generally more competitive pricing.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

- Jumbo financings for privatisation/infrastructure transactions including the Transurban consortium's A$7bn acquisition of Queensland Motorways Group, the A$9.7bn privatisation of the Port of Melbourne and the multi-billion-dollar NSW electricity privatisations of TransGrid and AusGrid.
- Large corporate loans syndicated in the Asia-Pacific loan markets included retailer, Woolworths's A$2bn loan, and Origin Energy's *ca.* A$4.5bn+ refinancing facilities.
- The world first syndicated fronted bank guarantee facility, arranged by Commonwealth Bank and National Australia Bank for leading retailer, Woolworths Ltd – which saw global insurers provide back-to-back indemnities to fronting banks, freeing up bank credit lines and gaining exposure to a blue-chip corporate. Several other corporates have now used this product.
- The A$750m+ 11-bank staple financing package arranged by KKR Capital Markets for the sale of leading cancercare provider, Genesis Care by KKR to the China Resources/ Macquarie Group consortium. This was the first sell-side arranged staple that has been used for an acquisition in the Australian leveraged finance market.

KWM acted on all the above transactions and on the bids for TransGrid and AusGrid.

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.

In determining whether to grant a guarantee or provide security, directors may consider both direct benefits and indirect benefits of doing so. Indirect benefits may include that the provision of the guarantee is a requirement for the ongoing support of other members of the corporate group where the support also indirectly benefits the company. 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.

A guarantee that does not commercially benefit a company may be voidable 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.

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

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.

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 the shareholders of 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. 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 and assignments of certain receivables) which may not secure payment or performance.

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 over one or more types of specific assets under a specific security agreement ("**SSA**") (e.g. shares in a company, book debts, deposit accounts, goods). 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 and the land is material to the security package, separate real property mortgages are also usually entered into and registered on the appropriate real property register for priority perfection purposes.

The PPSA provides for perfection of a security interest in personal property by one of three means:

- registration on the Personal Property Securities Register ("**PPSR**") – this is the most common method of perfection;
- in the case of goods and certain intangible rights, possession by the secured party; or
- in the case of certain financial assets (including shares and bonds), control by the secured party.

It is not mandatory to perfect security interests governed by the PPSA, but if they 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 acquire an interest in the collateral free of the secured party's interest.

Australian law recognises fixed charges (or, using PPSA terminology, security interests over "non-circulating assets") and floating charges (security interests over "circulating assets").

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes.

Security over interests in land typically takes 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.

Security over plant, machinery and equipment is usually taken under a GSA or SSA. Since plant, machinery and equipment (as long as they are not fixtures attached to land) are personal property, security over them is registrable 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 an SSA.

If a 'fixed charge' over receivables is required, the secured party must control dealings by the grantor with the receivables and register that it has control.

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

There is no requirement to notify the debtor in order to perfect the security interest or to obtain priority over other security interests. However, the secured party may wish to do so to obtain legal title to the receivables and the legal right to enforce in its name and power to give a good discharge.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes.

Security over accounts with a bank or an approved deposit-taking institution (an "**ADI**") can be taken under a GSA or an SSA.

An ADI with a security interest in an ADI account held with it is taken to have perfected its security interest by control and need not take any steps to perfect its security interest in that account. However, any other person who takes a security interest in an ADI account can only perfect their security interest by registration on the PPSR.

If a 'fixed charge' is required over a bank account or ADI account, the secured party must control dealings by the grantor with the account and register that it has control.

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 in a company can be taken under a GSA or an SSA.

Shares in unlisted Australian companies are generally certificated. It is market practice in Australia that security over certificated shares is perfected by control (i.e. secured party holding share certificates and blank share transfer forms) as well as by registration on the PPSR.

Shares in listed Australian companies are uncertificated and are recorded on an electronic register. They are transferred in accordance with Australian Securities Exchange rules. In addition to registration on the PPSR, control is obtained by the secured party entering into an agreement with a "controlling participant" to regulate dealings with the shares in the clearing system.

Even though an English or New York law governed document can create valid security over shares in an Australian company, an Australian law governed SSA is the preferred technique used in practice, given Australian law is likely to govern the validity and perfection of the security under conflicts of law rules in the PPSA and at general 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 an SSA.

If a 'fixed charge' over inventory is required, the secured party must control dealings by the grantor with the inventory and register that it has control.

It is not usual for a secured party to take control over inventory as the grantor will need the freedom to deal with it in the ordinary course of 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. This is subject to corporate benefit, financial assistance requirements and other issues mentioned in this paper.

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.

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 and Queensland.

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. However, the PPSR registration system is highly prescriptive and invalidating errors are easy to make so care needs to be taken to ensure that registrations are correctly made.

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 solely as security for the purposes of a moneylending agreement then a moneylenders 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)).

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

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, control or possession) 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.

An Australian 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 and the shareholders of relevant holding companies. There are some other fact specific exemptions. Approval by shareholders of a company (first company) and the shareholders of the ultimate Australian holding company of the first company 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.

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.

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

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.

Some 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 in Australia.

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 below.

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 notice of 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, an award made in an international arbitration with a seat in one of the Contracting States to the *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958)* (the "**New York Convention**") will generally be recognised and enforced by Australian Courts, as if the award were a judgment or order of that court. Australian courts will not re-examine the merits of the arbitral award.

There are limited grounds upon which the court may refuse to enforce the foreign award under Article V of 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?

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 appoint its own receiver to enforce its security within the 13 business days of notice of the administration. 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, auditors' fees, administrators' 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 the 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 Will Stawell and Liqing Mao 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 KWM's Sydney office and KWM's Global Practice Coordinator for Banking & Finance. She specialises in acquisition financings, general corporate finance and project/infrastructure finance.

Yuen-Yee is a recognised market leader in banking & finance, having been consistently ranked Band 1 in Acquisition Finance and Banking & Finance in Chambers' *Global Guide*, *Best Lawyers* in Australia 2008–16 and Asian Legal Business's *Legal Who's Who.*

Yuen-Yee's recent transactions include the Baring Private Equity/SAI Global Term Loan B acquisition financing, the KKR Capital Markets' arranged Genesis Care A$750m+ staple financing, Woolworths' $2bn syndicated facilities, HanesBrands' acquisition financing for Pacific Brands, Woolworth's pioneering A$400m syndicated fronted bank guarantee facility, Origin Energy's $4.5bn+ 2016 refinancing facilities, and various leveraged finance transactions for KKR, Affinity Equity Partners, CHAMP Private Equity and Quadrant Private Equity.

Yuen-Yee has been an APLMA Documentation Committee (Aust) member since 2008 and is a regular speaker at industry forums, including the IBA Private Equity Symposium.

Elizabeth Hundt Russell
King & Wood Mallesons
Level 61, Governor Phillip Tower
1 Farrer Place, Sydney NSW 2000
Australia

Tel: +61 2 9296 2736
Fax: +61 2 9296 3999
Email: elizabeth.hundtrussell@au.kwm.com
URL: www.kwm.com/en

Elizabeth Hundt Russell is a Banking and Finance Partner in the Sydney office of KWM. She specialises in leveraged/acquisition finance and general corporate finance.

Elizabeth has significant experience working in London and New York and is qualified as a New York attorney. She regularly advises local, regional and global private equity firms and domestic and investment banks on their financing matters. Elizabeth was named Senior Associate of the Year in Lawyers' Weekly's Women in Law Awards, 2015.

Elizabeth has acted for corporate clients on various banking facilities. Her recent deals include Cabcharge's corporate facilities and Woolworths's world-first syndicated fronted bank guarantee facility backed by global insurers and Qantas' first A$158 million fronted bank guarantee facility.

Elizabeth's recent acquisition finance transactions include HanesBrands Inc.'s A$1.1bn takeover of ASX-listed Pacific Brands group and she has acted on multiple leveraged finance transactions for Quadrant Private Equity, Affinity Equity Partners, CHAMP Private Equity and KKR.

KING&WOOD
MALLESONS
金杜律师事务所

King & Wood Mallesons (**KWM**) is a unique leading global firm headquartered in Asia.

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 includes:

- Best Law Firm (revenue over $200m) and Best Professional Services Firm (over $200m) AFR Client Choice 2016.
- Most Innovative Law Firm in China and Innovation in the Business of Law, Financial Times Asia-Pacific Awards 2016.
- Regional Law Firm of the Year and National Firm of the Year (for the 6th year) – China, International Financial Law Review 2016.
- Banking Law Firm of the Year, ALB China Law Awards 2016.
- Finance Team of the Year – Hong Kong, The Asia Legal Awards 2016.
- Best Financial Law Firm – Australia/New Zealand, FinanceAsia's 2015 Awards.
- Law Firm of the Year, Australian Banking & Finance Awards 2015.

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

Belgium

Hadrien Servais

White & Case LLP

Nathalie Colin

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The year 2016 was characterised by relatively strong liquidity and a moderately high degree of sponsor activity. Unitranche providers continue to be active, in particular in the context of sponsor deals where speed and flexibility of terms is key.

On the regulatory side, there has been quite a lot of focus on the consultation by the European Central Bank on guidance relating to leveraged transactions, especially in light of the far-reaching impact of the leveraged guidelines issued by the FED a few years ago.

Another significant development is the complete overhaul of the legal regime applicable to security interests in movable assets (expected to become effective in 2018), which will make it possible to perfect by way of filing in a central register (like in the US) and will strengthen Belgium's position as a creditor-friendly jurisdiction.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Noteworthy transactions include the refinancing of Hamon's EUR 380 million bank facilities, the approx. EUR 420 million financing incurred in connection with the acquisition of Continental Foods by CVC and the EUR 320 million financing put in place in connection with PAI's acquisition of AS Adventure. White & Case had roles in some of these 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)?

A company can guarantee borrowings of other members of its corporate group subject to the guarantee being in its corporate interest (see question 2.2) and falling within its corporate object (see question 2.3 below), and provided that such guarantee does not breach the prohibition on financial assistance (see Section 4).

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 order to be enforceable, a guarantee granted by a Belgian company must be in its corporate interest. While it is generally accepted that downstream guarantees meet this requirement, upstream and cross-stream guarantees are the subject of much attention. Whether the granting of a guarantee meets the corporate interest test is a factual question that needs to be considered in light of all the circumstances of each individual case. Three criteria are particularly relevant for making such an assessment:

- the Belgian guarantor itself must derive a benefit from the granting of the guarantee (i.e., an overall benefit to its group is, as such, not sufficient);
- the guaranteed amount must not be disproportionate to (x) the benefit derived by the Belgian guarantor from the transaction and (y) the financial capabilities of such guarantor; and
- as a subsidiary matter, consideration may be given to whether the Belgian guarantor is part of a structured corporate group with a common economic interest.

Directors' liability can be triggered when directors fail to act in the corporate interest of the company, and in extreme cases, directors may be criminally liable for misuse of corporate assets if no corporate benefit can be shown.

2.3 Is lack of corporate power an issue?

All transactions entered into by a Belgian company must fall within the scope of its corporate purpose. The concept of corporate purpose must be interpreted broadly, and not only includes all matters expressly referred to in the purpose clause of the company's articles of association, but also extends to all things which the company may need to do in the context of pursuing the purpose described in the articles of association.

Third parties may rely on agreements entered into by a Belgian company even if such agreement is not within the corporate purpose, unless such third parties knew, or should have known, that the corporate powers were being exceeded.

© 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?

As a general rule, in a corporate context, the granting of a guarantee is not subject to government approval or other formalities. There are, however, two main exceptions to that rule:

- the articles of association may require all guarantees (or all guarantees over a certain threshold) to be approved by the general meeting of shareholders; and
- with respect to certain types of limited liability companies (i.e., *sociétés anonymes/naamloze vennootschappen* and *sociétés en commandite par actions/commanditaire vennootschappen op aandelen*), the Belgian Companies Code requires that all change of control provisions be approved by the general meeting of shareholders, and that such approval be filed with the clerk's office of the commercial court.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

The amount of a guarantee granted by a Belgian company may be limited by a number of legal rules, including the corporate interest construct (see question 2.2) and insolvency law (see question 8.2).

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 in effect in Belgium.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Most types of assets are available to serve as collateral. The nature of the collateral will determine the type of security interest that may be granted. Belgian law has three main types of security interests:

- a pledge over assets, which is characterised by the requirement of dispossession. Dispossession may take various forms, depending on the type of asset. For instance, in the context of a pledge over inventory, dispossession will be physical (e.g., via a third-party pledgeholder), whereas when it comes to receivables, dispossession will be effected automatically via execution of the pledge agreement;
- a pledge over business, which is a pledge over the going concern (*handelszaak/fonds de commerce*) of the pledgor. The creation of a pledge over business is not subject to any dispossession requirement, such that the pledgor may run his business regardless of the pledge; and
- a mortgage, which is the security interest that may be created in real estate.

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 closest Belgian law equivalent to a blanket lien is a business pledge. As mentioned above, the underlying asset of such pledge is the business of the pledgor. Although not defined by law, it is generally accepted that a business is the combination of tangible and intangible assets brought together by a commercial entity in order to attract and retain customers, such as trade names, trademarks, customer base, business fixtures, lease rights, equipment, etc. Up to 50% of the inventory may be included if explicitly referred to in the business pledge agreement. The scope of a business pledge does not extend to real estate assets by nature (such as land and buildings).

A business pledge may only be granted to a Belgian or EU-based credit institution. However, this requirement does not prevent an EU-based agent from holding the security in favour of non EU-based lenders or lenders that are not credit institutions.

In order to be enforceable against third parties, business pledges must be recorded with the mortgage registry of each judicial district in which the pledgor has a place of business. The recordation is effective for 10 years and may be renewed.

In an effort to reduce recordation duties, it is customary to enter into a mandate to create a pledge on business, whereby the pledgor grants a power of attorney to a third party (usually an employee of the pledgee) to create a pledge on the business for part of the amount to be secured. Unlike a business pledge, a mandate will not give rise to recordation fees until the power of attorney is exercised and a business pledge is created (which may never occur). It is important to note that a business pledge created following exercise of a mandate will rank behind any previously registered pledges and could be invalidated as new security for pre-existing debt if its registration is made during the suspect period preceding bankruptcy.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over real estate property (land or buildings) is taken by way of a mortgage. A mortgage can only be validly created pursuant to a notarial deed. The mortgage becomes enforceable against third parties upon recordation of the deed at the mortgage registry of the place where the mortgaged piece of property is located. The recordation is effective for 30 years and may be renewed. In order to limit duties, a mandate to create a mortgage is often used in conjunction with a fully fledged mortgage. Similar to business pledge mandates, the main drawback of mortgage mandates is that an actual security interest will only be created and take rank upon the exercise of the mandate.

Security over machinery and equipment may be granted by way of either a business pledge (see question 2.2 above) or a regular pledge. The latter is relatively uncommon in practice (other than in the context of certain specific types of asset lease financing, such as aircraft and train equipment financing) since it would require the pledged assets to be delivered to the pledgee or a third party acting as custodian.

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 taken by way of a pledge over receivables. Such a pledge is created by means of a private agreement and may cover both existing and future receivables. A pledge on receivables is created and perfected against all third parties other than the debtor of the pledged receivable upon entry into the pledge agreement. Perfecting against underlying debtors requires the said debtors to be notified of the pledge. Before such notification, underlying debtors could validly pay the pledgor.

In practice, only certain types of underlying debtors are notified upon creation of the pledge or shortly thereafter. Those debtors generally

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

include intra-group debtors, insurance companies and banks. Trade creditors are typically only notified upon the occurrence of a pre-agreed trigger event, such as an event of default or an enforcement event.

Specific procedures and conditions apply to receivables when transactions are subject to public procurement rules. Also, some receivables which are by their terms or by law not freely transferable may not be effectively pledged.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Security over bank accounts is created by way of a pledge over bank accounts. Since bank accounts are technically receivables against the account bank, pledges over bank accounts basically follow the same regime as pledges over receivables.

It is common for lenders to require the pledgor to ask the account bank to waive the benefit of any set-off and "unicity of account" provisions.

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 may be taken by means of a pledge over shares. Shares are either registered or dematerialised. Pledges over registered shares are perfected by recording the pledge in the shareholders' register of the company whose shares are being pledged, whereas pledges over dematerialised shares are perfected by crediting the pledged shares to a special pledge account.

Although the shares of Belgian entities are sometimes pledged pursuant to New York or English law governed documents (usually when the parties to the finance documentation have agreed that the borrower group does not have to go through the hurdle of granting share security in the various jurisdictions in which subsidiaries are located), it is not a recommended practice in light of the many uncertainties arising therefrom. Pursuant to Belgian conflict of laws rules, the *lex contractus* would govern the contractual aspects of the security between the parties to the pledge agreement. However, the law of the company's headquarters (in the case of registered shares) or of the location of the account on which the shares are credited (in the case of dematerialised shares) will govern the *in rem* aspects of the security.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

There are two ways security over inventory can be created: either by way of a business pledge (see question 3.2) or by means of an ordinary pledge. However, the latter is not always a practicable option as it requires the dispossession of the pledgor.

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 secure both its own obligations as a borrower under a credit facility and as a guarantor of the obligations of other borrowers or guarantors, subject to the limitations described in questions 2.2 and 2.3 above and question 4.1 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?

Mortgages and business pledges are the most expensive types of security interest. Duties and fees amounting to approximately 1.50% of the amount secured by a mortgage and 0.50% of the amount secured by a business pledge must be paid in connection with taking such security interests.

No fees are payable in connection with taking a pledge over shares, bank accounts or receivables, or an ordinary pledge over inventory.

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 filing, notification or registration requirements are not time-consuming or expensive, except with respect to mortgages and business pledges, which can be expensive (see question 3.9 above).

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No, but exceptions may apply with respect to regulated entities and assets in the public domain.

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)?

Other than with respect to security over real estate (which must be notarised and recorded – see question 3.3 above) and business pledges (which must be recorded – see question 3.2 above), there are, as a general rule, no documentary or execution requirements applicable to commercial pledges. Documents may be signed in counterparts as long as there are as many originals as there are parties to the agreement.

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 Belgian limited liability company may not advance funds, make loans or grant security with a view to the acquisition of its own shares

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

by a third party. The prohibition on financial assistance is strictly interpreted and does not apply to, for instance, funds made available by way of dividend distributions or capital decreases. A whitewash procedure is available but rarely used, given its cumbersome nature.

(b) Shares of any company which directly or indirectly owns shares in the company

Although there is no conclusive case law on that issue, it is generally considered that the prohibition on financial assistance does not apply to the acquisition of shares of a parent of the company unless fraudulent intent can be shown.

(c) Shares in a sister or subsidiary

No.

Specific rules apply with respect to financial institutions.

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 a trust cannot be created under Belgian law, Belgian law will, in principle, recognise the effects of trusts governed by foreign laws. However, to avoid the uncertainties of relying on foreign trusts, a parallel debt structure is generally created. Significantly, the law transposing the financial collateral directive recognises the role of the agent with respect to pledges over financial instruments (i.e., shares, bonds, etc.) and bank accounts.

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, the parallel debt structure (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?

Loans are usually transferred by way of assignment or novation. Debtors must be notified of assignments in order for them to be effective. All security rights and guarantees securing the loans are automatically transferred. In a novation, a new debt is created and, unless expressly stated otherwise, the security interests and guarantees securing the old debt are extinguished.

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 principle, a 30% withholding tax (WHT) is levied on the interest paid to domestic and foreign lenders.

However, there are many exemptions to this rule: if the lender is a Belgian company and if the loan is not embodied in an instrument (because that interest is already subject to the corporate income tax); if the lender and the borrower are companies linked through a shareholding of at least 25% for at least one year; if the lender is a Belgian financial institution and the loan is embodied in a debt instrument (bonds for example); if a Belgian company pays interest to a foreign financial institution and the loan is not embodied in an instrument; if a Belgian company pays interest to a non-resident and the loan is in the form of registered bonds; and if the borrower is a Belgian financial institution paying interest to a non-resident and the loan is not embodied in an instrument, except if it is in registered instruments. The application of some of these exemptions and reductions is subject to formal conditions.

For cross-border loans, the WHT rate can usually be reduced if the lender resides in a country that has entered into a tax treaty with Belgium.

(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 Belgium (irrespective of the tax residence of the beneficiary).

However, the Belgian tax authorities may view the payments by a Belgian guarantor under the guarantee as interest payments, and therefore subject to WHT. However, based on an administrative comment by the Belgian tax authorities referring to a decision of the Belgian Supreme Court, it can reasonably be assumed that these payments should not be classified as interest payments insofar as the beneficiary has not put any capital at the disposal of said Belgian guarantor.

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 in certain circumstances (see question 6.1 above) is very attractive for foreign lenders.

(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 whether they are Belgian or foreign for loans, mortgages or other security documents for the purposes of effectiveness or registration – see question 3.9 above for details with respect to taxes in relation to registration with the tax authorities (if required).

© 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, 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, whether they are Belgian 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 official language of the region where they are being registered.

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 if some or all of the lenders are organised under the laws of a jurisdiction other than Belgium. When the loan is granted by a related party or by a lender located in a low tax jurisdiction (regardless of whether it is related or not), interest payments are subject to thin capitalisation rules.

In terms of deductibility of interest, if a lender is resident for tax purposes in a state or territory qualified as a "blacklisted" country, the borrower will be subject to specific mandatory duties in order to be able to deduct the relevant incurred costs.

Transfer pricing rules (which require notification of the tax authority and preparation of transfer pricing documentation in accordance with the action plan on "Base Erosion and Profit Shifting" – OECD) apply to borrowing from foreign affiliated 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?

Subject to conflict of law rules with respect to the *in rem* aspects of security interests, a choice-of-law clause in favour of foreign law will in principle be recognised and enforced in Belgium. The parties enjoy the freedom to choose any governing law, provided however that, irrespective of the governing law, certain overriding mandatory rules of another jurisdiction may apply directly to the contract (e.g., consumer protection).

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 originating from the English or New York courts will be recognised and enforced in Belgium without re-examination of the merits of the case. A Belgian court would only be able to refuse on the basis of a limited number of grounds (e.g., for reasons of public order, violations of rights of defence).

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 Belgian procedural rules provide for a summary proceeding ("*korte debaten/débats succincts*") if the defendant does not dispute the claim. In that case, a judgment could be obtained within approximately three months. If the defendant disputes the claim, the procedural rules regarding an ordinary proceeding would apply, and it could easily take one year to obtain a judgment.

Generally, an exequatur in order to enforce a foreign judgment can be obtained within 15 days to one month provided that no party files any opposition. Attachments in execution can then be served, which takes around one to six months depending on the nature of the underlying asset (real estate, movable assets, third-party attachment, etc.) and whether or not a prior authorisation of the attachment is required.

Prior to the exequatur, in urgent cases, attachments in conservation can be served. Generally, attachments in conservation will take between 15 days and three months depending on the nature of the underlying asset (real estate, movable assets, third-party attachment, etc.) and whether or not a prior authorisation of the attachment is required.

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 generally requires prior authorisation by the attachment judge ("*beslagrechter/juge des saisies*") and is typically carried out through a public auction, in the context of a sale by a bailiff or notary. The rules for financial collateral security within the scope of the Law on Financial Collateral Security (e.g., pledge on shares or bank account) provide, however, for relatively flexible and expedited enforcement proceedings and, under certain conditions, entitle a security holder to appropriate the funds or instruments directly. Save for sector-specific regulations, no regulatory consents are required for the enforcement of collateral security.

© 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?

In principle, no distinction is made between foreign and domestic lenders. We note that subject to certain conditions a defendant may request that a non-EEA claimant provide a guarantee for the costs and damages arising out of the procedure ("*guarantee judicatum solvi*").

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 commencement of bankruptcy or reorganisation proceedings triggers an automatic stay of enforcement with respect to lender claims and collateral security. Upon the commencement of bankruptcy proceedings, all attachments will automatically be revoked, while upon the commencement of reorganisation proceedings, the attachments in conservation will in principle continue to exist.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Belgium has been a party to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention") since 1975, for the recognition and enforcement of (foreign) arbitral awards.

Belgian courts will not re-examine the merits of the case. However, the recognition and/or enforcement may be refused if certain requirements are not satisfied (e.g., the arbitration agreement is not valid, there is irregularity in the composition of the arbitration authority or in the arbitral procedure, etc.). Furthermore, an award would not be recognised if the subject matter cannot be settled by arbitration in Belgium or the arbitral award goes against public policy.

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.

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 granted during the so-called "suspect period" is subject to being voided by court order if such security was granted (i) in order to secure a previously-incurred debt, or (ii) while the secured party was aware of the debtor's insolvency. The suspect period starts when the debtor is in a state of cessation of payments, as determined by the court (except in cases of fraud, not more than six months prior to the bankruptcy order).

Belgian law recognises a number of statutory liens (including for tax debt, employee's claims, social security payments, etc.), which may either apply to the whole bankruptcy estate (the general statutory liens) or to specific assets of the borrower (the specific statutory liens). Secured claims will, as a general matter, take priority over general statutory liens. Priority between secured creditors and creditors with a specific statutory lien needs to be determined on a case-by-case basis.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Non-merchants and certain public bodies may not be declared bankrupt.

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 beneficiary of a pledge over financial instruments or bank accounts may, under certain conditions, sell or appropriate the pledged assets without the need for a prior court order (see 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?

Parties enjoy the freedom to submit their disputes to a foreign jurisdiction by way of a forum selection clause, provided that the matter does not belong to the exclusive jurisdiction of Belgian courts. The most relevant exception relates to disputes with respect to rights *in rem* on immovable goods.

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, as a matter of principle, enforceable under Belgian law, but do not entail a waiver of sovereign immunity from execution.

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 requirement to obtain a banking licence is only triggered by a combination of lending activities and deposit-taking activities.

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

Therefore, no banking licence is required to make loans to commercial entities in Belgium as long as the lender does not carry out deposit-taking activities in Belgium. Other than the fact that a business pledge may only be granted in favour of Belgian or EU-based credit institutions, there are no eligibility requirements applicable to 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?

Not in the context of a typical acquisition financing.

Acknowledgment

The authors would like to thank counsel Willem Van de Wiele and associates Olivier Van Wouwe and Aurélie Terlinden, as well as Christophe Goossens and Justine Polchet of Goossens Meessen Wasserman for their contribution.

Hadrien Servais
White & Case LLP
rue de la Loi 62
1040 Brussels
Belgium

Tel: +32 2 239 25 44
Fax: +32 2 239 27 44
Email: hadrien.servais@whitecase.com
URL: www.whitecase.com

Hadrien Servais represents major commercial and investment banks, private equity investors and corporates in a wide range of leveraged, corporate finance and project finance transactions, including domestic and cross-border acquisition financings, investment-grade facilities, asset-based lending facilities, real estate financings, restructurings and infrastructure financings. Before joining White & Case, Hadrien worked in the New York and London offices of two leading international law firms.

Nathalie Colin
White & Case LLP
rue de la Loi 62
1040 Brussels
Belgium

Tel: +32 2 239 25 32
Fax: +32 2 239 27 32
Email: nathalie.colin@whitecase.com
URL: www.whitecase.com

Nathalie Colin leads our Belgian practice on Dispute Resolution. She has been a commercial litigator since 1994, with extensive experience of cross-border and domestic litigation in both the corporate and banking sectors.

She specialises in white-collar crime and regulatory investigations for banks, financial institutions and large auditing firms and has represented large financial and corporate institutions in high-profile white-collar and corporate litigation, including securities litigation.

Nathalie helps corporates set up robust compliance and training programmes, conducts risk assessments and compliance audits. She has comprehensive experience in national and international complex arbitration. Other areas of expertise include procedures before the Supreme Court of Belgium and construction law.

WHITE & CASE

White & Case is a global law firm with longstanding offices in the markets that matter today. Our on-the-ground experience, our cross-border integration and our depth of local, US and English-qualified lawyers help our clients work with confidence in any one market or across many.

We guide our clients through difficult issues, bringing our insight and judgment to each situation. Our innovative approaches create original solutions to our clients' most complex domestic and multi-jurisdictional deals and disputes.

By thinking on behalf of our clients every day, we anticipate what they want, provide what they need and build lasting relationships. We do what it takes to help our clients achieve their ambitions.

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

Bolivia

Andrea Mariah Urcullo Pereira

Criales & Urcullo

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 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 bank 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$ 16,875 million in July 2016, which means it exceeded the sum reached in 2015 by approximately US$ 2,000 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 2016 were granted to the microcredit and housing loans sectors. Loans granted to the industry sector continued growing as well.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The Bolivian Financial Services Law distinguishes three types of financial institutions: (i) State-owned or State-controlled financial institutions, which include (a) development banks, (b) public banks, and (c) financial development institutions; (ii) 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 (iii) complementary financial services companies, which include (a) leasing companies, (b) factoring companies, (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 beginning of the fourth quarter of 2016, 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 the lowest level of credit defaults registered in Bolivian history and adequate patrimonial support.

Public deposits closed at a balance of US$ 20,493 million, a decrease of 0.2% compared to 2015.

Loans Portfolio

As of November 2016, the loans portfolio closed at US$ 18,892 million, an increase of US$ 2,234 million compared to the end of 2015.

Industry, Commercial and Services Sector Portfolios

As of November 2016, the loan portfolio for the industry sector, which comprises entrepreneurs' credits, micro credits 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) amounted to US$ 7,223 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 apartment.

© 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 November 2016, the social housing sector portfolio in Bolivia reached US$ 1,611 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.

© 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?

Bolivian law does not provide for this.

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 its 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 and such certificates 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.

© 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 Bolivia, the law does not prohibit the role of an agent or trustee 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

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

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. 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 one to two months (depending on which exceptions shall be made, also counting the evidence term which will take 10 additional days). In 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 it is enforceable, 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 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 its 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 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 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
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 in 2012 as an associate lawyer. Her main practice areas are corporate and commercial law, financial law, procedure law and intellectual property.

Daniel Mariaca Alvarez
Criales & Urcullo
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 has Master of Law studies in Universidad Privada Boliviana (2008).

Daniel joined Criales & Urcullo 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. Finally, in 2015 he rejoined Criales & Urcullo as an associate lawyer.

His practice focuses on Corporate and Administrative Law.

Criales & Urcullo 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, 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 country's biggest stock exchange brokers and investment funds.

© 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 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. 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.

© 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?

(a) 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.

(b) 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 Headquarter operations.

The following table summarises the tax advantages of the Botswana IFSC:

Tax	Botswana ISFC 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

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

of DTAAs that 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; 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 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 types 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 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 deposit-taking activities that attract 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: +267 391 1694
Fax: +267 391 1690
Email: shakilakhan@kcl.co.bw
URL: www.kcl.co.bw (from April 2017)

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. 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 debt 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).

Until December 2016, given the economic scenario, local lending markets were: 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).

The Brazilian economy has been recovering since the latest political events and the local lending market is becoming even more attractive to foreign and local investors. Some Brazilian companies started looking offshore for lending opportunities, followed by several debt issuances by Petrobras throughout 2016.

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$6.75 bn five- and 10-year dollar-denominated bonds by Petrobras (May 2016); the switch made by USJ of bonds in April, replacing $246 million of its 9.875% 2019 bond with a $197 million 9.875%/12% payment-in-kind toggle note due in 2021; and the issuance by Marfrig Holdings (Europe) BV, European subsidiary of Marfrig Global Foods S.A., of a seven-year single-tranche bond, raising $750 million at a yield of 8.25%.

In the infrastructure sector only, it is expected that over the next five years an amount of approximately R$70 billion to R$100 billion 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

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

for a company to guarantee 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?

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 outside 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 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

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

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.

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 the 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. The security interest over shares held in custody with the stock exchange or other agent, in order to be valid in Brazil, 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 types 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.

© 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)?

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 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 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 vary 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.

© 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?

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 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: (i) a related party to the Brazilian borrower; or (ii) located in a blacklisted (tax haven) or greylisted (privileged tax regime) low-tax jurisdiction. Such tax limitations mays 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 occurring 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.

© 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?

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 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, 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.

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

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 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 the 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 the 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 of whether 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 limitations 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.

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

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.

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 Advogados, 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

Maples and Calder

Michael Gagie

Matthew Gilbert

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. Recent amendments to the key corporate legislation, the BVI Business Companies Act (as amended) (the "**Act**") have enhanced the protection of secured creditors including on a continuation of the domicile of a BVI company out of the BVI and into another jurisdiction, and on a liquidation, where 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. 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, 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 the company's memorandum and articles of association require it.

© 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?

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 of 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 of Corporate Affairs fee for registering a register of charges is US$100. A small amount of time will be required for the preparation of the particulars of 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 of 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 (as amended) (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?

Under the Arbitration Act 2013, the 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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.

A "foreign" lender, which does not carry on business in the British Virgin Islands, would not be required to be licensed in order to lend to a British Virgin Islands company.

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

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.

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 British Virgin Islands team in London and advises on corporate, finance and banking law matters involving British Virgin Islands 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 British Virgin Islands companies on international stock exchanges, including the London Stock Exchange/AIM, Tel Aviv Stock Exchange, NASDAQ and Toronto Stock Exchange. Matthew also advises on British Virgin Islands 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 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, the 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

McMillan LLP

Don Waters

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 recent years, there has been increasing growth of the private debt investor market in Canada. A number of newer non-bank funds and institutions have become active in mid-market leveraged lending and other lines of business. These opportunities have arisen in large part due to the increased regulatory burden and capital requirements faced by banks following the financial crisis. With continued active participation by Canadian banks as well as foreign lenders, and the increasing presence of non-bank lending funds, the Canadian lending market remains very competitive and lending margins remain tight.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

One of the largest and most complex finance transactions in 2016 was the restructuring of Pacific Exploration & Production Corporation, which involved, among other things, the conversion of approximately $5.4 billion of existing indebtedness into equity. Cross-border lending into Canada, particularly from the United States, remained active in 2016, including the financing of the acquisition of Trader Corporation, Canada's largest digital automotive marketplace and software solutions provider to automobile dealers, valued at approximated $1.6 billion. Lending in the public-private partnership (P3) space continues to gain momentum, especially as more provinces and municipalities are turning to the P3 model for funding their infrastructure projects. In particular, Ontario and Québec, two of the most active provinces for P3 projects, saw in 2015 the design, build, finance and maintenance of the Eglinton Crosstown LRT in Toronto (valued at $8.25 billion) and the design, build, finance, operation, maintenance and rehabilitation of the Champlain Bridge in Montréal (valued at $4.2 billion), the largest P3 projects to date in those provinces.

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 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.

© 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 for corporations incorporated federally or under the laws of most provinces. However, the corporate laws in a few Atlantic Provinces and in two 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 apply 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 the collateral is 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, although there are certain additional formalities that must be met when taking security on 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 property 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

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

from the secured party that the receivable has been assigned to it. In addition, an absolute assignment of receivables constitutes a "security interest" regardless of whether it secures any obligations.

Under the *Civil Code of Québec*, if assigned receivables constitute a "universality of claims", the assignment must be registered for such assignment to be set up against third parties (i.e. perfected). However, account debtors must still be notified of such assignment before an account debtor is obligated to pay the receivable directly to the secured party. 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 or through a control agreement with the issuer. 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.

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

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.

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 certain territories (the Northwest Territories 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.

© 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?

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 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

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

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 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?

To maintain an action in certain provinces, foreign lenders may be required to become extra-provincially registered.

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

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

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 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.

© 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 (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, 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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

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

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 6, 2017. 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

This chapter was updated and edited with the assistance of Julie Han, a partner in the McMillan Financial Services group: Tel: +1 416 865 7199, Email: julie.han@mcmillan.ca.

Julie represents both borrowers and lenders on transactions involving commercial debt financing, acquisition financing, secured lending and project financing.

In addition, Julie has extensive experience in advising both private sector partners and finance parties on PPP projects and has been involved in some of McMillan's most significant PPP engagements, including the closing of the Champlain Bridge Project in Québec, the Highway 407 Phase 2 Project in Ontario, the Emily Carr University of Art + Design Project in British Columbia and the Saskatoon Civic Operations Centre Project in Saskatchewan, the first PPP project procured by the City of Saskatoon.

Jeff Rogers
McMillan LLP
Brookfield Place, 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
Brookfield Place, 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 *IFLR1000* in Banking, Capital Markets, Structured Finance and Securitisation and in *Best Lawyers* in Canada in Structured Finance Law.

Don regularly represents Canadian and foreign financial institutions, borrowers and private equity sponsors. Recent transactions include financings for Canadian Tire, Honda Canada Finance, 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

Cayman Islands

Maples and Calder

Tina Meigh

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The Cayman Islands recently introduced a new, flexible, hybrid entity, the limited liability company (each an "**LLC**"), that is subject to the Limited Liability Companies Law, 2016 (the "**LLC Law**"). The LLC is a new vehicle anticipated to be utilised significantly in the investment funds space and which incorporates advantageous features from both company and limited partnership regimes. The LLC is a body corporate with separate legal personality in the same way as a company and has capacity, in its own name, to sue and be sued, and to incur debts, obligations and to enter into secured transactions. The introduction of the LLC reinforces the Cayman Islands' reputation as an influential, innovative and creditor-friendly jurisdiction. Legislative principles in respect of bilateral and multilateral set off and netting and recognition of validly created security interests in the face of the insolvency of any company, exempted limited partnership and now LLCs will further strengthen the jurisdiction in the context of financing and secured lending arrangements.

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 law governed security.

The main types of security are, in the case of funds established in the form of exempted limited partnerships, security over capital calls (the right to call such capital and the right to receive the proceeds of such calls) and, more generally, security over Cayman Islands equity interests, either in the form of registered shares or exempted 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, total return swaps and portfolio company financings.

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 (2016 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, aircraft 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 (2016 Revision). An LLC must make an entry on its register of mortgages and charges in a similar manner to an exempted company incorporated or referenced under the Companies Law, in accordance with section 62(1) of the LLC Law. However, failure to comply with these requirements does not invalidate the security interests created by either a company or LLC.

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 and LLC 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 choses 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).

© 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?

Security over shares in Cayman Islands companies, where the register of members is maintained in the Cayman Islands, is usually 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 (2016 Revision). An LLC must make an entry on its register of mortgages and charges in a similar manner to an exempted company incorporated or referenced under the Companies Law, in accordance with section 62(1) of the LLC Law. This step is usually undertaken by the registered office service provider of the company or LLC 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 (or manager, as the case may be) or of an LLC 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 or an LLC's agreement. 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 a revolving 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 (2016 Revision) and the LLC Law.

© 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

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.

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 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?

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**")

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

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 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?

No formal corporate rehabilitation procedure exists under either the Companies Law (2016 Revision) or the LLC Law, as is the case in England and Wales or in the United States, that would give a company or LLC the benefit of moratorium provisions in the payment of its debts, including certain secured debts. Each of a Cayman Islands company and LLC is subject to voluntary or involuntary winding up proceedings under the Companies Law (2016 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 or LLC but before an order for the winding up of the company or LLC 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 vehicle 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

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

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 (2016 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 or LLC 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, each of the Companies Law (2016 Revision) and the LLC Law provide that secured creditors may enforce their security notwithstanding that a winding up order has been made in respect of the applicable company or LLC.

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 and LLCs 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 or LLC.

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?

Neither companies nor LLCs incorporated in the Cayman Islands are excluded from proceedings under the Companies Law (2016 Revision), the LLC Law 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 (2016 Revision) 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 or LLC may have a compromise or arrangement imposed upon him under the Companies Law (2016 Revision) 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 or LLC 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 or LLC in a security document to the jurisdiction of the courts of a particular jurisdiction will be legal, valid and binding on the company or LLC 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 and LLCs 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.

© 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 or LLC. 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 or LLC. Any lenders that are incorporated or registered in the Cayman Islands or otherwise carrying on business in the Cayman Islands will be required to register and licensed, as applicable, in accordance with Cayman Islands law.

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.

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 Cayman Islands office of Maples and Calder, where she is head of the fund finance group. She specialises in finance transactions and has extensive experience in all aspects of fund finance, banking, structured finance, derivatives and securitisations. She represents hedge funds, private equity funds and banks 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. She also has significant experience of general corporate and commercial matters and the establishment of offshore investment funds.

MAPLES

With 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, the 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

Carey

Diego Peralta

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

According to the Chilean Superintendency of Banks and Financial Institutions ("**SBIF**"), during the 12 months leading up to December 2016, the growth of credit was a modest 2.16% compared to 6.97% in January 2016. This is explained by slow commercial lending (dropping 0.85% over the year). The housing sector also grew at a slower pace. The energy sector continued to be 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 traditional PPAs, although the Alto Maipo project is facing issues due to a cost overrun.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Carey advised Latin America Power in a long-term loan for USD306 million to finance a 185MW San Juan windfarm, granted by AB Svensk ExportKredit, Banco Security, DNB Group, KfW IPEX-Bank, Sumitomo Mitsui and Eksport Kredit Fonden, and in a USD30 million credit for VAT obligations, granted by BCI and Banco Security. The date of completion was November 19th, 2015.

Another transaction in which Carey played a key role was advising SunPower, as the sponsor and parent company of Total SunPower El Pelícano, in the development and financing of the construction, commission, operation and maintenance of a 100MW photovoltaic plant located in the Coquimbo Region, in the borough of La Higuera, and its related transmission lines and civil engineering works. A syndicate comprised of Crédit Agricole Corporate and Investment Bank, The Bank of Tokyo-Mitsubishi UFJ, Sumitomo Mitsui Banking Corporation and Korea Development Bank, have agreed to finance the project with a construction loan convertible into a long-term loan, which includes the issuance of letters of credit of approximately USD200 million, whereas Banco de Crédito de Inversiones (BCI) has agreed to provide financing for the Value Added Tax for the construction of the project with a USD22 million VAT loan. The date of completion was July 8th, 2016.

Carey advised International Finance Corporation (IFC) in granting a loan agreement for the financing of subprojects by way of subloans to Banco Itaú Chile for up to USD200 million. The date of completion was December 21st, 2015.

Carey also advised BTG Pactual Chile Administradora General de Fondos on behalf of BTG Pactual Deuda Directa Fondo de Inversión in a credit agreement for USD198,800,000 granted by Corpbanca and Corpbanca – New York Branch in order to pay part of the purchase price for the obligations that Inversiones Quinchamalí has with BTG Pactual – Cayman Branch. The date of completion was December 22nd, 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)?

Following certain corporate requirements depending on the type of company involved, provided the guarantor benefits somehow from these operations, and subject to applicable insolvency, moratorium or similar laws relating to or affecting creditors' rights generally, and general principles of fairness (regardless of whether considered in a proceeding in equity or at law), there is no restriction for this type of guarantee.

Additionally, under Chilean general banking law, banks are not authorised to grant mortgages or pledges over their own physical assets, unless to guarantee payment of the purchase price thereof. Considering this, it has been construed that banks can provide guarantees over financial assets subject to certain restrictions regulated by the SBIF.

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 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 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,

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

provided that (i) the counterparty has known the company's poor state of business, and (ii) 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 case of onerous act or contract, the counterparty of the debtor was also aware of the poor business condition of the debtor.

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) the agent acts beyond the limits of its mandate.

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 also if the guaranteed obligations exceed 50% of the guaranteeing corporation's assets, an extraordinary shareholders' meeting must be called in order to grant approval. Nevertheless, if the guaranteed company is a subsidiary, the Board's approval suffices.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No. Nevertheless, any operation executed between related parties needs to be for the company's benefit, complying with the market's standards for price, terms and conditions, as explained above.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control regulations. Payment in foreign currency is possible if the parties have agreed such form of payment. In order to enforce a guarantee (as an accessory obligation) it is required that the secured obligations 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 regard to the enforcement of foreign judgments procedure.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Securities can be classified into two big groups, i) guarantees over assets or rights *in rem*, and ii) personal guarantees.

i) Guarantees over assets: There are guarantees over moveable assets (pledge agreements) and guarantees over real estate, vessels and aircraft (mortgage agreements).

a) Guarantees over moveable assets:

- **Civil Pledge**: This 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, losing the ability to use and enjoy it.
- **Commercial Pledge**: This aims to secure commercial 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: (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) the amount of the debt secured and the pledged asset must be defined in the agreement; and (iii) for a pledge granted over a credit, the debtor of the credit must be notified not to make any payment under the pledged credit but to the creditor.
- **Banking Pledge over Securities**: This may be granted over bearer securities of any kind in favour of banks and other financial institutions, even foreign. This pledge may secure all current or future obligations of the pledgor with the pledgee. It only requires the handing over of 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 issuer by a Notary Public. This pledge does not allow the pledgor to remain in material possession of the pledged assets. It is worth noting that the Constitutional Court of Chile ruled in one case that this procedure was not compliant with the due process constitutional protection, thus it declared the same unconstitutional. This is not a general ruling, but it may show a tendency.
- **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 party obligations, present or future, irrespective of whether 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, with the signatures of the appearing parties 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; (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 extent to which the pledge secures several obligations, if applicable. The PwC agreement must be registered in a special registry called the Pledge without Conveyance Registry. Upon its registration, the pledge without conveyance is enforceable upon third parties.
- **Pledge over deposited securities**: A new pledge was created at the end of 2016 to simplify the pledging of securities deposited with depository entities. The latter shall need to enter into a master agreement with all depositors to allow this type of pledge.

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

b) **Guarantees over Real Estate**:

- **Mortgages**: Granted by means of a public deed, allows not only existing and determined obligations but present and future obligations of the borrower (*cláusula de garantía general*) to be secured. The mortgage is perfected by means of its registration in the corresponding Mortgage Lien Registry. Generally, the mortgage deed will also contemplate a prohibition to transfer, convey and enter into acts or contracts with respect to the mortgaged property.
- 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.
- **Guarantees over vessels and aircraft**: 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.

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 bound to pay the debtor's obligation in the event 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. Under Chilean law, guarantees 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). The Chilean Civil Code does not provide for any formalities at all to grant sureties but if the obligation intended to be secured 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 is a widely used tool in Chile 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). The most advisable manner is to have an agreement for every type of asset.

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 credits.

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. Please refer to question 3.3. The Corporations Law states that any liens or rights *in rem* over shares of a company must be 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.

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 mainly depends 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. 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.

© 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?

No, expenses are generally not material, and in general, procedures do not take long, although it depends on the registrar and workload at the time of the registration request The PwC Registry charges a fixed fee of CLP30,000 (approx. USD46.15) for each such registration.

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)?

Yes; please refer to the answers above. In case of the execution of foreign agreements in Chile, documents must be apostilled and if not in Spanish, shall need to be translated to be presented in 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?

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. Their appointment requires the existence of at least two creditors and may grant 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 can 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.

Regarding the guarantees, the Chilean Civil Code provides that assignment of credits encompasses assignment of guarantees securing the same, by operation of law.

In all such cases, the changes must be reported to the Central Bank of Chile.

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, interest paid by Chilean taxpayers to foreign lenders is 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 benefit from 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.

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

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.?

There are transactional fees and translation costs, as explained in our answer above in question 3.9, but 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 greater than three times its tax equity at the end of the year when 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 the 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 may 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.

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 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*

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

Concursal), during which neither the declaration nor the initiation of a liquidation proceeding against the debtor or foreclosures 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. The credits that contravene this restriction will be postponed in payment until all of the creditors have been paid off. This period may be extended under certain circumstances twice more.

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 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 policy 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?

Please see our answer to question 7.6 above.

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 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, has preference over 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 no 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 and the republic and its agencies and municipalities are excluded. Mutual, investment 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.

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 prepayment 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.

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

Diego Peralta
Carey
2800 Isidora Goyenechea Ave., 43rd Floor
Las Condes
Santiago
Chile

Tel: *+56 2 2928 2200*
Fax: *+56 2 2928 2228*
Email: *dperalta@carey.cl*
URL: *www.carey.cl/en*

Diego Peralta is a Partner at Carey and co-head of the firm's Banking and Finance Group. The main focus of his practice is the creation and structuring of financial products and financing for all kinds of businesses, both from the lender and the borrower's perspective, in the purchase and sale 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 lawyer in several prestigious international publications, such as *LACCA*, *Best Lawyers*, *The Legal 500* and *IFLR*.

He is 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).

/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?

The year 2016 witnessed significant developments in the Foreign Debt management system. On 25 January 2016, the Notice of the People's Bank of China ("**PBOC**") on Expanding All Pilot Programs of Macro Prudential Administration of Cross-Border Financing ("**PBOC Notice**") became effective, which applies to enterprises registered in the China (Shanghai) Pilot Free Trade Zone, China (Guangdong) Pilot Free Trade Zone, China (Tianjin) Pilot Free Trade Zone, and China (Fujian) Pilot Free Trade Zone ("**Enterprises Implementing the Pilot Program**") and 27 banking financial institutions ("**Financial Institutions Implementing the Pilot Program**"). Pursuant to the PBOC Notice, Enterprises Implementing the Pilot Program and Financial Institutions Implementing the Pilot Program may carry out cross-border financing in domestic and foreign currencies based on a celling quota calculated by reference to their respective capital or net assets, as the case may be. A foreign invested enterprise ("**FIE**") which implements the pilot program and foreign invested banks which implement the pilot program may choose the existing cross-border financing management model or the model as prescribed in the PBOC Notice.

On 29 April 2016, PBOC issued the Circular of the People's Bank of China on the Nationwide Implementation of Macro-prudential Management of Full-covered Cross-border Financing Activities ("**Circular 132**"), which became effective on 3 May 2016 and expanded the application scope of the PBOC Notice to the whole country. Under the PBOC Notice and Circular 132, it is much easier than before for Chinese incorporated enterprises to borrow from overseas financial institutions and we have seen a number of deals under this structure notwithstanding the depreciation of Renminbi.

In terms of foreign exchange control, companies (excluding financial institutions) incorporated in the PRC are now permitted to freely convert foreign exchange proceeds into RMB. Pursuant to the Notice of the State Administration of Foreign Exchange on Reforming and Regulating the Policies for the Management of Foreign Exchange Settlement of Capital Account ("**Notice 16**"), foreign exchange proceeds under capital accounts, including loans borrowed from overseas, can be converted into RMB based on the actual needs of the company, except to the extent restricted in current regulations.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The year 2016 was significant for bond issuance in Chinese Inter-Bank Bond Market. On 2 September, the World Bank issued its first Special Drawing Right (SDR)-denominated bond in the Chinese Inter-Bank Bond Market, achieving a landmark development for China's bond market and for the SDR as an international reserve asset.

Syndicated loan transactions continued to be active this year. Sun Hung Kai Properties, a major property developer in Hong Kong, was financed with a RMB 14.5 billion onshore loan at the beginning of 2016.

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 association ("**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 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 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 PRC law to be mortgaged, or any other rights that can be pledged as stipulated by 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

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

with the China Securities Deposit and Clearing Corporation Limited. In the case of shares of a FIE, the pledge is subject to approval from or online filing with the Ministry of Commerce or its local branch ("**MOFCOM**"), as the case may be, depending on whether such FIE's business scope falls into the catalogue of encouraged/permitted industries for foreign investment or restricted industries for foreign investment (approval from MOFCOM may be required if the FIE falls into a restricted category). 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 online filing with or approval from (as the case may be) MOFCOM and SAIC registration. The approval from MOFCOM normally takes a couple of months while online filing and SAIC registration may take a couple of weeks. A mortgage of equipment or property on the other hand can take a considerably 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 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 a company chop, due execution of the contract requires both signing by authorised signatory(ies) as well as affixing of the company chop. If a contract does not require both signing and affixing of a company chop, either signing by authorised signatory(ies) or affixing a 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 duly complied with.

© 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?

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 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 rights 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 6% value added 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 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 2016, the PRC government has entered into tax treaties with 102 countries, and Hong Kong and Macau Special Administrative Regions, of which 98 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. FIE and non-FIE companies may carry out cross-border financing in RMB or foreign currencies in accordance with Circular 132, whilst a FIE may choose between the regulation regime under Circular 132 and its existing Foreign Debt management system.

© 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?

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.

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 that a lender is foreign does not in itself impose additional restrictions 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 a 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.

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

The administrator may also petition the court to claw back 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.

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, seizure of 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 the exclusive jurisdiction of the PRC courts. As for the enforcement of a 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 as 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 activities (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 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 that, in 2016, against the background of Renminbi depreciation and decrease in China's foreign exchange reserves, SAFE has provided guidance to PRC banks to impose strict scrutiny on the purchase and outbound payment of large amounts of foreign exchange – this has implications on paying funds out of China in cross-border financing transactions.

© 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
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, aluminum 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
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, and 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 cards 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.

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 includes:

- Best Law Firm (revenue over $200m) and Best Professional Services Firm (over $200m) AFR Client Choice 2016.
- Most Innovative Law Firm in China and Innovation in the Business of Law, Financial Times Asia-Pacific Awards 2016.
- Regional Law Firm of the Year and National Firm of the Year (for the 6th year) – China, International Financial Law Review 2016.
- Banking Law Firm of the Year, ALB China Law Awards 2016.
- Finance Team of the Year – Hong Kong, The Asia Legal Awards 2016.
- Best Financial Law Firm – Australia/New Zealand, FinanceAsia's 2015 Awards.
- Law Firm of the Year, Australian Banking & Finance Awards 2015.

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

Cyprus

Marinella Kilikitas

George Economides

E & G Economides LLC

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.

Four years on, the measures have made a positive impact: deposits have stabilised and the record-high levels of non-performing loans (NPLs) (which still comprise 47% of total loans) are experiencing a slow, albeit marked, downturn (by way of illustration the total value of NPLs in the Cypriot banking system fell in December by almost €3.7bn in two years to €23.7bn, the lowest since December 2014). Furthermore, Cyprus is experiencing a gradual growth phase and forecasts estimate that the Cypriot economy will continue to expand by approximately 2.7% this year and maintain average annual growth rate at approximately 2.5% over the next three years.

In an attempt to enhance growth, the European Investment Bank (EIB) has partnered with ten local banks over the last two years to provide credit lines to small to medium-sized enterprises with investment needs of less than €25 million. To date the EIB has funded a total of €475 million of SME loans with approximately 50% of those funds already benefiting approximately 230 new private sector investments, mainly in the infrastructure and tourism sectors.

Although the outlook for Cyprus generally 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).

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, if (i) there is commercial benefit in it doing so (whether direct or indirect), and (ii) it is permitted to do so under its constitutional documents.

By way of example, it may be argued that a parent company granting a downstream guarantee to its subsidiary to secure the latter's borrowing obligations towards a third party has commercial benefits not only for the wider group but also for the parent company itself; especially where, as a result of the giving of the guarantee, the subsidiary can sustain upward profitability, and in turn, the distribution of increased dividend payments to its 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 (acting always as a board) owe certain duties to the company which derive from both statute and common law. Under common law, these fiduciary duties include the duty of the directors to exercise their powers in good faith for the purposes for which they were conferred, and to act 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 named shareholder and/or shareholders.

In the absence of judicial guidance on the matter, it is not clear whether the absence (or insufficiency) of corporate benefit would render a guarantee void, and consequently a creditor's rights thereunder, unenforceable. Given this grey area, the directors of a company should be able to demonstrate that they have fully considered corporate benefit issues and relevant considerations will invariably include 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 sought from the shareholders in a general meeting, provided there is no fraud on the minority. It is considered good practice to have in place a shareholders' resolution to ratify, confirm and approve any decision of the directors to approve the company in acting as

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

guarantor. Relief may also be sought under the Companies Laws of Cyprus, Cap. 113, as amended. The relevant statutory provision provides that in proceedings brought against a director for breach of duty, the relevant director may be absolved from liability, provided that he or she can prove that he or she acted honestly and reasonably, having regard to all the circumstances.

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 the risk of a transaction being rendered void for lack of corporate benefit (see question 2.2 above). 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, it is more common to have in place specific security agreements in relation to certain assets such as land and shares (see questions 3.3 and 3.6 below, respectively), with any other assets being caught by an all-encompassing debenture creating security over all asset classes owned by a charger; in this way, any additional statutory perfection requirements and formalities affecting the validity and enforceability of a particular security arrangement are more easily satisfied.

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.

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

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.

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 the assignability of the receivables in question); or (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 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,

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

however, be subject to corporate benefit, capacity, solvency and financial assistance issues – see questions 2.2, 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 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 approx. €680 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,

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

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 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 the 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 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

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

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.

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, this being 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 Law (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 it 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.

© 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?

The main provisions relating to corporate insolvency in Cyprus are contained in the Companies Law (sections 202–305 inclusive) as amended by Law No. 62(I)/2015. The lender's ability to enforce its rights as a 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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.

© 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 25866 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 has also been involved in a restructuring of existing debt facilities for one of the largest quarries in Cyprus (borrowers' 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 25866 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 major Cyprus 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 extensively 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

Denmark

Thomas Melchior Fischer

Nielsen Nørager Law Firm LLP

Brian Jørgensen

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Interest levels remain historically low and the general market conditions for doing business in Denmark continue to improve as the financial crisis is left behind. Pension funds are showing an increased interest in funding large infrastructure projects and corporations. The most recent example is the pension fund PKA's DKK 4.2 billion facility to finance a new construction stage of the Copenhagen district 'Carlsberg Byen'. Lending-based crowdfunding is rapidly increasing as an alternative source of financing.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

See question 1.1.

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)?

As a general rule, Danish private and public limited companies may guarantee borrowings of one or more other members of its corporate group provided, in particular, that the corporate benefit requirement is adequately observed (see question 2.2), and that Danish legislation on financial assistance is complied with (see question 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?

Under Danish law, it is the directors' duty to ensure that corporate transactions and positions are in the best interest of the company; which often, but not always, mirrors the interest of the shareholders. Put differently, each action of the company must be financially, commercially, or strategically justified. The corporate benefit must accrue to the individual Danish company rather than the corporate group as a whole. In addition to the duty to continuously ensure that the available capital resources are adequate, the corporate benefit requirement entails, for example, that the directors must establish a reasonable balance between the corporate benefit and the risk assumed pursuant to the guarantee.

Under certain circumstances, e.g., in the event of bad faith of the beneficiary, and if the corporate benefit requirement is not duly observed, the guarantee granted by the company may be invalid and unenforceable and the directors may be subject to personal liability for damages and criminal sanctions. Especially in case of a Danish company's granting of upstream or cross-stream guarantees in favour of direct or indirect parent or sister companies, the directors may find it desirable to include limitation language in the guarantee addressing the fulfilment of the corporate benefit requirement.

2.3 Is lack of corporate power an issue?

Lack of corporate power is generally not an issue. In addition to satisfaction of the company's signing powers, lenders usually require a board resolution of the guarantor to minimise potential doubt about lack of corporate power and corporate benefit concerns. Lenders' diligent examinations also include a review of the guarantor's articles of association and publicly available corporate information to ensure among other things that the guarantor's corporate objectives are wide enough to cover the issue of a guarantee.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No; generally, under Danish law, guarantees are not subject to specific formalities.

Broadly speaking, while granting a guarantee is not in the nature of an extraordinary matter to be transacted at the general meeting, in special circumstances the board of directors may find it desirable – even merely as a gesture – to refer such a matter to the general meeting, thereby alleviating disagreement between the shareholders and minimising subsequent shareholder criticism.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No; however, the directors must at all times ensure that the financial resources of the company are adequate, i.e. that the company has sufficient liquidity to meet its current and future liabilities as they fall due. The duty implies that the directors must assess the company's financial position and ensure that the available capital

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

resources justify the granting of the guarantee. To accommodate directors' liability concerns, limitation language concerning the scope of guarantee is often included.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No.

Naturally, it is good practice to examine whether *non-Danish* exchange control or similar obstacles apply.

Denmark enforces 'freezing of funds' and similar financial restrictive measures adopted by the UN and the EU.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Lending obligations may be secured by a number of different types of security under Danish law, including by way of a pledge, security assignment, mortgage, general floating charge covering specific groups of assets and retention of title. In general, any type of asset may be validly pledged. Furthermore, it is possible not only to agree a negative pledge over certain assets *inter partes* but also to register the negative pledge in the Personal Register whereby it will also have legal effect towards third parties.

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?

Danish law does not recognise the concept of a general security agreement covering all assets of the security provider. Each type of asset must be regulated in an individual security agreement or in a combined security agreement incorporating the necessary regulation of each type of security and clearly identifying each individual asset granted as security.

However, a Danish company may provide security by way of a general floating charge over a number of specifically allowed classes of its assets, including trade receivables, inventory, vehicles not previously registered in Denmark, operating equipment and machinery, IPR and goodwill, which is perfected by registration in the Personal Register.

Further, a company operating from a leased property may mortgage its operating equipment, including machines and technical installations.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security may be taken over real property by way of real estate mortgages, which are perfected by registration in the Land Register. On properties permanently fitted for a specific business, such mortgage will also cover technical installations, machinery and operating equipment, unless otherwise agreed.

Provided that assets are not covered by a real estate mortgage, security can be taken separately over machinery and operating equipment in the form of a chattel mortgage, which is perfected by registration in the Personal Register or by physical removal of the assets from the pledgor. Similarly, operating equipment and machinery may be mortgaged under a general floating charge. See question 3.2 with respect to granting security over operating equipment and machines of a company operating from a leased property.

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 created by way of a floating charge covering all of the security provider's trade receivables; or by a separate assignment of specific, identified receivables. A floating charge is perfected via registration in the Personal Register and does not require individual notice to the debtors. An assignment on the other hand must be notified to the relevant third party debtor(s); such notice must include an instruction to pay directly to the security holder in order for the assignment to be duly perfected.

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 a bank account by establishment of a pledge over the bank account. Due perfection requires notification of the pledge to the bank and that the account holder is deprived of all disposal rights to the bank account. Consequently, pledges over bank accounts are impractical with respect to accounts used in a company's day-to-day operations.

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 unlisted companies can be pledged unless otherwise set out in the company's articles of association. Shares need not be in certificated form in order to be pledged. Provided that the company has not issued negotiable share certificates, the pledge of shares (regardless of whether the shares are certificated or not) is perfected by written notice to the company stating that the share(s) are pledged, such notice to be provided no later than the time of disbursement of the loan proceeds to avoid risk of claw-back in case of bankruptcy.

If negotiable share certificates have been issued, duly perfection requires that the pledgor is deprived of its physical share certificates. However, physical share certificates are usually not issued by Danish companies.

If the company's shares are issued in dematerialised form through a central securities depositary ("**CSD**"), the pledge is perfected by registration in a Danish CSD (currently only one CSD in Denmark: VP Securities A/S).

A share pledge agreement may be governed by the laws of a foreign jurisdiction. However, Danish law would still apply in respect to perfection requirements. Furthermore, Danish law contains certain mandatory duty of care provisions aimed at protecting a pledgor in connection with enforcement of the security. It is therefore advisable that the share pledge agreement is governed by Danish law which is also market practice in Denmark.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over inventory can be created by way of a general floating charge or a separate pledge. A general floating charge is perfected

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

by registration in the Personal Register. A pledge over inventory or stock is perfected by the pledgor being physically prevented from freely disposing of the pledged assets (in Danish: *nøglepant*).

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 limitations described under question 2.1, 2.2 and 4.1.

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?

There are no notarisation requirements.

Registrations of charges and mortgages with the Land Register, the Motor Vehicle Register and the Personal Register are subject to stamp duty calculated as 1.5 per cent of the nominal value of the mortgage plus a filing fee of DKK 1,660. Registration of a mortgage over commercial vessels is subject to stamp duty of 0.1 per cent of the secured amount.

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, it involves only limited amount of time and expense, save for security involving registration with the Land Register, the Personal Register or the Motor Vehicle Register, which is subject to stamp duty; see question 3.9.

Registrations with the Land Register and Personal Register are carried out online, and most often it is possible to obtain a final registration the very same day as the filing is made.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In general, no regulatory consents are required. Consents from third parties in underlying contracts may need to be considered.

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)?

If a mortgage requires registration with, e.g., the Land Register or Personal Register, and the digital filing is signed by a person pursuant to a power of attorney, such power of attorney must be prepared in the mandatory format of the Danish Registers and the signatures of the principal must be witnessed by two persons.

No other documentary or execution requirements apply.

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

According to the general rule set forth in the Companies Act, a private or public limited company may not, directly or indirectly, advance funds, grant loans, or provide security (including guarantees) for a third party's acquisition of (or subscription for) shares of that company or of its parent company (i.e. a prohibition against financing of purchase of own shares).

This general prohibition does, however, not apply if certain requirements concerning the following matters are met: (i) shareholder approval; (ii) the proposed transaction is advisable considering the company's financial position or, if it is a parent company, its consolidated financial position; (iii) a report by the central management body to be publicly registered with the Danish Business Authority; and (iv) the proposed transaction is entered into on market terms including preparation of a credit rating of the purchaser and, if relevant, the financier.

Furthermore, the general prohibition does not apply to banks or mortgage loans granted by mortgage credit institutions or to transactions for the acquisition of shares to or from the employees of the company or any subsidiary.

Certain post-financing situations regarding acquisition of companies have been held to be unlawful by the Danish Business Authority, although such matters in themselves could be seen as justified corporate actions.

A recent amendment to the Companies Act effective as of 1 January 2017 eases the requirements applicable to financial assistance (in general) to parents, shareholders, members of management, etc., thereby bringing the rules in line with similar regulation in most European countries; however, this legislative change may not be benefitted from if the transaction at hand is financing of purchase of (or subscription for) shares in the company or its parent company, in which case the existing more rigorous conditions set forth in the Act, *cf.* above, must be satisfied in order for the transaction to be lawful.

(b) Shares of any company which directly or indirectly owns shares in the company

The general prohibition including exceptions referred to under question 4.1 (a) also apply to a company's, direct or indirect, purchase of (or subscription for) shares in a parent company and presumably also in an indirect parent company.

(c) Shares in a sister subsidiary

Danish law does not stipulate any prohibition on financial assistance provided for the purchase of (or subscription for) shares in a sister subsidiary.

© 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?

Yes. Lenders may appoint agents, including security agents under the loan documentation and such agents may enforce the rights of the lenders and apply the proceeds from the security to the claims of all the lenders; *cf.* chapter 2a of the Danish Securities Trading Act.

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.

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 guarantee will often be granted in favour of the lenders from time to time and state that the guarantor's obligations are not reduced or discharged as a consequence of any transfer by a lender of its rights, in which case the loan and guarantee are enforceable by Lender B without further notice to the guarantor or other actions.

In the absence of such provisions in the guarantee, Lender B's enforcement of any rights under the loan requires that the borrower is notified of the transfer. In general, 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. However, the guarantor must be notified of the transfer in order to avoid the risk of the guarantor fulfilling its guarantee obligation by payment to the initial lenders or 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?

Apart from the obligation of a Danish borrower to withhold tax at source from interest payments to a foreign lender, *cf.* question 6.3, there are no requirements to deduct or withhold tax under Danish 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?

No tax incentives or other incentives are provided preferentially to foreign lenders.

Provided that no permanent establishment in Denmark exists with which the income from the loan, guarantee or security interest is effectively connected, no taxes apply to foreign lenders in such cases; *cf.* question 3.9 with respect to applicable stamp duties.

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. Tax liability requires, as a general rule, that the foreign lender has a permanent establishment in Denmark. Similarly, loan interest income secured on real property does not in itself lead to tax liability.

A Danish borrower may, however, be subject to withholding tax at source from interest payments, i.e. tax on unearned income, regarding certain intra-group loans (22% of the total interest amount) if not otherwise provided by, for example, applicable double taxation agreements, or EU Directive 2003/49 on a common system of taxation applicable to interest and royalty payments made between associated companies of different EU Member States.

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.

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.

Danish tax law includes a number of deductibility limitation rules to be applied in the order given below: (1) the 'thin capitalisation' rule; (2) the 'interest-rate ceiling' rule; and (3) the 'EBIT' rule.

The 'thin capitalisation' rule

The thin capitalisation rule entails that thin capitalised companies' access to deduct interest and capital loss on controlled loans is limited. The thin capitalisation rule only kicks in if the controlled debt exceeds DKK 10 million and the lender(s) is/are not a natural person. It includes back-to-back structures involving third party lenders, e.g. banks. The thin capitalisation rule presupposes (i) a debt-to-equity ratio of four to one at the end of the income year, i.e. that the debt of the company exceeds the equity of the company by more than four times, and (ii) that the company does not prove that a similar financing can be obtained between independent parties. Any interest on debt to related parties in excess of this ratio will be subject to deductibility reduction.

The 'interest-rate ceiling' rule

The 'interest-rate ceiling' rule entails that a company's access to deduct net financing expenses is reduced. Unlike the thin capitalisation rule, this rule also has an impact on debt to independent

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

lenders. The deductibility reduction caused by the 'interest-rate ceiling' entails that the net financing expenses are only deductible to the extent that they do not exceed the tax value of the company's assets multiplied by a standard rate of return. This deductibility reduction rule only applies to the net financing expenses exceeding DKK 21.3 million.

The 'EBIT' rule

The taxable income before net financing expenses (EBIT income, i.e. earnings before interest and taxes) may as a maximum be reduced by 80 per cent as a result of the net financing expenses following a deductibility reduction, if any, under the 'interest-rate ceiling' rule. Like the 'interest-rate ceiling' rule, the EBIT deductibility reduction rule only applies to the net financing expenses exceeding DKK 21.3 million. Net financing expenses restricted under the EBIT rule may be carried forward for tax deduction in the following years.

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?

Danish courts will generally recognise the law of a foreign jurisdiction as the governing law in a contract and enforce the provisions of such contract with the exception of any provisions contrary to Danish 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?

A judgment rendered in the courts of a country which is not a contracting state under: (i) Council Regulation (EC) No 1215/2012, as amended, and implemented in Danish law; (ii) the Brussels Convention of 27 September 1968; or (iii) the revised Lugano Convention of 30 October 2007, would not be recognised or enforceable in Denmark without a retrial on the merits. Accordingly, a judgment rendered by a New York court would not be enforceable in Denmark.

A final judgment rendered by a court in any EU Member State, e.g. England, or any country that is party to the revised Lugano Convention, will be recognised and enforceable by the Danish courts in accordance with the provisions of the Council Regulation and the revised Lugano Convention, respectively.

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 duration of the legal proceedings will depend on which Danish court determines the case. If the Copenhagen City Court is the court of first instance, we estimate that it will take approximately 9–12 months to obtain an enforceable judgment. If the loan agreement satisfies the requirements for a debt instrument (in Danish: *gældsbrev*) and includes a clause of immediate enforceability, claims under the loan agreement may be enforced directly by the lender by application to the Bailiff's Court without having to obtain a judgment beforehand; *cf.* question 8.4.

Unless otherwise stated in the judgment and subject to the debtor's appeal of the judgment which may suspend the lenders' right to enforce the judgment, a judgment will become enforceable 14 days after the date of the ruling. Enforcement is carried out through the Bailiff's Court (in Danish: *fogedretten*) under the relevant district court by written application to the Bailiff's Court with the objective to seize the assets of the debtor and sell these via a forced sale. This procedure will likely take two to three months.

A similar duration of the enforcement process should be expected with respect to enforcement of foreign judgments if the Council Regulation applies, i.e. with respect to judgments rendered by a competent court of another EU Member State (see question 7.2).

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, a creditor is free to enforce a pledge in accordance with the enforcement provisions of the pledge agreement without having to obtain a judgment provided that the pledgor is given one week's prior written notice to satisfy the claim and the loan agreement satisfies the requirements for immediate enforceability.

Notwithstanding the above, enforcement of certain types of security e.g. real estate mortgages, floating charges and dematerialised shares issued through a CSD must be carried out in accordance with specific, statutory procedures set out in the Administration of Justice Act and the Securities Trading Act, including certain provisions regarding public auctions that may impact the timing of the enforcement. Further, a secured creditor is subject to a general duty of care obligation and obliged to look after the interests of the pledgor when enforcing security interests. No regulatory consents are otherwise required; see, however, section 8 regarding bankruptcy proceedings.

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?

If required by an EU or EFTA defendant (i.e. including a Danish 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, unless such plaintiff resides in a country having entered into a bilateral treaty with Denmark permitting a plaintiff residing in Denmark to bring a legal claim against a person in that country without having to furnish security.

In general, no restrictions apply to foreign lenders in the event of foreclosure on 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?

The Bankruptcy Act contains certain limitations on secured creditors' access to enforce security during the period when an insolvent

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

company is taken under reconstruction proceedings. Reconstruction proceedings may be initiated by the insolvent company or any of its creditors. However, if more than 50 per cent of the creditors (based on the amounts owed to these) present at the first meeting of the creditors do not support the proposed reconstruction plan and the opposing creditors constitute no less than 25 per cent of the company's total known debt, the reconstruction proceedings will immediately be terminated. See also 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. Foreign awards based on an arbitration agreement are recognised and enforced in Denmark in accordance with the New York Convention as ratified by Denmark in 1972.

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 claims are covered prior to the statutory ranking of creditors. To the extent the value of the asset granted as security does not cover the secured claim, any uncovered part of the claim will be subject to the statutory ranking of creditors.

If the lender's claim is secured by way of a pledge (in Danish: *håndpant*) or other corresponding security interest, including a floating charge on claims (in Danish: *virksomhedspant*) or receivables charge (in Danish: *fordringspant*), the secured lender is entitled to enforce its claim independently of the bankruptcy estate.

As for other claims secured by real estate mortgage or chattel mortgage, such ordinary claims are enforced in cooperation with the bankruptcy estate. Where the estate has not made a petition for a forced sale within six month from the date of the bankruptcy order, any mortgagee with an overdue claim may demand that the estate conducts a forced sale without undue delay.

Effective as of the time of the decree of the bankruptcy proceedings, unsecured creditors cannot levy execution on the property of the insolvent 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?

The Bankruptcy Act includes clawback provisions which effectively set aside certain transactions executed during the period leading up to the bankruptcy proceedings provided, among other things, that:

- The transaction was made to the detriment of the creditors or result in fraudulent preference of some creditors' over other creditors (e.g. in the form of presents, renunciation of inheritance, wages and other remuneration for work, early repayment of debt, provision of security without new credit being granted, etc.).
- The transaction took place after or within a specified period before commencement of bankruptcy; i.e. within three months, six months, or – in case of related parties and provided that the burden of proof of solvency at the time of the transaction is not met – up to one year or two years.
- The relevant point in time to be considered when assessing if a security interest may be avoided is the time of perfection of the security interest.

In addition, the clawback provisions include an avoidance rule not limited in time applicable in the event that the debtor was or became insolvent as a consequence of the transaction and the preferred party knew or should have known of the debtor's insolvency and the circumstances causing the transaction to be fraudulent.

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.

Public authorities such as municipal authorities are excluded from bankruptcy proceedings.

As for enterprises of which the members are personally liable for the debts of the business, e.g. a partnership (in Danish: *interessentskab*) or a limited partnership (in Danish: *kommanditselskab*), a bankruptcy procedure may only be initiated if *all* such members have been declared bankrupt.

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 a creditor is in possession of a basis of enforcement (in Danish: *eksekutionsgrundlag*) e.g. a judgment, settlement, or certain mortgages, the creditor may take the claim directly to the Bailiff's Court (in Danish: *fogedretten*), without the need to obtain prior judgment, in order to enforce the security through the Bailiff's 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?

In general, a party's submission to a foreign jurisdiction will be legally binding and enforceable under Danish law, subject to certain exceptions regarding consumers and employees.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, save for matters specifically protected by international law, e.g. diplomatic immunity and assets protected by diplomatic immunity or other provisions under international law.

© 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 other eligibility requirements in Denmark for Danish or non-Danish lenders. Granting loans without receiving deposits from the public does not in itself require authorisation. This also applies to Danish and non-Danish (security) agents under a syndicated facility. If other categories of financial activities are to be conducted, this may be subject to authorisation/licence and supervision by the Danish FSA. A financial institution, e.g. a bank or a mortgage credit institution, which is subject to the Financial Business Act, may by way of example not carry out activities until it has obtained a designated authorisation/licence from the Danish FSA.

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.

Thomas Melchior Fischer
Nielsen Nørager Law Firm LLP
Frederiksberggade 16
1459 Copenhagen K
Denmark

Tel: +45 31 18 04 34
Email: tf@nnlaw.dk
URL: www.nnlaw.dk

Thomas Melchior Fischer is a lawyer with several years of experience specialising in financial law, corporate finance, M&A, general company law as well as capital markets law.

Brian Jørgensen
Nielsen Nørager Law Firm LLP
Frederiksberggade 16
1459 Copenhagen K
Denmark

Tel: +45 31 62 61 68
Email: bj@nnlaw.dk
URL: www.nnlaw.dk

Brian Jørgensen is a senior associate at Nielsen Nørager and focuses primarily on banking and finance law. Brian has comprehensive experience of advising both lenders and borrowers in Danish and international finance transactions, including within financing of acquisitions, project finance and ship financing. Brian Jørgensen also advises Danish and foreign clients on transfers of undertakings and all corporate and contractual aspects related thereto. Finally, Brian advises on general shareholder matters, reorganisations of undertakings and establishment of joint ventures in Denmark and abroad.

NIELSEN NØRAGER

Located in the centre of Copenhagen, Nielsen Nørager Law Firm LLP advises international and Danish clients on complex commercial transactions within finance and banking; corporate and commercial, debt and equity capital markets; private and public M&A; IPOs; securities regulation, venture and private equity; tax; and a number of other practice areas.

Nielsen Nørager and its lawyers are recommended by a number of international rating firms including *Chambers & Partners*, *IFLR1000*, *The Legal 500*, etc.

Nielsen Nørager benefits from strong international relations.

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

England

Darren Hanwell

Allen & Overy LLP

Temi Esho

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

With uncertainty over the Brexit vote, general elections in both the Netherlands and France, as well as in the US, and the imminent application of new ECB leveraged lending guidance, you could have been forgiven for expecting a quiet European loan market in 2016. However, despite all this, liquidity in the European loan market remained strong in 2016. There was also limited supply in the European M&A market, meaning the competition for assets was fierce; and in addition, interest rates remained low.

This combination of high liquidity, short supply, resilience to political uncertainty, and low interest rates has produced a very borrower-friendly market environment. There have been numerous dividend recaps and repricings seen over the past 12 months, with more expected in 2017. Covenant-lite structures are increasingly prevalent, particularly in the larger transactions, and covenant-loose (with a single maintenance covenant) is the next most likely package. Borrowers are also able to negotiate significantly more flexibility into their documentation. The market is also increasingly familiar with less restrictive regimes for disposals, acquisitions (so-called 'limited condition acquisitions') and restricted payments as the convergence between loan and bond terms continues.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The cross-border acquisition of UK asset Morrison Utility Services Group by the US investor First Reserve successfully signed over the period of the referendum result in 2016, highlighting (along with various price reduction transactions which were also successfully completed over the period) the resilience of the European market in uncertain political times. Such uncertainty and any related currency fluctuations can provide an opportunity for cross-border investors.

In the leveraged loan market, second lien debt continues to be a popular feature. Atos Medical, Allegro, and Ammeraal Beltech are all good examples of this.

Asahi Group Holdings Ltd, the international Japanese brewer, acquired five former SABMiller businesses in Central and Eastern Europe for EUR7.3bn, having earlier in the year completed the EUR2.5bn acquisition of Peroni, Grolsch and Meantime. Both acquisitions were supported with debt borrowed under English law. It was the largest deal in Asahi's 127-year history, and highlights the continued appetite for inbound Asian investment in the European market as well as the opportunities that major acquisitions, such as the acquisition of SABMiller by Anheuser-Busch Inbev, present to the market and competitors.

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 the company is of doubtful solvency where a long-term view is unrealistic, 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 there is no reasonable prospect that the company can avoid insolvent liquidation or administration, 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 (if any) 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.

© 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?

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.

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 a 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.

© 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?

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 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.

If a legal mortgage over certificated shares is taken, the mortgagee may be required to provide information to the relevant company in order to comply with certain obligations under the "people with significant control" regime. Failure to provide this information is a criminal offence. These obligations do not arise under an equitable mortgage (which is the more common approach to share security) and so are not usually a concern. The obligations do arise where security is taken over shares in Scottish companies.

The mortgagee should also satisfy itself before taking security over shares that there is nothing on the PSC register of the relevant company which indicates that a restriction notice could be issued. A restrictions notice affects whether security can be given or enforced (as well as whether dividends can be paid or voting rights exercised).

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 (£23 paper filing and £15 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 the 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.

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

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.

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,

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

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 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 or English 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 proxies; 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,

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

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.

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, who have recourse to the secured assets). Security rights against the company remain enforceable. In a compulsory liquidation, there is a limited moratorium meaning that 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, an interim 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, among other things, the enforcement of security and the commencement of legal proceedings without the permission of the court, and a permanent moratorium will come into effect upon the appointment of an administrator (the interim moratorium falling away if the appointment is not made) which cannot be lifted without consent of the court or the administrator.

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 (which is, broadly, security over cash, shares, tradeable bonds and certain loans which meet other specified criteria) 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?

The statutory moratorium (which will arise in an administration and in some CVAs; see question 7.6 above) will restrict a creditor from enforcing its security rights including, for example, by appointing a receiver (see question 7.6 above).

However, if during the interim moratorium a secured creditor appoints an administrative receiver before the appointment of the administrator becomes effective, it will not be possible for an administrator to be appointed (and the interim moratorium on enforcement of security will terminate and the permanent moratorium will not come into effect). 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 security, including a floating charge over the whole or substantially the whole of the company's assets) may instead 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.

© 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?

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 (and generally ranges from six months to two years).

Certain claims are treated as preferential and hence the order of priority in which a company's assets will be distributed is broadly: (i) fixed-charge holders' claims out of the fixed charge assets (if the assets are insufficient to meet these claims then the secured creditor will have a claim as an unsecured creditor for the surplus); (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 in the United Kingdom.

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 administrator (in circumstances where 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.

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

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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).

The UK voted to leave the European Union in June 2016. There is no immediate change to the law in the UK as a result of the vote but it is likely that there will be changes once the terms of the exit are settled. Once the UK government formally issues notice that it intends to leave the Union (the so called 'Article 50 notice'), there will be a period of up to two years during which the terms of the UK's exit from, and future relationship with, the European Union will be negotiated.

The European Central Bank is expected to publish finalised leveraged lending guidance during the first half of 2017. The guidance is intended to be consistent with the Interagency Guidance on Leveraged Lending (particularly regarding leverage levels and the ability of borrowers to repay debt) which has been in force in the US since 2013. The guidance is intended to maintain stability in the European banking system, and as such, applies to 'significant' credit institutions supervised by the ECB. Non-bank lenders, and banks established outside of the Eurozone, are not expected to the subject to the guidance (although branches of non-Eurozone European banks operating within the Eurozone could be covered, if they are 'significant').

Acknowledgment

The authors would like to acknowledge the assistance of Sarah Cantwell in the preparation of this chapter.

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

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 partner 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.

Temi Esho
Allen & Overy LLP
One Bishops Square
London E1 6AD
United Kingdom

Tel: *+44 203 088 3491*
Fax: *+44 203 088 0088*
Email: *temi.esho@allenovery.com*
URL: *www.allenovery.com*

Temi is a London-based senior associate specialising in leveraged finance and event-driven transactions. Temi joined A&O as a trainee in 2007 and has spent time on secondment with Deutsche Bank.

ALLEN & OVERY

Our ambition at Allen & Overy is to help the world's leading businesses both maximise the opportunities that globalisation presents and meet the potential challenges. Our teams across the world work together in a highly integrated manner to leverage their expertise and experience for our clients' benefit. We foster creative, independent thinking within a collaborative culture and, as a result, our lawyers are involved in many of the most influential cutting-edge commercial transactions, and are known for providing our clients with transformative solutions to the toughest legal challenges.

Allen & Overy's market-leading New York and English law global leveraged finance practice (comprising an integrated loans and high yield bonds practice) operates in all of the main financial centres throughout the world. 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. Our practice is supported by pre-eminent Private Equity, Equity Capital Markets, Debt Capital Markets, Securitization and Restructuring teams. This collective expertise combined with in-depth sector insights makes us one of very few firms with the ability to advise on complex cross-border leveraged finance transactions across the full spectrum of the capital structure, as well as on all types of "crossover" and emerging markets loan and bond transactions.

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

Finland

Tanja Törnkvist

White & Case LLP

Oona Lilja

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Nordic banks remain strong, but also international banks, especially German banks, continue to increase their market share. Competition among lenders is fairly intense as many Finnish blue chip companies have limited need for debt funding due to strong balance sheets and plenty of liquidity. Another development that has increased competition among debt providers is the Finnish bond market. The debt capital markets in Finland have been developing strongly during the past five years and an increasing number of, particularly, publicly traded companies, but also private companies, have raised funding through bond financing. A number of large Finnish publicly traded companies have Euro Medium Term Note programmes in place and the domestic Finnish corporate bond market, where bonds are issued under local law documentation, has developed favourably.

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)?

Finnish limited liability companies are generally free to guarantee the financial obligations of one or more members of their corporate group, subject, however, to certain limitations described under questions 2.2 and 4.1 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?

Although Finnish companies are generally free to provide guarantees and security, potential concerns of, in particular, unlawful financial assistance and distribution of assets contrary to the mandatory provisions of the Companies Act (624/2006, as amended) (the "**Companies Act**") may arise in relation to upstream as well as cross-stream guarantees and security (for further discussion regarding financial assistance, please see section 4 below). If the provision of a guarantee or security reduces the assets of a company or increases its liabilities without such company obtaining sufficient corporate benefit therefrom, such actions may constitute unlawful distribution of assets. In addition to such corporate benefit requirement, provision of the guarantee/security: (i) must fall within the company's business purpose; (ii) may not contravene the provisions of the Companies Act relating to the equal treatment of shareholders; and (iii) may not result in the company becoming insolvent, nor may the company be insolvent at the time of granting the guarantee/security.

Failure to comply with the above requirements may constitute breach of the general duty of care imposed on the Board of Directors and the managing director of a Finnish limited liability company pursuant to the Companies Act and result in liability to pay damages to the company, its shareholders or third parties or even criminal sanctions in the event that such distribution of assets constitutes deliberate violation of the protection of the company's shareholders or creditors.

In order to alleviate the above concerns, finance documents typically include wording limiting any guarantees and security provided by Finnish companies to the extent that the provision of such guarantees or security would be contrary to the mandatory provisions of the Companies Act.

2.3 Is lack of corporate power an issue?

Lack of corporate power is generally not an issue *per se*, with the provision of guarantees and security usually being resolved upon by the Board of Directors or, if such action falls within the ordinary course of business, even the managing director. The general duty of care requirements and risk of unlawful financial assistance and distribution of assets described under question 2.2 above and section 4 below may, however, impose *de facto* limitations on the provision of guarantees and/or security.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental or other consent or filing is required in order for a Finnish limited liability company to provide guarantees. Please, however, see question 3.9 below regarding registration requirements in respect of certain security assets. Although not an absolute legal requirement, shareholder approval is customarily requested as a condition precedent in financing arrangements.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Although there are no limitations on the amount of a guarantee *per se*, the mandatory provisions of the Companies Act may in practice

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

limit the amount of a guarantee that can be considered valid and enforceable. In particular, Finnish limited liability companies may not provide guarantees if doing so would violate the provisions of the Companies Act relating to unlawful financial assistance or distribution of assets, or endanger the guarantor's solvency. Please see question 2.2 above and questions 4.1 and 8.2 below.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control or similar obstacles in Finland restricting the enforcement of guarantees issued by Finnish limited liability companies.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under Finnish law, various types of security assets (including but not limited to shares, real estate, business mortgage and receivables) may be pledged as security. In order to validly pledge an asset, such asset must be: (i) sufficiently individualised; (ii) separately transferable and capable of being foreclosed on; and (iii) have monetary value.

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 Finnish law, it is possible and common market practice to grant security over various assets by way of a single omnibus security agreement.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Under Finnish law, security over real property is taken by registering a real estate mortgage on the relevant real estate (or e.g. a part or parcel thereof or leasehold registered thereon) and perfected by delivering the real estate mortgage note(s) representing such real estate mortgage to the possession of the pledgee or its order.

Security over machinery and equipment can be taken in a number of ways. For one, machinery and equipment may be pledged as movable property subject to a fixed charge, such pledge to be perfected by delivering such machinery and equipment to the possession of the pledgee or its order or by otherwise precluding the pledgor from utilising such assets or, in the event that such assets are in the possession of a third party, by delivering a notice of pledge to such third party. Secondly, a business mortgage registered against a Finnish company will, in principle, cover all of its movable business assets (including plant, machinery and equipment), without limiting the pledgor's ability to dispose of such assets in the ordinary course of its business. Such security is perfected by delivering the business mortgage note(s) representing the business mortgage to the possession of the pledgee or its order.

Under certain circumstances, machinery and equipment may, however, be considered sufficiently integrated with the underlying real estate or leasehold to constitute fixtures or appurtenances thereof, thus falling within the scope of a real estate mortgage rather than a business mortgage. It should also be noted that under Finnish law, it is possible to register such assets as belonging or, conversely, not belonging, to the underlying real estate or leasehold.

In addition to business mortgages and real estate mortgages, there are also certain limited assets (being aircraft, certain vessels and certain vehicles), over which security can be taken by registering a mortgage thereon.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Under Finnish law, security can be taken over receivables and is perfected by delivering a notice to the relevant debtor, with instructions to make all payments to the pledgee or its order. In practice, perfection is usually delayed and the debtor continues to make payments to the pledgor until the occurrence of a credit event, even though the security is thus subject to a risk of clawback. It should, however, be noted that Finnish law does not contain provisions regarding the pledge of future receivables which do not derive from pledged assets. The prevailing view of legal scholars is that receivables that exist before the pledgor-debtor is declared bankrupt or enforcement proceedings commence should be regarded as being subject to a perfected security interest *vis-à-vis* third parties, although it is recommended that another separate notice is served on the relevant debtor(s) each time after such receivables have been earned.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Under Finnish law, security can be taken over cash deposited in bank accounts and is perfected by delivering a notice of pledge to the account bank with instructions to prohibit the pledgor from making withdrawals from or otherwise using the account. To the extent that e.g. deposit accounts are pledged, the parties generally agree on delayed perfection, where the pledgor is only precluded from disposing over the account(s) following certain credit events. It should, however, be noted that until the security is fully perfected, the pledge will not be considered effective in relation to the pledgor's third-party creditors.

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?

Share pledges are commonly used as security in Finland. Security taken over shares is perfected: (i) if the company whose shares are pledged has not issued share certificates, by the pledgor typically notifying such company of the pledge and requesting that it record such pledge in its share register (customarily also in the shareholder register); or (ii) if the company whose shares are pledged has issued share certificates, by delivering the share certificates to the possession of the pledgee, usually duly endorsed in blank (although not a requirement, notice as referred to under (i) above is customarily also delivered to the company even if it has issued share certificates). Dematerialised shares registered on a book-entry account may also be pledged, with such security being perfected by notice to the relevant book-entry register and registration of the pledge therein.

Choice of foreign law (such as English or New York law) is generally accepted (please also see sections 7 and 9 below) and valid *inter partes* unless the application of such foreign law would be

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

contrary to the fundamental principles of the Finnish legal system. It should, however, be noted that the parties cannot by choice of law circumvent mandatory provisions of Finnish law relating to e.g. protection of third-party creditors. Prevalent market practice is thus for share pledge agreements creating security over shares in Finnish entities to be governed by Finnish law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

In order to validly perfect a pledge over inventory, the pledgor's ability to stipulate the pledged assets must be precluded. This may be effected by transferring physical possession of the asset(s) to the pledgee or its order, or allowing the asset to remain in the pledgor's premises but preventing the pledgor from accessing and dealing with the asset(s) (such as disposing thereof) through factual arrangements (e.g. handing over the keys to such premises to a third party). Although inventory pledges may in many cases be considered impractical, oil reserves have been used as security in a novel manner in Finland where an independent third party was engaged to operate, manage and control the pledged oil reserves on behalf of the pledgee and the pledgor was entitled to request the release of a certain portion thereof from time to time. Nevertheless, a more common way to take security over movable assets such as inventory would be by way of a business mortgage as described under 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)?

In general, yes. Please, however, see question 2.2 above and section 4 below regarding certain limitations to the provision of guarantees and 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?

Under Finnish law, no notarisation, registration, stamp duty or other fees are payable in connection with granting security over receivables, shares or other movable assets which are not registered, save for customary court and enforcement authority fees. The creation of security over publicly registered assets (e.g. real property and business mortgages) is generally subject to minor registration 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?

Notification and registration procedures, as referred to under questions 3.3–3.7 above, are usually initiated promptly and completed within a couple of weeks, and do not generate significant expense. Under Finnish law, there are no filing requirements in relation to the creation of security, except that in connection with legal proceedings, the relevant security agreements may need to be filed with the appropriate court or administrative body and translated into Finnish or Swedish.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consent is required in order to create a valid security interest in Finland.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Securing obligations under a revolving credit facility does not raise any particular priority or other concerns under Finnish law.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Although Finnish law does not impose any particular documentary or execution requirements in relation to the creation of security interests or the provision of guarantees, it is recommended that all security agreements and guarantees are made in writing.

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 the Companies Act, a Finnish limited liability company cannot provide a loan, funds, security or a guarantee for the purpose of enabling a third party to acquire shares in such company or its Finnish parent company.

(b) Shares of any company which directly or indirectly owns shares in the company

Under the Companies Act, the prohibition of financial assistance described under paragraph (a) above applies to Finnish parent companies of a Finnish limited liability company. The Companies Act and the Accounting Act (1336/1997, as amended) define a parent company in relation to its subsidiary as an entity which: (i) holds over 50 percent of such subsidiary's shares or voting rights; (ii) has the ability to appoint a majority of such subsidiary's board of directors or similar; or (iii) otherwise holds *de facto* control over such subsidiary. Therefore, the financial assistance provisions under the Companies Act do not apply to the extent a shareholder is not considered a Finnish parent company in accordance therewith. Notwithstanding the foregoing, the provisions concerning corporate benefit and equal treatment of shareholders referred to under question 2.2 above should be taken into account.

(c) Shares in a sister subsidiary

The provision of guarantees and/or security for the purpose of enabling the acquisition of the shares in a sister company is not subject to the financial assistance prohibition described under paragraph (a) above. However, the provisions concerning corporate benefit and equal treatment of shareholders referred to under question 2.2 above should be taken into account.

© 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?

Even though the English law concept of a trustee is not recognised under Finnish law, lenders may appoint a facility and/or security agent to represent them in all matters relating to the finance documents and/or security. Agents may be appointed to enforce, for and on behalf of the lenders, any of their rights under the finance documents, including any security, and to apply the proceeds therefrom in satisfaction of the secured claims of the lenders, in each case as set out in the relevant finance 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?

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?

In order to perfect the transfer of a loan and ensure its enforceability against third parties, the borrower must be notified thereof and, although not a requirement, the guarantor may also be notified of such transfer in order to ensure that it does not fulfil its guarantee obligations to the initial 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?

No withholding tax is deductible under Finnish law from interest payable on loans, proceeds of claims under guarantees or enforcement proceeds payable to domestic or foreign lenders.

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 6.3 below. No specific tax incentives are provided to foreign lenders in Finland.

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 taxes apply to foreign lenders as long as they do not have a permanent establishment in Finland which is effectively connected to the proceeds of the loan, guarantee or security interest.

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 Finnish borrower solely due to some or all of the lenders being established in a jurisdiction other than Finland. Finnish law does not contain any thin capitalisation rules *per se* but there are certain restrictions on the deductibility of interest on related-party loans.

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 parties to a contract are generally free to choose the governing law provided that such choice is made expressly or otherwise clearly demonstrated by the terms of the contract. Finnish courts would uphold choice of foreign law, except to the extent that such would be contrary to the mandatory laws or public policy of Finland. Notwithstanding any choice of foreign law, Finnish law will be applied in any bankruptcy, insolvency, liquidation, reorganisation or other similar proceeding in respect of, or any execution proceeding against, a Finnish entity. Further, in the event that a Finnish court is unable to obtain an account of the content of applicable foreign law, Finnish law may be applied.

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 judgments are in principle not recognised or directly enforceable in Finland unless otherwise agreed. For example, Finland and the United States have not entered into such an agreement and, thus, Finnish courts would not recognise or directly enforce a judgment rendered by a court located in the State of New York.

Judgments rendered by the courts of Member States of the European Union on or after 10 January 2015 are, however, as a general rule directly enforceable in Finland in accordance with Regulation (EU)

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

No. 1215/2012 of 12 December 2012 of the European Parliament and of the Council on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters (the "**Brussels I Recast**"). Thus, as long as the United Kingdom remains a member of the European Union, judgments rendered by English courts, fulfilling the requirements of the Brussels I Recast, remain directly enforceable in Finland in accordance with the Enforcement Code (705/2007, as amended) (the "**Enforcement Code**").

Please see question 7.7 below with regard to the recognition of foreign arbitral awards in Finland.

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?

According to Statistics Finland, in 2013 district courts resolved around half of their civil cases within two months and nearly all cases in less than six months. Most of the cases were resolved during written proceedings and only very few proceeded to a main hearing, where they were on average resolved within a year. The statistics do not take into account any potential enforcement proceedings. Both Finnish judgments and foreign judgments fulfilling the requirements of the Brussels I Recast are directly enforceable in Finland in accordance with the Enforcement Code upon submission of an application to the competent enforcement authority. The length of the enforcement proceedings may, however, vary significantly depending on the assets subject to enforcement.

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?

Subject to limited exceptions, the parties to a security agreement may agree on applicable enforcement procedures. Security over most movable assets may be enforced by the creditor itself through private sale or, alternatively, the creditor may seek enforcement by bailiff in accordance with the Enforcement Code. As an exception to the foregoing, security created by way of a mortgage registered in a public register (e.g. business mortgages and real estate mortgages) requires an enforceable enforcement order for execution and, accordingly, such security may only be enforced by bailiff in accordance with the Enforcement Code.

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 such restrictions apply to foreign lenders in the event of filing suit against a company in Finland or foreclosure on security, which would not apply to local lenders either.

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 principle, reorganisation proceedings under the Corporate Reorganization Act (47/1993, as amended) (the "Reorganization Act") impose a moratorium on legal proceedings and enforcement actions against a debtor and, save for limited exceptions, no creditor may enforce security or collect debt until the court has confirmed the reorganisation plan. Notwithstanding such stay, secured creditors remain entitled to receive interest payments and other debt-related fees provided for in the original credit documentation and, under certain circumstances with permission of the court may even be entitled to enforce security. The commencement of bankruptcy proceedings does not, however, impose a similar moratorium – 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?

According to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 and the Finnish Arbitration Act (967/1992, as amended), foreign arbitral awards will, unless contrary to the public policy of Finland, be recognised and enforced by the courts of Finland subject to application for enforcement thereof with the District 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?

In principle, the commencement of bankruptcy proceedings does not limit the right of creditors secured by a fixed charge over movable or immovable property to enforce their rights over security. A creditor seeking to enforce security must, however, provide the bankruptcy administrator with certain information on the claim and the security in a letter of lodgement as well as notice of its intention to enforce the security, and the time and place of such enforcement. The administrator may within two weeks of receipt of such notice prohibit such enforcement for no longer than two months for the purposes of clarifying the creditor's right to the security or safeguarding the rights of the bankruptcy estate. It should also be noted that, under certain circumstances, the bankruptcy estate may seek the court's permission to sell the security assets or to enforce the security through a bailiff.

The above rights do not, however, apply to creditors secured by a business mortgage, which may only be enforced as part of the general bankruptcy enforcement. Therefore, creditors secured by a business mortgage are entitled to proceeds from the bankruptcy estate only at the same time and through the same process as unsecured creditors, although with better priority. It should also be noted that security over business mortgages requires an enforceable enforcement order for execution (please see question 7.4 above) and that, in insolvency, receivables secured by a business mortgage are considered secured only up to 50 percent of the value of the mortgaged property and rank after receivables secured by fixed charges. Please also see 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?

Under the Act on Recovery to a Bankruptcy Estate (758/1991, as amended) (the "**Recovery Act**"), a security interest may be recovered or reversed in connection with reorganisation, bankruptcy or enforcement proceedings if: (i) such security was granted less than three months, or less than two years if granted to an affiliated party, prior to the filing for reorganisation, bankruptcy or execution and was not agreed on in the underlying loan (or other) agreement or subsequently perfected without undue delay (in the case of security granted to an affiliated party over three months but less than two years prior to the filing for reorganisation, bankruptcy or execution, the security interest may be recovered or reversed unless it can be shown that the debtor was not insolvent at the time of granting the security and did not become insolvent due to the security arrangement); or (ii) the granting of such security interest in an inappropriate manner favoured a particular creditor, involved the transfer of assets beyond the reach of the debtor's other creditors, or increased the debtor's indebtedness to the other creditors' detriment, provided, however, that the debtor was either insolvent at the time or that the act contributed to the debtor becoming insolvent, and the other party to the transaction was, or should have been, aware of this and of the adverse effect thereof on the debtor's financial situation, as well as of the factors that resulted in such security being considered inappropriate. Security granted more than five years prior to the filing for reorganisation, bankruptcy or execution may, however, in any case only be recovered or reversed if granted to an affiliated party.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Subject to certain exceptions (e.g. the State of Finland, Finnish municipalities, the Evangelical Lutheran Church and the Orthodox Church and their parishes), any natural person or legal entity may be subject to bankruptcy proceedings under the Bankruptcy Act (120/2004, as amended). After the commencement of reorganisation proceedings under the Reorganization Act, a debtor may, however, only be declared bankrupt in certain limited situations.

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, a pledgee may enforce security over movable property (save for business mortgages and certain other movable assets in respect of which a mortgage is registered) through private sale. Otherwise, enforcement is carried out by bailiff in accordance with the Enforcement Code, and requires an enforceable judgment or arbitral award against the debtor. However, if there is a danger that the debtor may seek to hide, destroy or dispose of its assets or take any other action which would e.g. endanger repayment of indebtedness, injunctive relief can also be sought to safeguard the assets.

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 Finnish law, the parties may agree on the submission of disputes to the courts of a foreign jurisdiction subject to certain criteria. The agreement must generally be made in writing. In addition, there are certain provisions in order to protect weaker parties, such as consumers or employees, and to ensure their access to Finnish courts at all times, which cannot be deviated from by submission to a foreign jurisdiction.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Finnish legislation does not contain specific provisions on the waiver of sovereign immunity, nor has Finland ratified the United Nations Convention on Jurisdictional Immunities of States and Their Property. The Supreme Court of Finland (KKO 2007:49) has, however, ruled that an entity may validly waive its sovereign immunity. It should, nevertheless, be noted that due to limited case law and the lack of specific legislation on the matter, whether or not, and to what extent, a waiver of sovereign immunity may be considered legally binding and enforceable under Finnish law may be subject to legal interpretation.

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 Finnish law, neither Finnish nor foreign lenders require a licence or other authorisation for issuing credit to corporations only. If, however, such entity receives repayable funds from the public and offers credit and financing for its own account in Finland as set forth under the Act on Credit Institutions (610/2014, as amended), it will be subject to a licensing requirement. Specific requirements concerning e.g. the owners, management and financial standing of such entity further depend on whether or not its statutory registered office is located in an EEA Member State. Failure to comply with such requirements may be subject to administrative and criminal sanctions as well as liability for damages. There are no particular licensing or other requirements for agents.

© 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 material legal issues to be considered when participating in financing and taking security in Finland have been addressed herein.

Acknowledgment

The authors would like to thank Krista Rekola for her invaluable assistance in the preparation of this chapter.

Tanja Törnkvist
White & Case LLP
Pohjoisesplanadi 37 A
FI-00100 Helsinki
Finland

Tel: +358 9 228 641
Fax: +358 9 228 64 228
Email: ttornkvist@whitecase.com
URL: www.whitecase.com

Tanja Törnkvist is a partner in White & Case's Banking practice and is based in the Helsinki office. She advises on a wide range of corporate and financing transactions and, in particular, has expertise in advising financial institutions and corporate clients in acquisition finance, general bank lending, project finance, real estate finance and financial restructuring.

Tanja is recognised as being among the leading bank finance lawyers in Finland and is in strong demand from domestic and international clients.

In a legal career spanning two decades, exclusively at White & Case, she has been at the forefront of developments in bank finance in Finland. These include documenting a novel way to take security over oil reserves, being among the first Finnish finance lawyers to introduce omnibus security agreements and breaking new ground in the Finnish high yield securities market, *pari* secured bank/bond structures as well as super senior revolving credit facilities.

Among Tanja's pioneering deals that were market 'firsts' are the first-ever full-scale consent solicitation process related to Finnish law-governed bonds and the first-ever domestic secured bond issue and programme by a Finnish issuer.

Oona Lilja
White & Case LLP
Pohjoisesplanadi 37 A
FI-00100 Helsinki
Finland

Tel: +358 9 228 641
Fax: +358 9 228 64 228
Email: oona.lilja@whitecase.com
URL: www.whitecase.com

Oona Lilja is an associate in White & Case's Banking practice and is based in the Helsinki office. Oona supports Finnish and international clients in various corporate and financial transactions, including bank finance and mergers and acquisitions.

Oona's bank finance experience includes acquisition finance, real estate finance, project finance and general bank lending, representing financial institutions as well as corporate clients. Oona also represents private equity, venture capital and corporate clients in M&A transactions across a range of business sectors.

WHITE & CASE

White & Case is a truly global law firm with 39 offices in 28 countries. Our diverse team of local, US and English-qualified lawyers advise clients on complex, cross-border transactions in almost every area of law. In both established and emerging markets, our lawyers are integral, long-standing members of the community, giving our clients insights into the local business environment alongside our experience in multiple jurisdictions. We work with some of the world's most respected and well-established banks and businesses, as well as start-up visionaries, governments and state-owned entities.

White & Case is a leading law firm in the Nordic region with a long-established and credible presence, having opened our Stockholm office in 1983 and our Helsinki office in 1992. As the only global law firm with offices in both Stockholm and Helsinki, we have significant transactional experience throughout the Nordic region and strong client relationships in each of Sweden, Finland, Denmark and Norway. Outside of Sweden and Finland, we maintain good connections with leading local law firms.

In Sweden, White & Case offers clients substantial experience in complex issues of Swedish law and regulation and we advise clients on a variety of transactions within Sweden, throughout the Nordic region as well as in Europe and beyond. Key practice areas include M&A, Banking, Capital Markets and Dispute Resolution. In Finland, we advise Finland-based and international clients on their Nordic and worldwide activities. We work in close cooperation with the Firm's other offices and specialised practice groups throughout the EMEA region, the Americas and Asia. Our core practice areas in Helsinki include M&A, Capital Markets, Banking and Real Estate.

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

France

Emmanuel Ringeval

Orrick Herrington & Sutcliffe LLP

Cristina Radu

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

With the French economy finally showing signs of recovery, the number of financing transactions in France has increased in 2016 compared to 2015. This was driven by a majority of refinancing activity taking advantage of the attractive interest rate environment and the high level of liquidity in the market.

The year 2016 also saw debt funds continuing to be more and more active in France, with "ticket" size becoming larger. "Cov-lite" financings also bounced back in 2016.

However, the rippling effects of Brexit and the uncertainty surrounding the results of the coming elections in France are likely to affect business activity in 2017 in France.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The French financing market saw numerous small-cap, mid-cap and large-cap LBO financing transactions in 2016. There have been several significant large-cap LBO financing transactions such as the financing of the acquisition of Foncia by Partners Group and the financing of the acquisition of B&B by PAI Partners.

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. Although the concept of "illicit cause" no longer exists under French law since a reform of the French civil code which came into force on 1 October 2016, an equivalent concept of "illicit content of an agreement" has been introduced by the reform and may be applied by the French courts with respect to the guarantees/security interests granted after 1 October 2016 which would not comply with the corporate benefit requirements.

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).

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

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.

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; and various tangible assets. 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 which 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); (iii) a delegation (*délégation*); or (iv) a security trust (*fiducie-sûreté*).

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 required in order to render the pledge enforceable against the debtor(s), but not for validity purposes. 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 required in order to render such assignment enforceable against the debtor(s), but not for validity purposes.

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.

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

A security trust (*fiducie-sûreté*) over receivables may also be granted. The notification of the security trust (*fiducie-sûreté*) to the debtor(s) is also required in order to render the security trust (*fiducie-sûreté*) enforceable against the debtor(s), but not for validity purposes.

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 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 2017, 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 (the statutory notary fees may be negotiated since a recent reform implemented in 2016 and discounts may be obtained in certain circumstances), 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 registry tax fees (*taxe de publicité foncière*).

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

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 between three and five 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 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) a pledge over intellectual property rights which may take up to five 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 more than 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 européenne*) 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, 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.

© 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 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 loan may be transferred in France by way of (i) assignment (which is the method generally used), (ii) novation, (iii) transfer of agreement (*cession de contrat*), or (iv) transfer of debt (*cession de dette*).

Since the French civil code reform entered into force on 1 October 2016, a transfer made by way of assignment is no longer required to be notified to the French borrower(s) by bailiff (*signification par huissier*) (or alternatively to have such transfer agreement signed by the French borrower(s) in a notarised form). A simple notification of the French borrower(s) by any other means is now sufficient (or the signing by the French borrower(s) of the transfer agreement in a form which does no longer require to be notarised). Such notification (or signing of the transfer agreement by the French borrower(s)) is also required in case of a transfer of the loan by way of a transfer of agreement (*cession de contrat*) or by way of a transfer of debt (*cession de dette*).

If the transfer of the loan is made by way of novation, transfer of agreement (*cession de contrat*) or transfer of debt (*cession de dette*), the consent of the debtor is required. Also the consent of the guarantor(s) as well as the consent of the security provider(s) is required in order for Lender B to be able to enforce its rights under the guarantee or under the relevant security interests. Such consents may be granted concomitantly with the transfer or prior to such transfer (such prior consent may also be provided in the loan agreement and/or in the guarantee/security interest agreement).

In order for Lender A to be discharged from its obligations under the loan agreement in case of a loan transfer by way of a transfer of agreement (*cession de contrat*) or by way of a transfer of debt (*cession de dette*), an express consent of the debtor to such discharge must also be obtained.

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 in 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 2016): Botswana; Brunei; Guatemala; the Marshall Islands; Nauru; Niue; and Panama.

(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 tax resident in 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

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

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.

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?

Under French law, a contract is governed by the law chosen by the parties.

This principle has been established by the 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, which 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 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 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.

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

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 (relating to due process, public policy, and the incompatibility with earlier decisions). These grounds are more restrictive than those applicable to the standard exequatur procedure.

Judgments rendered after 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 filed 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 instance court ("*tribunal d'instance*"). 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).

Pursuant to article 509 of the French Code of civil procedure, 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. It should, however, be noted that pursuant to article 524 of the French Code of civil procedure, a stay of enforcement can be ordered by the *Premier Président de la Cour d'appel* if the due process ("*principe du contradictoire*") has been breached and if the provisional enforcement is likely to result in clearly excessive consequences. *Ordonnances de référé* may in any case 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 in the first instance. 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 types of security interests), whereas enforcement through private foreclosure may generally 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

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

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. It should, however, be noted that for the writ of summons before the Commercial Court ("*tribunal de commerce*") to be valid, the foreign plaintiff has to elect domicile in France.

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. Pursuant 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.

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.

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

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 was recently 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 decision of the French supreme court (*Cour de cassation*) dated 13 May 2015 has, until recently, been 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.

This was, however, amended on 9 November 2016, following the enactment of the *Loi Sapin 2*, which entered into force on 11 December 2016 and provides that interim or enforcement measures relating to property belonging to a foreign sovereign State may only be authorised if the following cumulative conditions are met:

- the foreign sovereign State has expressly consented to such a measure;
- the foreign sovereign State has reserved or assigned the property in accordance with the request;
- where a judgment or arbitral award has been rendered against the foreign sovereign State and the property at stake is specifically used or intended to be used by that foreign sovereign State otherwise than for the purposes of public service; and
- there is a relationship with the foreign sovereign State entity against which the proceedings were instituted.

A specific regime has also been created by the *Loi Sapin 2* with respect to property (including bank accounts) used in the exercise of diplomatic missions of foreign States by requiring for this category of property an express and special waiver of immunity from the foreign State in order for any interim or enforcement measures to be taken with respect to such property.

Loi Sapin 2 has also introduced a new authorisation procedure that requires the creditor to seek, in an *ex parte* proceeding, an order for an interim or enforcement measure against the foreign sovereign State.

Finally, no interim measures and no enforcement action against property belonging to a foreign sovereign State can be authorised by a French judge in favour of the holder of a debt obligation or an instrument or right with characteristics similar to a debt instrument if:

- the foreign sovereign State was receiving aid from the Development Assistance Committee of the OECD when it issued the debt document;
- the holder of the debt obligation acquired that security when the foreign sovereign State was in default on that debt obligation or proposed a change in the terms of the debt obligation; and
- the default status on the debt obligation is less than 48 months at the time the holder of the debt obligation seeks a court order authorising him to seek an order for 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 (irrespective of whether such entity is located in or outside of 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. These provisions have become effective on 22 April 2016 when a decree listing all the conditions to be met for such loans to not fall foul of the French banking monopoly rules has been published. There are more than 20 conditions which have to be met, including 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;

(c) the borrower must be a small or medium-sized 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.

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

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 loans to companies subject to certain conditions being met) or to 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 on no later than the day of entering into of the credit agreement.

Emmanuel Ringeval
Orrick Herrington & Sutcliffe LLP
31, avenue Pierre 1er de Serbie
Paris
France

Tel: +33 1 53 53 75 00
Fax: +33 1 53 53 75 01
Email: eringeval@orrick.com
URL: www.orrick.com

Emmanuel Ringeval is a partner in the Finance department of Orrick Herrington Sutcliffe LLP in Paris.

He has over 20 years of experience representing French and international financial institutions, corporates, private equity funds and alternative capital providers on French and cross-border transactions. He focuses on leveraged finance, direct lending and restructuring transactions. He has also developed substantial experience in the energy and infrastructure sector in the context of complex financing and refinancing transactions involving loan and/or bond financings.

Prior to joining Orrick in 2016, Emmanuel Ringeval was a partner at Freshfields Bruckhaus Deringer and at Weil, Gotshal & Manges.

Cristina Radu
Orrick Herrington & Sutcliffe LLP
31, avenue Pierre 1er de Serbie
Paris
France

Tel: +33 1 53 53 75 00
Fax: +33 1 53 53 75 01
Email: cradu@orrick.com
URL: www.orrick.com

Cristina Radu is an associate in the Finance department of Orrick Herrington Sutcliffe LLP in Paris. Prior to joining Orrick, she was an associate at Freshfields Bruckhaus Deringer and at Weil, Gotshal & Manges.

She graduated from the University of Paris 1 Panthéon-Sorbonne and from the University of Bucharest and she has obtained two post-graduate degrees from the University of Paris 1 Panthéon-Sorbonne in international commercial law and in banking and finance law. 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.

Orrick is an international law firm specialised in the financial services, energy and technology sectors.

Founded in 1863 in San Francisco, Orrick offers its clients a unique combination of an in-depth knowledge of the local contexts and a global technical expertise, throughout more than 25 offices.

With over 1,000 lawyers, our firm has all the expertise required to meet our clients' legal needs in their development, and guarantees access to a global platform.

Worldwide, we have more than 300 lawyers active in the finance industry. Highly experienced, our Finance team is known as one of the strongest and most diversified teams in the market covering the full-spectrum of the Banking & Finance industry including acquisition finance, corporate finance, project finance, real estate finance and restructuring.

© 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?

In spite of market uncertainties resulting from the continuing impact of the European sovereign debt crisis, from the Brexit vote of the United Kingdom, and from the worldwide slowing global economy in 2016, lending markets in Germany continued to improve in 2016. The current outlook for the country's economic development and, consequently, for its lending markets, is generally viewed as positive. 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. In particular, there has been a solid flow of high-volume deals in Germany since 2013. 2016 marked the highest volume year for leveraged buy-out transactions in Germany since 2007, and the outlook for further growth in 2017 is regarded as one of the highest in Europe. New lenders such as debt funds and insurance companies are increasingly active and provide significant liquidity in Germany. 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 2016.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

In 2016, Henkel took up a $3.6 billion acquisition financing for the takeover of The Sun Products Corporation. Furthermore, the acquisition of Officefirst Immobilien AG (valued at €3.3 billion) by Blackstone Group from IVG, as well as the acquisition of Atotech by Carlyle Group from Total, constituted the largest debt-financed private equity transactions in Germany in 2016. Another example for the strong leveraged buy-out market in Germany was the acquisition of Xella International GmbH (valued at €2.2 billion) by Lone Star Funds from PAI Partners and Goldman Sachs. Overall, there were six buy-out transactions valued at over €1.0 billion in Germany in 2016. 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.

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

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 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 arm's 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.

© 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?

Under German law, there are no exchange controls that would pose an obstacle to enforcement of a guarantee or other collateral.

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.

© 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?

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 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.

© 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 generally no special priorities or other concerns with regard to a revolving credit facility. Security can even be created 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.

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

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.

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 German tax or other 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 also be added

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

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 1st 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 EU Member States (excluding Denmark), Singapore 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 22nd 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 in 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 1st 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 10th 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. (*See* below as regards the future reduction of this preference period.)

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. (*See* below as regards a future additional requirement for the ability of the insolvency administrator to challenge a "cash transaction".) "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 May 2016, the BGH rendered a decision clarifying claw-back rights against creditors attempting to support restructuring efforts of a creditor in financial difficulty. It held, *inter alia*, that a restructuring concept of the creditor that was meant to be implemented and based on corresponding expert opinions but ultimately failed might not subject such creditors to claw-back if such creditors obtained sufficient information about the restructuring concept and its feasibility from the creditor.

On a European level, the EU regulation governing cross-border cases was revised in 2015 and will take effect for insolvency proceedings opened on or after 26th June 2017. Such regulation will, *inter alia*, extend its application to pre-insolvency proceedings, will establish an EU-wide system of insolvency registers, will try to prevent "forum shopping" and establish new procedures with the aim of facilitating cross-border coordination and cooperation between multiple insolvency proceedings in different Member States relating to members of the same group companies.

On 22nd November 2016, the European Commission issued a draft directive in relation to early stage restructuring frameworks, rules to allow entrepreneurs to benefit from a second chance and rules to increase the efficiency of insolvency, restructuring and discharge procedures. This is currently also being discussed in Germany, but no legislative proposal has been issued yet.

On 7th February 2017, the German Federal Fiscal Court (*Bundesfinanzhof* – "**BFH**") rendered a decision that will have a significant impact on the German restructuring market. In German restructurings, a debt waiver has been frequently used to avoid insolvency. The BFH decision limits such option by holding that the so-called Restructuring Decree (*Sanierungserlass*), which was introduced by the German tax authorities to generally grant relief from an otherwise taxable cancellation of debt income, violates fundamental German constitutional rights and is therefore void. Although many German municipalities already refused to apply the Restructuring Decree in the past (particularly with regard to trade tax assessments), market participants expect that, going forward, the BFH decision may force numerous companies into insolvency, and call for legislative action. In the meantime, the parties to a restructuring transaction will need to devise alternative approaches, such as a debt push-up or a debt-asset swap.

On 16th February 2017, the German Parliament passed a bill with certain amendments to the clawback regime described above, with the goal to increase (on the basis of existing case law) 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 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 a creditor knew of the debtor's illiquidity at that point in time, (ii) in case a creditor was entitled to repayment or a grant of collateral that otherwise would be considered a fraudulent transfer, the creditor will be deemed to have knowledge of the debtor's fraudulent intent only where the insolvency administrator can demonstrate that the creditor had knowledge of the actual cash flow insolvency and not just (as is the case before the amendments to the clawback regime become effective) that the creditor expected such an insolvency, and (iii) the preference period for such transactions be decreased from 10 to four years. Furthermore, under the bill an additional requirement for any challenge of "cash transactions", besides the existence of intent to impair the debtor's third parties, will be the other party's awareness that the debtor acted with such intent. Other amendments relate, *inter alia*, to the clawback of payments of wages to employees and interest rates for clawback claims. Overall, it is expected that the amendments will result in a lower clawback risk for transactions and for situations in which in a restructuring context creditors negotiate payment relief measures (such as payment in instalments) with the debtor. It is expected that the bill will become effective in the first half of 2017.

In addition, important legislative changes relating to the insolvency of corporate groups are still pending in Germany.

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.

© 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?

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 KWG provides that the extension of cash loans in a commercial 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). These licensing and eligibility requirements are not different for a foreign lender.

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, including where such services are rendered by foreign lenders on a cross-border basis. According to BaFin, the reverse solicitation exception typically applies in the case of large corporate clients and institutional investors. However, where foreign lenders target potential borrowers with their cross-border services directly, they are subject to the German licensing requirement, unless they operate under a European passport in relation to such services.

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 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 an additional 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 became effective on 18th March 2016. Under such act, non-German EU funds 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.

On 23rd November 2016, the European Central bank published draft guidance on leveraged transactions to banks, which aim at ensuring safe and sound origination and distribution practices.

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

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

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 more than 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. In 2016 he advised Henkel in connection with its $3.6 billion acquisition financing for the takeover of The Sun Products Corporation. 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*, *European Legal 500*, *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 18 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 2016 he was part of a team that advised a U.S. insurance company on a tax-driven, complex cross-border share deal acquisition of a famous real property in Berlin, the first real estate investment of that company in the German market. 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 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 1,000 lawyers in 19 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 Firm

Ilianna Sotiria Koraki

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The year just gone, 2016, has been another year of negative credit expansion and within such an environment, the framework for the sale and servicing of non-performing loans (NPLs), which was established in 2015 by Law 4354/2015, has been significantly reformed. In addition, exclusive changes to the Bankruptcy Code have been adopted, whereas a statutory debt settlement is being drafted in order to address the NPL problem of the Greek economy. Note that most banking transactions are still operating under capital controls regime, which, however, has been loosened since August 2016.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The most significant lending transactions during 2016 were partly formed by the restructuring process of large enterprises. The most featured example is the financings included in the restructuring package of Marinopoulos, the large failing retailer in rescue proceedings by its creditors.

At the same time, international financial institutions (such as EIB, EBRD, BSTDB and IFC) are providing (even directly) liquidity to Greek corporates. In this framework, OTE, the largest Greek telecommunications provider, has entered into a €339 million syndicated loan arranged by EBRD and a €50 million parallel bilateral loan with the BSTDB.

Finally, other significant lending transactions which took place in 2016 include the €400 million syndicated loan to Hellenic Petroleum S.A. (one of the leading energy groups in South East Europe) and the issuance of €250 million of senior notes by the Luxembourg financing vehicle of Intralot Group under the guarantee of the Greek parent company.

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 *société 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 a 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

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

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, in which shareholders representing 1/10 of the paid-up share capital (1/20 in the case of listed companies) do 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 two-thirds majority (increased to 19/20, if provided on a post-transaction basis).

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?

Although the capital control regime has loosened since August 2016, nevertheless the capital control limitations 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 conditional mortgage, which may be rendered final (with retroactive effect as of the issuance of the prenotation order), 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: 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

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

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 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 24%), 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 to 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

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

(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 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?

Such a notion may be statutorily 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 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. All other related arrangements between creditors are agreed on a contractual basis, whereas the agent and trustee roles need to adapt to statutory requirements applicable to each separate level and its clauses.

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 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.

© 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 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 1.1.2014, 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.

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 or EBRD, 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 according to the new amendments of the GCCP, effective as of 1.1.2016, this

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

might take as long as 13–15 months approximately, 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. Note, that the above mentioned time frames have been significantly shortened due to the changes introduced to the GCCP.

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. Note that the recent amendments introduced to the GCCP present a significant effort to constrain the length of the enforcement process in a bid to obtain faster processes.

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, taking into consideration the recent changes introduced to the GCCP: 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 two years prior to the first auction or 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 other 10% of the auction proceeds shall satisfy the unsecured claims. If there are no unsecured creditors then creditors holding general privileged claims shall receive one third of the auction proceeds, whereas the other two thirds shall be distributed to the secured creditors. If again secured and unsecured claims coincide, the latter creditors shall receive 10% 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 with the 30% of the auction proceeds and creditors holding a general privileged claim with 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 proceedings involve suspension on all enforcement actions, which, however, apply for a limited period of time. In case of declaration of bankruptcy, a moratorium is enforced an all unsecured and general preferential creditors. Secured creditors may pursue their satisfaction by the secured assets, unless they are closely connected with the debtor's business. The suspension may last up to 10 months from the day of the bankruptcy declaration. In case of reorganisation, collateral security rights may be amended, as provided by the reorganisation 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 reorganisation 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 bankruptcy proceedings.

© 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?

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 regard 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?

Bankruptcy proceedings may be applied to any merchant (individual or legal entity) or any non-profit legal entity. Public entities and local authorities are excluded from bankruptcy proceedings. Furthermore, the following legal entities 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.

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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, was 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.

Finally, pursuant to article 5 of Law 2367/1995, venture capital companies are allowed to invest in bonds issued by Greek 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?

In any case, lenders and equity investors need to obtain special legal and tax advice when participating in financings in Greece.

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

George N. Kerameus
KPP Law Firm
10 Paradeisou 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 Kerameus 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, whereas 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.

Ilianna Sotiria Koraki
KPP Law Firm
10 Paradeisou Str.
GR 151 25 Maroussi, Athens
Greece

Tel: *+30 210 3390 741*
Fax: *+30 210 3390 342*
Email: *i.koraki@kpplaw.eu*
URL: *www.kpplaw.eu*

Ilianna Sotiria Koraki has been a member of the Athens Bar Association since 2013. In November 2016, she joined KPP Law as an associate. Ilianna holds an LL.B. from the Dimokrition University of Thrace, and an LL.M. in Corporate Restructuring from Heidelberg University of Germany. Ilianna practises in the areas of corporate law, civil law, banking, insolvency and restructuring law and is fluent in Greek, English and German.

KPP Law (Kerameus, Papademetriou, Papadopoulos & Associates Law Firm) 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

King & Wood Mallesons

David Lam

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Syndicated lending for the first three quarters of 2016 in Asia Pacific (excluding Japan) were down from their 2015 levels by 8.7%, with volumes at US$334 billion. The number of deals was also down by over 11% from 2015 levels to 925 transactions. While deal flow in the second quarter was good, this tailed off dramatically in the third quarter.

China was once again the main contributor, but even there volumes were down significantly from the previous year. On the other hand, Hong Kong posted significant increases in deal flow, with volumes up over 20% against the corresponding quarters in 2015. This was supported by healthy offshore borrowing by Chinese companies, including a US$12 billion+ loan to China National Chemical Corp (ChinaChem). Acquisition related lending in the region also received a huge boost, jumping over 45% compared to the same period of 2015.

Liquidity among banks remains strong, and the decline can be attributed in large part to a lack of borrower demand. Macro-economic uncertainties present at the start of 2016 with respect to Chinese credit and real estate markets have not gone away, and concerns may have been amplified by major events happening outside of the region, such as the Brexit vote and the United States presidential elections. The expected interest rate increase by the US Federal Reserve may also dampen borrower demand going forward.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The stand-out deal for the first three quarters of 2016 has been the US$12 billion loan to ChinaChem for the acquisition of Swiss company, Syngenta AG. This deal was the single most important factor in contributing to the increases in Hong Kong-based and acquisition finance syndicated lending.

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 security provisions covering all assets). However, it is also possible to have individual security documents covering 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 be 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 an assignment is prohibited, then it may be possible to take security with a charge instead.

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. To enhance the chances of having a fixed charge instead of a floating one, it is common to require that withdrawals from the account may only be made with the chargee's consent.

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 the account bank is required to acknowledge the notice. In addition to perfecting the assignment, this would enhance the control of the assignee creditor. For example, the notice

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

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.

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 of such 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 amount of 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 containing 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.

© 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

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.

"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 on 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 relation 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 such lender 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 it benefits from a guarantee or security from a Hong Kong grantor.

© 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.?

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 a foreign governing law provided this would not be contrary to public policy 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 the defendant does mount a defence, then the creditor may be able to get summary judgment within three to nine 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 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.

© 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?

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.

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 Kong 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 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 (in respect of jurisdiction, proceedings or execution) given by it in the relevant agreement may not be 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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. The licensing requirements apply equally whether the lender is based in Hong Kong or overseas.

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

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?

The Contracts (Rights of Third Parties) Ordinance (Cap. 623) is now effective, with the result that it is possible for parties to a contract to grant rights to persons who are not parties. Thus far, most loan and security documentation contains additional clauses designed to exclude the effect of the Ordinance, or otherwise to provide that to the extent a third party does derive any rights from the Ordinance, such third party's consent is not required in order to amend the document.

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

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; and 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

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.

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 includes:

- Best Law Firm (revenue over $200m) and Best Professional Services Firm (over $200m) AFR Client Choice 2016.
- Most Innovative Law Firm in China and Innovation in the Business of Law, Financial Times Asia-Pacific Awards 2016.
- Regional Law Firm of the Year and National Firm of the Year (for the 6th year) – China, International Financial Law Review 2016.
- Banking Law Firm of the Year, ALB China Law Awards 2016.
- Finance Team of the Year – Hong Kong, The Asia Legal Awards 2016.
- Best Financial Law Firm – Australia/New Zealand, FinanceAsia's 2015 Awards.
- Law Firm of the Year, Australian Banking & Finance Awards 2015.

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

Hungary

Szabolcs Mestyán

Lakatos, Köves and Partners

Andrea Spisák

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

In 2016, there was growth in corporate lending in the Hungarian market. Credit conditions for corporations continued to ease, which was justified by the favourable economic prospects and ample liquidity in addition to growing competition. Real estate project financing and NPL acquisition financing transactions have been significant amongst lending transactions.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Major real estate projects involved the financing of shopping centres. In the field of NPL acquisition, major transactions involved the financing of the acquisition of corporate NPL portfolios.

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. Hungarian guarantee limitations are not as restrictive as in other jurisdictions (e.g. Austria and Germany).

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 upstream guarantees granted by a Hungarian company in order to guarantee debt of its (indirect) shareholders or affiliated companies should be provided on arm's-length terms and in consideration of corporate benefit. However, it is not common in practice for the validity or enforceability of a guarantee to be successfully challenged by a third party liquidator or third party creditor. The potential grounds of such may be that it represents a transaction at an undervalue, giving preference to a creditor or the "deprived claims" principle.

Few court precedents are available regarding such challenges and these confirm that the consideration for the granting of collateral by a third-party collateral provider is the disbursal of the loan secured by such collateral whether or not the third-party collateral provider actually receives any benefit from such disbursed loan.

Directors' liability towards third-party creditors applies if the company underwent an insolvent winding up procedure and unsettled claims remained as a result of the director not taking the interest of the creditors into account.

2.3 Is lack of corporate power an issue?

Ultra vires rules could be considered as straightforward under Hungarian law. With respect to third parties, no by-laws or internal regulations affect the binding nature of a contract executed by the authorised representatives of a company, provided that the third party acted in good faith and has no express or constructive knowledge of the restrictive by-laws.

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 (or quota holder) approval might be prescribed by the constitutional documents of the respective company or required by the directors of the company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no such limitations.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no such obstacles.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Securities over bank accounts:

(i) Security deposit over bank accounts.

(ii) Bank account charge (often) accompanied by a prompt collection right.

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

Securities over business shares:

(iii) Security deposit over shares.

(iv) Charge over securities.

(v) Quota charge.

Security over receivables and other assets:

(vi) Charge over receivables.

(vii) Real estate mortgage.

(viii) Fixed charge over moveable assets.

(ix) Asset pool charge.

(x) Charge over IP rights.

Call option right and assignment may also be used to create security.

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 customary to conclude separate agreements in relation to different types of asset to reflect differing perfection requirements (including registration) and enforcement mechanisms.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. The real estate mortgage should be registered with the competent land registry. Note that title to the real property does not transfer to the mortgagee. If so agreed, a mortgage over a land plot automatically extends to superstructures established after the establishment of the mortgage (in which case additional registration may be needed).

The fixed charge over plant, machinery and equipment should be either registered with a specific registry (e.g. aircraft, vessels) if there is such or with the security interest register maintained by notaries if there is no applicable specialised register.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

A charge or a security assignment may be created over receivables.

A receivable charge needs to be registered in the notarial register. Notification of debtors is not a perfection criteria, but is advisable for the purposes of protecting the secured creditors' interest and necessary for enforcement purposes.

A security assignment is created by the agreement of the secured creditor and the security provider which becomes fully perfected upon the notification of the debtor.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. Hungarian law governed security agreements over bank accounts usually create (i) a bank account charge, (ii) a security deposit, and (iii) a prompt collection right.

Bank account charge

A charge may be created over bank accounts which must be registered in the notarial register. The notification of account banks is not a perfection criteria, but is market practice. Due to a restriction introduced in 2014, bank account charges may be enforced only via judicial enforcement, which means that a simple bank account charge is slow to enforce and does not provide sufficient comfort to lenders.

Security deposit

A security deposit is created by a tripartite agreement by the account bank, the security provider and the beneficiary. The bank account is blocked and the security provider has no control over the accounts. Security deposits may be enforced directly by the beneficiary, without any involvement of bailiffs or notaries. Enforcement occurs by the secured creditor instructing the account bank to sweep the amounts from the relevant accounts.

In order to enable the security provider access to its funds during the security period, lenders may agree to perfect the security deposit (i.e. block the relevant accounts) only upon the occurrence of an event of default (at least in respect of accounts which are used in the daily operation of the security provider).

Prompt collection right

The collection right authorises the account bank to accept and enforce collection orders submitted by the secured creditor. Accordingly, if the secured creditor submits a collection order, the account bank debits the relevant accounts with the relevant amount and transfers it to a Hungarian account of the secured creditor.

A collection right does not qualify as a security interest and therefore does not provide the creditor with secured creditor status in insolvency. There is also a risk that courts may set aside the collection right on the basis that by using the right the parties in fact circumvented the requirement of judicial enforcement with respect to bank account charges.

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 different types of business shares held in companies under Hungarian law, depending on the corporate form of the relevant company: (i) companies limited by shares have shares (in dematerialised or certificated form); and (ii) limited liability companies have "quotas".

Shares

Security deposit

The creation method of the security deposit depends on the form of the shares.

In case of dematerialised shares, a tripartite agreement involving the relevant securities account holder, the security provider and the secured creditor is needed, on the basis of which the securities account will be blocked or the shares are transferred to a blocked securities sub-account.

In case of share certificates, the share certificates shall be delivered to the secured creditor or a third-party custodian.

Charge

A charge may also be established over the shares regardless of their forms. In such case, the charge is registered in the notarial register and the security provider's disposal right is not restricted. Therefore, a share security deposit provides considerably more comfort for lenders.

Foreign law security

It is possible to create a security over shares under New York or English law to the extent the share certificates are located in New York or England or the dematerialised shares are held in an account in such jurisdictions.

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

Quota charge

Quotas are transferable and may be encumbered by way of a charge. The quota charge must be registered with the Company Court. Note that the quota charge does not transfer title or possession and is simply an encumbrance notifying that the relevant rights are secured in favour of the named beneficiary.

No foreign law-governed security may be created over quotas.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Hungarian law does not recognise the concept of a floating charge, but it is possible to create a charge over a group of assets by describing such assets or by referring to type and quantity. The asset pool charge must be registered in the notarial register. If an asset falling under the description of the pool is acquired in the future, such future asset could also be covered by the asset pool charge without further formality.

The chargor is able to dispose of the assets covered by the pool. Ownership in that case transfers free of encumbrance, provided that the transferee has acted in good faith and acquired the assets for consideration.

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 may grant security interests as a borrower and as a guarantor. For restrictions regarding financial assistance, please see question 4.1 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?

In connection with creating security interests, registration fees will be payable to the notary, the land registries and the Company Court. The registration fee due to the security interest register kept by notaries is around EUR 25 per security interest. The registration of one quota charge with the Company Court is approximately EUR 80. Land registries charge EUR 50 in respect of each mortgage. Registration fees are payable at the time of submitting the application for registration of the security interest.

Charges of the notarisation cannot be calculated precisely in advance. The amount of the notarial fees depends on the value of the secured interest, the length of the security documents and the number of counterparts requested by the parties. In our experience, notarial fees tend to be in the region of EUR 3,000–6,000 plus VAT. Notarial fees are payable upon the execution of the notarised documents. The notarised documents are not released by the notary until the receipt of evidence of payment.

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 practice, the registration of the securities generally does not take more than two to three weeks and registration in the notarial registry may be effected promptly on signing. The land registry sets an official general registration deadline of 30 days which, in practice, may take longer.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Besides the perfection requirements described above (and below in licensing), there are no general regulatory or similar consent requirements. Specific requirements may apply in relation to regulated sectors. The constitutional documents of the company may also prescribe shareholders' or other consents or approvals.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

If the wording of the security documentation is precise and appropriate, there shall be no specific concerns because of the revolving nature of the credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Security agreements should be notarised. The enforcement of notarised security documents is swifter than that of security documents in private deed. Notarisation ensures that the document is enforceable without obtaining a court order, which may take years. Notarised documents have an additional advantage: the burden of proof regarding the validity and existence of the debt (and the terms of the contract) is on the debtor.

A notarised and/or apostilled or legalised (as applicable) power of attorney from each party is generally required in relation to any non-Hungarian party to the security agreements.

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

Financial assistance rules apply only in respect of public companies limited by shares (i.e. a company the shares of which are listed on a stock exchange). Such company may provide financial assistance to third persons regarding the acquisition of shares issued by the company only on an arm's-length basis, on the account of the company's assets available for dividend distribution and provided that such assistance is supported by ¾ of the votes of the general meeting of shareholders.

Any security for any part of the debt which is not used to acquire or refinance the acquisition of the shares in a company is permitted and will not be affected by the financial assistance rules.

(b) Shares of any company which directly or indirectly owns shares in the company

This is not applicable in Hungary.

(c) Shares in a sister subsidiary

This is not applicable in Hungary.

© 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?

English trust is not recognised by Hungarian law. It is customary for the security agent or the security trustee to act on the basis of parallel debt which is untested in front of the Hungarian 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?

Hungarian law provides for the concept of "security holder" (in Hungarian: "*zálogjogosulti bizományos*"), the function of which covers the function of a security trustee in a syndicated lending transaction.

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 order to effect the transfer of the contractual position under Hungarian law, 'transfer of contracts' (in Hungarian: "*szerződésátruházás*") is required. Such transfer may be effected between the entering, the exiting and the remaining parties. If the remaining parties granted prior consent to the transfer, their notification of the transfer makes the transfer effective without the necessity of their participation.

If the contract is governed by a law other than Hungarian law, there are no special requirements under Hungarian 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?

Currently, there is no withholding tax/tax deduction on interest paid by a Hungarian tax resident company to a foreign entity.

No tax deduction or withholding tax applies to proceedings of a claim under a guarantee or the enforcement of security.

Note that corporate income tax ('CIT'), local business tax ('LBT') and/or bank tax can be payable on the proceeds if the lender is a Hungarian tax resident entity or has a permanent establishment in Hungary.

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 provided to foreign lenders. No taxes apply to loans, mortgages or other security documents in Hungary. Regarding stamp duties and potential costs of registration, please see 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?

The income of the foreign lender will not become taxable solely on the ground of granting a loan, guarantee, or security.

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 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.

Consideration paid (including interest) to a controlled foreign company ('CFC') by a Hungarian tax resident company is not deductible as an expense for the purposes of CIT in general.

The following rules are not specific in respect of the origin of the lenders; however, the rules on (i) thin capitalisation, (ii) transfer pricing, and (iii) unrealised capital gains may affect the Hungarian borrower as follows:

(i) *Thin capitalisation*: According to the Hungarian thin capitalisation regulation, the debt:equity ratio at a company should not exceed 3:1, otherwise the interest on the amount of debt exceeding this ratio shall not be deductible. Debt against credit institutions and financial undertakings are excluded for the purpose of thin capitalisation. Debt of credit institutions and financial undertakings is also excluded if related to their financial services.

(ii) *Transfer pricing*: The interest on the loan shall be determined at arm's length if the loan is provided by a related party (such as a subsidiary and its parent) to the Hungarian entity in accordance with the Hungarian transfer pricing regulation; otherwise, the CIT base of the entity shall be adjusted accordingly (interest exceeding the arm's-length price is not deductible for CIT purposes).

(iii) *Unrealised capital gains*: If the borrower has loans denominated in a currency other than its bookkeeping currency, it may incur taxable unrealised capital gains due to the obligatory fiscal year-end revaluation of such liabilities. The CIT Act allows the deferral of such gains on long-term liabilities until the write-off of such liability or its reclassification to short-term liabilities.

© 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?

Subject to public policy and mandatory provisions of Hungarian law, a choice of foreign law will be recognised by Hungarian courts. The parties to a contract have the freedom to set the applicable law.

The courts of Hungary will enforce a contract that has a foreign governing law, provided that the Hungarian courts have jurisdiction over the contract and the contract is legal, valid and binding under the law by which it is expressed to be governed.

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?

English court judgments

A judgment given in an EU Member State shall be recognised without special proceedings on the basis of the Brussels I Regulation.

New York court judgments

Judgments obtained in the courts of New York will be enforceable in the courts of Hungary without re-trial or re-examination of the merits of the case if:

(a) the jurisdiction of the court or authority is found to be legitimate under Hungarian law or the jurisdiction of such foreign court was stipulated by the parties in the relevant documents;

(b) the judgment is final and non-appealable and complies with the requirements relating to the form and content of foreign judgments; and

(c) none of the following reasons set out below are applicable to it:

- (i) the recognition of the decision would violate Hungarian public policy;
- (ii) the foreign court would not have had competence under its own laws to proceed against its own citizen (including legal entities) in a similar matter;
- (iii) the party against whom the decision was made did not attend the proceedings in person or by way of a representative because the summons, statement of claim or other document on the basis of which the proceedings were initiated was not properly served at his domicile or residence or in a timely fashion in order to allow adequate time to prepare his defence;
- (iv) the decision was based on the findings of such proceedings, which seriously violated the basic principles of Hungarian procedural rules;
- (v) a final judgment has been served or a proceeding has been commenced with respect to the same legal matter and factual background between the same parties prior to the commencement of the foreign proceedings; or
- (vi) a Hungarian court or other authority has exclusive jurisdiction (for example, proceedings related to real estate located in Hungary).

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 specific case, it may take years to reach a final and non-appealable judgment.

(b) The European Enforcement Order makes it possible to enforce a judgment directly in another Member State. Please note, however, that a European Enforcement Order may only be issued if several conditions, such as the absence of a dispute over the nature or extent of a debt, are met. In the absence of a European Enforcement Order, the Hungarian courts – following a prompt procedure of purely formal checks of a judgment rendered by an EU court – will issue a declaration of enforceability (without re-trial or re-examination of the merits of the case) for the purposes of its enforcement in Hungary.

The procedure of declaring a non-EU foreign judgment enforceable may take a couple of months.

The enforcement procedure itself generally takes one to three years, based on the complexity of the case, the location of the assets and the cooperation of the debtor, etc.

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 two main types of enforcement in Hungary: (a) judicial enforcement; and (b) out-of-court enforcement.

In order to commence a judicial enforcement procedure, the creditor must obtain an enforceable document. A notarised mortgage, together with the notarised declaration of the creditor stating that the secured claims have become due and payable, will qualify as an enforceable document.

The primary method of realisation in a judicial enforcement procedure is a public sale organised by a bailiff by an electronic auction held approximately 60 days following foreclosure.

Out-of-court enforcements are less time-consuming and have lower cost implications than judicial enforcement proceedings. Consequently, for secured creditors, the out-of-court enforcement procedure is the preferred way of enforcement.

In case of an out-of-court enforcement, no statutory fee applies; costs include valuation, advisors, notaries and bidding organisers. Our experience is that costs are usually EUR 200,000–300,000 in large transactions. Timing depends on market, number of bidders, type of sale, due diligence and negotiations. Processes could be closed within three to six months but could also take one to two years, while judicial enforcement proceedings take somewhere between one and three years.

Note that security deposit is directly enforceable by the secured creditor by a unilateral notice to the account holding bank and can also be effected during a bankruptcy moratorium; therefore, it is considered to be the "strongest" collateral security.

© 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?

No general restrictions apply, but a foreign lender: (i) may be required to pay a security for costs before national courts to ensure that the costs of the legal procedure are covered; and (ii) is required to appoint a delivery agent if it does not have a Hungarian registered seat.

Please refer to question 10.1 for licensing requirements for enforcement of 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?

Upon the submission of a bankruptcy petition, a temporary moratorium (not longer than five business days) starts and if the bankruptcy procedure is ordered and published by the court, the temporary moratorium ends and a 120-day moratorium is granted automatically. The moratorium may be extended to a maximum of 240 days from the commencement date of the bankruptcy procedure or exceptionally to 365 days.

A moratorium means the temporary suspension of the debtor's payment obligations to allow reorganisation of its debt with a view to be able to continue business operations as a going concern.

During the period of the moratorium, *in rem* security interests (such as mortgages, charges and pledges) and option rights established for the purposes of securing a debt may not be enforced. Security deposits created prior to the commencement date of the bankruptcy proceeding are exempted from that rule, provided that the secured party is a type of institution specified in the Hungarian Bankruptcy Act (e.g. a financial institution).

Please further refer to 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?

The same legal effects are attached to an arbitral award as to an ordinary court judgment and therefore a court may not re-examine the arbitral award on its merits.

Hungary is a Contracting Party to the New York Convention on Arbitration. Consequently, arbitral awards issued in the territory of another Contracting Party State shall be recognised and enforced without a re-examination of the merits of the case (to the extent the arbitral award complies with applicable Hungarian civil procedure laws and the procedures established by the Hungarian legislation on commercial arbitration for the enforcement of arbitration decisions, and insofar as such award is not contrary to public policy in Hungary).

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?

There are two types of insolvency proceedings in Hungary: (i) bankruptcy proceedings; and (ii) liquidation proceedings. Bankruptcy proceedings may be initiated only by the debtor itself and are designed to arrange for the reorganisation of the company being in financial difficulties.

Enforcement of security in bankruptcy proceedings

Regarding security enforcement during a bankruptcy moratorium, refer to question 7.6.

Enforcement of security in liquidation proceedings

During the liquidation proceeding, *in rem* security interests may be enforced only by the liquidator by way of selling the secured assets. The liquidator shall deduct the costs of the maintenance of the secured assets (and other similar ancillary costs) and a 5% liquidator's fee from the net proceeds of the sale. The remainder of the sale price will be, in principle, credited to the secured creditor.

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?

Hardening periods

Any creditor of an insolvent company or the liquidator has the right to challenge transactions concluded by such insolvent company, which is of a type falling under any of the criteria set out under subparagraphs (i)–(iii) below within 90 days from the date of becoming aware of the existence of such transactions, but in any event within one year from the date of publication of a court ordering the liquidation proceedings. The types of transactions open to challenge are the following:

(i) Contracts concluded within five years of the date preceding the date when a competent court received a petition for the initiation of liquidation proceedings, or at any time thereafter, if such contract or legal declaration resulted in a decrease in the value of the insolvent company's assets, and the intent of the insolvent company was to defraud any or all of the creditors, and the contracting party, or beneficiary of the legal declaration, had or should have had knowledge of such intent.

(ii) Contracts concluded within two years of the date preceding the date when a competent court received a petition for the initiation of liquidation proceedings or at any time thereafter, if the subject matter of such contract or legal declaration is: (A) an asset transfer by the insolvent company for no consideration; (B) an undertaking by the insolvent company in respect of its assets for no consideration; or (C) an arrangement resulting in evidently disproportional benefit in value to the contracting party.

(iii) Contracts concluded within 90 days of the date preceding the date when a competent court received a petition for the initiation of liquidation proceedings or at any time thereafter, if the subject matter of such contract or legal declaration is to grant preference to any one creditor, in particular an amendment of an existing contract for the benefit of such creditor, or provision of collateral to an unsecured creditor.

The liquidator, acting on behalf of the insolvent company, is entitled to seek to recover within the time periods referred to in the first paragraph above, any service rendered by the insolvent company within 60 days of the date preceding the date when a competent court received a petition for the initiation of liquidation proceedings or at any time thereafter, if the provision of such service resulted in a preference to any one creditor and was not made in its normal course of business.

Termination right of the liquidator

The liquidator is entitled to terminate the contracts previously concluded by the insolvent company with immediate effect, in which case the other contracting party has 40 days from the date of such termination to enforce its claim arising as a result of the termination by reporting the claim to the liquidator.

© 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?

Financial institutions, insurers, investment service providers and municipalities may not be subject to bankruptcy proceedings and a special regime applies to their liquidation. Generally, particular legislation (such as the Hungarian Banking Act) will provide specific provisions on their liquidation proceedings which are supplemented by the general rules set out in the Hungarian Bankruptcy Act.

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?

During the liquidation proceeding, ***in rem security interests*** *may be enforced only by the liquidator* (i.e. secured creditors may not conduct enforcement) by way of selling the secured assets. The liquidator shall deduct the costs of the maintenance of the secured assets and a 5% liquidator's fee from the net proceeds of the sale. The remainder of the sale price will be, in principle, credited to the secured creditor.

A ***security deposit*** may be directly enforced within three months from the commencement date of the liquidation proceeding.

A ***call option right*** constituted prior to the commencement date of the liquidation may be enforced during liquidation; however, no set-off may be exercised by the creditor. This means that the entire call option purchase price shall be transferred to the debtor.

Receivables assigned (with perfection) and collected prior to the opening of the liquidation do not form part of the liquidation pool.

In liquidation proceedings, ***set-off*** may be exercised against the insolvent company only if the underlying claim has been registered as a non-disputed claim and the underlying claim has not been assigned following the commencement of liquidation. However, if the second tender or auction is unsuccessful and the relevant asset is secured, the liquidator may, with the consent of the creditors' committee, sell the asset to the secured creditor having a security interest over the asset at an appraised value. The secured creditor may settle the purchase price by setting off its claim against the purchase price.

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 no national asset is involved).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes (provided that no national asset is involved).

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 and taking security are regulated activities and a licence of the National Bank of Hungary is required in respect of a transaction undertaken in a "business-like manner". The applicable legislation provides that if the following three criteria are met cumulatively, then a licence will be required: (i) the activity is conducted regularly; (ii) consideration is received; and (iii) lending/taking security is a service of the secured creditor which is provided by it generally and not only to specified persons or in respect of specific transactions.

No licence is required from the National Bank of Hungary if lenders having a registered seat in an EU or OECD Member State may also comply with the licensing criteria by way of passporting their lending licence into Hungary.

Otherwise, foreign incorporated lenders are usually able to rely on the exemption provided by condition (iii) not being satisfied on the basis that they do not offer services to, or solicit, Hungarian clients and they enter into transactions only with specific persons with whom a specific transaction is negotiated and agreed.

It is also common practice to include a recital in the finance documents making clear the "unsolicited nature" of the transaction.

The regulator has, to date, not imposed a fine in respect of foreign lenders to Hungarian corporate borrowers or against members of a syndicate of lenders. Consequently, a number of lenders lend in Hungary without making any structural change to the loan or security interests. Lenders who transact regularly, on the other hand, may look to introduce licensed affiliates or a licensed intermediary into the structure (and then participate through acquiring a sub-participation). In respect of Hungarian borrowers having operations/holding companies/branches also outside of Hungary, an additional solution may be also available, namely to disburse the loan to the foreign entity which may pass the funds downstream as intercompany financing.

In any event, lending and taking security without a licence (if applicable) will not result in the invalidity or unenforceability of the underlying agreements but in the imposition of a fine (the amount – which is between EUR 300 and EUR 6.5 million – is determined by the regulator in its discretion, taking into account the circumstances); this would ordinarily constitute part of the secured obligations under the security documents.

© 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?

There might be other special and material considerations to be taken into account depending on the details and the circumstances of a specific transaction. Consultation with a local advisor is recommended in each case.

Szabolcs Mestyán
Lakatos, Köves and Partners
Madách Imre út 14
1075 Budapest
Hungary

Tel: +36 1 429 1300
Fax: +36 1 429 1390
Email: szabolcs.mestyan@lakatoskoves.hu
URL: www.lakatoskoves.hu

Szabolcs Mestyán is a Partner and Head of the Banking & Finance Group and Aircraft Finance Group at Lakatos, Köves and Partners in Budapest, Hungary. Szabolcs's practice areas include Banking & Finance, Restructuring/Insolvency, Aviation and Dispute Resolution.

He has developed expertise and acquired knowledge of asset and project finance, as well as the Hungarian law aspects of securitisation matters. He has been involved in most of the major dispute resolution and insolvency (restructuring) matters that have emerged in Hungary since the crisis and is specialised in complex cross-border insolvency procedures and multi-jurisdictional restructurings. Szabolcs is regarded by legal directories as a cutting-edge expert in banking matters.

Andrea Spisák
Lakatos, Köves and Partners
Madách Imre út 14
1075 Budapest
Hungary

Tel: +36 1 429 1300
Fax: +36 1 429 1390
Email: andrea.spisak@lakatoskoves.hu
URL: www.lakatoskoves.hu

Andrea Spisák is a Senior Associate in the Banking & Finance Group at Lakatos, Köves and Partners in Budapest, Hungary. She has developed expertise in banking and finance and capital markets regulatory matters as well as the laws and supervision of the European financial markets at the National Bank of Hungary. Andrea has further acquired knowledge in corporate and commercial financing deals and transactions at a leading global law firm.

LAKATOS, KÖVES AND PARTNERS
ÜGYVÉDI IRODA

Lakatos, Köves and Partners (LKT) is a nine-partner, 40-lawyer, full-service commercial law firm based in Budapest, Hungary, with a predominantly international client base, offering cutting-edge know-how and matching innovative legal solutions to business needs. For many years the firm was Clifford Chance's office in Budapest, but since 2009 has been independent. LKT's market standing is reflected in top-tier rankings in many areas including Banking & Finance, Corporate/M&A, Real Estate, Dispute Resolution, TMT and Tax. The firm has an extensive referral network of leading international law firms.

LKT's Banking & Finance practice continues a long history of innovation, providing advice to lenders and borrowers and other market participants in the financial services sector. The team played an important role in the development of the syndicated loan market in Hungary, and was heavily involved in the financing of infrastructure projects. Currently, areas of focus include advice on insolvency and restructuring in the real estate and other sectors, advice on regulatory issues facing banks, and a growing asset (particularly aircraft) finance practice.

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

India

Anjan Dasgupta

HSA Advocates

Harsh Arora

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Despite higher economic growth, the banking sector has been under tremendous stress due to the sharp increase in non-performing assets ("**NPAs**"). Asset quality reviews conducted on banks showed significant discrepancies in the reported levels of impairment and actual positions, leading to increasing levels of provisioning requirements. However, banks showed some improvement pursuant to considerable capital infusion from the Central Government and a slew of changes in the treatment of certain balance sheet items. To address the issue of revitalising distressed assets and financial restructuring of large accounts, the Reserve Bank of India ("**RBI**") introduced the Scheme of Strategic Debt Restructuring ("**SDR Scheme**") on June 8, 2015 and Scheme for Sustainable Structuring of Stressed Assets ("**S4A**") on June 13, 2016 in addition to RBI's Framework for Revitalising Distressed Assets in the Economy dated February 26, 2014 and the Strategic Debt Restructuring Scheme issued on June 8, 2015.

The Indian Parliament passed the Insolvency and Bankruptcy Code, 2016 ("**Bankruptcy Code**" or "**Code**"), a comprehensive legislation dealing with the insolvency and bankruptcy resolution of companies, limited liability partnerships, partnership firms and individuals in a time bound manner. The Code aims to maximise asset value, revive business on a going concern basis while keeping the interest of all stakeholders. A working group of the Central Government has also proposed the Financial Resolution and Deposit Insurance Bill, 2016 to, *inter alia*, address the resolution of distressed financial service providers (through a resolution corporation) and provide deposit insurance to financial services consumers.

The Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, was also notified in August 2016. The amendment includes certain procedural changes to ensure stricter timelines for filing written statements, conclude proceedings, etc., filing written applications/statements in an electronic form and bringing debenture trustees within the ambit of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 ("**DRT Act**") and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI**"), allowing them to enforce security without court intervention and approach the tribunals under the DRT Act to recover unpaid debt. The Central Registry of Securitisation Asset Reconstruction and Security Interest of India ("**CERSAI**") was also introduced and lenders are now required to mandatorily register the security created in their favour on the CERSAI within the timelines stipulated.

The RBI also brought in the concept of computing interest rates on advances in March 2016, based on the marginal cost of funds based lending rate ("**MCLR**"). The directions mandate that all rupee-denominated loans sanctioned/renewed from April 1, 2016 will be priced as per the MCLR, the internal benchmark for the banks. Prior to MCLR, the interest rates charged by banks were governed by the concept of 'base rate'.

The framework for external commercial borrowings ("**ECBs**") from overseas lenders also received a make-over with the introduction of fewer restrictions on end-uses, higher all-in cost ceilings, expansive listing of eligible lenders to include insurance companies, pension funds and sovereign wealth funds, permission for higher interest on long-term ECBs, etc. To encourage investment in start-ups, the RBI has permitted start-ups to raise up to USD 3 million in a financial year for a three-year tenure.

Additionally, some provisions of the Companies Act, 2013 ("**Companies Act**") were amended pertaining to inter-corporate loans and corporate resolutions for borrowing. Foreign portfolio investors have now been allowed to invest in defaulted bonds with a maturity of three years or more. Registered foreign portfolio investors have also now been allowed to invest in unlisted bonds subject to certain terms and conditions. RBI also issued in-principle approvals to 11 applicants on August 19, 2015 for setting up payment banks and on September 16, 2015; in-principle approvals were granted to 10 applicants for setting up small finance banks. The RBI also issued banking licences to private sector banks, including IDFC Bank Limited and Bandhan Bank.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The current banking and finance trends in India have seen significant lending by way of, *inter alia*, the following:

I Corporate Bonds

The past 18–20 months have brought in numerous regulatory changes including the introduction of regulations to govern 'Masala Bonds' (Indian Rupee-denominated bonds issued to overseas investors), regulatory amendments to laws governing private and public placement of non-convertible debentures (listed and unlisted), amendments to laws pertaining to foreign currency borrowings, foreign currency convertible bonds, etc. Some landmark issuances include India's first listed offshore green rupee-denominated bonds by International Finance Corporation and the world's first listed 'Masala Bond' issuance by Housing Development Finance

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

Corporation in July 2016. Other high-profile issuances included foreign currency convertible bond issuance by Videocon Industries, and listed non-convertible debenture issuances by Peninsula Land, Muthoot Finance Limited, and Indiabulls Housing Finance Limited.

II Real Estate Financings

Real estate finance has gained momentum following the Central Government's aim to liberalise overseas investment in the Indian real estate sector, considering it is one of the largest employers in India. Real estate financing transactions included debt funding by banks, financial institutions and non-banking financial companies ("**NBFCs**") and equity financing by way of foreign direct investment (through mezzanine financing, structured equity instruments, etc.). The External Commercial Borrowings norms for affordable housing and enhancement of limits for listed non-convertible debentures has also helped increase funding avenues for the real estate sector. Some significant debt funded real estate financing includes lease rental discounting loans by Deutsche Bank to, *inter alia*, the Raheja Group, private equity investments by GIC Pte Ltd (Singapore), Blackstone Group, and Asian Development Bank's financial assistance to Bangalore Metro Rail.

III Renewable Power Project Financings

There has been a considerable amount of financing in the renewable power (especially solar and wind power) sector. Numerous policy initiatives have increased the development of renewable power projects hence the increase in project financing for such projects. Many banks and NBFCs, including financing arms of L&T, and government-owned banks and financial institutions such as State Bank of India, Power Finance Corporation Limited and Rural Electrification Corporation Limited have undertaken and continue to fund several renewable power projects across the country through unilateral and consortium financing.

IV Restructurings and Stressed Asset Buyouts

Given the increase in stressed assets in the market, RBI has changed the regulations governing restructured debt financing and financing of companies in financial distress. The introduction of revised legislations for corporate debt restructuring have prompted lenders to be more open to financing structured debt, turning into majority equity owners, gaining management control of troubled companies and selling stressed assets. Some significant restructured financing deals include Gammon India, Electrosteel Steels and Monnet Ispat.

HSA Advocates has, in its capacity as lenders' legal counsel, advised in several banking and financing transactions under the abovementioned types of financings.

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)?

No company shall, directly or indirectly, give any guarantee in connection with any loan taken by him or to *any other person in whom the director is interested*. However, a holding company can give guarantee or provide security in respect of loan made:

- to its wholly owned subsidiary company; or
- by any bank or financial institution to its subsidiary company,

where such loan is to be used for the principal business activities of the company in whose favour guarantee or security is being provided.

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?

Yes. No consideration whether by way of commission, brokerage fees or any other form, is allowed to be paid by the borrower to the guaranteeing/securing company.

2.3 Is lack of corporate power an issue?

The Companies Act stipulates that every company shall take consent of the directors present at the board meeting before giving any guarantee and providing security and in case any term loan is subsisting from public financial institutions, a prior approval from such public financial institution shall be obtained (if any default in payment of interest or term loan is subsisting).

In addition to the above, prior approval of members by a special resolution passed at a general meeting of the company issuing such guarantee is required, in case such guarantee is beyond the limit i.e., exceeding 60% of its paid-up share capital plus free reserves plus securities premium account or 100% of its free reserves plus securities premium account, whichever is more ("**Limit**").

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

The following approvals, consents and filings are required in addition to compliance with conditions given under question 2.6 herein below:

1. prior approval of members by a special resolution passed at a general meeting and filing of the same with the registrar of the companies (if the guarantee is beyond the Limit);
2. prior approval from such public financial institution in case of a subsisting loan (if any default in payment of interest or term loan is subsisting);
3. to maintain a register which shall contain the particulars of the guarantee given. The entries in the register (either manual or electronic) shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose; and
4. to disclose the details in the financial statement of the company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No company:

1. directly or indirectly, shall give any guarantee in connection with a loan to any other body corporate or person – exceeding the Limit – unless such guarantee is authorised by a special resolution passed in a general meeting of the shareholders of the company; or
2. which is in default in the repayment of any deposits accepted before or after the commencement of the Companies Act or in payment of interest thereon, shall give any loan or give any guarantee until such default is subsisting.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Yes, the Reserve Bank of India has stipulated controls on issuance and enforcement of a guarantee through various guidelines namely:

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

1. Foreign Exchange Management (Permissible Capital Account Transaction) Regulations, 2000;
2. Foreign Exchange Management (Guarantees) Regulation, 2000;
3. Master Direction – External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers ("**ECB Master Directions**"); and
4. Foreign Exchange Management (Borrowing and Lending in Foreign Exchange) Regulations, 2000 ("**Borrowing and Lending Regulations**").

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

A lending obligation may be secured by way of collateral security which may take the form of tangible or intangible property (whether movable and immovable both current and fixed), shares and other securities including convertible and non-convertible debt instruments, bank accounts, contractual rights (such as rights available to a borrower under its project documents), receivables and intellectual property (including goodwill, trademarks, copyrights, etc.). Any collateral security shall be subject to applicable laws and the terms of the contractual arrangement between the lender and the borrower and any arrangement between the borrower and the counter parties to its project documents.

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 way of a general security agreement; however, it is not prevalent in the market. Security over various types of collateral may be created as follows:

Security over immovable property, including leasehold rights over such properties, is required to be created by way of a mortgage. The law provides for creation of mortgage in several forms, of which simple mortgage, English mortgage and equitable mortgage are prevalent. Simple mortgage and English mortgage need to be executed in writing and compulsorily registered with the relevant sub-registrar of assurances and stamped as per applicable stamp laws. An equitable mortgage (also mortgage by deposit of title deeds) is created and perfected by depositing the title deeds of the immovable properties, with the lender/security trustee/agent. Parties generally decide on the form of mortgage, based on various considerations, including stamp duty implications in the state where the property is situated/where the security documents/title deeds are being executed/deposited. Some States have made registration of equitable mortgage mandatory and liable to stamp duty.

Security over movable property may be created by way of:

(i) A deed of pledge with a fixed or floating charge (depending on the contractual terms and commercial understanding of the parties) on shares and debentures or other securities. A pledge is perfected by actual or constructive delivery of the pledged assets to the lender and is often accompanied by a power of attorney executed by the pledger in favour of the pledgee, authorising the pledgee to, *inter alia*, transfer the pledged shares and exercise other rights and powers thereof, in the event of default.

(ii) A hypothecation is a floating charge (without transfer of possession and as per the contractual terms and commercial understanding of the parties) on movables created pursuant to a deed of hypothecation and includes inventory and other trading stock. Charge by way of hypothecation is crystallised upon an event of default.

Companies are required to register charges/mortgage/pledge with the concerned registrar of companies as per the provisions of the Companies Act read with rules thereto, whereas banks and financial institutions are required to notify charges created in their favour to the CERSAI.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security can be created over movables and immovables (including leasehold rights thereto) such as land, plant, machinery and overhead or underground equipment. Simple mortgage, English mortgage and equitable mortgage are common forms of mortgage for taking security over immovable properties. Movables may be secured by means of a pledge or by hypothecation with a fixed or floating charge. The procedure has been briefly mentioned in 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?

Trade and other cash receivables (including receivables under insurance contracts) may be secured/charged in favour of a lender by a borrower by way of hypothecation, mortgage, or an assignment (depending on the terms of the lending transaction). Assignment is generally avoided due to stamp duty implications. Generally, notice of assignment of receivables in favour of the lender is required to be given to the debtors under the Factoring Regulation Act, 2011.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Subject to the terms and conditions stipulated in the contract between the creditor and debtor, collateral security may be created over cash deposited in bank accounts as stated in question 3.4 above. The general practice in large lending transactions where the security envisaged is the borrower's cash deposits, is to create a security over the cash deposits by a deed of hypothecation or create a charge over the accounts maintained with the account bank in which the borrower's cash deposits lie.

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 can be taken over shares by way of a pledge. The procedure for creation of a pledge is briefly stated in question 3.2 hereinabove. Shares may be in dematerialised or physical form. A pledge of shares entails constructive or actual delivery of the share certificates evidencing title thereto. A pledge over dematerialised shares may be created by following the process prescribed by the rules of the relevant depository together with the provisions of the Depositories Act, 1996 and the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 (collectively "**Depositories Regulations**"). The pledgor's depository participant

is required to notify the depository to block the pledged securities and prevent any transfer of the same until the charge is satisfied and the pledge is released by the pledgee by filing requisite forms and annexures as provided, *inter alia*, under the Depositories Regulations.

Pledge over shares can be validly created under English or New York law. However, for the pledge to be enforceable in India against the Indian company, it must be compliant with the provisions of Indian laws including the Code of Civil Procedure, 1908 ("**CPC**"), and the Depositories Regulations. However, general market practice does not include creating a pledge over shares of an Indian company, under foreign law.

Under Indian law, the execution of a foreign decree is governed by the provisions of Section 44A of the CPC unless it falls under any of the exceptions given under Section 13 of the CPC, which provides that a foreign judgment shall be conclusive as to any matter thereby directly adjudicated between the same parties or between parties under whom they or any of them claim litigating under the same title, except: (a) where the judgment has not been pronounced by a court of competent jurisdiction; (b) where it has not been given on the merits of the case; (c) where it appears on the face of the proceedings to be founded on an incorrect view of international law or a refusal to recognise the law of India in case where such law is applicable; (d) where the proceedings in which the judgment was obtained are opposed to natural justice; (e) where it has been obtained by fraud; or (f) where it sustains a claim founded on a breach of any law in force in India. Section 44A of the CPC provides that where a foreign judgment has been rendered by a superior court in a territory which the government of India ("**GOI**") has by notification recognised to be a "reciprocating territory", it may be enforced in India by proceedings in execution as if the judgment had been rendered by a relevant court in India. A "reciprocating territory" is any country or territory outside India, which the GOI may, by notification in the official gazette, declare to be a reciprocating territory. The United Kingdom has been declared by the GOI to be a reciprocating territory for the purposes of Section 44A and a judgment by a high court or any superior court in the United Kingdom enforceable in Indian district courts provided it is brought in India within 3 (three) years from the date of the judgment. It is to be noted that the proper procedure for the creation and enforcement of a pledge as per Indian law will be required to be observed. It may be noted that Section 44A does not cover decrees in respect of taxes, fines, penalties or other charges of a similar nature.

The United States of America has not yet been declared a reciprocating territory, and any judgment by any courts therefrom may not be enforceable in India. Judgments of courts in the United States of America can be enforced only by filing a suit in an Indian court for a judgment based on the foreign judgment. The time limit to file such a law suit in India is within three years of the foreign judgment.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over inventory (movable property) is generally created by way of a deed of hypothecation in accordance with the procedure prescribed under 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)?

Companies may grant security (i) in favour of their lender, subject to the provisions of the Companies Act, and (ii) as a guarantor, in favour of lenders of other borrowers and/or guarantors of obligations under credit facilities extended subject to the provisions of the Companies Act. For details please see our response to question 4.1.

Companies are required to execute security documents by their key managerial personal/directors and/or under a common seal if required, and register the security with the concerned registrar of companies as per the provisions of the Companies Act. A company may also have to obtain the approval of its shareholders, consent/no objection of the income tax authorities and permission of a lessor (if required under the lease deed) before proceeding with the creation and perfection of a charge. Creation of a charge on immovable property or movable property not being stock-in-trade, requires the consent and confirmation of income-tax authorities to ensure that no proceedings are pending against the security provider or such assets under the Income Tax Act, 1961 ("**Income Tax Act**").

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?

As stated in question 3.2 above, registered mortgage deed and mortgage by deposit of title deeds (in some states) is required to be registered with the concerned land registry. A deed of pledge or deed of hypothecation is not required to be registered, except with the concerned registrar of companies and with the CERSAI by the concerned lenders. Documents including power of attorney, declaration *cum* undertaking (affidavit), foreign documents and any other documents which may not be executed in the presence of a lender need to be notarised by a notary registered under the Notaries Act, 1952 and by paying minimal notary fees. Any security document including documents pertaining to mortgage, hypothecation and pledge attract stamp duty as per the rate prescribed by each State in India and may be fixed or *ad valorem*. Stamp duty rates substantially vary from state to state and parties generally decide the place of execution of security documents based on location of the parties, ease of security enforcement and stamp duty implications. It is to be noted that if a document is stamped in one state but the original or copy of such document is brought into another state that has a higher stamp duty, the differential stamp duty applicable in the state into which the document has been brought, may need to be paid on such document. Registration and stamp duty requirements of all the above security documents have been provided under question 3.2 above.

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 law generally provides specific timelines within which a security document needs to be filed/registered with the registrar of companies, CERSAI or the land registry (in case of security over land) any other concerned regulatory authorities such as the Directorate General of Civil Aviation (in case of security over the

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

aircrafts), the Registry of Ships in India (in case of security over the ships/vessels), the Trade Mark Registry (in case of security over the relevant intellectual property rights) and the Patent Office (in case of security over the patents), etc. The GOI, with an aim to forward its digital and green initiative, has begun to make e-filing mandatory for various corporate actions. Such filing, notifications or registration requirement does not involve significant amount of time and expenses.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Creation of security on property may require consents or approvals depending on the nature or use of the property. For example, in case of mortgage of a leasehold property, the mortgagor (also the lessee) may be required to take consent of the lessor. Similarly, in case of security on receivables arising out of a contract between borrower and a third party, consent of the third party may be required to be procured under the terms of such contract.

In addition to the above, the consent of income tax authorities is also required under Section 281(1)(ii) of the Income Tax Act, unless exempted therein.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

A revolving credit facility is generally secured by hypothecation over current assets and movables (having a floating charge). There is no special priority for revolving credit facilities, subject to the contractual arrangement between the parties. Since a revolving credit facility may be withdrawn and re-drawn by the borrower any number of times (depending on the contractual terms), lenders need to ensure that the facility is adequately secured at all times. The lenders may also need to ensure regular monitoring of the secured assets through financial statements, physical inspection, stock statements and registers.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Kindly refer to our response to question 3.9.

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 67(1) of the Act restricts a company limited by shares from directly or indirectly purchasing its own shares, without effecting a reduction in its share capital. Section 67(2) of the Act restricts public limited companies and their subsidiaries from providing security, guarantees or any kind of financial assistance for the purchase of, or subscription by, any person of any shares in the company or its holding company, subject to exceptions provided under Section 67(3) of the Act.

(b) Shares of any company which directly or indirectly owns shares in the company

In addition to our response under (a), Section 186 of the Act allows a company to provide security or guarantee for a loan to a body corporate without its shareholders' approval, provided such loan does not exceed 60% of its total paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more. However, companies need to ensure compliance with Section 185 of the Act in relation to loans to directors, etc., if applicable. Further, financing of any acquisition of a holding company's shares is also restricted under Section 67(2) of the Companies Act.

(c) Shares in a sister subsidiary

As provided under (b) herein above, subject to compliance of Section 185 of the Act, Section 186 of the Act lays down the law to be observed while giving security/guarantee by a company for a loan obtained by anybody corporate, for the aforesaid purposes, subject to the conditions laid down thereunder.

In addition to (a), (b) and (c) hereinabove, it is pertinent to note that as per the Banking Regulation Act, Indian banks are not allowed to provide financial assistance to companies for buy-back of their own securities. The RBI also places certain restrictions on Indian lenders funding companies' purchase of securities or investments in other corporates in concurrence with the Companies Act.

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?

While trusts are governed by the Indian Trusts Act, 1882, the concept of agency is governed by Section 182 of the Indian Contract Act, 1872. In large consortium or multiple banking transactions, it is standard practice to appoint a trustee or an agent (lenders' agent or trustee) and create security in favour of such trustee or agent to enable it to enforce the security/loan documentation on behalf of the lender(s). The agent or trustee must be given adequate powers *vide* the trustee or agent appointment agreement to enable it to enforce the security on behalf of the lender(s) and apply the proceeds therefrom towards the claims of all the lender(s), in accordance with the trustee agreement or the *inter se* agreement ("**ISA**") between the lenders. While the trustee or the agent has the technical or legal ownership of the assets, the lenders remain the ultimate beneficiaries. However, certain lending transactions such as issuance of secured debentures, make the appointment of a debenture trustee mandatory under the Companies Act.

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 mechanism of "trust" and "agent" is a well-recognised concept in India and may be carried out as provided in question 5.1 above. Alternatively, lenders may also appoint any one of the lenders

(usually the largest lender of the consortium) as a lead lender/ lender's agent to hold the security on behalf of all the lenders and distribute the proceeds thereof among the lenders, in the ranking provided under the contractual terms.

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?

Debt may be transferred by novation whereby all the rights, benefits and obligations under the loan documents are novated in favour of the new lender, or by way of an assignment where the existing lender assigns the whole or part of its rights under a loan in favour of the new lender. In case of a transfer of rights and obligations on the same commercial terms, Lender A may not need to procure consent of the borrower before transferring its loan to Lender B (subject to the contractual terms). However, if the commercial terms of Lender B differ from Lender A, the lenders will have to take consent of the borrower before proceeding with such transfer. Further, Lender A will also be required to release and return the guarantee executed in its favour so that a fresh guarantee may be executed in favour of Lender B. This process would involve additional costs (especially stamp duty on the guarantee and other accession/ novation documents). It may also be noted that as per the Master Circular – Loans and Advances – Statutory and Other Restrictions, issued by the RBI from time to time, the transferee bank must obtain necessary credit information of the borrower from the transferor bank before taking over an account/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?

Withholding tax at the rate of 10% is applicable in case of payment of interest to loans from domestic lenders. Withholding tax is required to be deducted or withheld by a borrower in case the interest is to be paid to a foreign lender, as per the provisions of Section 194LC of the Income Tax Act. The present rate of withholding tax ranges from 5% to 20% under Section 194LC of the Income Tax Act (depending on the category of borrower). Withholding tax is determined by the finance acts and/or double taxation treaties with other countries and entities may avail the benefit of a lower tax rate if available thereunder. Withholding tax will also have to be deducted from the proceeds of a claim under a guarantee or from 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?

Tax and other incentives to foreign lenders will depend upon the nature of the lending transaction, the income from such transaction, the type of lender, as well as the type of borrowing entity and the country of origin. As stated in question 6.1 herein above, tax incentives and benefits, if any, may be availed of under any double taxation treaties executed with other countries. Taxes applicable to foreign lenders has been provided under 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?

In addition to our response under question 6.1 hereinabove, it may be noted that mere grant of security from a domestic entity will not subject the foreign lender to tax implications.

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.?

Expenses pertaining to creation and perfection of security (generally borne by the borrower), include stamp duty and registration charges. Affidavits, powers of attorney and declarations (in the form of affidavits) need to be notarised for evidentiary value. However, notarial fees and registration fees (before the registrar of companies) are nominal. Stamp duty charges vary from state to state.

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.

Foreign loans or credit facilities to an Indian borrower (external commercial borrowings or ECBs), are governed by the Foreign Exchange Management Act, 1999 ("**FEMA**") and rules and regulations made thereunder and also by the ECB Master Directions. As per the ECB Master Directions, a foreign equity lender is required to hold at least 25% of the equity of the domestic borrower to be an eligible foreign lender. Separately, the FEMA lays down certain restrictions on the remittance outside India, of enforcement proceeds of assets in India. Although the ECB Master Directions allow for remittances of principal, interest and other charges to foreign lenders, the ECB Master Directions lay down ceilings on the interest, fees, repayment and prepayment methods, and the amounts that can be raised *vide* ECBs, which need to be adhered to. Therefore, this may pose certain restrictions on the domestic borrower in terms of the amount of loans that it may avail, additional reporting requirements and end-use restrictions, etc.

The Income Tax Act does not recognise thin capitalisation principles.

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 addition to our response given under question 3.6 above, a party's submission to a foreign jurisdiction is permitted under Indian law. Choice of law by parties is governed by the rules of Private International Law/Conflict of Laws ("**PIL Rules**"), which generally permit a contract to be governed by the legal system chosen by

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

the parties to the contract. The choice of law must be express and should not be contrary to public policy. Indian courts may not oust the choice of a foreign law unless the parties show "good and sufficient reasons" or such choice results in "perpetuating injustice". The courts in India recognise foreign governing law documents. To determine whether a foreign law has a substantial connection to the contract, courts generally examine the place of residence or business of the parties, the place where the relationship of the parties was centred, the place where the contract was made or performed, or the nature and subject matter of the contract. However, if the cause of action of a dispute arises in India or if the subject matter has no real bearing to the foreign jurisdiction and both parties being domestic entities have chosen the foreign jurisdiction with the intention of circumventing Indian laws, then Indian courts would have the jurisdiction over the contract/transaction under question and the choice of law may not be upheld by the courts. Generally, courts in India, subject to certain conditions, recognise and enforce a judgment obtained from a competent court in relation to enforcement of a contract that has a foreign governing law. Please refer to our response given under question 3.6.

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?

Please refer to our response to question 3.6.

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 an event of a payment default under a guarantee or payment default by a borrower, foreign lenders may invoke the guarantee or enforce security by filing a suit against the guarantor/security provider before the concerned courts as per the provisions of the CPC.

(a) Proceedings as per the provisions of the CPC may take anywhere from three to five years depending on the specifics of the case and procedural delays.

(b) A foreign judgment (assuming it is of a reciprocating territory) will need to be filed before the concerned domestic courts and the procedure under Section 44A read, *inter alia*, with Section 13 of the CPC will need to be followed. Please refer to our response given under question 3.6.

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?

Collateral security can be enforced in several ways depending upon the type of security. A creditor (whether a bank, financial institution or other creditor), in whose favour a security whether by way mortgage, charge or hypothecation has been created, may enforce its security by various methods available under law. In India, various legislative measures have been adopted from time to time to facilitate the recovery of dues by banks, financial institutions and other creditors. Debt recovery tribunal ("**DRTs**") and debt recovery appellate tribunals ("**DRATs**") have been established under the DRT Act, to smoothen the process of recovery of dues from partnerships and individuals. For recovery of dues from corporate debtors, one may now to approach the concerned national company law tribunal ("**NCLT**") as per the provisions of the Bankruptcy Code. The Code also gives a borrower the right to provide a proposal for restructuring itself, failing which the borrower is required to be liquidated as per the timelines set forth under the Code. The Code also gives priority to secured creditors and workmen's dues over government dues. The Central Government has also recently notified the Companies (Transfer of Pending Proceedings) Rules, 2016, wherein all proceedings (except voluntary winding up) relating to winding up and otherwise stand transferred to the NCLT as per the dates given under the said notification.

The SARFAESI gives banks and financial institutions power to enforce security without the intervention of courts. Banks, financial institutions and asset reconstruction companies have also been given special powers to not only take possession of a borrower's secured assets but also to dispose of such assets through public auction or private sale to recover their dues. The SARFAESI also provides banks and financial institutions with the power to approach the concerned Chief Metropolitan Magistrate, if the borrower fails to hand over possession of the secured assets. Further, on August 8, 2016, the Ministry of Finance, GOI notified 196 (one hundred and ninety-six) NBFC registered with the RBI as "financial institutions" under the SARFAESI, facilitating security enforcement by systemically important NBFCs. Changes have also been made to the SARFAESI and the DRT Act to include a debenture trustee (appointed for secured debt securities listed in accordance with applicable regulations issued by the Securities and Exchange Board of India) as a secured creditor. Such changes have been carried out to ensure that lenders who are not specifically included under the SARFAESI or the DRT Act (such as funds, foreign portfolio investors and other investors in the corporate debt market) benefit from the provisions of these acts when acting through a debenture trustee in respect of listed debt securities.

Even though a lot more power has been given to lenders in recent years to enforce security and procure their dues, borrowers continue to use various tactics to delay the process of enforcement. Further, Rule 8 and 9 of the Security Interest (Enforcement) Rules, 2002 ("**Rules**") require a lender to provide a 30-day notice to the borrower, before undertaking the sale of any secured immovable property. The Supreme Court has also, on several occasions, held that unless 30 days' clear notice is given to the borrower, sale or transfer of secured property, by public sale cannot be effected under the SARFAESI. The Supreme Court has also held that if a sale which has been notified to the borrower falls through, the lender cannot effect the sale or transfer of such asset on a subsequent date without giving a fresh notice of sale to the borrower. It may be noted that Rule 8(8) of the Rules also provides for sale on private terms settled between the parties in writing.

It is also pertinent to note that Section 67 of the Transfer of Property Act, 1882 prohibits a mortgagee of "a railway, canal or other work in which the public are interested", from taking enforcement actions against such assets. In the event of default, the mortgagee can only recover earnings generated from such mortgaged assets.

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 enforce their rights over assets secured for their benefit, subject to the guidelines prescribed by the RBI.

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

However, they do not enjoy the same rights available to domestic secured creditors under the SARFAESI. Regulated foreign banks, bilateral or multilateral financial institutions and other eligible ECB lenders still need to undergo traditional court proceedings by filing a civil suit to recover their dues. Except the Asian Development Bank and International Finance Corporation, no other bank or financial institution or secured creditor has recourse to SARFAESI, for recovery of their dues. Foreign lenders also do not have the right to approach DRTs or DRATs established under the DRT Act for recovery of dues from partnerships and individuals. However, foreign lenders may now approach the NCLT as per the provisions of the Bankruptcy Code to institute necessary resolution or winding up proceedings.

In respect of foreclosure of collateral, on any enforcement/invocation of charge over an immovable asset or over movables, and subsequent sale, such assets may be sold only to a resident Indian as per applicable regulations issued under FEMA. Further, the sale proceeds may be remitted overseas to the ECB lender, subject to withholding tax. In case of invocation of a pledge, one needs to ensure that the transfer is made in accordance with the extant RBI and FEMA regulations governing the issuance and transfer of securities to and by 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?

An insolvency process for corporate debtors is initiated under the Bankruptcy Code. The Code envisages a two-step action to resolve a potentially insolvent or bankrupt entity. The first step is the insolvency resolution process, during which creditors assess whether the debtor's business is viable to continue the process of revival. Liquidation is then undertaken in the event the process of resolution fails. Prior to the Bankruptcy Code, the primary onus to initiate a reorganisation process was with the debtor, and lenders had the freedom to pursue various actions for recovery, security enforcement and debt restructuring. A financial or operational creditor may approach the NCLT or DRT (for partnerships and individuals) for initiating the insolvency resolution process against a debtor for any unpaid debts. The NCLT provides for a moratorium for the period of the resolution process. During this moratorium period no judicial proceedings for recovery (including an action by lenders for security enforcement under SARFAESI), enforcement of security interest, sale or transfer of assets, or termination of essential contracts may take place against the debtor. A resolution professional is appointed to oversee the resolution process and operates under the directions of the committee of creditors which considers revival and rescue proposals for the debtor. The resolution plan must be decided within 180 days from the date of admission of the application for resolution (subject to a one-time extension of 90 days after the expiry of 180 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?

The law relating to domestic and international arbitration and all matters connected therewith and incidental thereto is set out in the Arbitration and Conciliation Act, 1996 ("**Arbitration Act**"). Enforcement of domestic arbitral awards are governed by the provisions of Sections 34 to 36 of the Arbitration Act, whereas foreign arbitral awards are subject to conditions set out under Sections 44 to 60. An arbitral award given against the company shall be enforced by the courts in accordance with the provisions of the CPC, without going into the merits of the award and subject to any challenge to the arbitral award, the same will be enforceable as a decree and in such a situation, the principles of *res judicata* would apply and the arbitral award shall be final and binding on the parties and persons claiming under them respectively.

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?

Laws governing bankruptcy and winding-up proceedings of companies, has been considerably overhauled in the last one year, especially pursuant to the enactment of Bankruptcy Code. However, pending winding up proceedings will continue to be governed by the provisions of the Companies Act and any winding up proceedings instituted after the enactment and notification of the Bankruptcy Code shall be governed by the Bankruptcy Code. On December 7, 2016, the Ministry of Corporate Affairs issued a notification stating that all pending winding-up petitions filed under Section 433(e) of the Companies Act, 1956, before the concerned high courts, pending admission and which have been not been served on the respondent as required under Rule 26 of the Companies (Court) Rules, 1959 shall stand transferred to the NCLT. Under the Companies Act 1956, a secured creditor had a right to stand outside the winding-up/liquidation proceedings and independently enforce the security subject to the condition that the sale proceeds are distributed in accordance with the provisions of Section 529A (Section 326 of the Companies Act, 2013) thereto.

When a secured creditor enforces its security under the SARFAESI in respect of a company in liquidation, he is entitled to retain the sale proceeds of the secured assets after depositing workmen's dues with the liquidator. As per the Bankruptcy Code, a secured creditor can realise its security by standing outside a debtor's winding up/liquidation proceedings and can appropriate the sale proceeds towards its dues. However, during the moratorium process as given under question 7.6 above, no enforcement procedures may be initiated (including an action by lenders for security enforcement under SARFAESI) against the assets of the company under liquidation. Where the security enforcement yields an amount exceeding the debts due to the creditor, the secured creditor shall account to the liquidator for such surplus. The Bankruptcy Code has considerably changed the priority of distribution of liquidation proceeds. The costs of insolvency resolution (including any interim finance), followed by secured debt together with workmen dues for the preceding two years, rank highest in priority of distribution payments. Central and state government dues stand below the claims of secured creditors, workmen dues, employee dues and other unsecured financial 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?

As stated above under question 8.1, the Bankruptcy Code has considerably changed the priority of distribution of payments to workers, employees, secured creditors, etc. The Bankruptcy Code mandates that workmen's dues for two years and employees' dues for one year, preceding the liquidation commencement date, and government dues including taxes, etc. for two years preceding

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

the liquidation commencement date, fall within the category of preferential payment and are entitled to priority as per the distribution mechanism provided under Section 53 of the Bankruptcy Code.

As concerns clawback rights, certain provisions of the Bankruptcy Code, including Sections 45 to 49, provide the liquidator or creditor to make an application for avoidance of undervalued transactions which a borrower may have undertaken to keep the assets beyond the reach of any claimant, provided the conditions specified under the relevant Sections are fulfilled. A liquidator or resolution professional also has the power to apply for the avoidance of extortionate credit transactions involving the receipt of financial or operational debt by the borrower, in the two years preceding the commencement of insolvency proceedings in compliance with Section 50 of the Bankruptcy Code.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Any company registered under the Companies Act, 1956 or Companies Act, 2013 can be the subject of bankruptcy proceedings. The Code has expanded the scope beyond companies to cover limited liability partnerships, partnership firms and individuals. The GOI has also proposed the Financial Resolution and Deposit Insurance Bill, 2016 to, *inter alia*, carry out the resolution of certain categories of distressed financial service providers and to provide deposit insurance to consumers of certain categories of financial services. As of today, financial service providers are excluded from bankruptcy proceedings under the Code.

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?

Lenders may try and restructure the borrower's debts through the mechanism of corporate debt restructuring ("**CDR**") and/or through a joint lenders forum. To deal with stressed assets, RBI has recently introduced the SDR Scheme which allows banks and financial institutions to convert their loans into an equity (subject to corporate authorisations being in place) to expeditiously carry out management changes to bring the company back to good health. Banks and financial institutions including asset reconstruction companies have the power to take possession of a company's secured assets by following the procedure laid down under the SARFAESI and to realize the proceeds thereof without court intervention. As per the RBI's guidelines, a company's debt may be restructured with a super-majority of at least 60% of the creditors (by value) and 60% of the creditors (by number). Secured creditors having registered mortgage as a security on the borrower's movable/immovable property, also have the right to enforce such security without the intervention of courts, pursuant to Section 69 of the Transfer of Property Act, 1882.

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 refer to our response to questions 3.6 and 7.1.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A party's right to waive its immunity is recognised by Indian courts where the subject matter is commercial in 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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?

Loans by domestic lenders are primarily provided by banking companies, financial institutions and NBFCs. Banking companies are governed by the Banking Regulation Act and the Reserve Bank of India Act, 1934 ("**RBI Act**"). The Indian banking sector includes nationalised banks (private sector banks that were nationalised by the GOI in 1969 and 1979), private sector banks that were granted licences post-liberalisation, old private sector banks incorporated as banking companies and foreign banks. In February 2013, the RBI released guidelines for private sector entities looking to apply for banking licences and has most recently also issued banking licences to several private sector banks. Foreign and domestic banks are required to obtain a licence from the RBI under the Banking Regulation Act to establish branches and subsidiaries in India and provide banking services in India. Financial institutions are generally regulated by the respective statutes under which they have been incorporated as well as by the RBI Act.

Loans (foreign currency loans and rupee loans) by foreign lenders (without establishing branches and/or subsidiaries in India) are governed by the ECB Master Directions and the Borrowing and Lending Regulations (collectively, "**ECB Regulations**") enacted by the RBI, pursuant to the powers granted to it under the FEMA. While the ECB Master Directions set out the broad framework in respect of lending by foreign lenders to domestic borrowers in foreign currency as well as in Indian rupees. An eligible foreign lender does not need to obtain prior permission of the RBI if it meets the various conditions pertaining to all-in-cost, interest rate, average maturity, etc. specified under the ECB Master Directions. Eligible foreign lenders include international banks, capital markets, multilateral financial institutions, export credit agencies, foreign equity holders, etc. If a foreign lender does not fall under the category of an eligible lender, prior RBI approval is required. No other licensing is required. The domestic borrower is required to observe certain procedural formalities with the concerned authorised dealer bank and RBI to ensure the clear monitoring of inflow and outflow of funds.

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

NBFCs are required to obtain a certificate of registration from the RBI under the RBI Act and are also required to maintain a minimum net worth and fulfil certain other financial parameters to be recognised as an NBFC as per the RBI Act. Companies, individuals, societies and trusts are categorised as moneylenders under the respective State's moneylending acts and are required to obtain a money lending licence to operate as a moneylender in the relevant state.

Extending ECBs without complying with the ECB Regulations or the terms and conditions on which approval has been granted by the RBI can result in the imposition of large penalties under FEMA, as well as civil imprisonment in serious cases. Similarly, banking companies, financial institutions and NBFCs undertaking any activities without obtaining requisite licences/approvals will also be subject to penalties as well as suspension or cancellation of their licences.

A syndicate agent is generally appointed in large lending transactions with various kinds of loans where risk is shared among the lenders. The syndicate agent is generally the largest lender. However, it can be any of the syndicate lenders. The main responsibilities of a syndicate agent is to formulate the syndicate documentation, arrange for financiers or underwrite the loans, negotiate the terms and conditions of the loans, etc. The fees usually include underwriting fees, agency fees, participation fees, management fees, etc. The syndicate bank will necessarily require licences mandated by the RBI, depending on whether it is a banking company or a financial institution or an NBFC. In case the syndicate agent is an investment bank, appropriate licences from the Securities and Exchange Board of India will also have to be obtained depending on the kind of financing that is being underwritten/arranged for by the 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?

Foreign lenders need to carefully examine and understand the nuances of Indian laws, including the CPC, FEMA, the Depositories Regulations, etc. with particular reference to conditions pertaining to creation of pledge or transfer of shares and securities of an Indian company, creation of corporate and personal guarantees, royalty payments, technical know-how fees, eligibility of borrowers as well as the lenders under the ECB Regulations. Hedging of foreign exchange risk is also an important factor which a lender needs to address while proceeding with lending in India, in addition to ensuring that requisite approvals and licences are obtained before a loan is extended to a borrower.

Acknowledgment

We acknowledge the assistance provided by Mr. Avinash Khard, Senior Associate, Ms. Parul Verma, Senior Associate and Ms. Roochi Loona, Associate.

Anjan Dasgupta
HSA Advocates
Construction House, 5th Floor
Walchand Hirachand Marg, Ballard Estate
Mumbai 400001
India

Tel: +91 11 4340 0400
Email: anjan.dasgupta@hsalegal.com
URL: www.hsalegal.com

Anjan Dasgupta is a partner and core member of the firm's highly reputed infrastructure and finance practice. He focuses his practice on corporate and commercial matters with particular concentration in the development and financing of energy, transportation and general infrastructure projects including Public Private Partnerships.

He has more than 15 years of experience in advising on projects and transactions in emerging markets across a range of sectors including telecommunications, energy, mining, roads, oil and gas, air and sea ports, agribusiness and healthcare. He also has significant experience in clean technology and sustainable development projects.

Harsh Arora
HSA Advocates
81/1, Adchini, Sri Aurobindo Marg
New Delhi – 110017
India

Tel: +91 11 6638 7000
Email: harsh.arora@hsalegal.com
URL: www.hsalegal.com

Harsh Arora's focus areas of practice are Banking & Finance, Project Finance and Infrastructure. He has worked in projects in diverse industries such as healthcare, roads, oil and gas, electricity and environment.

Harsh has advised various kinds of transactions, ranging from structured finance, project finance, banking transactions, project development and Public Private Partnerships to acquisition of infrastructure assets through merger and acquisition.

HSA Advocates is a full-service Tier I law firm in India. It is a recommended law firm and a trusted legal advisor in the Banking and Finance sector.

Our commercially viable approach towards clients and a deep understanding of the Indian financial market has been instrumental in expanding businesses and helping investors grow. We have been representing various banks and financial institutions in dealing with high value and complex debt finance transactions including structured finance; debt restructuring; project finance and PPPs; cross-border finance; syndicated and bilateral loans; external commercial borrowings; trade finance and asset finance. We also regularly assist banks and financial institutions on banking regulations and product development.

© 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. 18/4/PBI/2016 dated 22 April 2016, which amended the BI Regulation No. 16/21/PBI/2014 dated 29 December 2014 concerning the Implementation of Prudential Principles for the Management of Offshore Loans of Non-Bank Corporations ("**NBCs**") ("**Regulation 16**"). Regulation 16, which comes 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 in foreign currency (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 through a derivative transaction in the form of forward, swap and/or option. During the first year after effectiveness (until 31 December 2015), 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 (an issuer credit rating and/or a debt credit rating, as the case may be, depending on the type and term of the term of the offshore foreign currency debt) 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, among others, (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, among others, 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.

The enactment of the BI Regulation No. 18/4/PBI/2016 dated 22 April 2016 has expanded the coverage of exemption on credit rating requirement so that multifinance companies would not be subjected to the credit rating requirement provided that certain requirements on financial soundness level and gearing ratio have been met. In addition to multifinance companies, the Indonesia Eximbank (*Lembaga Pembiayaan Ekspor Indonesia*) has also been exempted from the credit rating requirement.

It should also be noted that, according to the Regulation 16, as of 1 January 2017, hedging transactions for the purpose of fulfilling the hedging requirement must be conducted with banks in Indonesia. Receivables from hedging transactions which are not conducted with banks in Indonesia will not be considered as Foreign Exchange Assets, and will not be considered as fulfilment of the hedging and liquidity ratio requirements.

On 22 April 2016, Bank Indonesia issued Bank Indonesia Circular Letter No. 18/6/DKEM on the Implementation of Prudential Principles for the Management of Offshore Loans of Non-Bank Corporations to implement Regulation 16 ("**Circular 18**"); Circular 18 is an amendment to the preceding Bank Indonesia Circular Letters No. 16/24/KEM dated 30 December 2014 and No. 17/18/DKEM dated 30 June 2015 with the same subject.

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.

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

Although both government and corporate bonds are listed on the Indonesia Stock Exchange (IDX), they are mostly traded Over-the-Counter (OTC). Bank Indonesia (BI) also issues short-term bank certificates known as Certificates of the Central Bank.

On 1 December 2016, the Republic of Indonesia (the "**Republic**") successfully returned to the U.S. dollar bond markets, selling US$750 million five-year-long, US$1.25 billion 10-year-long and US$1.5 billion 30-year-long Senior Unsecured Fixed Rate Notes (the "**Notes**"). The Notes are rated Baa3 by Moody's and BBB- by Fitch. The five-year, 10-year, and 30-year tranche Notes priced at a coupon of 3.70%, 4.35% and 5.25% and a yield of 3.75%, 4.40% and 5.30% respectively. The maturity dates are 8 January 2022, 8 January 2027 and 8 January 2047, respectively. The transaction is a drawdown from the Republic's US$50 billion Global Medium Term Note Program, an upsize from US$40 billion. The Notes settled on 8 December 2016 and are listed on the Singapore Stock Exchange and Frankfurt Stock Exchange.

In terms of project finance, the Japan Bank for International Cooperation ("**JBIC**") has signed a loan agreement amounting to approximately US$2,052 million (JBIC portion) with PT Bhimasena Power Indonesia ("**BPI**") to finance the Central Java coal-fired power generation project, with generation capacity of 2,000MW (1,000MW x 2), in Batang Regency in Central Java Province, Indonesia. The loan, provided in the project finance, is cofinanced with Sumitomo Mitsui Banking Corporation, The Bank of Tokyo-Mitsubishi UFJ, Ltd., Mizuho Bank, Ltd., Sumitomo Mitsui Trust Bank, Limited, Mitsubishi UFJ Trust and Banking Corporation, Shinsei Bank, Limited, The Norinchukin Bank, and two Singaporean entities, DBS Bank Ltd and Oversea-Chinese Banking Corporation Limited, with a total cofinancing amount of approximately US$3,421 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, a company guarantee is commonly acceptable in financing practice.

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 certainly take years for enforcement.

© 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?

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 granted: **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 is recorded in the Fiduciary Register Book (*Buku Daftar Fidusia*) at the fiduciary registration office.
- Pledge:

  A pledge agreement can be executed in a notarial deed or executed privately, setting out the pledge's particulars. A pledge of shares 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.

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 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.

© 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?

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). A shareholder approval is also required in the 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 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 indeed recognises 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 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.

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, and 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 courts), 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

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

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.

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 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 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 one (1) 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.

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

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) and 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.

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 to 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 is 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 is an international commercial arbitrator, is a Fellow of the Chartered Institute of Arbitration and is registered at BANI, LCIA, SIAC and HKIAC.* 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 reputable insurance company in Indonesia. He also worked in the Netherlands, as a foreign trainee with an international legal and tax consultancy 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.

Mr. Gunadi returned to ABNR after a few months post with a major Indonesian power company as its senior legal manager. He has been listed by *The Asia Pacific Legal 500 2016* as a recommended lawyer in Projects & Energy and Intellectual Property.

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).

Ireland

John Breslin

Maples and Calder

David Burke

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

There are two key trends. First, a resurgence in property-based lending by banks and alternative lenders. There has been increased activity in property investment and development lending. The main players are banks taking the role of senior lender with alternative lenders providing mezzanine and/or equity finance. There is currently plenty of finance available to established players in the property development sector. Second, uncertainty as to the precise shape of the United Kingdom's post-Brexit relationship with the EU is impacting on the economy in general, and on some finance deals with a UK element.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Consistent with the recent growth in development finance transactions, a significant recent lending transaction was financing in late 2015 by senior and mezzanine lenders of the O'Flynn Construction group's purchase of their loans from Carbon (Blackstone) and which were formerly in the National Asset Management Agency (the institution created by the State to purchase loans from Irish banks during the recession). The total funding package was €400 million with senior debt of €45 million. Maples acted for the senior lender. The transaction is significant not only because it its size, but also because it represented a major sign of turnaround in the property development finance scene.

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. (See below as to the potential impact of the corporate benefit rule.)

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 Companies Act 2014 (**'CA 2014'**) largely abolishes the law of *ultra vires* (i.e. the rule that a company may not act for a purpose not expressly or impliedly provided for in its memorandum of association). However, CA 2014 does not address the basic and long-standing rule of company law that a company cannot enter into a transaction for no benefit ('the corporate benefit rule'). Accordingly, the prudent view is that the corporate benefit rule still applies in Ireland. Where a company enters into a transaction which does not benefit it, or benefits it only to a negligible degree, the transaction will be void. Directors who authorise such a transaction will be liable for breach of their statutory and fiduciary duties to the company. As regards intra-group transactions, however, Irish courts take a pragmatic approach and recognise that a commercial benefit accruing to a group company is likely to benefit indirectly other group companies. Accordingly, even in the case of an upstream guarantee (a guarantee given by a subsidiary for the parent's obligations), the corporate benefit to the parent is likely to be sufficient.

2.3 Is lack of corporate power an issue?

As noted at question 2.2, CA 2014 has largely abolished the law of *ultra vires*. Although a transaction outside the company's powers will be enforceable, shareholders may have a claim against the company for entering into such a transaction. The prudent view is that a lender should, notwithstanding CA 2014, still satisfy itself that the transaction is within the express or implied powers of the company. This is in order to avoid becoming indirectly involved with a dispute between the company and its shareholders.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Not in the case of a normal trading company. Where one or more of the shareholders in the company is a government minister, the constitutional documents may well provide that it should not enter into a guarantee without the consent of that minister. This will depend on the content of those documents.

© 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?

No. However, see section 8 below as to insolvency law issues.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No. However, a lender should, if relevant, check that the transaction will not be impacted by Irish and international legislation designed to counter money laundering/terrorist financing.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In principle, a lender can take security over any assets belonging to an Irish company.

The types of collateral security available under Irish law are as follows:

(a) Mortgage: this is the transfer of legal title to the asset as security for the obligation and a proviso that legal title will be transferred back to the obligor when it discharges its obligations. Mortgages are commonly encountered where the collateral comprises real estate, aircraft or ships.

(b) Charge: this is an agreement to make an asset available to the creditor to satisfy the underlying debt. This is the most common form of security under Irish law and is encountered where the collateral comprises real estate, intellectual property, bank accounts and securities. A charge may be fixed or floating in nature. A fixed charge is a charge which applies immediately upon execution of the charging instrument to make the asset available to the creditor if the chargor becomes insolvent or commits an event of default. A floating charge does not take effect immediately but upon certain defined events and/or if the creditor gives notice. The process by which a floating charge takes effect is called 'crystallisation'. Only a company may create a floating charge.

(c) Pledge: this is the transfer of possession of an asset to the creditor upon the agreement that possession of the asset will be transferred back when the secured obligation is discharged. Technically, true pledges are seldom encountered in commercial financings but the word is sometimes used to refer to a charge.

(d) Assignment: this is the transfer of legal or beneficial ownership in an asset upon the understanding that ownership is transferred back when the secured obligation is discharged. It is similar to a mortgage. It is mainly used for intangible assets such as debts and other receivables. The most secure form of an assignment is a legal assignment. This is the transfer of the whole asset, signed by the assignor, and where notice of the assignment is given to the underlying obligor, i.e. the debtor or payer of the receivable.

(e) Lien: a lien arises where a creditor has the right to withhold possession of an asset pending discharge of the secured obligation. A lien does not normally give rise to a right of sale. An exception to this is a banker's lien which traditionally involves the right not only to withhold possession of the asset but also to liquidate it. A lien can arise by agreement and, in certain circumstances, by operation of law – e.g. where a vehicle (such as a ship or aircraft) has been repaired or maintained and the owner has failed to pay for the repairs or maintenance, the service provider may retain possession until payment is received.

(f) Financial Collateral: security may be provided over relevant classes of instruments covered by the Financial Collateral Directive by way of collateral or title transfer. If the security option is chosen, recent case law from the Court of Justice of the European Union clarifies that the collateral taker must have practical and legal control over the posted 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?

It is possible to give asset security by means of a general security agreement. Where this is given by a company, it is frequently referred to as a 'debenture'. It is common practice, however, for a separate agreement to be used to effect a charge over shares, and a guarantee. Where security is created over real estate registered with the Property Registration Authority (**'PRA'**), a prescribed form is required.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. This is normally done by way of a general security agreement – i.e. a debenture. The collateral provider will execute the security by way of a deed and operative charging clauses will create security over different classes of assets which will be referred to generically, and, if possible, specifically. Where the real estate is registered with the PRA, a prescribed form must also be used.

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 best security over receivables is a legal assignment. This involves the assignor transferring ownership in the receivables to the creditor under a document signed by the assignor and where notice of the assignment is given to the debtor. This means that the assignee may sue for the debt, has priority over subsequent assignees (if any) and the debtor may not reduce the receivable by exercising a right of set-off against the assignor. Security may also be taken by way of a charge/equitable assignment or floating charge, but these are not as robust as a legal assignment.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. The best security over cash in a bank account is where the chargor is prohibited from withdrawing the cash, directing the cash to be paid to a third party, or transferring the account to a third party, without the consent of the creditor. This is referred to as a 'blocked account'. This may not be a commercially attractive form of security where the chargor requires ready access to the cash. In such a case, the collateral provider can create a floating charge over the account. This means that the charge does not become blocked until the floating charge crystallises either on a default and/or if the creditor gives a notice of crystallisation. However, a floating charge ranks behind preferential creditors such as the Irish Revenue Commissioners (**'the Revenue'**), and employees of the chargor in respect of unpaid wages, etc.

© 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?

Yes: security can be taken over shares issued by an Irish company. Shares may be in certificated or uncertificated form. In general, a private company will typically issue its shares in certificated form. A public company whose shares are listed on the Stock Exchange will have to issue shares in uncertificated form. Security can in theory be granted over shares and be governed by the law of a jurisdiction other than Ireland, e.g. the State of New York, or England and Wales. However, it is recommended that security over shares in an Irish company should be governed by Irish law because most likely the security will have to be enforced in Ireland and Irish remedies utilised. Security over shares is typically created by way of a fixed charge. This will be executed as a deed and will require a number of deliverables such as the share certificates, stock transfer forms and directors' letters of resignation for use in a default situation.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. This is created by way of a charge. If the chargor is a company, it is normal for the charge to be a floating charge so as to allow the company to sell the inventory in the course of its business so as to create an income stream.

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 interest in order to secure such 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?

When an Irish company creates security over certain types of asset, particulars must be registered with the Irish Companies Registration office (the **'CRO'**). Where the collateral comprises certain classes of financial asset such as cash, bank account claims and securities, the security may well be exempt from registration under CA 2014 and the Financial Collateral Regulations. The same applies to an external company registered in Ireland creating security over Irish assets. Where security is created over Irish real estate, an appropriate filing will be made with the PRA. Furthermore, specific registration regimes also apply for ships, aircraft, patents, trade-marks and agricultural assets respectively.

Where the security comprises a fixed charge over book debts, notification should be made to the Revenue so as to protect the chargee's interests should the chargor default on certain tax obligations in the future.

Irish stamp duty is not payable on the creation of security. Stamp duty may be payable by the purchaser of assets being liquidated on an enforcement event. Documents are not required to be notarised under Irish law.

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?

This depends on the extent and complexity of the security arrangements. Filing fees are modest but great care must be taken in preparing filing documents because errors may cause security over the relevant assets to be void and corrections may require an application to be made to court or new security to be taken.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In general, no – but certain types of company may be subject to a regime which restricts the security it may grant. For example, a regulated financial service provider will be restricted in creating security over its regulatory capital or over assets required to meet obligations to customers.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

In principle, no. However, the security should make it clear that the repayment of the facility does not extinguish the security and that the security operates to secure the outstanding amount owed at any given time by the debtor.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

It is prudent for security to be executed as a deed. This means that there can be no disputes as to identifying consideration for the security and also that the relevant statute of limitations for claims will be 12 years instead of six.

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: section 82 of CA 2014.

Where the party giving security is a private company, it can avail of a "whitewash" procedure which involves (amongst other things) the directors making a declaration that the company will not be rendered insolvent by giving the security. Where the company is a public company, it may not avail of the whitewash procedure, but other exemptions may apply.

(b) Shares of any company which directly or indirectly owns shares in the company

Yes: section 82 of CA 2014.

(c) Shares in a sister subsidiary

No: the prohibition only applies to shares in the company itself or in a holding company (direct or indirect).

© 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?

Yes. These structures are common in the Irish corporate market.

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.

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?

Lender B must give notice of the transfer of the loan, and the benefit of the guarantee, to the company and the guarantor respectively.

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) Withholding – loan interest

Where a payment of Irish source yearly interest is made, Irish tax at 20% must be withheld unless an exemption applies.

Interest will typically have an Irish source if the borrower is Irish resident or an Irish branch or if the loan is secured on Irish real estate. Interest will be yearly interest if it is paid under a loan that is capable of lasting more than one year.

There are a number of exemptions from withholding which may apply if the conditions are satisfied. For example, there are exemptions for interest paid on an advance from a bank carrying on business in Ireland and for payments to a company that is resident in an EU Member State or a state with which Ireland has signed a double taxation agreement (**'EU/treaty state'**) or which are exempted from tax by virtue of a double taxation agreement. There are also exemptions for payments to a "qualifying company" (within the meaning of section 110 of the Taxes Consolidation Act 1997) or payments by a "qualifying company" to a person resident for tax purposes in an EU/treaty state.

(b) Withholding – proceeds of guarantee/security

Where an interest payment obligation is discharged by a guarantor, or out of the proceeds of enforcing security, the analysis at (a) above should be relevant.

Where security includes Irish land or shares deriving their value from Irish land (and the proceeds of enforcement referable to those assets exceed €500,000) the purchaser is obliged to withhold Irish tax at 15% unless the seller provides a CG50A Tax Certificate from the Revenue Commissioners.

Where security is enforced, tax must be paid by the seller on any gains arising in priority to any secured 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?

There are no tax incentives 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, such as where a loan is convertible into Irish shares, stamp duty might arise on the acquisition of the loan by way of assignment. No stamp duty arises on origination or novation of a loan.

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, a foreign lender in receipt of Irish source interest income would be liable to Irish income tax. There are, however, exemptions from such income tax in Irish law available in certain circumstances to lenders resident in an EU/treaty state.

A foreign lender may also be subject to capital gains tax on gains arising from the disposal of loans secured over Irish real estate, based on current Irish Revenue guidance. This is a highly technical area and advice should be taken.

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. However, interest paid to a foreign lender that owns 75% of the shares in the Irish borrower may be regarded as a distribution and not tax-deductible in certain cases. However, this treatment is disapplied in a number of circumstances, including where the lender is resident in an EU Member State or pursuant to the terms of certain double taxation agreements.

© 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 – save for very limited exceptions and for certain consumer transactions. Yes – subject to the same exceptions.

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 New York courts, yes provided that the defendant has validly submitted to the jurisdiction of the courts of New York and the judgment is not for the recovery of tax. As regards English courts, the current answer is yes but this may change in the light of the outcome of the United Kingdom's negotiations on leaving the EU.

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 claim is admitted to the Commercial List of the High Court, judgment can be obtained within a period of four weeks or thereabouts. If the claim is not admitted to the Commercial List this period can take up to nine months. In general, a claim for over €1 million which is issued promptly will normally be admitted to the Commercial List.

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, no. However, in certain circumstances it may be necessary to hold an auction of real estate if this is the only way of ensuring that the best price reasonably obtainable is achieved.

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 do not apply.

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 debtor in possession process called examinership, which provides for a moratorium for companies of up to 100 days. The moratorium will prevent the enforcement of collateral security except where the security is in the form of collateral under the Financial Collateral regime. It is also possible to exercise a right of set-off during the moratorium period.

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, subject to a number of very limited circumstances. As a jurisdiction, Ireland is very supportive of providing certainty within the arbitral process while maintaining the independence of that process and protecting the autonomy of the parties who have chosen to arbitrate.

Ireland ratified the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the 'New York Convention') in 1981 and no reservations have been entered.

The Arbitration Act 2010 (the **'2010 Act'**), which adopted the UNCITRAL Model Law, as amended in 2006 (the **'Model Law'**), with some minimal amendments, applies to all arbitrations, both domestic and international. The grounds for challenging an arbitral award before the Irish High Court under the 2010 Act are limited to those expressly enumerated under Article 34(2) of the Model Law (which mirrors the grounds on which recognition and enforcement might be refused under the New York Convention as per Article 36 of the Model Law). The timelines for challenges are limited. The jurisprudence suggests Irish courts will construe the ground of public policy as extending only to breaches of the most fundamental notions of morality and justice.

As a signatory to the New York Convention, Ireland supports the recognition and enforcement of foreign arbitral awards. Article 36 of the Model Law as adopted by the 2010 Act prescribes the limited grounds upon which an Irish court can refuse the recognition or enforcement of a foreign arbitral award. Again, the grounds prescribed mirror those prescribed under 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?

A lender can enforce its rights as a secured party where the company which has granted security is in bankruptcy (liquidation). A secured lender may enforce its security and if this is insufficient to discharge the debt, the lender may claim the balance in the liquidation process.

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 provisions in Irish company law which allow for transactions which perpetrate a fraud on creditors to be unwound. A floating charge granted within 12 months of insolvency is invalid if no new moneys are lent to the company. (The period is three years where the floating chargee is connected to the company, e.g. a director.) A floating charge ranks behind preferential creditors such as the Revenue, employees in respect of unpaid salaries and local authorities in respect of rates and certain other payments.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

All trading companies in Ireland are subject to CA 2014.

© 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?

Other than certain "self-help" remedies such as exercising a right of set-off, repossession of goods subject to a valid retention of title clause and exercising a lien on assets, no.

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 under Irish law.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

In principle, an Irish court will recognise a party's 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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?

Where loans are made to companies a lender does not require an authorisation from the relevant regulator, the Central Bank of Ireland (the **'CBI'**). However, all lenders must comply with anti-money laundering/terrorist finance requirements under the Criminal Justice (Money Laundering and Terrorist Offences) Act 2010. Lenders will also be required to make statistical reports to the CBI under the Credit Reporting Act 2013. Irish law would likely apply to a foreign lender lending to persons located in Ireland. A lender which carries on business as a bank will have to obtain an authorisation from the CBI. Carrying on banking business without an authorisation is a criminal offence. It is also possible that any loans made by the lender will not be recoverable. Provided that an agent under a syndicated facility is not also carrying on banking business, it will not normally require a banking licence. In some circumstances a party purchasing consumer or SME loans from an institution regulated by the CBI (or an EU equivalent banking regulator) may be required to become, or appoint, an authorised credit servicer.

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?

Care should be taken when lending to individuals, either acting as such or in partnership. Such lending is likely to be captured by the retail credit regime which requires a CBI licence. Furthermore, an entity which purchases loans and associated securities from a bank authorised by the CBI in Ireland or which carries on business in Ireland passporting from another EU Member State will have to appoint a credit servicer to service the portfolio. This is in order to ensure that regulatory protections formerly enjoyed by the borrowers will continue even though the loans and security have been transferred.

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

John Breslin
Maples and Calder
75 St. Stephen's Green
Dublin D02 PR50
Ireland

Tel: +353 1 619 2074
Fax: +353 1 619 2001
Email: john.breslin@maplesandcalder.com
URL: www.maplesandcalder.com

John is a partner in the Finance group of Maples and Calder, Dublin. John is the author of Banking Law – the first ever text on the subject in Ireland. It continues to be the leading text in the area and is now going into its fourth edition. John advises banks and other financial institutions on transactional and regulatory issues. John is also the head of the firm's Advocacy group and regularly acts for clients in court, other tribunals and in the context of alternative dispute resolution. John is a Senior Counsel – the Irish equivalent of a Queen's Counsel.

David Burke
Maples and Calder
75 St. Stephen's Green
Dublin D02 PR50
Ireland

Tel: +353 1 619 2779
Fax: +353 1 619 2001
Email: david.burke@maplesandcalder.com
URL: www.maplesandcalder.com

David is a lawyer in the Tax group of Maples and Calder, Dublin. David advises on international financial transactions structured in and through Ireland. David works with companies, banks and investment funds and their advisors to structure and implement capital markets, structured finance and asset finance transactions.

MAPLES

Maples and Calder is a leading international law firm advising financial, institutional, business and private clients around the world on the laws of Ireland, the Cayman Islands and the British Virgin Islands. With a reputation as an innovative, entrepreneurial firm, Maples and Calder is known worldwide as a market leader with highly qualified lawyers who are specialists in their respective areas.

Maples and Calder's Dublin office provides a full-service offering across all aspects of commercial law. Its Finance group regularly acts for international and domestic players in the banking, funds and investment management areas. The Finance team regularly acts for regulated institutions, private equity funds and corporate borrowers. It has particular expertise in property finance, structured finance and aircraft and ship finance and in this regard the Finance team works closely with experts in Maples' Property and Investment Funds groups.

The Maples group comprises more than 1,400 staff worldwide, 350 of whom are based in our Dublin office.

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

Italy

Giulia Battaglia

Chiomenti

Gregorio Consoli

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

In recent years, the Italian Government has enacted several measures in order to stem the damages created by the so-called 'credit crunch' which deeply harmed the European economy.

In particular, in order to strengthen the alternative sources of medium- and long-term funding for Italian companies, the legislative interventions have introduced measures in order to expand the credit market in terms of: (i) actors involved; and (ii) products offered. In this respect, Law Decree no. 145 of 2013 (so-called "***Destinazione Italia***") has extended to non-listed companies the faculty to issue bonds at more favourable conditions previously applicable to listed companies only.

New forms of direct lending by non-bank entities have been introduced in order to allow new players to enter the market and stimulate competition among them. In this respect, Law Decree no. 91/2014, the so-called "*Competitiveness*" Decree, has introduced the possibility, under certain conditions and subject to compliance with the regulatory requirements provided by the relevant supervisory authority, for (a) securitisation vehicles, (b) insurance companies, and (c) investment funds, to grant direct lending to borrowers, other than individuals and enterprises which qualify as small enterprises. With specific reference to securitisation vehicles, on 8 March 2016, the Bank of Italy approved the relevant regulatory framework that now allows the application of these provisions.

With the same view of facilitating the enforcement process of NPLs, Law Decree no. 59 of 3 May 2016 ("**Decree no. 59/2016**") on "*New measures regarding Italian debt enforcement and insolvency procedures*" has introduced a number of measures that would allow banks to recover NPLs more easily with the view to attracting international investors. Decree no. 59/2016 has introduced, among others, the following measures: (a) a new instrument for non-possessory pledge over chattels (please see question 3.3 below); and (b) the possibility to execute a "springing mortgage" arrangement in the context of new loan agreements (such instrument will permit debts arising under loan agreements between a company and a bank – or other entity entitled to lend money to the public in Italy – to be secured by way of springing mortgage over land in favour of the creditor or a subsidiary or associated company thereof, which can then be triggered upon default of the borrower or other obligor). Decree no. 59/2016 shall be converted into law by 2 July 2016. Therefore, certain amendments to the current version may be implemented during the parliament process of conversion into law.

Details on certain implementation aspects will be subject to secondary legislation to be issued by the Italian Ministry of Economy and Finance, the date of which has not yet been issued.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Some significant lending transactions include the following:

A €4.7 billion syndicated guaranteed loan facility in favour of Saipem SpA and Saipem Finance International BV comprising: (i) a €1.6 billion term loan facility; (ii) a €1.5 billion revolving facility; and (iii) a €1.6 billion bridge-to-bond facility. In this respect, Chiomenti assisted Saipem S.p.A. The abovementioned syndicated loan facility has been made available in the context of "Project Techno", a transaction worth €8.2 billion, comprising a right issuance of €3.5 billion which is aimed at refinancing existing inter-company indebtedness towards a former controlling shareholder, ENI SpA, at the time of the sale by the latter of a 12.5% participation in the share capital of Saipem SpA to Fondo Strategico Italiano.

A loan facility granted by JP Morgan, Intesa SanPaolo, Unicredit and other lenders to China National Chemical Corporation for the takeover of Pirelli & C. S.p.A. (also through the launch of a mandatory tender offer); in this respect, Chiomenti assisted Camfin S.p.A. and Nuove Partecipazioni S.p.A. for the creation of an industrial and strategic partnership with China National Chemical Corporation entailing the acquisition of control over Pirelli & C. S.p.A., its de-listing and the subsequent reorganisation and long-term industrial value creation of the company. For this transaction, Chiomenti has been awarded the prize "Loan Deal of the Year" at the IFLR Awards 2016.

€250 million revolving credit facilities made available to Gianni Versace S.p.A. by a syndicate of banks composed by Banca IMI S.p.A., Banca Monte dei Paschi di Siena, BNP Paribas, Crédit Agricole, Cassa di Risparmio di Parma e Piacenza, Mediobanca S.p.A. and UniCredit S.p.A. and Banca Nazionale del Lavoro S.p.A. The deal was structured as a competitive tender offer organised by the borrower to refinance its entire debt on the basis of documentation (term sheet and loan agreement) prepared by its legal counsel. In this respect, Chiomenti Studio Legale assisted Gianni Versace S.p.A.

© 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)?

Under Italian law, a company belonging to a group can grant a guarantee in respect of borrowings of other members of the group, provided that: (a) it is permitted to do so by its constitutive documents; (b) it has a specific corporate interest (even if it is an interest of the group to which the securing company belongs) in doing so; and (c) no rule with reference to financial assistance is breached.

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 existence of an actual interest of the company guaranteeing or securing the financial obligations of its parent company or any other company belonging to the same group is a matter of fact and has to be assessed on a case-by-case basis. Such evaluation has to be carried out by the company's directors, which may be deemed liable, together with the controlling company, for the activities performed in the absence of any corporate interest of the company granting the security. However, any such action is without prejudice of the third parties' rights which have obtained the benefit of such guarantee in good faith.

2.3 Is lack of corporate power an issue?

Yes. If the company issues the guarantee without the power to do so, this may trigger the invalidity of the guarantee itself and, even if the guarantee is issued, as explained above, the directors of the company may be deemed liable for such activity.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No specific governmental consent of filing is required under Italian law, apart from what is specifically provided for financial assistance issues.

It must be considered that granting guarantees in Italy is an activity reserved for banks and financial intermediaries.

Notwithstanding the above, granting securities in respect of borrowings of other members of the group is not considered as exercising financial activities *vis-à-vis* the public and, accordingly, is not subject to prior regulatory consent or authorisation. The granting of the security shall be permitted under the articles of incorporation and shall be approved by the competent bodies of the company, in accordance with the articles of incorporation.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There is no specific test in order to assess the corporate interest or the maximum amount of the relevant guarantee. However, the potential total payment that might arise under the guarantee shall not be disproportionate to the assets of the company insofar as it leads to the company's insolvency and the maximum guaranteed amount shall be indicated in the documentation.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

As of today, there are no provisions under the laws of Italy, pursuant to which the enforcement of a guarantee is subject to any exchange of control. It must be noted that a payment under guarantee may not be enforceable if it is contrary to the exchange control restrictions imposed by the United Nations or the European Union from time to time.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

According to market practice, lending obligations are generally secured by means of mortgages (over immovable assets or over registered movable assets), pledges (over shares, IP properties quotas, accounts and receivables), assignments of receivables by way of security (for instance, trade receivables and VAT receivables) and special liens on certain movable assets.

Among these types of collaterals, pledges are particularly used in the context of "repo transactions" (realised through repurchase agreements) performed by means of GMRA standard documentation.

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?

No concept of floating charges was provided under Italian law. Each security requires a specific agreement and different formalities depending on the type of asset, which have to be fulfilled in order to create a validly enforceable security.

In this regard, please consider that Decree no. 59/2016 has introduced a new legal concept of "non-possessory pledge over chattels" (chattels being movable personal property) as better described under question 3.3 below.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral securities may be taken over immovable assets (such as real estate and land) by means of mortgages, which are to be executed before a public notary and registered in the relevant land register in order to be perfected.

A security over movable assets (such as machinery and equipment) may be created by means of pledge, which requires a written agreement bearing a date certain at law (*data certa*) and the delivery of the pledged asset to a custodian, with formalities that may vary depending on the type of assets subject to the pledge.

Furthermore, according to Article 46 of Legislative Decree no. 385 of 1 September 1993 (the "**Italian Consolidated Banking Act**"), a special privilege (*privilegio speciale*) may be created on movable assets forming part of the working capital (such as: wares; commodities; livestock; machinery; equipment; and receivables arising from the selling of such goods) in favour of medium- and long-term financing

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

granted by banks to enterprises. The applicability of special privilege has been extended to bonds and similar securities by the *Destinazione Italia Decree* (as better described under question 3.7).

In addition to the above, Decree no. 59/2016 has introduced a new legal concept of the "non-possessory pledge over chattels" (chattels being movable personal property), according to which Italian Companies may grant such a pledge to secure loans granted by banks and other financial intermediaries for current or future business purposes, if identified or capable of being identified and provided a maximum secured amount is specified. Please note that, as of today, the secondary regulations for the implementation of such new instrument have not been issued yet by the Italian Ministry of Economy.

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 over receivables may be granted through a pledge or an assignment by way of security.

In general terms, in order for a pledge to be perfected, notification to the debtor or acceptance by the same with a certain date is required by law. In respect to assignment by way of security, the consent of, notification to, or acceptance by, the assigned debtor is required only for the effectiveness and opposability of the assignment against the same debtor and any third party (and not for the perfection of the assignment among the parties themselves).

Where the assigned debtor is a public entity, specific rules apply, including formalities regarding the execution of the agreement and notification.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

It is possible to take a collateral security over bank accounts (technically, the receivables *vis-à-vis* the account bank) by means of a pledge over bank accounts.

Generally, according to Italian market practice, a deed of pledge over bank accounts provides that: (i) the pledgor is entitled to dispose of the deposits in a pre-default scenario; and (ii) upon default and acceleration of the pledgor's obligations, the cash is blocked and any withdrawal from the pledged accounts is interrupted and the creditor is entitled to enforce the pledge and directly sweep the positive balance of the accounts so as to recover its credit (it being understood that any amount in excess of the secured obligations has to be returned to the pledgor).

Please note that, under special legislation with respect to financial guarantees (i.e. Legislative Decree no. 170 of 21 May 2004) applicable to pledge over bank accounts, to the extent that certain requirements are met, even if a bankruptcy proceeding has been opened in respect of the pledgor, the lenders may withhold any amount of the credit of each of the pledged accounts and apply such amounts in discharging the secured obligations, and informing the pledgor and the bodies of the insolvency proceedings in writing about the manner of enforcement and the relevant proceedings.

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?

Pledges over shares and quotas by Italian companies are generally allowed. Different formalities are required in case of limited liability companies (i.e. pledge over quota), such as the registration of the pledge in the relevant companies register, or joint-stock companies (i.e. pledge over shares), such as endorsement of the pledge in the relevant share certificates, the delivery of the pledges shares to the creditor or to a third party and annotation in the shareholders' book (or the registration of the security over the shares in an account opened by the relevant intermediary, in case the shares are held in dematerialised form in accordance with the provisions of article 83-*octies* (2) of Legislative Decree No. 58 of 24 February 1998). Please note, however, that pledges over public shares are subject to certain law restrictions.

Under Italian law, the granting of a pledge over shares or quota by means of security documents governed by a foreign law is allowed, provided that all the formalities in respect of the enforceability of the security documents *vis-à-vis* third parties have been performed pursuant to the provisions of Italian law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

As anticipated above, article 46 of the Italian Banking Law provides for the establishment of a special privilege in favour of banks that grant loans to companies. Special privileges are executed before a public notary together with the list of the assets subject to the security and shall provide the maximum amount guaranteed. The *Destinazione Italia* Decree has extended the applicability of special privilege to bonds and similar securities issued by enterprises in accordance with Articles 2410 *ff.* or Article 2483 of the Italian Civil Code that have a medium- or long-term maturity and which are reserved to qualified investors.

Decree no. 59/2016 introduced a new legal concept of the "non-possessory pledge over chattels". The new instrument of non-possessory pledge over chattels is created by written deed. Unless the parties agree otherwise, the borrower (or third party granting the pledge) is permitted to transform, alienate or otherwise dispose of the pledged assets – in which case the pledge attaches to the asset into which it is transformed, the proceeds, or the substitute asset as the case may be, without this constituting a new grant of security. In order to be effective *vis-à-vis* third parties, the pledge must be registered in a computerised database held with the Italian tax authorities (*agenzia delle entrate*).

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 further details, please see question 2.1 above and previous questions in this section.

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?

This may depend on the nature of the collateral and on the formalities to be executed in order to ensure the perfection of the security interest.

In particular, mortgages, pledges over quotas, and pledges and assignments of receivables towards public entities require the relevant arrangements to be notarised. By contrast, pledges over shares, and pledges over bank accounts and trade receivables, do not need to be

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

notarised. The cost for the notary intervention varies depending on the value of the agreement and the activity requested of the notary.

With regard to the tax costs, in general terms, the collateral securities are subject to indirect taxes at a proportional rate that varies depending on the type of deed or contract. In this sense, please note that the most common forms of securities used in the context of financial operations are subject to the following indirect taxes:

Mortgages on real property: mortgage tax at a rate of 2% of the secured amount.

Assignments of receivables: registration tax applied at a rate of 0.5% of the amount of the receivables assigned.

Pledge over assets (other than real property) and right over such assets or personal guarantees: registration tax applied at a rate of 0.5% if the pledgor is someone other than the borrower (indeed, please note that guarantees granted by the borrower itself to secure its own liabilities are subject to a registration tax of €200); the taxable base is represented by the secured liability or, if lower, the amount of the cash or securities constituting the guarantee.

In addition, pursuant to article 15, par. 3 of the Presidential Decree of 29 September 1973, no. 601, a specific regime is provided for taxation of securities collateral in respect of a loan which has a maturity of longer than 18 months (i.e. at least 18 months plus one day, a so-called "*medium/long-term*" loan).

Indeed, if the medium/long-term loan is: (i) granted, *inter alia*, by an Italian bank (or an EU bank); and (ii) executed within the boundaries of Italian territory, it may be subject, in case a specific option is exercised, to a 0.25% substitute tax (on the amount of the loan) *in lieu* of any other applicable indirect tax (even if referred to the securities executed in connection to the loan). In other terms, the application of the substitute tax leads to exemption from any indirect taxes (e.g. registration tax, stamp duty, mortgage and cadastral taxes and taxes on governmental concessions) applicable in Italy to all acts, contracts, deeds and formalities in connection with the facility, its execution, amendment and termination, any guarantees granted with respect to the same facility, as well as to any subrogation, substitution, postponement, division and cancellation thereof, including any assignment of receivables (and of the relevant guarantees) related to the facility.

The substitute tax at stake is also applicable, on an optional basis, to guarantees granted in relation to financing structured as a bond issue or debentures, similar to bonds. Such tax shall apply to any subrogation, substitution, postponements and cancellations, even partial, including the supply of credit entered into in relation to the above transactions, the transfer of guarantees also resulting from the sale of said bonds, as well as modification or termination of such transactions.

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?

It depends on the nature of the collateral arrangements and the number of security interests created. In general terms, the procedure is carried out in a relatively short time. The notarial costs are usually included in the costs for the establishment of the relevant security interest.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Except for consent that may be required in connection with the object of the collateral (if any) or the nature of the assigned debtor (public debtor), no consents are required, apart from corporate authorisation. Restrictions on the creation of security may be set forth by means of agreement among the parties.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No particular concerns are envisaged for security interest under a revolving credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Certain formalities are required, depending on the type of security granted. Please see questions 3.9 and 3.10 above.

Under Italian law, a power of attorney ("**PoA**") is required when the document is not signed by a duly authorised director of the company. The execution of a PoA before a public notary is required only in case the relevant deed has to be executed before a notary public. In the event that the notary public belongs to a jurisdiction other than Italy, an apostille or similar certification may be required.

Italian law does not provide for the concept of execution by 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

According to the general principle provided under articles 2358 and 2474 of the Italian Civil Code, financial assistance by a company for the acquisition or subscription of its own shares or quotas is prohibited for both joint stock companies and limited liability companies, unless specific requirements are satisfied. The prohibition on financial assistance includes all transactions aimed at facilitating the purchase or subscription of the company's own shares or quotas, by means of any form of financing (both direct or indirect), or refinancing or securities and guarantees granted by a company for the benefit of third parties.

Under certain conditions, Italian law permits a joint stock corporation to provide loans or guarantees to third parties for the acquisition or subscription of such corporation's shares, provided that a special procedure for the approval ("whitewash" procedure) is followed. However, companies continue to be prohibited from accepting their own shares as a form of guarantee.

The amount of guarantees or loans provided as financial assistance shall not exceed the profits payable and the reserves available for distribution.

(b) Shares of any company which directly or indirectly owns shares in the company

Please see question 4.1 (a) above.

(c) Shares in a sister subsidiary

It is doubtful under Italian law whether securing the borrowings incurred to finance or refinance the acquisition of shares in a sister subsidiary falls under the financial assistance restrictions.

© 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?

Under Italian law, each creditor must be the beneficiary of the security and, in such position, is entitled to benefit from the rights provided under the security, including the enforcement rights. However, it is allowed – and is customary under syndicated loans – that the secured creditors may appoint a third party agent (usually belonging to the pool) to act in their name and on their behalf ("*mandatario*") pursuant to articles 1703 *et seq.* of the Italian Civil Code for the exercise of the rights and powers provided thereunder and for the enforcement of the security interests, on the basis of decision-making processes usually provided for in the intercreditor agreement.

However, while trusts regulated by foreign law are recognised by Italian law, they are not used due to technical issues in the context of Italian syndicated facilities.

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 this respect, 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?

The assignment of the receivables arising from the loan agreement – or the loan agreement itself – is to be notified to or accepted by the debtor and the guarantor.

With reference to the securities, as a general principle of Italian law, receivables are transferred together with all related security interests, privileges and charges, provided that the formalities required for effectiveness of the relevant transfer or assignment are duly fulfilled, such as, for instance: (i) in case of assignment of receivables, the notification to or the acceptance by the debtor; (ii) in case of mortgage, registration of the assignment in the land register; (iii) in case of pledge over quotas, registration in the companies register; (iv) in case of pledge over shares, registration in the shareholders' book and endorsement in the share certificate; and (v) in case of a special privilege, registration in the relevant register held by the competent court.

With reference to transfer or the assignment involving jurisdictions other than Italy, pursuant to article 14 of Regulation no. 593 of 2008 of the European Parliament and of the Council on the Law Applicable to Contractual Obligations ("**Rome I Regulation**"), the law governing the assigned claim shall determine whether the receivables are capable of being assigned, the relationship between the assignee and the debtor, the conditions under which the assignment can be opposed against the debtor and whether the debtor's obligations have been discharged. Moreover, pursuant to Article 9 of the Rome I Regulation, overriding mandatory provisions must be applied whatever the law applicable to the contract might be.

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 terms, interest distributed by an Italian company and received by a foreign lender is subject to 26% withholding tax.

Such a rate could be lowered pursuant to the relevant double tax treaties in force between Italy and the country of residence of the lender, if applicable.

In case of a payment of the proceeds of a claim under a guarantee or the proceeds of enforcing securities, in accordance with one interpretation of Italian tax law, any such payment would be equal to the payment under the loan and therefore may be subject to the same withholding tax.

In addition, according to article 26, par. 5-*bis* of Presidential Decree 29 September 1973, no. 600, the 26% final withholding tax is not applicable to interest (and other proceeds) arising from medium/long-term facilities (i.e., having a maturity period higher than 18 months) granted to an Italian enterprise by:

(i) banks established in an EU Member State;

(ii) insurance companies incorporated in an EU Member State and authorised under the legislative provisions of an EU Member State;

(iii) entities listed under article 2, par. 5, numbers from 4) to 23) of Directive 2013/36/EU; and

(iv) institutional foreign investors (such as investment collective funds) which, irrespective of their taxable status, are established in a country which recognises the Italian tax authorities' right to an adequate exchange of information and are therein subject to regulatory surveillance.

In order to apply such exemption regime, the non-resident entities granting the loan (and receiving the interest) have to respect all the provisions contained in Legislative Decree 1 September 1993, no. 385 (Banking Law) with reference to financing activity with the public.

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 refer to 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?

In general terms, granting a loan to an Italian resident entity does not meet the concept of permanent establishment and therefore the lender remains a taxpayer not resident in Italy for fiscal purposes.

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

However, it is important to outline that, according to Italian domestic laws, the interests paid by an Italian entity are considered as arising from Italy and therefore to be taxed in the Republic. Special provisions could be applicable on the basis of the double taxation treaties.

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.?

Notarial fees depend on deeds, contracts and formalities relating to the loan transaction executed in Italy by way of notarial deed. From this perspective, it is important to point out that in some cases (e.g. in case of a mortgage deed related to real estate located in Italy, or of a pledge over quotas of an Italian limited liability company), the deed/contract must necessarily be executed by way of notarial deed.

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.

Up until 2015, if a lender was resident for tax purposes in a State or territory qualified by the Italian Tax Administration as a "black-listed" country, the borrower had to comply with specific requirements in order to be able to deduct the relevant incurred costs. Law no. 208 of 28 December 2015 (the so called "Stability Law for 2016") repealed the black-list costs regime, starting in 2016.

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?

According to the general principles of Italian law, the parties have the freedom to choose the law applicable to their agreement and Italian courts may give effect to such choice of law made by the parties.

However, the acceptance of a foreign law is without prejudice for the application of mandatory provisions or public policy of Italian law by the Italian court.

However, even if the agreement is regulated by a foreign law, the judicial proceeding opened in Italy will be governed by Italian law.

Notwithstanding the above, please consider that security interests over assets which are located in Italy, in order to be enforceable in Italy, need the formalities provided for under Italian law to be perfected.

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 the Republic of Italy will recognise as a valid judgment and enforce any final, conclusive and enforceable judgment obtained in a European Member's court in accordance with and subject to the provisions of EU Regulation no. 1251/2012 (so called "***Bruxelles I-bis***"), which came into force in the Republic of Italy on 10 January 2015.

For the enforcement of final judgments issued by all other countries, the procedure set forth under Law no. 218/1995 applies.

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?

Under the Italian legal system, there is uncertainty with reference to the timing of an enforcement procedure, generally depending on the venue of the proceeding, and in particular where such enforcement has to be performed on the basis of a foreign judgment. Accordingly, even if there is no ground to provide any timing on the civil case, pursuant to certain unofficial statistics, in Italy an ordinary proceeding may require several on average, around eight years in total, with two years of the first instance. With reference to the enforcement proceeding, the duration may vary depending on a number of variables (such as, among others, number of creditors, type of asset). However, according to certain unofficial statistics, the average duration is estimated at around three years.

However, please note that, when the loan agreement is governed by a foreign law, certain formalities may be adopted to grant the lenders with an enforcement deed ("*titolo esecutivo*") in order to speed up the enforcement procedure of the securities granted under Italian law. In particular, it is standard practice that upon disbursement of a loan, the borrower releases a deed of acknowledgment and disbursement which may be used as enforcement deed in case of enforcement of the claims by the lenders.

Recently, with Decree 59/2016, the Italian government has implemented several measures in order to speed up the process of obtaining a final decision of an Italian 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?

Under general provisions of Italian law, enforcement of securities is conducted in accordance with the enforcement procedures ruled under the Italian code of civil procedure, which mainly provides for a public judiciary to sell the secured asset and repay the creditors on the basis of the relevant priority. In certain cases (e.g. assignment of receivables and pledge over receivables) the creditor is entitled to satisfy itself using the proceeds arising under the pledged (or assigned) claims.

In addition, in order to speed up enforcement over real estate property, certain additional procedures have been recently implemented under Italian law, such as auctions directly managed by the notary public or computerised auctions.

Finally, certain special legislations (such as Legislative Decree of 21 May 2004, No. 170) allow the creditors to avoid the above-mentioned procedures and to apply a faster enforcement procedure and also the parties, upon agreement, may avoid the procedural

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

enforcement procedures by means of public auction or, if the asset or good to sell has a market price (such as a financial instrument), by means of an authorised intermediary.

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 such restrictions in either case.

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 the commencement of insolvency proceedings, a general moratorium applies and creditors are generally prevented from individually and separately attaching the secured collateral. Certain restrictions on the general application of moratoriums apply to credits assisted by financial guarantees for that purpose (Legislative Decree no.170 of 21 May 2004).

As a consequence of the commencement of any insolvency proceeding, any distribution and allocation of payments upon liquidation of assets is made only on the basis of the distribution plans prepared by the receiver and authorised by the relevant court.

Moreover, even if they are privileged creditors, the lenders shall submit their 'recover credit' request to the bankruptcy procedure and the same could be satisfied only at the conclusion of the latter. In this respect, please note that, upon the opening of the procedure, creditors are granted a specified term in order to tender their claims.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Italian law allows parties to submit a dispute to arbitration, with the exception of disputes concerning non-disposable rights. Pursuant to Article 824-*bis* of the Italian Code of Civil Procedure (applicable to arbitrations where the place of arbitration is Italy, even if dealing with international disputes), arbitral awards have, as from the date of signature, the same effects as court decisions.

In addition to the above, under either the Brussels Regulation (EU) 1215/2012 (in the case of judgments from the courts of other EU Member States) and Title II of Law no. 218/1995 (in any other case), the jurisdiction of Italian courts can be derogated by contract in favour of foreign courts or of foreign arbitration.

The recognition and the enforceability of foreign arbitral awards is governed by the 1958 New York Convention, which have been ratified by Italy, according to which foreign arbitral awards are recognised and may be enforced in Italy even if the country realising the decision is not a party to the 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?

As explained above under question 7.6, lenders are privileged creditors on the basis of the collateral granted under the security documents, provided that the relevant formalities have been performed. Nevertheless, upon the opening of a bankruptcy procedure, the lenders shall submit their "recover credit" request to the bankruptcy procedure and the same could be satisfied only upon the conclusion of the latter.

Some special legislation, such as Legislative Decree no. 170 of 21 May 2004, allows the creditors to avoid the abovementioned procedures and to apply a faster enforcement procedure.

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?

Preferential creditor rights are provided under the Italian bankruptcy provisions, such as bankruptcy procedure costs, tax debts and employees' claims.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Under Italian law, only individuals carrying out a commercial activity – defined as "entrepreneurs" under article 2082 *et seq.* of the Italian Civil Code – and companies having the following requirements: (a) assets – on an annual basis – over the last three years greater than €300,000; and/or (b) annual gross revenues over the last three years greater than €200,000 and/or indebtedness – whether or not due – on aggregate greater than €500,000, may be declared bankrupted.

In addition to the above, special bankruptcy proceedings are applicable with respect to those companies which have a high number of employees and economic losses, as well as for regulated entities such as banks and 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?

Creditors may not avoid the above-mentioned court enforcement procedures, except where the relevant security interests are governed by special legislation implementing the directive on financial collateral (such as the Legislative Decree no. 170 of 21 May 2004) or the parties have agreed to avoid the enforcement procedures by means of a public auction or, if the assets or goods to sell have a market price (such as a financial instrument), by means of an authorised intermediary.

In addition to the above, please consider that the possession of a document of execution (*titolo esecutivo*, such as a notarised deed) may speed up the enforcement proceeding, thus the counterparty could always challenge the enforcement proceedings in the court.

Finally, creditors may apply for some safety measures *vis-à-vis* the debtor in order to avoid the detriment of the debtor's estate (*mezzi di conservazione della garanzia patrimoniale*) in case material adverse changes over the debtor's assets occur which, however, do not constitute an enforcement proceeding *strictu sensu*.

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 to a contract may freely choose the law applicable to the whole or a part of the contract, and select the court that will have

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

jurisdiction over disputes, provided that any such choice does not conflict with any provisions of Italian law of mandatory application. Generally, the principles setting limits to the recognition of foreign laws (such as public policy or mandatory principles of law) do not apply to commercial relationships.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Generally speaking, a party may waive its sovereign immunity; however, some matters are unquestionably subject to Italian law and a waiver of certain immunities will not be recognised or allowed by the 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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?

As a matter of the Italian financial and banking laws, lending activities within the Italian territory in whatever form *vis-à-vis* the public are restricted to banks and financial intermediaries enrolled in a register held by the Bank of Italy.

As anticipated in question 1.1 above, Law Decree no. 91/2014 has allowed, subject to certain limitations and compliance with the regulatory requirements provided by the relevant supervisory authority, certain non-banking entities to grant loans in Italy, such as: (a) special purpose vehicles incorporated under Italian securitisation law ("**SPVs**"); (b) insurance companies; and (c) Italian alternative investment funds. Any financing activity carried out in breach of the restrictions imposed by Italian provisions of law amounts to a criminal offence punished with imprisonment and fines. Moreover, any contract concluded in breach of such restricted activity regime may be declared as null and void.

With reference to agent services, such services can be performed by non-regulated entities to the extent the specific role does not include activities which are regulated in Italy (such as accepting deposits and dealing with investments).

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 this respect, it should be noted that article 25, paragraph 3, of Legislative Decree no. 342 of 4 August 1999 ("**Decree no. 342**"), enacted by the Italian Government under a delegation granted pursuant to Law no. 142 of 19 February 1992, has considered the capitalisation of accrued interest (*anatocismo*) made by banks prior to the date on which it came into force (19 October 1999) to be valid. After such date, the capitalisation of accrued interest is no longer possible upon the terms established by a resolution of the CICR issued on 22 February 2000. Law no. 342 has been challenged and decision no. 425 of 17 October 2000 of the Italian Constitutional Court has been declared as unconstitutional under the provisions of Law no. 342 regarding the validity of the capitalisation of accrued interest made by banks prior to the date on which Law no. 342 came into force.

In addition, please note that, recently, article 17-*bis* of Law Decree no. 18 of 14 February 2016 (as converted into Law no. 49 of 8 April 2016) amended article 120, paragraph 2, of Legislative Decree no. 385 of 1 September 1993, providing that accrued interest shall not produce further interests, except for default interests, and are calculated exclusively on the principal amount.

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

Giulia Battaglia
Chiomenti
Via Giuseppe Verdi 2
20121 Milan
Italy

Tel: +39 02 7215 7695
Fax: +39 02 7215 7224
Email: giulia.battaglia@chiomenti.net
URL: www.chiomenti.net

Giulia Battaglia is Head of the Finance Department. She has consolidated experience in the structured finance field (real estate financing, acquisition financing, project financing and securitisation, including distressed assets deals) and in debt restructuring. In 1994 she was a visiting lawyer at Slaughter and May in London.

Giulia Battaglia mainly provides assistance to Italian and foreign clients in Finance (Acquisition and Leveraged Finance, Real Estate Financing, Project Finance), Insolvency and Restructuring (Insolvency and Pre-Insolvency Proceedings, Financial Restructuring) and Infrastructure and Public Tenders (Energy Infrastructure Projects, Infrastructure Concessions and Contracts). She joined the firm in 1992 and became a partner in 2003.

Gregorio Consoli
Chiomenti
Via Giuseppe Verdi 2
20121 Milan
Italy

Tel: +39 02 7215 7637
Fax: +39 02 7215 7224
Email: gregorio.consoli@chiomenti.net
URL: www.chiomenti.net

Gregorio Consoli joined the firm in 2002 and became a partner in 2013. Since 2015 he has been Co-Managing Partner.

Gregorio Consoli provides assistance to banks, financial companies and investors in relation to structured finance and asset finance transactions and to major investment funds and other investors in the purchase of distressed assets.

Gregorio Consoli provides assistance in relation to lending and other financing transactions (project financing and construction loans) and in relation to the issuance of hybrid bonds and debt capital market transactions.

CHIOMENTI

Since 1948, Chiomenti is a leading Italian law firm characterised by an international outlook, with offices in Rome, Milan, London, Brussels, New York, Beijing, Shanghai and Hong Kong.

Chiomenti represents the interests of the clients in the truly important issues and it is committed to a constant evolution of its organisation and its competencies in order to do so even better in the future.

The Firm offers to the clients the skills and experiences of extraordinary value in order to assist Italian and international business leaders at all times.

The quality of the assistance provided by Chiomenti is consistent with the list of the operations and interventions of its clients and it contributes to the growth of client enterprises and institutions.

Quality that is also confirmed by the recognition the firm has received and by the public rankings by analysts of the sector such as *Chambers & Partners*, *The Legal 500* and *IFLR1000*, which assign Chiomenti and its professionals a position of absolute pre-eminence.

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

Ivory Coast

Annick Imboua-Niava

IKT & associates

Osther Henri Tella

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Lending market activity is showing strong growth in Côte d'Ivoire as local banks and international financial institutions, either separately or together, are becoming involved in many extension or development projects by private borrowers, mainly being mid-size or large companies.

With the increase of the public and private partnership sector, financial institutions are showing great interest in providing assistance to government entities as well.

The main challenge for borrowers within the lending sector is the negotiation of a low interest rate and an overall global interest rate for financings.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Important secured financings have taken place over recent years within the construction sector, including the construction of hotels – notably the Radisson Blu Hotel of Abidjan at about €40,000,000 – or the housing project to be completed in a suburb not far from Abidjan (Anyama) at €78,000,000.

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)?

Subject to compliance with the OHADA rules on securities and commercial companies, a limited company may guarantee the obligations of one or more other members of its corporate group. Further details are provided in the answers 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 OHADA rules on securities allow a third party to grant a security for another party without being the beneficiary of the loan. However, regarding important financial transactions, some restrictions apply in order to avoid a financial strain on the guarantor, a hidden value transfer or even money laundering.

Indeed, a guarantee or security interest granted by a limited company should not exceed the financial capabilities of the guarantor. As such, it is the lender's duty to ensure the financial capabilities of the guarantor when requesting such guarantee and the obligation of the guarantor to provide Board and/or shareholder approval of the transaction and the security package to mitigate the directors' liability risk and protect the minority shareholders' interests.

When it comes to a group of companies, the benefit of the company granting the security within a financial transaction concluded by another entity of the group must also be looked at to avoid unlawful value transfer and too much of a burden on that company. However, when a parent company which fully owns a subsidiary grants a security, there is no risk of unlawful value transfer because it is considered a full beneficiary of the loan. The only restriction would be to look at the fiscal implications of the financing when the subsidiary is in a different jurisdiction.

2.3 Is lack of corporate power an issue?

Only the legal representative of the company or any other person expressly designated can execute a finance transaction and grant securities attached to it. This legal representative must obtain the approval of the Board and/or the shareholders.

This should be a condition precedent before the finance documents are signed.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental approvals are required in order for a private entity to provide guarantees or grant security interests.

Shareholder approval is generally not required for public limited companies (unless requested in the articles of incorporation), but the Board of Directors must approve the granting of guarantees

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

and security interests. Shareholder approval is required for private limited companies.

Any personal guarantee granted by an individual must comply with the OHADA rules on personal security, such as handwritten consent of the amount and duration of the loan.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

For a local bank financing a company, the common banking rules of the WAEMU (West African Economic and Monetary Union) zone provide that the bank ensures that the borrower is able to repay the loan. As such, it is generally imposed by the lender as a CP – a non-bankruptcy certificate from the corporate registry where the borrower is incorporated.

In case a security has been granted despite the existence of an insolvency procedure of the guarantor, Côte d'Ivoire courts will declare the security void.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Exchange control provisions apply on top of the financing transaction, mainly regarding the disbursement of the loan. The enforcement of a guarantee must comply with local OHADA rules as long as the asset granted as a security is located in Côte d'Ivoire.

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 available under OHADA law. The most common are the pledge agreement for agricultural goods or the pledge of professional equipment, mortgages, and the assignment of receivables.

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 is necessary for each security granted. It is explained by the fact that each type of security has its own legal regime and requirements. For instance, when the law requests a registration of the security at the corporate registry, it is necessary to have a separate agreement to comply with such requirement.

We commonly see a facility agreement providing for all the securities that must be granted, but there is no general security agreement signed for all the securities to be granted and covering different assets.

Notwithstanding the above, it is possible to designate a security agent that will manage all the securities and ensure that they all comply with the applicable law.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

A security over real property is granted by a mortgage. Such agreement must comply with the local rules and be drafted by a notary public. Evaluation of the property must be conducted and proof of ownership provided. The agreement must outline whether it is granting first, second or third rank because the guarantor may have already granted a mortgage over the same property.

However, for machinery and equipment, a pledge is granted. This pledge does not prevent the guarantor from using the equipment. The equipment must be clearly described and the agreement must be registered at the corporate registry in order to be opposable to third parties.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

In granting an assignment of receivables, the guarantor must send a notification to his debtor, otherwise the debtor will continue to pay directly to the guarantor. Specific indications must be provided to the debtor regarding the payment modalities; for instance, providing another bank account where the secured debtor shall make the payments or designating the secured party or his representative.

In addition to the assignment of receivables considered as a security under OHADA law, we also have the delegation of receivables which is also a security but only under the general civil rules. A delegation of insurance proceeds is the most common security used. It still requires a notification or an acceptance of the insurer to avoid later litigation on the beneficiary of the sums to be paid.

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 and the bank account holder must be notified of the security granted.

Such security is granted by way of an account pledge for the benefit of the lender. In order for the pledge to be perfected and enforceable, the guarantor must waive all disposal rights to the bank account. Such bank account pledge should therefore not be secured for an account used in the day-to-day activities of the guarantor.

The bank account pledge is most effective on a deposit account, which is generally the account where the receivables pledged are paid.

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 of a company incorporated in Côte d'Ivoire can only be granted under OHADA law.

The pledge agreement needs to be registered at the corporate registry and the share register of the company must mention the security granted. There is no direct transfer of the shares as long as the facility agreement is still pending and default of payment has not yet been demonstrated.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

A pledge granted over agricultural goods is generally granted with the involvement of a collateral management agreement. The goods are kept in the warehouse of the collateral manager who has the obligation to control the reception and exportation of the goods.

© 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, subject to compliance with the applicable laws as described in 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?

Stamp duties are applied on the agreements before there are registered at the corporate registry of the commercial court. Registration fees are also applicable and paid based on a rate on the principal secured obligation.

Notarisation of the agreements is necessary when it comes to a mortgage. Fees are paid on the basis of the value of the secured obligation.

It is the borrower's duty to pay all the fees incurred by the facility.

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 are established more or less immediately. The applicable costs are those mentioned in question 3.9. Lawyers' fees for counselling the lending bank are the borrower's responsibility.

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. However, if the credit facility is under Côte d'Ivoire law, stamp duties will apply to confirm the date of signature.

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 are set out in the OHADA Uniform Act on Commercial Companies and the Uniform Act on Securities. Indeed, it is forbidden to provide financial assistance to a borrower with the purpose of acquiring shares in the 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?

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.

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 does not apply; 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 an assignment of receivables and due notification of the debtor under the loan that is being transferred.

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?

When the lender is a foreign entity, the borrower is required to withhold taxes on the revenue of interests paid to 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?

Unless there is a tax treaty between Côte d'Ivoire and the country of the foreign lender, there is no other tax incentive.

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

Taxes due by the lender are mainly those on the revenue of interests paid. The other taxes incurred by the loan are the obligation of the borrower.

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?

The income from the interest paid by the borrower is taxable in Côte d'Ivoire.

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 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 in such case. The lenders are only requested to comply with local mandatory rules are far as securities are concerned.

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 as long as the public order of Côte d'Ivoire is not threatened.

The courts of Côte d'Ivoire will not recognise the choice of a foreign law as the governing law of the facility agreement if such law was chosen as a method of avoiding rules or regulations of another jurisdiction which, as a matter of public policy, the courts of Côte d'Ivoire regard as being properly relevant to the facility agreement.

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?

No matter what foreign law governs the facility agreement, it is important to note that a foreign judgment is not directly enforceable in Côte d'Ivoire. It must go through the procedure of "Exequatur". This is not a re-litigation of the case, but a formal review of the case by a domestic competent court that would eventually render the judgment enforceable in Côte d'Ivoire.

The Exequatur is awarded when the following requirements are met:

- The decision must be provided from a competent jurisdiction according to the applicable laws of the country where it was made.
- The decision is not subject to appeal and is enforceable in that country.
- Due process has been observed: the condemned party must be called to the proceeding and must be given the opportunity to defend itself.
- There is no contradictory decision already in existence in Côte d'Ivoire before the foreign one has been rendered concerning the same case and the same parties.
- The decision is not contrary to public order.

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 a litigation procedure takes is highly dependent on the complexity of the case and the administrative organisation of the local courts.

Our experience leads us to advise that at least 12 months are necessary in order to obtain an enforceable decision (obtainment of an appeal decision included).

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 in our jurisdiction.

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 significant restrictions in our jurisdiction.

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. The Exequatur rules apply here too.

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. A creditor that has

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

a valid and perfected pledge is paid by preference before other creditors who do not have a security.

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?

Preferential creditor rights are granted to: employees' claims; tax debts, legal expenses; 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?

Legal entities are mainly 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?

There may be a direct transfer of the property when a mortgage is granted by a legal entity to another legal entity.

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. The principles of freedom of choice of law and choice of forum apply when it concerns facility agreements, but not security agreements when the assets are located in Côte d'Ivoire.

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 Côte d'Ivoire.

However, 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.

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 local entity granting credit must have a licence to do so in order to be called a bank or financial entity. The same requirement is not applicable when the borrower has obtained a loan from a foreign entity.

The security agent regime is governed by the OHADA Uniform Act on Securities.

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 Côte d'Ivoire entities, and taking security over Côte d'Ivoire assets, have been addressed above.

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

Annick Imboua-Niava
IKT & associates
Cocody-Ambassades
Rue Bya, Villa Economie
BP 670 Cidex 03 Abidjan
Ivory Coast

Tel: +225 22 44 74 00
Email: annick.imboua@ikt-avocat.com
URL: www.ikt-avocats.com

Annick Imboua-Niava, LL.M. assists English-speaking clients within finance transactions, cross-border transactions implying international contracts, banking law and securities, mining investment and community law in OHADA and UEMOA. She has been involved in the entry of the Indian company TATA Steel into the mining sector in Ivory Coast. Well-experienced in intellectual property and telecommunications law, she has assisted international clients in trademark infringement litigations and counselled clients whose activities are mainly electronic commerce.

Osther Henri Tella
IKT & associates
Cocody-Ambassades
Rue Bya, Villa Economie
BP 670 Cidex 03 Abidjan
Ivory Coast

Tel: +225 22 44 74 00
Email: osther.tella@ikt-avocats.com
URL: www.ikt-avocats.com

A well-experienced corporate lawyer, Osther Henri Tella advises important local companies as well as international financial institutions such as Afrexim Bank, AFRICINVEST FUND, FORTIS, etc. He is also mainly in charge of building and following up on structured financing projects for several international banks, including development and investment banks such as PROPARCO, DEG. He has been involved in public and private partnerships several times, for instance in an urban train project in Abidjan. He often executes various missions, especially due diligence on general legal issues and labour law issues for parent companies, subsidiaries and branches of large groups in West and Central Africa. In addition, Osther Tella is specialised in sports law, as the sector is in need of competent legal professionals in Africa.

IKT & associates is a certified law firm registered at the Côte d'Ivoire Bar Association, which was effectively created in January 2009.

It is a business-oriented law firm, with an emphasis on structured financing and corporate law. The IKT & associates team is composed of lawyers and in-house counsel, all bilingual, with strong experience in local and international transactions.

Regarding its litigation practice, the firm represents clients before all types of tribunals, whether it is in the regulatory first instance or appellate courts, and also before alternative dispute resolution tribunals such as the Arbitration Court of Côte d'Ivoire (CACI) and the OHADA Justice Arbitration Court (CCJA).

As for counselling matters, the firm aims to serve the needs of companies and individuals looking for the best advice to help them in their day-to-day or complex business decisions. As such matters are diverse and require the most time, we strongly analyse the client's activity and the legal issues they raise in terms of compliance and mitigation of risks.

In addition, IKT & associates regularly organises seminars with local clients to update them on new trends of the law regarding their activities.

The lawyers of IKT & associates regularly take part in UIA meetings and training activities to extend their potential and network. The firm is also referenced in global directories as a firm with a strong potential in international transactions.

© 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 the "*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) acquisition financing (leveraged buyout (LBO) financing, etc.), (ii) asset-based lending (ABL), (iii) debtor-in-possession (DIP) financing, and (iv) 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

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

basically invalid, with two exceptions: (i) if the pledgee/assignee is unaware of the prohibition agreement without gross negligence, the 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), 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).

Since the valid creation and perfection of a pledge over shares of stock companies (*kabushiki-kaisha*) incorporated in Japan should be governed by Japanese law, it is not practically recommended to elect New York law or English law as the governing law of the security agreement.

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 a filing (up to 1,000 movables)), and (iii) claim assignment registration (JPY 7,500 per a filing (up to 5,000 claims) and JPY 15,000 per a 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.

© 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?

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).

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 typically act in concert (subject to the majority approval of the syndication group).

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

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 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") and other relevant statutes, 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 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 general rules provided by the tax treaties effective as of February 28, 2017. 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 28, 2017, 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 generally 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. The effective corporate tax rate for the fiscal years commencing until March 31, 2018 is 29.97% (based on the standard tax rate, including local tax) 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.

© 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.

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).

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 United States 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

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

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 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.

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

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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.

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

Korea

Woo Young Jung

Lee & Ko

Yong-Jae Chang

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

In Korean lending markets, the most active areas are acquisition financing to facilitate M&A transactions, and project finance for large power plants, toll roads and other infrastructure-related transactions. Real estate finance transactions are gradually on the rise due to improved conditions in the real estate market (in particular, large office buildings in CBD areas). Refinancings of existing facilities have been quite steady.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

In recent years, there have been a few very large and significant lending transactions as follows: (i) the ING Life Insurance refinancing of more than 1 trillion Korean Won; (ii) Kakao Corporation's acquisition financing of 800 billion Korean Won to acquire Loen Entertainment (one of the top music streaming service providers in Korea); (iii) Brookfield's acquisition financing of 1.6 trillion Korean Won to acquire the International Finance Centre (IFC) from AIG Global Real Estate; (iv) MBK's acquisition financing of 4.3 trillion Korean Won to acquire Home Plus from Tesco; and (v) Carlyle's acquisition financing of 1.5 trillion Korean Won to acquire ADT Caps and its subsidiaries (which are leading security business companies in Korea) from Tyco. Lee & Ko advised the mandated lead arrangers and other lenders in four of the five deals above.

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 please refer to questions 2.2 to 2.6 below. In addition, in the case of a business group which is subject to restrictions on guarantees as annually identified by the Fair Trade Commission (a "Restricted Group"), companies within such Restricted Group are prohibited from providing a guarantee to another domestic company belonging to the Restricted Group (Article 10-2(1) of the Monopoly Regulations and Fair Trade Act). Further, a listed company cannot guarantee borrowings of one or more of the other members of its corporate group, unless there is an exceptional case in which such guarantee for its major shareholders is required for business purposes (Article 542-9 of the Commercial Code).

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 provisions in the Commercial Code relating to corporate benefit rules. However, if a director grants security over the company's assets to a creditor or guarantees borrowings without any benefit (or with small benefit) to the company in return, that director may be in breach of his fiduciary duty and held liable to the company for any damages that it sustains. The director can also be held criminally liable for his breach.

2.3 Is lack of corporate power an issue?

In general, a company, otherwise duly incorporated and in valid existence, has the power to perform its guarantee obligations provided that it has taken all necessary action to authorise its entry into the guarantee. In this respect, a company may only act within the scope prescribed under its purpose clause in its articles of incorporation, whether such acts are directly or indirectly related to such prescribed purposes.

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. As discussed in question 2.1 above, in the case of a guarantee by a listed company, the approval of the board of directors and a report at the annual shareholders' meetings is required (Article 542-9(3) of the Commercial Code).

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Korean law does not provide for net worth, solvency or similar limitations on the amount of a guarantee.

© 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. However, in the event a resident in Korea provides a guarantee in favour of a foreign party in a loan transaction which is in excess of certain prescribed limits, a prior report is required to be submitted to (and accepted by) the relevant regulator (Minister of Strategy and Finance, the Bank of Korea or designated foreign exchange bank, as applicable) under the Foreign Exchange Transaction Act and the relevant regulations (the "FX Regulations").

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

As described below in question 3.3, real property, movable property, plant machinery and equipment are available to secure lending obligations.

The following are the main types of security under Korean law:

(1) Mortgage (*jeodang-kwon*) or *Kun*-mortgage

Mortgages are most commonly used as security over immovable property, but can also be created over certain movable property, such as ships, aircraft and construction equipment.

A "*kun*-mortgage", as distinct from a fixed amount mortgage, is a type of mortgage which secures debts arising from a series of transactions up to a certain fixed maximum amount to be reached at a future date. The *kun*-mortgage is distinctive in that it secures the debt at its maximum amount without regard to any intermediate increases or decreases in the amount of the debt. In practice, *kun*-mortgage is more commonly used in Korea.

(2) Pledge (*jil-kwon*) or *Kun*-pledge

Pledges are most commonly used as security over movable property, receivables, shares, securities and intellectual property. Movable property that is subject to mortgages (such as certain ships, aircraft and construction equipment) cannot be subject to a pledge. A "*kun*-pledge" is a type of pledge which secures debts arising from a series of transactions up to a certain fixed maximum amount to be reached at a future date.

(3) Security by assignment (*yangdo-dambo*)

This security is not provided for in the Civil Code, but has been sanctioned by the courts and is used widely by creditors when taking security over movable property.

This security interest may be taken over any movable property, whether or not such movable property is otherwise subject to a mortgage or a pledge. A security by assignment is a transfer of ownership in the property as security, with an obligation to retransfer those rights to the security provider after satisfaction of the related obligations.

(4) Security registration under the Security Act (*dambo deung-gi*)

Security registration is a form of security created under the Security Rights on Movables and Claims Act (the "Security Act") that allows security to be taken over certain tangible movable property and claims and receivables by way of registration.

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?

Korean law does not allow for a pledge over the general assets of a company such as a debenture.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

(1) Real property

The two most common forms of security created over immovable property are mortgages and *kun*-mortgages.

The creation of a mortgage is effective upon an agreement between the borrower and lender(s) and registration at the relevant property registry (this also perfects the mortgage).

A *kun*-mortgage is created and perfected in the same manner as a mortgage. However, the agreement creating a *kun*-mortgage must specify the scope (or type) of claims to be secured and the maximum amount to which the *kun*-mortgagee has preferential rights.

(2) Movable property

The most common forms of security granted over movable property in secured lending transactions are pledges, security assignments, mortgages (which are only available for construction machinery, automobiles, aircraft and registered ships) and security rights (by way of security registration under the Security Act).

A pledge over movable property is created and granted by an agreement (not necessarily in writing) between the pledgee and the pledgor and delivery of the subject matter to the pledgee. Delivery includes actual delivery, summary delivery (that is, if the pledgee is already in possession of the movable property under an existing lease agreement, delivery will be assumed to have taken place) and transfer of possession by instruction. However, it excludes constructive delivery. Constructive delivery occurs where the pledgor enters into a lease agreement, simultaneously with entering into a pledge agreement, and is allowed to be in continuous possession of the movable property under that lease agreement. In that case, the pledge would only acquire "notional" possession of the movable property. A pledge over movable property is perfected by continuous possession of the subject matter of the pledge.

A security assignment of movables is created and granted through a granting contract (not necessarily in writing) and delivery. In contrast to a pledge (see above), delivery of the subject matter can take the form of constructive delivery. A security assignment over movable property is also perfected by continuous possession of the subject property.

A security right over movable property is created and granted by an agreement and registration but no delivery is required in that case (Article 2 of the Security Act).

(3) Plant, machinery and equipment

Under the Factory Mortgage Act (the "FMA"), a factory mortgage may be established on the factory comprising the land and buildings. Such factory mortgage also extends to anything which has been attached and become inseparable therefrom, machinery and apparatus installed thereon and any other tangibles offered for the use thereof. This factory mortgage would be established pursuant to Article 7 of the FMA.

In addition to the factory mortgage explained above, another type of factory mortgage is possible under the FMA. This alternative type of mortgage on a factory, which is called a "factory foundation" mortgage, can be established if the

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

owner of the factory creates a "factory foundation" comprising the land, buildings, machinery and equipment, lease rights (*cheonse kwon* and *imcha kwon*), superficies right (*jisang kwon*) and industrial property rights. If a factory foundation mortgage is established over such foundation, a mortgage will be established over such machinery and equipment, lease rights, superficies right and industrial property rights in addition to the real property therein.

In respect of real property over which a mortgage cannot be registered, a *yangdo dambo* may be established, whereby the title is acquired by the creditor and possession remains with the debtor. However, a *yangdo dambo* does not offer protection against *bona fide* purchasers as will be explained further in question 3.7 below on inventories.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

The most common form of security granted over claims and receivables is pledges. A pledge over claims and receivables is created by a granting contract. However, creating a pledge over a claim represented by a claim instrument requires delivery of the instrument and the execution of the granting contract. For a pledge over nominative claims, perfection is achieved (against the obligor of the claims) by giving notice with a fixed date stamp to, or obtaining an acknowledgment with a fixed date stamp from, each obligor (that is, the person obligated to pay the claims). Security rights (*chae-kwon-dam-bo-kwon*) over nominative claims (that is, claims for which creditors are specified and no claim instrument is issued) can also be created by registration at the relevant registry under the Security Act (Article 3 of the Security Act).

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Under Korean law, cash is not recognised as an asset that can be the subject of a security, but a pledge over the account "receivables" is feasible and a common form of security over cash deposited in bank account. As described in question 3.4 above, account receivables may be collateralised by a pledge with a pledge agreement between the pledgee and pledgor and perfected by notice and/or acknowledgment with a fixed date stamp.

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?

Korean law allows for a security to be taken over shares in a company incorporated in Korea. A common form of security over shares is the pledge, which can be divided into a registered pledge and an unregistered pledge.

A registered pledge is created and perfected through the execution of the pledge agreement, recording the pledgee's name on the back page of the share certificate, registration of the pledgee's name and address in the company's shareholders' register, delivery of the share certificate and a copy of the company's shareholders' register to the pledgee and continuous possession of the share certificate along with continued registration on the company's shareholders' register.

On the other hand, an unregistered pledge is created and perfected through the execution of the pledge agreement and delivery of the share certificate.

If the share certificates of the listed company are deposited with the Korea Securities Depository ("KSD"), a registered pledge over those shares is created and becomes effective on the recording of the pledge and the pledgee in the investor's account book maintained by the investment broker or dealer (or depositor's account book maintained by KSD).

According to the Conflicts of Law Act, property rights relating to movables and immovables (or other rights which are subject to registration), must be governed by their *lex situs* (that is, the law of the place where the property is located) (Article 23 of the Conflicts of Law Act). Accordingly, a security over shares in companies incorporated in Korea is not possible pursuant to a New York or English law-governed security agreement but instead there must be a Korean law-governed security agreement.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

A *yangdo dambo* may be established over inventory, products, raw materials, supplies and goods-in-transit. The Supreme Court has recognised that a pool of movable properties can be subject to a single security interest if that pool can be identified as being separate from the security grantor's other movable properties by specifying the type, location and quantity of the movable properties that are included in that pool. Although a *yangdo dambo* is possible on such movable property, there may be difficulties in perfecting such security interest. In order to protect against *bona fide* purchaser claims, notice may be posted at the place where such inventory is located, notifying that the goods are under security assignment to the financing parties as a *yangdo dambo*. Please note that a *yangdo dambo* may not offer complete protection against *bona fide* purchasers in certain cases.

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)?

As a borrower, a company may grant security interests to secure its obligations, as well as a guarantor of obligations of other persons (subject to certain restrictions on provisions of guarantee; see questions 2.1 and 2.2 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 registration costs for a mortgage or *kun*-mortgage would include, among others, registration tax and housing bond, and such costs are calculated on the basis of a secured amount or a maximum secured amount. It is common practice to create a *kun*-mortgage with a maximum secured amount (which is commonly one hundred and thirty percent (130%) of the loan amount to cover the principal, interest and other related costs). Registration tax (including education surtax thereon) is the biggest portion of the registration costs, in that it is calculated as 0.24% of the maximum secured amount.

The registration costs for other types of security (e.g., pledges and *yangdo dambo*) are quite nominal.

© 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?

In the case of a mortgage or a *kun*-mortgage, registration generally takes three to four business days. As to the other types of security which do not require registration, these do not require a significant amount of time.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Please see question 2.6 above concerning foreign exchange reporting requirements applicable to the provision of guarantees. In addition, in the case of the granting of a mortgage to a non-resident mortgagee over real property in Korea, a prior report with the relevant regulator under the FX Regulations 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?

There are no special priority concerns involving a revolving credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

There are no particular documentary or execution requirements; provided that in the case of a non-Korean language mortgage agreement, a Korean translation thereof will be required for registration with the registration 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?

There are no financial assistance rules in Korea. However, if a director grants security over the company's asset or guarantee by the company to support borrowings incurred to finance the acquisition of shares without any benefit to the company in return, that director may be in breach of his/her fiduciary duty, as discussed in question 2.2 above.

In addition, there are certain restrictions on the acquisition of shares as follows:

(a) Shares of the company

A company may acquire its own shares in its own name and for its own account in accordance with certain prescribed methods; provided that the total acquisition price does not exceed the distributable profit available for dividends (Article 341 of the Commercial Code).

(b) Shares of any company which directly or indirectly owns shares in the company

In principle, a company is prohibited from acquiring its own shares or the shares of its parent company while there are certain limited exceptions (Article 342-2 of the Commercial Code).

(c) Shares in a sister subsidiary

The Commercial Code 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?

The agent concept is recognised and is commonly used in syndicated loans. Depending on the provisions of the respective loan and intercreditor agreements, an agent can enforce rights on behalf of other lenders and apply the proceeds from the collateral to the claims of the lenders. However, the concept of a security trust (such as the holding of security through a security trustee) does not exist in Korea since, under Korean law, only a lender or holder of a legitimate claim (in connection with a loan transaction) is permitted to have security interest.

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?

The assignor (i.e., Lender A) may assign the loan to the assignee (i.e., Lender B) by proving a notice with a fixed date stamp to the borrower and/or acknowledgment with a fixed date stamp by the borrower of such assignment. In the case of a guarantee, it is automatically transferred with the loan unless otherwise agreed; provided, however, that, in practice, it is quite common to notify the guarantor of such loan assignment to avoid any dispute in the future.

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?

Pursuant to Article 98 of the Corporation Tax Act, a 22% withholding tax (including local income tax) is levied on the interest paid to foreign lenders under a loan.

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

However, if Korea and the country where the foreign lender resides are parties to a tax treaty, the withholding tax rate may be lowered or the obligation to withhold tax may be relieved entirely pursuant to the relevant tax treaty. For example, no more than 10% withholding tax is levied on interest paid to UK lenders.

Generally, the proceeds of a claim under a guarantee or the proceeds of enforcing security are similarly taxed.

For domestic lenders, they are required to pay corporate income tax (up to 24.2%) on the interest income *in lieu* of a withholding tax.

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?

Korea has generally provided a few incentives aimed at foreign lenders, including (i) tax on interest paid by a Korean borrower to foreign lenders would be exempt under the Restriction of Special Taxation Act, and (ii) pursuant to the relevant tax treaty as described in question 6.1 above, certain interest income would be either waived or limited to a ceiling rate.

In addition, if a lender is a financial institution in Korea, such lender would be subject to a stamp duty tax (up 350,000 Korean Won depending on the loan amount) if a loan agreement is executed in Korea.

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?

Any income of a foreign lender (with no permanent establishment in Korea) will not become taxable in Korea solely because of a loan to or guarantee and/or grant of security from a company in Korea. However, it will be determined by the relevant tax authority on a case-by-case basis after review of the transaction in more detail.

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.

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 Korean tax authorities may assert that instruments described as debt actually constitute equity for Korean tax purposes. The effect of such re-characterisation would be that payments on the instrument would not be deductible to the borrower (and could be subject to withholding in a manner different from interest payments). Moreover, even if treated as debt, Korean tax authorities 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 3 to 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 the foreign law to govern a contract will be recognised as the governing law of a contract under the laws of Korea, provided that in the event of an action, proceeding or litigation in a Korean court (i) Korean law bears upon the capacity of the Korean party to a contract to enter into contracts, (ii) Korean law, decrees and administrative regulations requiring governmental approvals, authorisations and consents for actions or contracts are executed by the Korean party, and (iii) the mandatory laws of Korea (including the principles of the Conflict of Laws Act of Korea) which will be applied because of their nature irrespective of the governing law in respect of non-contractual claims and disputes, are applied by the Korean courts.

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?

Korean courts in general observe foreign judgments, provided that submission to the non-exclusive jurisdiction of the New York courts or English courts is deemed to be valid and binding under the laws of the State of New York by the New York courts or the laws of England by English courts. In the event that a judgment of such courts is obtained, the same would be enforced by the courts of Korea without a further review on the merits, provided that: (i) such judgment was final and conclusive and given by a court having valid jurisdiction in accordance with international jurisdiction principles under the laws of Korea and applicable treaties; (ii) the party against whom such judgment was awarded (a) was served, in a lawful method, the complaint or document equivalent thereto and notice of the hearing date or order with sufficient time to prepare a defence thereof (except in the case of service by public notice or process similar thereto), or (b) responded to the action without being served with process; (iii) recognition of such judgment does not violate good morals, social order or public policy of Korea; and (iv) judgments of the courts of Korea are accorded reciprocal treatment under the laws of the State of New York in the New York courts or the laws of England in English 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?

Actual periods may vary depending upon the nature of the case; however, for a case tried in the lowest tier court (Korea's court system has three tiers), it would take approximately six months to one year in general (inclusive of enforcement process).

© 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?

Collateral security may be enforced pursuant to the relevant security agreement. In general, in the event a private sale becomes unfeasible, collateral security may be enforced in a public auction. Regulatory consents are generally not required, with the exception of certain assets (set forth under relevant laws).

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 the relevant court's decision, foreign lenders may have to provide security for the payment of the costs of legal proceedings in court.

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 Debtor Rehabilitation and Bankruptcy Act ("DRBA") regulates in-court insolvency proceedings in Korea. In the event that a rehabilitation proceeding has been commenced, secured lenders are prohibited from exercising their own collateral and are paid in accordance with the relevant rehabilitation plan. On the other hand, secured lenders may exercise their collateral in a bankruptcy proceeding.

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 final arbitral award properly obtained pursuant to arbitration in accordance with the terms of the contract would be enforced by the courts of Korea; provided that (a) none of the grounds for denial of enforcement of foreign arbitral awards provided for in the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 exists, and (b) the arbitral award is related to a commercial transaction.

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 Korea, the DRBA governs insolvency proceedings. There are two types of insolvency proceedings under the DRBA: rehabilitation proceedings; and bankruptcy proceedings. A bankruptcy proceeding is used for orderly liquidation of the debtor's assets, whereas the primary purpose of a rehabilitation proceeding is to rehabilitate a debtor.

In a rehabilitation proceeding, secured creditors' claims are stayed unless they are qualified as common interest claims or have obtained court approval, and will be adjusted by, and repaid under, the rehabilitation plan.

In a bankruptcy proceeding, a secured creditor may freely enforce its right over the collateral security.

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 certain cases, security interests of a secured creditor may be invalidated and may be subject to other preferential rights.

(1) Right of cancellation

Under the Civil Code, where (a) a debtor engages in a legal act (including a contract) that harms its creditors (e.g., the debtor's assets are reduced due to such act), (b) the debtor's liabilities exceed its assets prior to or as a result of such act, and (c) the debtor and the beneficiary of such act are aware of the harm to the creditors, then a creditor of the debtor has a right to seek cancellation of such act and return of benefits. This right is not available once a rehabilitation or bankruptcy proceeding is commenced with respect to the debtor.

(2) Right of avoidance

Under the DRBA, the following acts may be avoided by the trustee in bankruptcy proceedings or receiver in rehabilitation proceedings:

(a) Any act of the debtor with the knowledge that it would prejudice creditors. Prejudice includes not only a reduction of assets, but also a preferential treatment.

(b) Any act of the debtor taking place after a "suspension of payment" (which refers to the debtor's explicit or implicit admission that, due to the lack of financial resources, it cannot pay its liabilities continuously as they become due) or an application for commencement of a bankruptcy or rehabilitation proceeding (collectively, the "Triggering Event") that (i) creates a security interest in the debtor, (ii) discharges any obligation of the debtor, or (iii) is otherwise prejudicial to creditors.

(c) Any act of the debtor taking place after or within 60 days before a Triggering Event which (i) creates a security interest in the debtor company, or (ii) discharges any obligation of the debtor, where the debtor is not obligated to give rise to such creation or discharge.

(d) Any gratuitous act (for example, a grant of a gift) of the debtor taking place after or within six (6) months before a Triggering Event.

If the act was carried out by a person who has a special relationship with the debtor, as defined under the DRBA, then more relaxed standards for avoidance are applicable.

(3) Preferential treatment of certain claims

There are certain claims that are awarded with preferential treatment in judicial distribution of proceeds from the sale of a debtor's assets, including taxes levied regarding the assets sold, wages for three months, key money deposits for residential leases, etc. These claims are paid before those paid to secured creditors.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The insolvency proceedings under the DRBA are interpreted to be available to all natural and legal persons. However, most commentators agree that a bankruptcy proceeding cannot be commenced with respect to local governments, while some commentators argue that a local government may be put into a rehabilitation proceeding.

© 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?

No. Court proceedings are required in order for creditors to seize any assets not in their possession for enforcement of their claims.

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?

An agreement between parties on the foreign jurisdiction is legally binding and enforceable if:

(i) Korean courts do not have exclusive jurisdiction over the case;

(ii) foreign jurisdiction is permitted for the case;

(iii) the relevant foreign jurisdiction has reasonable nexus to the case; and

(iv) the parties' agreement does not violate the general public policy of Korea.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Although there is no specific statute or legislation on sovereign immunity, there is a court precedent in Korea which confirmed that a waiver of sovereign immunity is permissible. Hence, a party's waiver of sovereign immunity could be legally binding and enforceable under the laws of Korea.

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 person who conducts lending business in Korea must obtain a licence under the relevant supervisory regulations (e.g., the Banking Act, Financial Investment Services and Capital Markets Act, the Insurance Business Act, the Act on Registration of credit business and Protection of finance users). In case of a foreign lender, although no licence would be required if a lending activity takes place outside Korea (without carrying out its business in Korea), a Korean borrower is required to file a report to, or obtain an approval from, relevant foreign exchange authorities (e.g., Ministry of Strategy and Finance, Bank of Korea or a designated foreign exchange bank) pursuant to the FX Regulations. Such report or approval from relevant foreign exchange authorities is required regardless of the lender.

If the licence requirement is not complied with, there will be sanctions and penalties to be imposed under Korean law.

There is no licence requirement for an agent under syndicated facility for lenders and, in Korean syndicated loan transactions, it is quite common for one of the lenders to be appointed as their agent.

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 Korean borrower may be required to obtain a prior report/approval from relevant authorities under the FX Regulations in the event foreign lenders provide financing to the borrower and the borrower is providing collateral security to the foreign lenders. The foreign lenders should make sure that the Korean borrower has duly obtained such report/approval on or prior to the transaction.

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

Woo Young Jung
Lee & Ko
Hanjin Building, 63 Namdaemun-ro
Jung-gu, Seoul 04532
Korea

Tel: +82 2 772 4383
Fax: +82 2 772 4001
Email: wooyoung.jung@leeko.com
URL: www.leeko.com

Woo Young Jung is Head of the Banking & Finance Group at Lee & Ko with more than 25 years of practice experience in the areas of banking and finance. During his long tenure as a banking and finance lawyer, he has handled and advised on a wide variety of financing transactions, including asset financing, project financing, equity financing, corporate rehabilitation and asset backed securitisation, with a concentration on the area of ship finance. He is highly regarded as one of leading banking and finance lawyers in Korea by *Asialaw*, *The Legal 500*, *Chambers Asia*, *IFLR 1000* and *Who's Who Legal*.

Yong-Jae Chang
Lee & Ko
Hanjin Building, 63 Namdaemun-ro
Jung-gu, Seoul 04532
Korea

Tel: +82 2 772 4394
Fax: +82 2 772 4001
Email: yongjae.chang@leeko.com
URL: www.leeko.com

Yong-Jae Chang is a Partner in the Banking and Finance Group at Lee & Ko with more than 20 years of experience. His main practice areas include acquisition finance, structured finance, securitisation, project finance, real estate finance and Islamic finance. He has been involved in many high-profile and award-winning Korean financing transactions representing major international and Korean financial institutions and is highly regarded as one of the leading banking and finance lawyers in Korea by *Asialaw*, *The Legal 500*, *Chambers Asia*, *IFLR 1000* and *Who's Who Legal*.

The Banking & Finance Group at Lee & Ko has been rated top-tier by all leading legal magazines and is renowned for its extensive experience and expertise in providing a wide range of legal advice to Korean and foreign financial institutions and corporations on matters that include, among others, general banking, project finance, acquisition finance, structured finance and securitisation, trade finance, lease and transportation finance, derivatives transactions, insurance, mergers and acquisitions and the development of various financial products. Our clientele includes most of the major Korean banks and foreign banks doing business in Korea.

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

Mexico

Gonzalez Calvillo, S.C.

José Ignacio Rivero Andere

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

2016 was the year in which the world was witness to Brexit and the election of President Trump; two underdog events that represent a step back from globalisation and towards nationalism and protectionism, and that have created uncertainty and unease in financial markets around the world.

Particularly, in 2016, Mexico's financial markets were hit, among others, with a 30% devaluation of the Mexican Peso against the US Dollar that is expected to continue to some degree throughout 2017; as well as with the expectation of a renegotiation of NAFTA (North America Free Trade Agreement) that will redefine the rules of trade with Mexico's most important commercial partner, the United States of America.

Additionally, President Trump has shown a substantial amount of animosity toward our country and its people and, among others, has threatened to impose tariffs on Mexican goods and to build a wall along the US-Mexico border.

As a result of the above, 2017 is expected to be a challenging year for Mexico with little new capital coming into our country and a significant number of US Dollar-denominated debt restructurings and rearrangements with our US commercial and financial partners. That said, once the financial markets around the world find ease (if they do at all) and assuming Trump's radical positions are somehow softened, Mexico is expected to continue seeing the results of its recent structural reforms (2013–2016) with the injection of noteworthy capital in the energy and infrastructure sectors, which constitute the core of the growing potential of the Mexican economy and, in the case of the energy sector, the opening of an area that was closed for more than 50 years to private investment with a material potential to develop.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Trends have remained consistent over recent years, as the most significant lending transactions are those related to the construction, operation and maintenance of energy and infrastructure projects.

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 allow guarantee of the obligations of third parties. These guarantees can be created either under Mexican or foreign law, provided that, when created under foreign law, certain provisions shall be included in the foreign documents to ensure enforceability of a judgment thereto in Mexico against the Mexican guarantor (e.g. limitations on guarantee language; appointment of process agent; submission to jurisdiction; conditions precedent related to the Mexican guarantor; withholding taxes gross-up).

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; however, directors must comply with their statutory duties in resolving any transaction that is subject to their review. Specific duties under Mexican law for directors acting for private entities are abstaining from voting in matters where they have a conflict of interest, and confidentiality; for public entities, these are the duty of loyalty and the duty of care.

2.3 Is lack of corporate power an issue?

Yes, for the validity of the guarantee (i) the Mexican guarantor shall be authorised under its by-laws to act as a guarantor of third party obligations, (ii) the Mexican guarantor, if applicable under its by-laws, shall obtain the necessary corporate approvals (shareholders/BoD), and (iii) a duly appointed representative of the Mexican guarantor with sufficient powers and authorities under Mexican law shall 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 may be required.

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

Subject to the contractual provisions applicable to the Mexican guarantor, third party consents may be required.

In general, no governmental consents are required (exception made for regulated entities and sectors where governmental approvals would apply).

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No. However, please note that 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 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 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.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Security trusts, pledges and mortgages. These can be created over: (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?

1. Pledge over Equity: To perfect collateral in Mexico over equity issued by a Mexican company, a Mexican equity pledge agreement shall be implemented, jointly with the delivery of (i) if applicable, stock certificates duly endorsed in guarantee, (ii) evidence of an entry regarding the pledge in the shareholders/partners registry book of the issuer, and (iii) stock powers to be exercised upon the occurrence of an enforcement event.

2. Pledge over Movable Assets: To perfect collateral in Mexico over any type of assets (other than equity and real estate assets), a Mexican floating lien/regular asset pledge shall be implemented. When structured as a floating lien pledge, the possession of the pledged assets will remain with the pledgor; when structured as a regular pledge, the possession of the pledged assets will be transferred to the pledgee.

Additionally, collateral over equity or movable assets can be created through a security trust (referred to below).

In connection with (1) and (2) above, please note the following:

The signatures of the parties to the equity pledge (to ensure priority over tax credits) and the floating lien/regular asset pledge (to comply with perfection requirements under Mexican law) shall be ratified before a Mexican notary public and registered at the Sole Registry of Movable Security. To accomplish the notarial ratification, representatives of such parties must be available at closing to execute these documents in front of a Mexican notary public with a valid Mexican law PoA. Also, in case the floating lien/regular asset pledge covers any trademarks registered in Mexico, such pledge shall also have to be registered at the Mexican Institute of Intellectual Property (IMPI). Additional formalities and third party consents may apply depending on the nature of the grantor and the collateral assets.

3. Security Trust: As an alternative to the pledge structures referred in 1 and 2 above and to the mortgage structure referred in question 3.3 below, a Mexican guarantee trust structure could be implemented and used to create, among others, a general security structure encompassing all or a substantial number of the assets of a grantor or a relevant project.

Generally speaking, under a trust, the sponsors/security providers will transfer title of assets to a trustee (a Mexican bank or a financial entity authorised to act in such capacity), with the purpose of (i) securing the payment and the performance of obligations under the relevant financing documents, (ii) managing the collateral assets, and/or (iii) serving as a source of payment of the relevant debt.

The formalities for incorporating, operating and transferring assets to a trust will depend on the nature of the sponsors/security providers and the assets involved. These formalities will be the ratification of the trust before a Mexican notary public, and its registration before the Sole Registry of Movable Security; to accomplish the notarial ratification, representatives of the parties to the trust must be available at closing to execute these documents in front of a Mexican notary public with a valid Mexican law PoA.

The primary advantage of the trust structure is that it makes all collateral remote to the bankruptcy of the sponsors/security providers as there is a "true sale" of the assets to the trustee, and that it gives additional control and enforcement capabilities over the assets in an EOD. The primary disadvantage of the trust structure is that it may interfere with the operations of the grantors and affect third parties related to the business (as the assets are transferred to a third party (trustee)), and that its implementation represents additional costs.

Any PoAs granted outside of Mexico must be notarised and apostilled or legalised in the country in which they were granted, and sent to Mexico for further notarisation.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral over Real Estate Assets (land and buildings): To perfect collateral in Mexico over Mexican land and/or buildings, a Mexican mortgage agreement shall be implemented.

- In terms of Mexican law, this mortgage shall be granted through a notarial deed and thus representatives of the parties thereto shall 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 shall be registered in the public registry of property of the place where the assets are located.
- In relation with the creation of security over machinery and equipment, please refer to question 3.2, point 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?

It can be taken; see question 3.2, point 2.

Debtors are not required to be notified of the creation of the collateral for such collateral to be perfected; however, it is a good practice to notify such debtors so that they acknowledge the pledge and the fact that once and if enforced, they should pay to the parties acquiring the receivables as a result of enforcement.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

It can be taken; see question 3.2, point 2.

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 can be taken; see question 3.2, point 1.

The form of the certificates depends on the corporate form of the issuer; generally, shares are in certificated form.

Such security can only be granted by means of Mexican collateral documents.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

It can be taken; see question 3.2, point 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)?

Yes, so long as the by-laws of the company allow the granting of security interests. These security interests should 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 to perfect the security interests being created; see question 3.2, points 1 and 2. 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 and/or security interest being created; 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 for security over real estate assets are associated with security registration at public registries. 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 from 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).

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.

© 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?

No, not generally.

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. In some cases, the granting of a PoA to the agent by the secured parties to act as such may be advisable.

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.

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 must be complied with. Also, unless the Mexican borrower entity is notified of the assignment, it will be released of its 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 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.

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.

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.

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 section 3.

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. Mexican law generally allows the parties freedom in the choice of law and jurisdiction, and Mexican courts will recognise a judgment under a contract governed by a foreign law, provided such laws do not contravene Mexican law principles.

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?

See question 7.1.

© 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?

Timing depends on the circumstances of the particular cases, applicable foreign governing laws, and applicable foreign jurisdictions, as well as on the consistency with Mexican law principles.

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 choose 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 may 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 unsecured) creditors. However, please note that credits against

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

the asset mass, such as certain tax or labour credits, debts incurred while at the reorganisation process, asset maintenance and other similar costs, may 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 could 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; 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?

See question 7.1.

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.

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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, no.

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

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, securities, capital markets; corporate law, mergers and acquisitions, real estate, and private equity. Mr. Rivero serves as member of the board of several companies and his practice has been recognised by *Chambers and Partners Global* and *Latin America*. A significant part of his work is consistently featured by *Latin Lawyer*'s briefing.

Mr. Rivero has international experience, both professionally and academically, having worked as an international associate for the firm Proskauer Rose LLP in New York, as well as having obtained the following degrees: a certificate in business administration (2008), Northwestern University, Kellogg School of Management; a Master of Laws (LL.M.) (2008), Northwestern University, School of Law; and an attorney at law (JD Equivalent), Escuela Libre de Derecho, with honours (2005).

For 30 years, González Calvillo, S.C. has stood as a leading Mexican law firm that has rewritten the model of the full-service law firm by combining its transactional and deal-making core with superb support practice areas. The firm's business and legal practice is well diversified and provides a complete range of legal services directed to all kinds of businesses and industries.

The firm is known for its ability to build cross-disciplinary teams in the most challenging and sophisticated of transactions and providing legal, business and regulatory advice in a broad range of areas of practice.

The firm is consistently recommended as a leading full-service in the Mexican legal marketplace. Most of the firm's lawyers have pursued international legal studies in the United States or Europe and a large number have experience working as foreign associates in highly prestigious global law firms.

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

Norway

Kyrre W. Kielland

Advokatfirma Ræder DA

Anne Christine Wettre

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 at present (January 2017) prices remain below half of earlier levels. Needless to say, investments in the offshore industry which has driven economic growth in Norway for years have dropped significantly, and many suppliers to the Norwegian offshore industry are struggling. Almost two thirds of outstanding debt in the bond market was related to the oil and gas sector, and the borrowers' distress caused 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.

Consequently, the continuing trends in the Norwegian lending market for 2017 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?

During 2016, Lundin Petroleum secured a seven-year reserve-based lending facility for up to USD 5 billion with a group of 23 international banks. The facility will enable Lundin Petroleum to develop the major oil field "Johan Sverdrup" which was discovered by Lundin in 2010. In April 2016, Norwegian ship owner Østensjø Rederi took delivery of the offshore vessel "Edda Freya" from Norwegian yard Kleven Verft. OCV "Edda Freya" is among the world's largest offshore construction vessels with an estimated new build cost of approximately NOK 1.4bn, i.e. approximately USD 170 million. The vessel was financed through a loan syndicate consisting of DNB, NIBC, GIEK and Eksportkreditt Norge. Later the same year, in September 2016, the Norwegian ship owner Solstad Offshore ASA took delivery of the gigantic pipeline laying vessel "Normand Maximus" from Norwegian yard Vard Brattvaag. VLS "Normand Maximus" is the largest and most expensive offshore vessel ever built in Norway with an estimated total cost of approximately USD 390 million. The vessel financing was syndicated by DNB, NIBC, Swedbank, GIEK and Eksportkreditt Norge.

We might also mention that the European Investment Bank (EIB) in December 2016 approved a EUR 800 million financing to a consortium comprising the Norwegian transmission system operator Statnett and DC Nordseekabel GmbH & Co. KG, each with a 50% share in the construction of a high voltage (HVDC) link connecting Norway and Germany across the North Sea.

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 scenarios other 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.

© 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?

Unenforceability might be an issue if the guarantee/security has been issued by a limited liability company contrary to the provisions of the LLC Acts Chapter 3, the provisions of which 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, 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.

© 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?

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 fishery tools and thereby create a floating mortgage over such groups of assets.

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 are 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 in 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 a 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

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

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.

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 and 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.

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 (No: *Kommandittselskap* or *KS*), 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

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

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.

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?

At present (January 2017), 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?

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.

6.4 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.?

The signature of a foreign lender will rarely be subject to notarial confirmations, etc., unless specifically requested by one of the parties to the transaction. Registration fees might apply in the course of perfection of security granted by the Borrower, but this cost will be similar to Norwegian and foreign lenders.

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.

© 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?

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.

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 two to four 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 (No: *Namsfogden*) 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 (No: *Namsfogden*) 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 (No: *Namsfogden*); please see question 7.2 above.

© 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?

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 has initiated enforcement proceedings that has resulted in distress over company assets within three months of the filing of bankruptcy, such distraints 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 sections 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 sections 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.

© 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?

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 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 have 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 10 April 2015. As a general rule, a licence is required for credit or financing services within the Norwegian territory. 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 licensing requirements will not cause the facility agreement to be unenforceable, but wilful or negligent breaches may be punishable by corporate fines or, in exceptional circumstances, fines or up to one year in prison for involved persons.

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.

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

Kyrre W. Kielland
Advokatfirma Ræder DA
P.O. Box 2944 Solli
N-0230 Oslo
Norway

Tel: *+47 23 27 27 00 / +47 45 02 20 56*
Fax: *+47 23 27 27 01*
Email: *kwk@raeder.no*
URL: *https://en.raeder.no*

Kyrre W. Kielland has broad experience in financing and other transactions within shipping, aviation and real estate. He advises banking institutions/lenders, companies and others with negotiations and the 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). Kyrre holds valuable experience in 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.

The Legal 500 recommends Kyrre within *Banking and Finance* (including *Shipping Finance*).

Anne Christine Wettre
Advokatfirma Ræder DA
P.O. Box 2944 Solli
N-0230 Oslo
Norway

Tel: *+47 23 27 27 59 / +47 90 04 16 25*
Email: *acw@raeder.no*
URL: *https://en.raeder.no*

Anne Christine Wettre has long and extensive experience within insolvency, bankruptcy and restructuring. Her specialist fields are monetary claims, law of mortgages and pledges, enforcement, property law and value added tax. In addition she is regularly appointed trustee of bankruptcy estates by the City Court of Oslo.

Through her work with bankruptcy proceedings, Anne Christine has built up the unique ability to not only provide answers to purely legal issues, but also to find practical solutions that are specifically adapted to the client's business activities and the legal problems the client is facing. Furthermore, she has a significant ability to study and assess financial statements and other company documentation and also assist our clients with audits from the tax authorities.

Before she came to Ræder in 2007, Anne Christine held a position as a lawyer at the Norwegian division of Euler Hermes Credit Insurance. Through her vital role within compliance and contract law, she built up important skills within all aspects concerning the management of debt recovery activities.

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

Carlos Saco-Vertiz Tudela

Estudio Saco-Vertiz & Landerer

Jaime Sabat Pancorvo

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Peruvian governments in office since 1990 have prioritised a policy for the promotion of private investment in public infrastructure and public services, among other fields, through a stable legal framework that provides incentives to foreign and local investors in a context of free competition, protection of private property and freedom of contract. Under this legal framework, the Peruvian economy has grown substantially, on a constant basis, during the last 15 years. This has created the conditions for enabling Peruvian companies with a strong economic basis and capitalisation to have access to financing facilities from foreign banks, at financing conditions more competitive than those offered by local banks. From their side, local bank and finance entities have invested strongly in technological improvement and systems to compete with the foreign banking system, as well as to provide clients with more innovative financing products, including project finance, and to participate in syndicated loans.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

We indicate below some of the significant lending transactions that have been executed since 2014. Most of the relevant transactions have been entered into by Credicorp and Banco de Crédito, such as:

- El Brocal Leaseback – US$180m.
- Termochilca Medium Term Financing – US$135m.
- Buenaventura Syndicated Loan – US$275m.
- Hayduk Syndicated Loan – US$120m.
- Tecnoglass Medium Term Loan – US$120m.
- Isquared Syndicated Loan – US$450m.
- Enersur Leasing – US$290m.
- Transmantaro Medium Term Loan – US$250m.

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)?

Peruvian legislation does not prohibit intercompany guarantees between entities of the same corporate group from guaranteeing financing facilities assumed by one or more companies of such group. However, there are restrictions to the loans that companies may provide or the guarantees (including the issuance of security interests) that they may constitute collateralised with their own shares, and they may not provide loans to their own shareholders or to third parties to acquire their own shares, under Article 106 of the Peruvian Companies Law (“*Ley General de Sociedades*”).

In addition, guarantees given by a company to secure indebtedness or other obligations assumed by a related company may be subject to a nullity action filed before a court by other creditor(s) of the guarantor/securing company in cases where the issuance of guarantees exceeds the business purpose (“*Objeto Social*”) of the respective guarantor, or if no remuneration for the benefit of the guarantor has been agreed between such related parties.

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?

Peruvian law does not regulate or sanction the event in which there is a disproportionately small (or no) benefit to the guaranteeing/securing company, including that there are no enforceability restrictions or prohibitions if such event occurs. It should be noted, however, that the minority shareholders or the creditors of the guaranteeing/securing company may file a nullity action in court to obtain a judicial declaration as void of guarantee, if the granting of such guarantee was effected without complying with the corresponding previous corporate authorisations foreseen in the by-laws (“*Estatuto*”) of such company. Under Article 181 of the Peruvian Companies Law, the legal action may also seek indemnity for damages against the officers or representatives of the company that executed such guarantees and/or the board members that approved the granting of such guarantee without having the needed legal authority under the *Estatuto*. In addition, under the abovementioned rule, the creditors of the guaranteeing/securing company may only file a legal action against the officers and board members of the company if: such action has the purpose of reconstituting the net worth of the company; such action has not been initiated by the company or its shareholders; or the objected guarantees constitute a serious menace (risk) for the guarantee(s) of the credits held by such creditors.

2.3 Is lack of corporate power an issue?

Yes it is. Under Article 13 of the Peruvian Companies Law, only duly authorised officers and representatives of a company will

generate an obligation for the company, even if the officers and representatives acted on behalf of the company when executing the questioned contracts or acts. Consequently, a guarantee issued by a company acting through officers or representatives that exceeded their authority or did not have any to execute such act will not be a legal, binding and enforceable obligation for such company, but will be obligations personally assumed by the respective officer or representative.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In the cases of ordinary companies, that is, companies that are not regulated entities (such as Banks, Insurance Companies, Private Pension Funds Managing Companies (*AFP*)), they will not need to obtain specific authorisations, nor are they subject to limitations or restrictions in the amount of the direct or indirect indebtedness that may be assumed and issued by such companies. Therefore, such ordinary companies may issue guarantees insofar as the needed internal corporate approvals are obtained (approval by the board of directors and/or by the shareholders' meeting), and the guarantees are executed by the duly authorised officers and representatives. In that respect, the creditors and other beneficiaries of such guarantees should review the updated by-laws and the powers of attorney rules and limitations of the guarantor as a precedent condition to accept the respective *Fianza* or guarantee.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, there are no net worth, solvency or similar limitations imposed by Peruvian law on the amount by which the guarantee may be issued. Without prejudice to the above, Article 1873 of the Peruvian Civil Code provides that bonds ("*Fianzas*") may not be issued for an amount that exceeds the guaranteed obligations of the debtor, unless the contrary is set forth in the *Fianza*; additionally Article 1878 of such Code contemplates that the *Fianzas* issued for an unlimited amount will cover all the accessory obligations to the main guaranteed obligation, as well as the court costs and expenses, even those that may have accrued after the payment of the *Fianza* was required.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Peruvian law does not contemplate any exchange controls nor any similar legal impediments for the enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Peruvian law contemplates personal and real guarantees.

Personal guarantees are denominated *fianzas* (guarantees that are supported by all the assets of the guarantors) and *avales* (guarantees that secure a specific credit document (*titulo valor*)). Peruvian banks may issue "*Cartas Fianzas*", which are guarantees highly valued in the Peruvian market that are subject to a specific regulation issued by the Superintendence of Banks, Insurance Companies and AFP. They are extensively used to secure loans and other financing operations by banks. In addition, the other premium guarantees in the local banking and financial sector are stand-by letters of credit and other banking guarantees.

With respect to real guarantees, traditionally banks and financing companies have accepted as guarantees to secure loans and other financing: "*Hipotecas*" (mortgages) on real estate property as well as concessions on infrastructure projects as well as for public services; and "*Garantías Mobiliarias*" (pledges) on movable assets such as aircraft, ships, equipment, machinery, vehicles, receivables, future accounts, shares and other "*Títulos Valores*" and inventories. In addition, the warrants and certificate of deposit issued by licensed warehouses are also accepted by banks and financing entities in cases where the depositor is a well-renowned client.

During the last 15 years, the use of "*Fideicomisos en Garantía*" (guarantee trusts) has grown in the banking and financial market as a more valued guarantee than mortgages and pledges, because the assets (real estate, movable assets, rights, future flows and receivables) that may be transferred in trust ("*Transferencia en Dominio Fiduciario*") have the effect of almost transferring ownership of the assets to the "*Fiduciario*" (trustee) for the purpose of constituting the trust ("*Fideicomiso*"), for the benefit of the creditor(s) and facilitating the execution of the trust and sale of the assets by the trustee in the event of a default on the guarantee obligations. The rules and procedure for the realisation of the trust and direct sale of the assets are more efficient in the practice than the procedure for the execution of a mortgage and/or a pledge, because the judicial process until the realisation of such guarantees may last two years instead of the three to six months that it may take for the execution of the trust. The "*Fideicomisos en Garantía*" are regulated by the "*Ley General del Sistema Financiero y Orgánica de la Superintendencia de Banca y Seguros*" (Law N° 26702, as amended) and the secondary rules issued by such Superintendency (*SBS*), which means that only banking and financial entities and specific companies licensed by the SBS may act as trustees, which are under and subject to the surveillance and regulation of the SBS. Guarantee trust agreement should be recorded at the "*Registro Mobiliario de Contratos*" (Movable Assets Contracts Public Registry), and at the specific public registries where certain assets should be recorded, such as: the Real State Public Registry; the Concessions Public Registry ("*Registro de Concesiones para la Explotación de Servicios Públicos*"); and the Aircraft Public Registry, among others. Such registration will allow the trust to be enforced against third parties.

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 constitute guarantee by means of a general security agreement. The Peruvian Civil Code contemplates the "*Hipoteca sobre una unidad de producción*", that is, a mortgage that covers a whole production unit, which may comprise different types of assets (equipment, machinery, real estate property, inventory and spare parts) that are integrated as a production unit. This type of mortgage is subject to special rules for execution, because the execution will cover all of such assets of different natures as if it would be single assets.

In addition, a guarantee trust may be structured to include all of the assets, rights, contracts and legal relationships of a company in order to allow the trustee to sell all of the business of the borrower or debtor to a single acquirer through the sale procedure under the rules foreseen in the guarantee trust agreement. One should note that the "*Ley de la Garantia Mobiliaria*" (Pledge Law) permits the constitution of pledges over inventory.

© 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, please refer to our response to question 3.1. In that respect, real property may be given in guarantee, either under a mortgage or under a security trust; the same is applicable for all types of movable assets, such as plant, machinery and equipment, and even concessions over infrastructure projects as well as public services. The respective agreement, in both cases, should be formalised by a public deed ("*Escritura Pública*") elaborated by public notary and should be recorded at the "*Registro Mobiliario de Contratos*" (Movable Assets Contracts Public Registry), and at the specific public registries where certain assets should be recorded, as has been indicated in our response to question 3.2.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes; please refer to our response to question 3.1. In that respect, receivables may be subject to guarantees either under a pledge or under a security trust. Under our Civil Code receivables, collection accounts and future expected flows may be given guarantee, either as a pledge or a guarantee trust and the formalities indicated in the response to the question 3.3 should be complied with. The corresponding pledge agreement or trust agreement on receivables may produce legal effects before third parties after the debtor is notified of the existence of the security through the registration of the pledge or the trust agreement at the Movable Assets Contracts Public Registry.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes; under the Civil Code a pledge may be constituted over cash deposited in bank accounts, and the formalities indicated in the response to the question 3.3 should be complied with.

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 guarantee may be constituted over shares issued by companies incorporated in Peru, either under the form of the pledge or under a trust agreement. Shares are issued in physical certificates in those companies where the shares are not listed at the Lima Stock Exchange (*BVL*), and the respective pledge or the trust agreement over shares will produce legal effects against the issuer and third parties once such guarantee is recorded at the Share Registry ("*Matrícula de Acciones*"), which is a private registry maintained by the issuer and is not accessible by the public. Shares that are recorded at the BVL are represented by an electronic registry (book entry form) at CAVALI S.A. ICLV, which is the settlement house of the BVL and where securities that are listed at the BVL are recorded by "*Anotaciones en Cuenta*" (book entry form). Pledges and guarantee trusts constituted on shares recorded at such electronic registry should registered at such registry in order for such guarantee to take legal effect. The formalisation procedure for the constitution of such pledges in guarantee trust is the execution of the public deed before a local public notary.

Yes, the Peruvian Civil Code allows individuals and companies domiciled in Peru to freely agree the governing law for their contractual arrangements, as well as the jurisdiction which will resolve their disputes; that is, they may subject the resolution of such disputes to a foreign court, in which case the language of the respective agreement may be the same language used in such jurisdiction. Consequently, a pledge agreement or a guarantee in trust on shares issued by a Peruvian company may be granted under a New York or English law governed document; however, there are certain public order rules that should be contemplated in such foreign law-governed guarantee agreements, otherwise Peruvian courts may not recognise and enforce judgments issued by English or New York courts as the case may be.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, the inventory may be given in guarantee; either under the "*Garantia Mobiliaria*" or under a "*Fideicomiso en Garantia*". Please refer to our responses to questions 3.1 and 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)?

Yes, Peruvian law allows a company to constitute a guarantee on its assets to secure obligations under a loan or credit facility assumed by such company, as well as to guarantee obligations of other borrowers and/or guarantors of obligations under a loan or credit agreements assumed by such third party. The only restriction is that contemplated in article 106° of the Peruvian Companies Law, which is explained in our response 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?

Pledges, mortgages and guarantee in trusts agreements should be formalised as public deeds elaborated by public notaries and executed by the parties, which should then be recorded at the respective public registry as explained in this section. This formality is required for the respective guarantee to produce legal effect and be enforceable before third parties. Notarial fees and expenses may vary depending on the notary that is chosen by the parties. There are no official notarial tariffs. Such costs and fees are negotiated with the respective notary and are estimated by the respective notary, substantially based on the secured amount and the number of pages of the respective agreement. The public registry costs are established by the government, and currently the amount is equivalent to 0.75/1,000 of the amount of the guarantee. If the amount of the guarantee exceeds the equivalent of US$10,000.00, then the public registry fees will be calculated on the equivalent of 1.5/1,000 of the amount of the guarantee, and in all cases, the amount of such registry fees may not exceed one Referential Tax Unit (UIT), which is currently S/ 4,050.00 (approximately US$1,260.00).

© 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?

If compared to the timing of certain jurisdictions, the registration of guarantee documents at the respective public registries of their jurisdictions – which in some cases may be three to five days – then yes, the local registration procedures to register mortgages, pledges and guarantee trusts may take a significant amount of time, in the worst case thirty (30) business days, unless there are substantial observations by the public registrar because certain essential requirements have not been complied with in the respective documents. Under normal circumstances, the registration may take ten (10) to fifteen (15) business days.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally, Peruvian law does not contemplate regular or other similar consents for companies or individuals to constitute a guarantee on their respective assets in any of the alternatives that have been explained in this section (pledges, mortgages, and guarantee in trusts). There are certain restrictions and need for the public regulatory body consent for certain regulated banking and insurance companies as well as pension private funds managing companies (*AFP*), as well as companies that are concessionaires of public infrastructure projects or public services.

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 no special priority concerns in cases of borrowings that are guaranteed by revolving credit facilities. There are no special creditor priority concerns, but it should be noted that if the borrower is declared insolvent or is subject to any other restructuring procedure under the "*Ley General Concursal*" (Insolvency Law – Law N° 27809, as amended), the labour debts will have the first priority rights over all creditors, even secured creditors on the proceeds of the realisation of the respective guarantees, including trust guarantees. Such secured creditors, however, will have higher priority rights on tax obligations of the insolvent party and over unsecured creditors.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Yes, they have been explained in the responses to questions included in this section. The guarantee documents (private agreements for mortgages, pledges and guarantee in trusts), executed by the parties should be formalised and converted into public deeds by a public notary, and then such public deeds should be executed by all parties for the purpose of such guarantees to be recorded at the respective public registries, in order that the guarantees be enforceable and produce legal effects before third parties. The representatives of the parties should be vested with the sufficient power of attorney (approved by resolution of the Board of Directors or the General Shareholders' Meeting), giving the needed authority to execute and sign, on behalf and in representation of the grantor, the respective guarantee instruments, either by the specific power of attorney granted for the respective transaction, or acting under the authorisation given by the general powers of attorney regime approved by resolution of the Board of Directors or the General Shareholders' Meeting or contemplated in the incorporation documents of the company. In all cases, such specific powers of attorney or the general powers of attorney regime should be recorded at the competent Companies Public Registry ("*Registro de Personas Jurídicas*").

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 it has been indicated in our response to question 2.1, companies may not provide loans or guarantees (including the issuance of security interests) which may be collateralised with their own shares, nor may they provide loans to their own shareholders or to third parties to acquire their own shares – under Article 106 of the Peruvian Companies Law (*Ley General de Sociedades*).

(b) Shares of any company which directly or indirectly owns shares in the company

This specific case has not been contemplated by the prohibition set forth in the abovementioned Article 106 of the Peruvian Companies Law. Therefore, we consider that the financing by a company of an indirect acquisition of shares of such company or to guarantee such financial transaction is not prohibited by Peruvian law, because there is a principle of law in our legislation under which rules that provide prohibitions to act or to abstain to act, or restrictions to the exercise of rights, should be expressly set forth; consequently such prohibitions or restrictions may not be applicable by extension. Nevertheless there have been no court cases (jurisprudence) where a litigation in which such financing transactions have been challenged has been resolved.

(c) Shares in a sister subsidiary

We have the same opinion with respect to this type of transaction as explained in our response 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?

Yes, under Peruvian law, such role and the corresponding rights for an agent or a trustee under a syndicated lending will be recognised.

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 our opinion, the rights and attributions of agents and trustees provided in the respective syndicated loan or on a lender's agreement

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

will be recognised under Peruvian law for the purpose of enforcing claims on behalf of all the respective 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?

Under the Peruvian Civil Code, any assignment of a contractual position (in this case, the position of lender or borrower, as the case may be), under a contract or agreement should be approved by the other party(ies) to such contract or agreement. With respect to the assignment of rights under a contract or agreement by one of the parties to a third person, it should be notified to the other party(ies) to such contract or agreement in order for such transference or assignment to produce legal effects. Such requirements and restrictions will be applicable in addition to any requirements, limitations or restrictions that may be contemplated in the corresponding loan or financing 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?

a) Under the Peruvian Income Tax Law, the interest generated by a loan, where the borrower is a Peruvian company, is considered taxable income in Peru. In that sense, the only requirement for the borrower to withhold the Peruvian Income Tax is the filing of a Form made by the borrower to the Peruvian Tax Authority (*SUNAT)*.

b) The answer to this point should be analysed by every specific "claim". However, it should be noted that, in accordance with the Peruvian Income Tax, the tax obligations and the payment of the relevant tax must be made at the time of the registration of the invoice in the accounts of the borrower.

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 current Peruvian income tax legislation, the interest, fees, commissions, prime, and any other payments made in excess of the repayment of the principal of the loan to the lender, made by a Peruvian company (borrower) to a foreign lender, is subject to a preferential Withholding Tax (Income Tax) rate of 4.99%. This special rate is applicable if the loan complies with specific requirements established in the Peruvian Income Tax Law; otherwise, the rate applicable would be 30%. In addition, Peru has executed tax treaties with a number of nations, such as Chile, Canada, Switzerland and Korea, to avoid double taxation.

The only tax that could apply to a foreign lender as a consequence of the execution, application and compliance of the respective loans, mortgages or other security documents, is the abovementioned Withholding Tax (Income Tax). Local borrowers should pay IVA Tax (Sales Tax), at the rate of 18%, on the interest, fees, commissions, prime and any other payments made in excess of the repayment of the principal of the loan.

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?

Article 9 of the Peruvian Income Law establishes that the interest, commissions, fees, prime, and any additional amount originated or related to any loan where the borrower is a Peruvian company will be considered subject to the Withholding Tax (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.?

Yes, the borrower will have to pay the notarial and registration fees and expenses accrued in connection with compliance with the formalities and registration, which is required under Peruvian law in connection with the execution and constitution of the real guarantees and trust guarantees regarding the loan or the respective financial facility, as explained in 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.

The only restriction that the Peruvian Income Tax Law regulates is that, when the foreign lender is an individual domiciled in a tax haven, the tax rate will be increased from the preferential rate of 4.99% to 30%. It is important to note that this rule only applies to individuals, not to companies, funds or trusts.

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, under Peruvian law, specifically the Peruvian Civil Code, foreign governing law will be recognised, including foreign governing law provisions for loans and other financial facility agreements that the Peruvian State may enter into with foreign lenders.

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 Peruvian court would give a judgment based upon a judgment of the courts of a foreign country, including the State of New York and of any Federal Court or Appellate Court of the United States sitting in New York City, obtained against the local debtor with respect to a claim arising out of a loan or other type of financial facility, without reconsideration of the merits, provided that it is ratified by the applicable Peruvian Courts ("*Cortes de la República*"), under

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

the *exequatur* procedure, in compliance with the applicable rules of the Civil Procedure Code ("*Código Procesal Civil*") of Peru. Such ratification will occur provided that the following conditions and requirements are met:

(a) such final and conclusive judgment does not resolve matters under the exclusive jurisdiction of Peruvian courts (such as matters involving real estate property);

(b) the court which issued the judgment had jurisdiction under its own conflict of law rules and under the general principles of international procedural jurisdiction;

(c) the defendant was served with process in accordance with the applicable laws of the jurisdiction of the court rendering such judgment and was guaranteed due process rights;

(d) the judgment has the status of *res judicata* as defined 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 final judgment is not incompatible with another judgment that fulfils the requirements of recognition and enforceability established by Peruvian law unless such foreign judgment was rendered first;

(g) such final judgment is not contrary to Peruvian national sovereignty, public order (*orden público*) or good morals;

(h) it has not been proven that the foreign court who issued the judgment denies enforcement of Peruvian judgments or engages in a review of the merits thereof;

(i) such judgment has been (y) duly apostilled by the competent authority of the jurisdiction of the issuing court, in the case of jurisdictions that are party to the 1961 Hague Convention Abolishing the Requirements of Legislation of Foreign Public Documents (the "Hague Apostille Convention"), or (z) certified by Peruvian consular authorities and legalised by the Ministry of Foreign Affairs of Peru, in case of jurisdictions that are not party to The Hague Apostille Convention, and is accompanied by a certified and officially translated copy of such judgment into the Spanish language, issued by a public official translator licensed in Peru, prior to its submission for consideration of any Peruvian authority or its admission as evidence in any courts of Peru, and such official Spanish translation would prevail over its original version; and

(j) the applicable court taxes or fees have been 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?

A court case and procedure initiated by a foreign lender to obtain the recognition and enforcement (*exequatur*) of a judgment issued by a foreign court ordering the local borrower to pay an amount and/or to comply with certain obligations contemplated in a contract or agreement subject to the jurisdiction of such foreign court may take between approximately two and three 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?

The enforcement in court of a real guarantee or a guarantee trust is subject to minimal rules of transparency and protection of rights for the defendant to obtain a reasonable value of the assets that are foreclosed, including the need that such assets be sold in a public auction conducted by an auctioneer designated by the judge from an official court list. No regulatory consents are required for enforcement of guarantees granted by local debtors, including the Peruvian State. The guarantee trust agreements contemplate in their enforcement clauses private foreclosure procedures that should be followed by the trustee in connection with the sale of the assets of the trust, in which it is a standard practice that the rules for the enforcement and sale of the assets contemplate an initial appraisal by a specialised company and a procedure to make the best efforts to receive more than one bid.

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 in those cases.

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?

Ley General Concursal (Insolvency Law – Law N° 27809, as amended), mentioned in our response to question 3.12, establishes that after the publication of the declaration of insolvency of the debtor in the Official Newspaper (*Diario Oficial el Peruano*), all of the obligations of the insolvent party existing up to such date, including tax, labour and secured obligations, as well as the enforcement of court and arbitral procedures and the execution of embargos and other judicial injunctions, will be suspended and become unenforceable during a period that will last until the creditors' meeting (*Junta de Acreedores*). The insolvent party must also approve a restructuring plan, a global refinance agreement or a liquidation agreement, where the new payment terms and conditions of the recognised credits included in the procedure will be set forth, referring to the enforceability of such credits and the applicable rate of interest for each case. The payment terms and conditions will be enforceable against all creditors included in the procedure.

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, Peruvian courts will recognise and enforce an arbitral award given against a local company without re-examination of the merits, under the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The competent court to resolve a demand for recognition of a foreign arbitral award will be the "*Corte Superior del Perú*".

Peruvian law contemplates certain cases where such foreign arbitral awards will not be recognised by such Superior Court.

© 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 it has been explained in the response to question 7.6, during insolvency of a debtor, the lender may be able to enforce its right under the terms and conditions that will be established by the creditors' meeting ("*Junta de Acreedores*"), in the restructuring plan, a global refinance agreement or a liquidation agreement, that would be approved by such creditors' meeting, where the new payment terms and conditions of the recognised credits included in the procedure will be set forth. In that respect, the creditors' meeting may not adopt any resolution affecting the existence or the terms and conditions under which the security interests provided by the mortgage pledge or guarantee in trust was constituted, but the credits secured by such guarantees will be paid in accordance with the terms and conditions contemplated by the respective restructuring plan, global refinance agreement or liquidation agreement. Each of such secured creditors will be paid from the proceeds of the execution of the respective real guarantees and/or trust guarantee securing its specific credit, but such proceeds will be also used to pay, on *pari passu* terms, the preferential credits, that is, those credits that rank above them, as explained in the response 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?

Yes, the *Ley General Concursal* provides that labour claims and debts have the first priority preference, that is, they rank above secured creditors. Labour debts include unpaid remunerations, severance obligations, contributions to the private pension fund system or to the public pension system and social benefits. These labour credits will be paid *pari passu* with the respective secured creditor, with the proceeds of the foreclosure of the respective guarantees, including guarantees in trust. In the event that secured credit is not cancelled with such proceeds, the unpaid balance will be paid *pro rata* with the unsecured credits. Unpaid taxes rank below the secured creditors. It should be noted that, despite a restructuring or the global refinancing agreement being set forth, the timetable in which the guarantees securing secured creditors will be foreclosed and the proceeds from the sale of the assets of the real guarantee or to the guarantee in trust will be distributed *pari passu* among labour credits and the respective secured party. The priority for such secured credits cannot be amended or extinguished by such agreements.

The preferential order for payment, set forth by the *Ley General Concursal*, is the following:

1) Labour debts, including unpaid remunerations, severance obligations, contributions to the private pension fund system or to the public pension system and social benefits.
2) Alimony claims, which are applicable only to individuals who have declared insolvency.
3) Secured credits, as well as embargoes, attachments and other judicial measures affecting the transferability of assets.
4) All kinds of tax claims.
5) Non-secured credits.

The Insolvency Law provides that guarantees, transference of assets, contracts and other agreements, under onerous terms or not, entered into within a period of one (1) year before the date in which: (i) the insolvency party filed the petition to be declared insolvent or to applied for any restructuring or refinancing scheme foreseen in such Law; (ii) the insolvent party was notified with the Resolution of INDECOPI notifying the petition of one or more creditors for such party to be declared insolvent; or (iii) the insolvent party was notified by INDECOPI of the initiation of the dissolution or liquidation procedure, may be declared by void by a court and without legal effects before the creditors in the insolvency procedure.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes, banks, financial entities, insurance companies and other entities that are subject to regulation and surveillance by the SBS, under the "*Ley General del Sistema Financiero y Orgánica de la Superintendencia de Banca y Seguros*" (Law N° 26702, as amended). Under this law, such entities may be interfered with by the SBS in certain events related to the failure to keep the solvency and net worth minimum levels set forth in the abovementioned Law, such as: repeated non-compliance with the mandatory indications of the SBS or the Central Reserve Bank; a deficit in the regulatory capital in excess of 15% of such amount; management that is questioned for their lack of action to solve or to file to the SBS a plan to correct the failures incurred by the entity; and repeated violation of the abovementioned Law and/or the bylaws of the entity. The intervention of the SBS may conclude in the liquidation of the respective entity. The liquidation of one of such entities is executed under the specific rules provided in the abovementioned Law, where the SBS will designate the liquidators and the specific rules for priorities of payment and ranking of the credits of the entity subject to the liquidation procedure contemplated in such Law, and in the specific rules issued by the SBS will be applicable. In that respect, the abovementioned entities are excluded from the scope of application of the "*Ley General Concursal*"; however, the liquidation rules contemplated in the "*Ley General del Sistema Financiero y Orgánica de la Superintendencia de Banca y Seguros*" provides that guarantees constituted before the SBS issued the Resolution ordering the initiation of the liquidation process will not be affected, and therefore the secured creditor will keep its priority right *vis-à-vis* unsecured creditors to pay its secured credits with the proceeds of the foreclosure of the assets subject to the respective guarantee. However, such creditors will be subject to the preferential rights of the preferential creditors, which are labour debts (including unpaid remunerations, severance obligations, contributions to the private pension fund system or to the public pension system and social benefits), and the holders of savings, who have first priority in collection from the proceeds of the sale of the assets, subject to such guarantees.

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?

Peruvian regulations applicable to pledges on movable assets and rights ("*Ley de la Garantía Mobiliaria*") mentioned in section 3 above allow the parties to agree out-of-court procedures for the execution and sale of the guaranteed assets, which will be conducted by a representative ("*Representante*") designated in the respective agreement, that should be an individual or a company not related to the creditor or the pledger. Such out-of-court foreclosure procedures are, in practice, more efficient in terms of the time that it would take for the creditor to obtain collection out of the proceeds of the sale of the assets, than a court execution of the pledge.

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

Mortgages may only be executed through the court proceeding contemplated in the Civil Procedure Code, and in practice the process may take up to two (2) years until effective collection of the debt is obtained from the proceeds of the public auction of the real estate property subject to the mortgage.

As has been explained in the response to question 3.1, one of the benefits of the guarantee in trust and the reason why the use by local and foreign banks and financial entities of this type of guarantee to secure loans and all types of financing facilities has been increased in the last fifteen (15) years, is that it facilitates the execution of the trust by the trustee and the foreclosure of the assets through the direct sale of such assets under the rules contemplated in the guarantee trust agreement, avoiding court procedures. In that respect, it should be noted that as the assets in trust are subject to trust ownership ("*Dominio Fiduciario*") by the trustee, as a condition of its role as a trustee, the trustee has all the authority and right to sell the assets as if it was the proprietor or owner of such assets in accordance with the rules and procedures for such foreclosure contemplated in the trust guarantee agreement. It should be noted that all types of assets may be transferred in trust to constitute a trust guarantee, including: future flows; receivables of all kind; real assets; movable assets; machinery; equipment; aircraft; all types of vehicles; ships; and credit documents, among others.

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, as the Peruvian Civil Code (Article 2060) allows Peruvian companies and individuals to choose the court that will resolve the controversies, disputes, claims and differences in interpretation of an agreement or contract entered into with foreign or local parties in the jurisdiction of foreign courts in connection with monetary or economic obligations. This is the case except for matters where Peru has exclusive jurisdiction, which are cases where the controversy pertains to real estate properties or rights on such properties, or civil liabilities originated from crimes or misdemeanours committed in the Peruvian territory or whose effects have been produced in such territory.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The Peruvian Constitution and laws do not contemplate sovereign immunity, including for Peruvian State-owned entities.

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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?

Peruvian law, including the "*Ley General del Sistema Financiero y Orgánica de la Superintendencia de Banca y Seguros*" (Law N° 26702), does not contemplate the need for any licence, requirement or authorisation by any public or governmental entity, including the SBS and the Central Reserve Bank of Peru, for a foreign bank, financial entity and, in general, any foreign lender to be able to give any loan or financial facility to Peruvian companies and individuals, including companies owned by foreign shareholders or partners, as well as foreign citizens that are resident in Peru. It should be noted that, from a Peruvian income tax perspective, the interest, fees and expenses that should be paid by local borrowers under loans and credit facilities given by foreign multinational entities (World Bank, the IFC, the Inter-American Development Bank and the IIC) and foreign banks and financial entities, will always be subject to the special withholding tax rate of 4.99%. Instead, the interest, fees and expenses that should be paid by local borrowers under loans and credit facilities given by foreign entities or companies, that are not foreign multinational entities, banks and financial entities, will be subject to such special withholding income tax rate if certain requirements contemplated in the Peruvian Income Tax law are complied with; otherwise, the general income tax rate will be applicable to such payments.

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?

We consider that the material considerations that should be taken into account by foreign lenders are all contained in the answers above.

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

Carlos Saco-Vertiz Tudela
Estudio Saco-Vertiz & Landerer
Avenida Paseo de la República N° 6010
Distrito de Miraflores
Lima 18
Peru

Tel: +51 1 200 3500
Email: csacovertiz@sacovertiz.com
URL: www.sacovertiz.com

Education

- Pontificia Universidad Católica del Perú.
- Universidad de Piura – Advanced Management Program – PAD.

Fields of Expertise

Financial, Banking, Insurance, Capital Markets, Corporate, Foreign Investment, Aviation, Trade and Tax Law. Carlos has renowned expertise in financial and banking law, and has counselled local and foreign banks, such as Morgan Stanley, JP Morgan, Deutsche Bank, Societé Generale, Goldman Sachs, DNB Nor Bank, Bancolombia, Interbank, BBVA, Banco de Crédito, Scotiabank, Banco de Comercio, Financiera Oh!, Inteligo Bank, Financiera Proempresa, Financiera TFC and Caja Rural de Ahorro y Crédito Los Andes.

Professional Experience

- Sacovertiz & Asociados Law Firm (2012).
- Bellido, Saco-Vertiz & Bellido Law Firm (1993–2012).
- Martínez, Bellido, Berninzon & Lavalle Law Firm (1986–1993).
- Lavalle Law Firm (1984–1985).

Teaching Experience

- Professor of Commercial Law at Universidad del Pacífico (1988–1990).
- Professor of Corporate Law at Universidad de Lima (1987–1988).

Board Membership

Carlos is a member of the Board of Corporations in the Banking, Insurance, Manufacture and Retail sectors.

Languages

Spanish, English.

Jaime Sabat Pancorvo
Estudio Saco-Vertiz & Landerer
Avenida Paseo de la República N° 6010
Distrito de Miraflores
Lima 18
Peru

Tel: +51 1 200 3500
Email: jsabat@sacovertiz.com
URL: www.sacovertiz.com

Education

Universidad Peruana de Ciencias Aplicadas.

Fields of Expertise

Tax, Customs, Corporate, Foreign Investment and Trade Law. Jaime has expertise in tax law, and has counselled local and foreign banks, such as Banco de Comercio, Financiera Oh!, Financiera Proempresa, Financiera TFC and Caja Rural de Ahorro y Crédito Los Andes.

Professional Experience

- Sacovertiz & Asociados Law Firm (2012).
- Bellido, Saco-Vertiz & Bellido Law Firm (2010–2012).

Languages

Spanish, English.

SACOVERTIZ & LANDERER
ABOGADOS

Our firm was founded in June 2012, with the aim of providing its local and foreign clients with full-service advisory services and specialised legal assistance in the areas of legal practice related to corporate affairs, banking, financial, insurance, capital markets, M&A, labour, tax, real estate projects, mining, infrastructure, agribusiness, telecoms, manufacturing and general industry, telecommunications, business services, hotels, oil and gas, aerospace, litigation and competition, among others. Our team has well-recognised expertise in working in highly sophisticated transactions and cross-border operations.

Our firm provides services based on priority, timeliness and professional attentiveness from our partners and associates, all based on the use of firm, honest and transparent values and the principles of professional ethics and strict respect of the rules of conflict of interest.

This is how our team of partners and associates have achieved a recognised reputation in the market and earned the trust of a client base of national and international leading companies, providing them with counselling and legal assistance.

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

Russia

Grigory Marinichev

Morgan, Lewis & Bockius LLP

Alexey Chertov

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Despite the turbulent economic situation, the lending market remains rather active. One of the main trends in the Russian lending market is active participation of lenders in prepayment finance transactions (apart from traditional PXF financing transactions). The prepayment markets have extended well beyond the oil market to copper, aluminium, gold, coal and other goods in recent years. Banks and other lending institutions are becoming very important players in this market, which previously was dominated mostly by foreign trade finance institutions.

Other important trends are the increasing number of rouble-denominated financing deals and active application of Russian law in the structuring of domestic financing transactions, further to substantial reform of the Russian civil and insolvency laws in previous years.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Significant lending transactions, among others, include:

- the over $12 billion financing of Russia's Yamal liquefied natural gas (LNG) project by Chinese banks;
- a $1.2 billion facility agreement for Uralkali, one of the world's largest potash producers, with ING Bank N.V., Natixis and AO UniCredit Bank as Global Coordinators; and
- a $800 million pre-export finance facility for the major global agrochemical holding EuroChem Group AG arranged by a syndicate of banks led by ING Bank and Citibank.

Notable prepayment finance transactions include a $165 million prepayment financing for SUEK AG by Sberbank (Switzerland) AG to be repaid by coal deliveries and a $100 million prepayment for Russian Copper Company Group (RCC), the third largest Russian copper producer, arranged by SIB (Cyprus) Limited to be repaid by copper deliveries.

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 there are no restrictions to provision of guarantees or sureties by a Russian company in favour of members of its group. If a guarantee or surety constitutes a "major" or "interested party" transaction, it may be subject to certain corporate consents (notifications).

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?

Any transaction, including a guarantee or surety, may be challenged by the company and, in certain cases, by its shareholders or members of the board if such transaction is entered into to the detriment of the company and the counterparty was aware about such circumstances.

Also, a director of a Russian company shall generally act reasonably and in good faith and in the best interest of the company. If such obligations are breached, the directors may be sued for losses caused to the company.

In case of insolvency of a company, a guarantee or surety may be challenged if such transaction is aimed at a violation of creditors' rights or constitutes a preferential transaction. Directors and controlling persons of a company may be subject to "subsidiary liability" if the insolvency occurred as a result of their actions.

2.3 Is lack of corporate power an issue?

Subject to certain exceptions, Russian companies can enter into any lawful transactions. In the meantime, the powers of a director may be limited by the company's charter. In certain cases, a guarantee or surety may require consent of (notification to) the shareholders (participants) or the board of directors if it constitutes a "major" (i.e., a transaction amounting to 25% or more of the company's assets) or an "interested party" transaction.

© 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?

Generally no governmental consents or filing are required in respect of guarantees or sureties. As described in question 2.3, a guarantee or surety may require consent of the shareholders (participants) or the board of directors if it constitutes a "major" or "interested party" transaction for the company and in other cases stipulated by the company's charter.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Generally there are no such limitations. However, if the value of the transaction exceeds certain thresholds (such as 25% of the company's assets), this may be taken into consideration if the company's transaction is contested in the course of the company's insolvency.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are generally no such obstacles other than insolvency of a company. In order for a company to make certain payments to a foreign lender in a foreign currency under the guarantee or surety, the company may be required to file with a Russian authorised bank certain documents in support of any such payment (including a transaction passport ("*паспорт сделки*")). Such filing is required to be made as a condition to a payment transfer rather than to the entry into the underlying transaction. Such requirement is of an administrative nature and does not restrict or affect the company's obligation to make payments under the guarantee or surety.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Russian law allows using various types of collateral including pledge of immovable property (mortgage), pledge of equipment, pledge of rights under bank accounts, pledge of goods in turnover, pledge over shares and participatory interest and pledge over receivables.

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?

Russian law generally allows extending the pledge to "all assets" of the company. The respective pledge agreement shall be made in written form. In the meantime, it is unlikely that a pledge created by such a pledge agreement would automatically extend to certain types of assets such as rights under bank accounts, immovable assets (mortgage), participatory interest in limited liability companies or shares in joint stock companies since pledges over such assets are subject to registration/notarisation or other specific formalities.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over immovable property (land, buildings, etc.) can be taken by way of mortgage. The mortgage agreement shall be made in written form. The mortgage shall be registered in the Unified State Register of Immovable Property ("*Единый государственный реестр недвижимости*"). Security over machinery and equipment is usually taken by entering into a pledge of movables.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, such security is usually taken by way of a pledge over receivables. The debtor shall be notified about the pledge of receivables. Consent of the debtor is generally not required unless otherwise provided by the underlying contract.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Such security is usually done by way of a pledge of rights under bank accounts. The Russian Supreme Court has recently supported a view that a pledge of rights under a bank account is possible only in respect of specific pledge accounts ("*залоговые счета*"), which means that there is substantial risk that a pledge of rights in respect of an ordinary bank accounts may be unenforceable. It is impossible to bypass this rule by changing the status of an ordinary bank account to the specific pledge accounts. A new pledge account must be opened for this purpose. A pledge of rights under a bank account is created from the moment when the respective account bank is notified about the pledge. However, if the account bank is the pledgee, the pledge will be created from the date of the pledge 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?

Russian law makes a distinction between shares in joint stock companies and participatory interests in limited liability companies. Both can serve as collateral and both are in a non-documentary form.

In respect of the participatory interests, a pledgor must obtain the prior consent of a majority of participants in the limited liability company if the pledge is made in favour of a third party. A participatory interest pledge agreement must be made in written form and notarised. A pledge of participatory interest is deemed to be created from the moment of its registration in the Unified State Register of Legal Entities.

In contrast with a participation interest pledge, notarisation of a share pledge is possible but not mandatory. No consent of other shareholders is required. A share pledge must be registered in the shareholders' register or a depositary.

Pledges of participatory interests and shares are usually governed by Russian law. New York and English law may also be used in practice, but enforcement of such pledges may be more complicated.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Russian law recognises the pledge of inventory (pledge of goods in turnover). The subject matter of a pledge of goods in turnover can be determined by specifying the generic features of the goods and their location (e.g. goods in certain premises).

© 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, both options are possible as long as the required corporate consents (if any) are obtained.

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?

Any pledge agreement shall be made in written form. Notarisation of a pledge of participatory agreement is mandatory, while notarisation of pledges of other types of assets is possible but, as a rule, not mandatory. However, out-of-court enforcement of the pledged assets by way of notarial endorsement is only possible if the agreement is notarised.

The amount of notary fees depends on the amount of the secured obligation and whether the notarisation is mandatory. If the notarisation is mandatory, the amount of the notary fee cannot exceed RUB 150,000. If the notarisation is not mandatory, this amount cannot exceed RUB 500,000.

Pledges of most assets (other than immovable property, shares, participatory interests, rights under bank accounts and pledges of other assets, transfers of rights in respect of which are subject to mandatory registration) can be notified to the register of notices on pledges maintained by the notaries. Such notification is not mandatory and is not required for the validity of a pledge. However, the notification makes the pledge public and third persons are deemed notified about such pledge. This is particularly important in case of a dispute in respect of the priority of pledges. The fees in connection with registration of such notices are nominal (RUB 600 per notice as of 1 March 2017).

The fee for registration of mortgage by legal entities in the Unified State Register of Immovable Property is RUB 4,000.

No stamp duties are payable as a matter of Russian law.

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 statutory term for registration of a mortgage is up to five business days, but in practice sometimes takes longer.

Notarisation of a participatory interest pledge and registration of the respective pledge in the Unified State Register of Legal Entities usually takes 7–15 days. Foreign pledgors and pledgees must collect and submit to the notary a set of notarised and apostilled corporate and other documents, which often takes some additional time.

Notices regarding pledges of movable property are submitted by the notaries and can be done within 1–2 hours.

Registration and notary fees are described in more detail in question 3.9.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Regulatory or similar consents are generally not required with respect to creation of security unless the rights of third parties are involved. In certain cases, corporate consents (notifications) may be required if the pledge agreement constitutes a "major" or "interested party" transaction.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Russian law previously required having a detailed description of the secured obligations, which created complications in instances when collateral secured the revolving facilities. At the moment, Russian law is far more flexible in respect of the requirement to describe the secured obligations, and expressly provides that the pledge may secure future obligations, so in our view the previous priority concerns in respect of a security relating to revolving facilities is less likely to be an issue at the moment.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Please refer to question 3.9 in respect of the pledge agreements which require notarisation. Execution of contracts by means of electronic communication is allowed as long as such execution makes it possible to determine that the document is sent by the relevant party.

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 financial assistance restrictions like those which exist in Germany and certain other jurisdictions do not exist in Russia. In the meantime, such guarantee or security may in certain cases require corporate consent. Please also refer to question 2.4 for further details.

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?

Russian law does not currently recognise the agency or trustee relationship which is common in English law. In the meantime, the Russian Civil Code now contains provisions allowing the creditors to enter into a pledge management agreement and appoint a "pledge manager" to act on behalf of several creditors in connection with the pledge. The pledge management agreement may contemplate payment of a fee to the pledge manager. The pledge manager shall act in the best interest of the creditors. The proceeds received by the pledge manager in connection with the pledge become the common property of the creditors unless the pledge management agreement provides otherwise.

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

It should be noted that the provisions regarding pledge management agreements are relatively new and are still to be tested by Russian 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?

Please refer to the answer to 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?

Rights under loan agreements and guarantees governed by Russian law are usually transferred by way of assignment. The consent of the debtor is not required unless otherwise provided by the loan agreement or guarantee. If the consent is required by the loan agreement or guarantee but is not obtained, the assignment would still be valid but the initial creditor would be liable for breach of contract.

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 loans made by Russian lenders (lenders incorporated in Russia and foreign lenders which have permanent establishment in Russia) is generally subject to Russian income tax at a rate of 20%. The same rate applies to a foreign lender receiving their income from interest on loans at a source in Russia. In this case, taxable income is withheld by the borrower.

Proceeds under a guarantee are subject to the same rules as taxable income under loan agreements.

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 general approach under Russian law is that foreign lenders are subject to the same rules as Russian lenders. However, international tax treaties provide certain specific tax exemptions or reductions. In order to enjoy such exemptions or reductions, the foreign lender must provide the borrower with the tax residence certificate issued by the relevant competent tax authority in that lender's jurisdiction of residence confirming that the lender is tax resident in such tax jurisdiction for the purposes of the relevant tax treaty. Such certificates are usually provided before the first payment of interest under the loan and thereafter annually until the full repayment of the loan.

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 refer to questions 6.1 and 6.2.

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.?

Notarisation of loan agreements and guarantees is not mandatory in Russia. No registration of loan agreements or guarantees is required in Russia. Notarial and other fees applicable to security are described 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.

A loan from a foreign entity can be considered as "controlled indebtedness" if such loan is provided or secured by a foreign entity (or a Russian entity controlled by such foreign entity).

If the amount of such "controlled indebtedness" exceeds the amount of a borrower's own equity by more than three times, the interest paid on such loan can only be considered as expenses subject to certain limits. The remaining interest is considered as dividends paid to a foreign entity and is subject to 15% taxation (unless an international treaty allows specific tax exemptions or reductions).

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?

Russian courts should generally recognise (and enforce) foreign governing law, provided that such laws do not conflict with Russian public policy or specific mandatory rules ("*нормы непосредственного применения*") of the laws of the Russian Federation. The concepts of public policy and specific mandatory rules are not defined in the laws of the Russian Federation and, therefore, are open to interpretation by Russian courts. Furthermore, a Russian court will apply foreign law as the law of the contract only provided that such Russian court has properly established the content of the relevant foreign law in relation to the issues considered by it. If a Russian court is not in a position to establish the content of foreign law within a reasonable period of time, it is entitled to apply the laws of the Russian Federation. In any event, the laws of the Russian Federation will apply as to the matters of evidence and procedure.

© 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?

Judgments of foreign courts may be enforced in the Russian Federation only if there is a treaty between the Russian Federation and the relevant foreign jurisdiction on the mutual recognition and enforcement of court judgments or, in the absence of such a treaty, on the basis of reciprocity. As of today, no such treaty is currently in force and no formal legal procedures for reciprocal enforcement of court judgments exist between the Russian Federation and England or Russian Federation and the United States of America, which means that the risk that judgment of an English or a New York court could not be recognised and enforced in Russia is substantial.

We are aware of some cases in which judgments of foreign courts were successfully recognised and enforced in Russia (the claimant usually provided evidence, including an expert opinion, that, under similar circumstances, a judgment of a Russian court would be enforceable in the respective foreign jurisdiction), but we are also aware of a number of cases in which enforcement of foreign court judgments was denied by Russian 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) Obtaining a final and binding judgment of the arbitrazh (commercial) court of first instance usually takes three to four months. The proceeding at the court of appeal usually takes from two to three months. Enforcement of a Russian court judgment should normally be completed within two months from the day of the commencement of the enforcement proceedings, although sometimes it takes much longer due to various delays.

(b) Enforcement of a foreign judgment should technically be completed within one month, but may in practice take several months.

A bad faith debtor may substantially delay the court or enforcement proceedings by means of raising various objections in respect of the substance of foreign law as well as various procedural objections.

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 in respect of most types of pledges assets is possible both in court and out of court. In most cases, out-of-court enforcement of the pledged assets requires notarial endorsement and such endorsement is only allowed if the pledge agreement is notarised.

Out-of-court enforcement may be exercised by the following methods: public auction; private auction; retention; and private sale without an auction. Out-of-court enforcement and the particular method of enforcement shall be provided by the pledge agreement. The methods of the court enforcement are public auction, retention and private sale without an auction. Acquisition of shares in certain companies through an enforcement procedure may require certain antimonopoly and similar consents.

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 creditors should generally be treated in the same way as Russian creditors in terms of filings of suits and enforcement of the collateral security. All documents filed to the Russian arbitrazh (commercial) courts must be in Russian; any documentation in any other language must be translated into Russian, notarised and apostilled, unless originally made in Russian.

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?

There is a general moratorium on enforcement of lenders monetary claims since introduction of the supervision procedure (first insolvency stage). Creditors are not entitled to enforce collateral security during the supervision procedure. During the financial rehabilitation and external management procedures (further insolvency stages), secured creditors are generally entitled to enforce their security.

If a secured creditor opts for enforcement of security during the financial rehabilitation or external management procedure, it must file an application to the court. Enforcement is possible only if there is risk of loss or substantial devaluation of the security. If the debtor proves that enforcement of the security will make restoration of the debtor's solvency impossible, the court can reject the creditor's enforcement application. In such case, a secured creditor obtains full voting rights at the creditors' meetings during that bankruptcy stage. Unless enforced during the previous stages, the collateral security should generally be sold during the final bankruptcy stage (liquidation).

During bankruptcy proceedings, the company's pledged property can only be sold at an auction and any provisions in the security documents concerning the out-of-court enforcement of a pledge do not apply.

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 needs to be recognised and enforced in Russia, and the creditor must obtain an executory writ for the execution of an arbitral award. The decisions of international arbitration tribunals are generally enforceable in Russia subject to compliance with the provisions of the 1958 New York Convention and the requirements of Russian procedural legislation. The process of recognising and enforcing a foreign arbitral award must be made without re-examining in substance or re-litigating the underlying dispute. In practice, however, due to the absence of clearly established practice in this regard, Russian courts sometimes refuse to enforce foreign arbitral awards without substantiating such a decision with a sufficient legal explanation.

© 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?

Please refer to 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?

The proceeds obtained from the sale of pledged property are applied as follows:

(a) 80% (in the event of the pledge securing a loan agreement) or 70% (in all other cases) of the proceeds (in an amount not exceeding the aggregate amount of principal and interest) is allocated to satisfy the claim of the relevant secured creditor;

(b) 15% (in the event of the pledge securing a loan agreement) or 20% (in all other cases) is allocated to satisfy "first priority" and "second priority" claims if the unencumbered property of the company is insufficient to satisfy these claims; and

(c) the remaining amounts are allocated to the cost of court and bankruptcy proceedings.

Russian insolvency laws provide that certain transactions qualifying as "suspicious" or "preferential transaction" may be contested in the course of insolvency.

"Suspicious" transactions are those entered into with the intention to infringe creditors' rights and entered into by the company within the three-year period preceding the commencement of the insolvency proceedings.

A so-called "preferential transaction" is a transaction entered into with a creditor or another person that results or may result in the preferential satisfaction of a claim of one of the creditors in comparison to claims of other creditors.

"Preferential transactions" may be challenged if they are entered into within the one-month period preceding the initiation of insolvency proceedings. However, the hardening period is extended to six months if a "preferential transaction" is entered into with a person who was aware of the debtor's inability to meet its obligations or that the amount of the debtor's obligations exceeded the value of the debtor's assets. A related party is automatically deemed to have such knowledge.

The concept of "preferential transactions" captures prepayment under the existing agreements, set-offs, transfer of the debtors' property, granting security for an existing debt and other arrangements which can be frequently seen in the course of a debt restructuring. Therefore, the risk of challenge in insolvency should be carefully considered by the creditors prior to agreeing any restructuring arrangement with a company.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

According to the Russian Civil Code, certain entities such as political parties, religious organisations, public enterprises and most state corporations are excluded from bankruptcy proceedings. Liquidation of such entities is usually subject to the Civil Code and special 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?

During bankruptcy proceedings, the assets of the company can be enforced only within the insolvency proceedings. Any provisions in the security documents concerning the out-of-court enforcement of a pledge do not apply.

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 by parties of a contract to a foreign jurisdiction should generally be binding and enforceable if at least one party is a foreign entity and the subject matter of the contract is not subject to the exclusive jurisdiction of Russian courts.

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 in Russia.

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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?

Russian law provides different legal regimes with respect to loan agreements and facility agreements. Only banks (including foreign ones) may enter into a facility agreement, while loan agreements may be made by any legal entity.

In order to carry on business, all banks incorporated in Russia must receive the Central Bank of Russia's licence. No licence is required to be obtained by a foreign bank to make a loan to a Russian company.

In terms of a cross-border transaction, it should be noted that:

(a) the borrowings under a foreign currency loan can be credited to a Russian borrower's offshore account with a bank located in a state which is a member of the Organization for Economic Co-operation and Development (OECD) or the Financial Action Task Force (FATF), provided that (1) a lender is an agent of a foreign government or located in an OECD or FATF jurisdiction, and (2) the maturity of a loan exceeds two years; and

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

(b) a Russian company, for the purposes of effecting any payment exceeding $50,000 to a non-resident, shall open a deal passport with an authorised 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?

One of the most important considerations which should be addressed at the financing stage is the necessity to obtain a pledge or mortgage from a Russian company as collateral, which is beneficial not only because it entitles a creditor to receive satisfaction of its claim from the proceeds of the sale of the pledged or mortgaged property, but also because the status of a secured creditor gives a creditor substantial comfort during insolvency proceedings.

Further considerations which must be taken into account are the requirement to obtain corporate consents and, in respect of state-owned companies, the procurement regulations.

Grigory Marinichev
Morgan, Lewis & Bockius LLP
Legend Business Center
Tsvetnoy Bulvar, 2
Moscow, 127051
Russia

Tel: +7 495 212 2420
Fax: +7 495 212 2400
Email: grigory.marinichev@morganlewis.com
URL: www.morganlewis.com

Grigory Marinichev represents international lenders and borrowers in structured finance, syndicated lending, debt restructuring transactions, and insolvency issues. Grigory advises clients in the metals, mining, telecommunications, oil and gas, and power generation industries on a range of financial transactions – from syndicated and bilateral credit facilities, refinancing, and bond issues, to export financing, loans, and loan restructurings. He also represents and advises project sponsors, export credit agencies, and multilateral financial institutions.

Prior to joining Morgan Lewis, Grigory was a partner and head of the Russian banking and finance practice of another international law firm, resident in Moscow.

Alexey Chertov
Morgan, Lewis & Bockius LLP
Legend Business Center
Tsvetnoy Bulvar, 2
Moscow, 127051
Russia

Tel: +7 495 212 2504
Fax: +7 495 212 2400
Email: alexey.chertov@morganlewis.com
URL: www.morganlewis.com

Alexey Chertov advises clients on banking, finance, restructuring, and insolvency matters. He counsels banks in connection with financing transactions and debt collections, and represents banks that are creditors in bankruptcy proceedings. He also helps corporate clients in restructuring loan portfolios and in insolvency proceedings. Before joining Morgan Lewis, Alexey was an associate in the banking practice of another international law firm. From October 2013 until May 2014, Mr. Chertov was seconded to Sberbank Europe AG, where he worked on a number of international financing transactions as in-house legal counsel. A native Russian speaker, Alexey is also fluent in English.

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 30 offices in the US, Europe, the Middle East and Asia, including financial centres such as New York, London, Paris, Moscow, Frankfurt, Dubai, Singapore, Hong Kong, Shanghai, 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

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?

Prolonged weak growth and low interest rates have dampened the local lending market. The weak growth rate could weaken the ability of corporates and households to service debt, which in turn affects banks' asset quality. Low interest margins also affect bank profitability. Given the challenging economic backdrop, there has been a general slowdown in lending (particularly in cross-border loans) although domestic lending continues to be healthy (in domestically oriented sectors such as the building, construction and housing sectors).

Separately, significant amendments were made to the Banking Act (Cap. 19) and these have been passed by Parliament in the first quarter of 2016. The amendments seek to strengthen the existing prudential safeguards, enhance the corporate governance regime and introduce risk management controls in the banking industry. Some notable amendments include empowering the Monetary Authority of Singapore (***MAS***) to direct a bank incorporated outside Singapore to transfer all or part of its banking business in Singapore to a Singapore incorporated company if it is of the opinion that this is necessary or expedient in the public interest and requiring banks to immediately inform MAS of any developments that materially affects the banks adversely.

At the same time, the Ministry of Finance and the Accounting and Corporate Regulatory Authority of Singapore (***ACRA***) are continuing to amend and update the Companies Act (Cap. 50) (***CA***). The recent proposed amendments have two broad aims in mind. First, the new amendments seek to reduce the regulatory burden and to improve the ease of doing business locally. Second, the new amendments will introduce an inward re-domiciliation regime in Singapore. The inward re-domiciliation regime will allow foreign entities to transfer their registration from their original jurisdiction to Singapore seamlessly. This ensures that the foreign entity will retain its identity and history whilst still being able to transfer its jurisdiction to Singapore. Some other jurisdictions that have similar regime include Australia, Canada and New Zealand.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Some significant transactions in 2016 include the issuance of Rs 13.3 billion worth of Masala bonds that were listed on the Singapore exchange by Indiabulls Housing Finance, and DBS Group Holdings' (***DBSH***) US dollar-denominated Basel III-compliant Additional Tier 1 perpetual capital securities offering which reached the target issue size of US$750 million. DBSH's securities were issued under DBSH's US$30 billion Global Medium Term Note Programme. DBS Bank Ltd. was the Sole Global Coordinator. Citigroup Global Markets Singapore Pte. Ltd., DBS Bank Ltd., Deutsche Bank AG, Singapore Branch, The Hongkong and Shanghai Banking Corporation Limited and Société Générale acted as joint bookrunners for the issuance.

Significant lending transaction in the previous two years include the 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. In the year before, the industry saw 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.

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

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

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 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 entering 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.

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, 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

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

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 Land Titles Act (Cap. 157) (***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, 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 prescribed requirements.

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

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.

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 of the 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 two to three business days.

The timeframe for registration at specialist registries differs according to each registry. 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. This is rarely an issue in practice however, 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*.

© 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?

S76 of the CA provides, *inter alia*, that a public company or a company whose holding company or ultimate holding company is a public 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) 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) (***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.

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

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 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) 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) (***RECJA***), without re-examination of the merits.

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

In 2016, Singapore also introduced the Choice of Court Agreements Act 2016 (***CCAA***), which implements the regime created by the 2005 Hague Convention on Choice of Court Agreements (***Hague Convention***). The CCAA applies to judgments given by courts of states that are parties to the Hague Convention. These states currently comprise all of the EU Member States (except Denmark, but including England) and Mexico. Under the CCAA, where parties have entered into an agreement designating the English courts as having exclusive jurisdiction in respect of a particular matter, and an English court renders a judgment in that matter, the English judgment may be recognised and enforced in Singapore without re-examination of the merits. This is subject to certain exceptions. For example, certain types of matters are excluded from the scope of the CCAA, such as insolvency matters and matters involving consumers. Recognition and enforcement may also be refused if, for example, this would be incompatible with the public policy of Singapore or where the English judgment is inconsistent with a Singapore judgment given in a dispute between the same parties.

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) 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.

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 or liquidation order is made. Notwithstanding the moratorium, secured creditors may enforce their security in a provisional liquidation or liquidation.

The legislation also provides for an automatic moratorium upon the making of an application for a judicial management order, and upon the making of a judicial management order. However, in these situations, a creditor may not enforce any security over the company's assets without permission from the court or the judicial manager.

The court may also grant an order for a temporary stay of proceedings if requested by an applicant proposing or intending to propose a scheme of arrangement. Generally, a temporary stay of proceedings does not restrict the enforcement of collateral security granted by the applicant. However, a new Companies (Amendment) Bill introduced in 2016 would, if passed, give the court express power to also restrain the enforcement of security over the property of the applicant or any of its related companies.

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) 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

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

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. For restrictions on enforcing security in the context of liquidation, schemes of arrangement and judicial management, see question 7.6 above.

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.

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 will generally be upheld as valid and binding in any action in the courts of Singapore provided that it is *bona fide* and there is no reason for avoiding such submission on the grounds of public policy.

In particular, where a party has submitted exclusively to the jurisdiction of a state that is party to the Hague Convention, the CCAA would apply and a Singapore court must stay or dismiss proceedings in the Singapore courts in favour of proceedings in the foreign court. This is subject to certain exceptions. For example, the CCAA does not apply to certain types of matters, such as insolvency matters and matters involving consumers. The Singapore court can also refuse to stay or dismiss proceedings in its courts if, for example, the agreement to submit to the foreign jurisdiction is null and void under the law of the foreign jurisdiction, or if giving effect to the agreement would lead to manifest injustice or would be manifestly contrary to the public policy of Singapore.

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).

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 Moneylenders Act (Cap. 188) (***MA***), 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. The same prohibition would apply to a "foreign" lender who carries on the business of moneylending in Singapore from a place outside Singapore.

"Any person licensed, approved, registered or otherwise regulated by the MAS under any other written law," amongst others, 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) and Finance Companies Act (Cap. 108) respectively. The question therefore is whether "foreign" lenders or other non-bank entities 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, amongst others, "any person who lends money solely to corporations" or "any person who lends money solely to accredited investors within the meaning of section 4A of the Securities and Futures Act (Cap. 289)" 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 or only to accredited investors.

There has been academic debate on whether a "foreign" unlicensed lender or other non-bank entity would not be deemed to be an

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

excluded moneylender if it had in the past lent money otherwise to individuals who were not accredited investors. The prevailing view, however, 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 generally been covered by the above answers.

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. 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?* Cited as 'excellent and intelligent' and having a 'sterling reputation for project loan work', she has also received accolades from *Asia Pacific Legal 500, Chambers Global/Asia-Pacific, Who's Who Legal* 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 *Asia Pacific Legal 500, 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*".

Drew & Napier has been providing exceptional legal service and representation to discerning clients since 1889. We are one of the largest law firms in Singapore.

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 four 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

South Africa

Lionel Shawe

Allen & Overy LLP

Lisa Botha

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

There has been a marked increase in offshore acquisitions by South African corporates in recent years off the back of a sluggish South African economy. Some South African corporates have sought foreign listings to improve their ability to raise foreign capital for foreign acquisitions; others have used novel structuring techniques. From a structuring and documentation perspective, there has been a move away from raising the required funding for transactions through separate local and foreign facilities. Corporate borrowers are tending to raise their required funding through multi-currency syndicated facilities provided under a single English law LMA-style facility document involving both local and foreign lenders.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Some recent significant lending transactions include:

- Private hospital group Life Healthcare's acquisition of UK-based Alliance Medical Group for an initial cash consideration of ZAR10 billion was funded by bridge financing through a syndicate of domestic and foreign banks, which will be refinanced through a rights offer.
- Restaurant franchise group Famous Brand's acquisition of UK-based burger chain Gourmet Burger Kitchen for ZAR2.1 billion is the biggest deal for Famous Brands in its 22-year history as a JSE-listed company and was funded initially through short-term debt. As a result of the acquisition, the company has suspended dividend payouts until the 2018 financial year to conserve cash in the business.
- Oceana Group's acquisition of US-based fishmeal and oil specialist Daybrook Fisheries for ZAR4.6 billion was funded through a combination of Oceana cash on hand, term debt facilities, and equity bridge facility and US debt.

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 the company satisfies the requirements for the granting of financial assistance and (to the extent applicable) the making of a distribution under the relevant provisions of the South African Companies Act, 2008 (the **SA Companies Act**) prior to its obligations under the guarantee coming into force.

See section 4 below for the requirements for financial assistance under the SA Companies Act.

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 requirement under South African law for there to be corporate benefit to the guaranteeing/securing company. Directors have a fiduciary duty both in terms of the SA Companies Act and South African common law to act in good faith and for a proper purpose and in the best interests of a company. A breach of fiduciary duty may attract personal liability for that director.

2.3 Is lack of corporate power an issue?

Under South African law, a company has all the legal powers and capacity of a natural person except to the extent (1) it is incapable of exercising such power or of having such capacity, or (2) its memorandum of incorporation provides otherwise. However, where capacity of a company is limited in terms of its memorandum of incorporation, all third party effects of the limitation are voided. A transaction outside the 'limited' capacity of a company only gives rise to internal remedies. Shareholders, directors or prescribed officers of a company may apply to court to restrain a company from acting contrary to a limitation on its capacity, but any such action is without prejudice to the rights of a third party who obtained such rights in good faith and who did not have actual knowledge of the limitation of capacity. In addition, any action outside the 'limited' capacity of a company is capable of ratification by special resolution of the shareholders. To the extent, however, any limitation applies to a company's ability to grant financial assistance, any provision of financial assistance in contravention of that limitation (or the SA Companies Act) is not capable of ratification.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Under the SA Companies Act, the provision of financial assistance (which includes the granting of a guarantee) requires shareholder approval by way of special resolution (unless such financial assistance is pursuant to an employee share scheme that satisfies

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

the requirements of section 97 of the SA Companies Act) and board approval. The shareholder approval can be generic (i.e. approval for a category of recipients and the recipient falls within that category) or transaction-specific and it must have been adopted within the past two years of the board resolution. Prior to authorising the provision of financial assistance at board level, the board must be satisfied that: (1) the company would satisfy the solvency and liquidity test immediately after providing the financial assistance in question; (2) the terms under which the financial assistance is given are fair and reasonable to the company; and (3) any conditions for financial assistance contained in the company's memorandum of incorporation have been satisfied.

To the extent the financial assistance (i.e. the guarantee) is granted for the benefit of a director or officer of the company or a related or inter-related company and the total value of the financial assistance granted exceeds 1/10th of 1% of the guaranteeing company's net worth at the time of the board resolution authorising the financial assistance is taken, the board of the guaranteeing company must give notice of the financial assistance to all shareholders of the company and any trade unions representing employees of the company. This is an administrative step and not a requirement for financial assistance under the SA Companies Act.

In addition to financial assistance, a guarantee for the benefit of one or more holders of any shares of the guaranteeing company (i.e. an upstream guarantee) or one or more holders of any shares of another company within the same corporate group constitutes a "distribution" as defined in section 1 of the SA Companies Act and requires board approval under section 46 of the SA Companies Act. This approval must include an acknowledgment that the board has applied the solvency and liquidity test and has reasonably concluded that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution.

See question 2.5 below for an explanation on the solvency and liquidity test under the SA Companies Act.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Not strictly, although the board of the guaranteeing company is required to confirm that the company will satisfy the solvency and liquidity test as provided for in the SA Companies Act immediately after providing the financial assistance, and to the extent applicable, immediately after completing the distribution.

The solvency and liquidity test is satisfied if, considering all reasonably and foreseeable financial circumstances of the company at that time the test is applied: (1) the assets of the company (fairly valued) equal or exceed the liabilities of the company (fairly valued); and (2) the company will be able to pay its debts as they become due in the ordinary course of business for the 12-month period following the provision of financial assistance or completion of the distribution, as applicable.

See question 2.6 below regarding limitations that may be imposed by the South African Reserve Bank.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Funds flowing in and out of South Africa are subject to exchange control in terms of the Exchange Control Regulations, issued under the Currency and Exchanges Act, 1933 (the Exchange Control Regulations). Exchange control is controlled by the Financial Surveillance Department (FinSurv) of the South African Reserve Bank. Certain powers set out in the Currency and Exchanges Manual for Authorised Dealers (previously known as the exchange control rulings) have been delegated to authorised dealers, which are banks authorised by FinSurv to deal in foreign exchange.

The enforcement of a guarantee given by a South African resident in favour of a foreign lender is subject to the requisite exchange control approval for that guarantee being in place. The approval must be obtained from FinSurv on application by the South African resident company through its authorised dealer. While there is no regulatory limitation on the amount of a guarantee under the Exchange Control Regulations or rulings, FinSurv has a general discretion to impose any conditions on the approval granted by it. FinSurv has recently tended to include in its approval a limitation that any amount recovered under the guarantee is limited to the net asset value of the guaranteeing company at the time of recovery.

The approval process generally takes between four and six weeks.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

It is possible to take security over most common assets of a South African 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?

South Africa does not have a universal corporate security interest covering all assets generically. The appropriate form of security is determined by reference to the classification of the assets concerned as immovable (land) or movable and in respect of movable assets, further sub-classification as corporeal (tangible) or incorporeal (intangible).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over immovable property (land) is created by way of registration of a mortgage bond specially mortgaging the land. Registration at the deeds registry where the land is registered perfects the security. There is no prescribed form for mortgage bonds, although there are recommended forms for certain types of mortgage bonds. The content of a mortgage bond is determined by banking and conveyancing practice, the common law and statute law.

Security over plant, machinery and equipment may be caught by any mortgage bond over the land to the extent those assets are sufficiently attached to the mortgaged land and were intended to be annexed permanently to the land. In these circumstances, the plant, machinery or equipment would be classified as immovable property.

Security over plant, machinery or equipment not constituting immovable property under South African property law is usually taken by way of mortgage in the form of either a special notarial bond or a general notarial bond. A special notarial bond is a mortgage by the debtor of specifically identified tangible movable property in favour of a creditor as security for a debt or other obligation. The property secured must be clearly identified and described in such a manner which makes it readily recognisable. A special notarial bond must be registered at the deeds registry within three months

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

after the date of its execution. Once registered, the creditor is a secured creditor in the estate of the debtor.

A general notarial bond is a mortgage by the debtor of all its present and future tangible movable property in favour of a creditor as security for a debt or other obligation. A general notarial bond must be registered at the deeds registry within three months after the date of its execution. A general notarial bond does not confer a real right of security in the property concerned unless the creditor obtains possession of the property prior to insolvency of the debtor.

Both a special and general notarial bond must be prepared by a notary public and executed by either the owner of the movable assets (the mortgagor) encumbered under the bond or the notary public under a formal power of attorney granted to him by the mortgagor.

It is also possible to grant security over plant, machinery and equipment by way of a pledge, although this form of security requires delivery of the assets concerned, in addition to the agreement to grant the security over the asset, to perfect the security over those 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 over receivables is taken by way of cession. There are no formalities: the security interest is created by the debtor agreeing to grant security by way of cession over the receivables in favour of the creditor.

It is not necessary to notify the underlying debtors of the cession to perfect the security created over the receivables and given the fluctuating nature of receivables, it is fairly uncommon to give notice of the cession to the underlying debtors prior to the occurrence of an event of default. In the absence of notice, however, any payment by an underlying debtor to a security provider following the occurrence of the event of default constitutes a valid discharge by the underlying debtor of its obligations in respect of such receivables and the creditor will have to recover these amounts from the security provider.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, security over cash deposited in a bank account is taken by way of cession.

As discussed above in relation to security over receivables, there are no formalities for a cession: the security interest is created by the debtor agreeing to grant security by way of cession over the cash in the bank accounts in favour of the creditor.

It is more common in the case of a cession over cash in bank accounts to notify the banks of the security interest created at the time of creation of 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 a New York or English law governed document? Briefly, what is the procedure?

Yes security can be taken over shares in companies incorporated in South Africa. Shares in a private company are generally in certificated form; while shares in a public company are generally in uncertificated form.

Security over shares in a South African company is taken by way of pledge and cession. Similar to security over receivables and cash in bank accounts, the security interest is created by the debtor agreeing to grant security over the shares in question. There are no other perfection requirements; however, it is fairly common to have any share certificates together with undated and blank share transfer forms delivered to the secured creditor at the time of creation of the security interest to facilitate enforcement if needed following the occurrence of default. There is a statutory obligation (not a perfection requirement) to "effect" any security interest over shares lodged and immobilised in South Africa's central securities depository by "flagging" the relevant securities account in accordance with the Financial Markets Act, 2012.

Under South African law, the formalities for establishing a valid security interest in an asset are the formalities of the law of the place where the asset is situated (*lex situs*). For assets in South Africa, the formalities of South African law must therefore be fulfilled. For this reason, it is not competent to grant security over shares issued by a South African company under a New York or English law-governed document.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, security over inventory is possible and usually takes the form of a special or general notarial bond.

See question 3.3 above for the procedure for taking security by way of a special or general notarial bond.

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 requirements for the granting of financial assistance and the making of a distribution under the SA Companies Act are satisfied where applicable.

See question 4 below for the requirements for financial assistance under the SA Companies Act.

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 or other documentary tax payable under South African law for the granting, or taking, of security. Nominal registration fees are payable for the registration of mortgage bonds, general and special notarial bonds, aircraft mortgages, ship mortgages, hypothecations relating to trade marks, designs and patents. A mortgage bond must be prepared by a conveyancer and a notarial bond by notary public, both of whom are entitled to charge fees on a tariff-fee basis in South Africa calculated by reference to the principal amount of the secured debt for preparing the bonds.

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 the preparation and lodgement of mortgage bonds and notarial bonds can be significant. It is fairly common, however, for conveyancers and notary publics preparing and lodging these documents to offer a fairly significant discount to the tariff rates.

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

The current turnaround time at the deeds registry for registering bonds is between three and four weeks, depending on the number of bonds and linked transactions.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Exchange control approval is required for the enforcement by a foreign lender of any security granted by a South African resident, but it is common practice to obtain this approval prior to the creation of the security. As discussed in question 2.6 above for exchange control for a guarantee, the approval must be obtained from FinSurv on application by the South African resident company through its authorised dealer. The approval process generally takes between four and six weeks.

There may be particular requirements for regulated entities or assets. For example, a cession over shares in a company that holds a mining licence requires the consent of the Department of Minerals and Energy in South Africa.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Generally, there are no other special priority or other concerns.

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 resolutions approving the transaction for evidentiary purposes and to ensure any financial assistance requirements have been satisfied.

The Uniform Rules of Court (of South Africa) provide for the authentication of any document signed outside of South Africa which is to be received in the courts of South Africa. A document executed outside of South Africa that has not been authenticated in accordance with the Uniform Rules of Court (of South Africa) remains valid and is admissible in evidence in a South African court but there is an evidentiary risk in respect of due execution. This risk can be mitigated in various ways, including, but not limited to, resolutions passed authorising a person to execute documents, specimen signatures of signatories and copies of passports or identity documents of signatories.

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?

Both a private and public company are restricted from providing financial assistance (including by way of guarantee or security) in connection with the acquisition of:

(a) its own shares;

(b) the shares of its holding company; and

(c) the shares in a sister company,

unless the financial assistance has been approved in accordance with the relevant provisions of the SA Companies Act.

The board of a company may not authorise the provision of any financial assistance unless that financial assistance is pursuant to an employee share scheme under section 97 of the SA Companies Act or has been approved by way of a special resolution of the shareholders of that company that provides for generic approval for a category of recipients and the recipient falls within that category or for transaction specific approval. The shareholder resolution must have been adopted within the past two years of the board resolution. Further, the board must be satisfied that: (1) the company would satisfy the solvency and liquidity test immediately after providing the financial assistance in question; (2) the terms under which the financial assistance is given are fair and reasonable to the company; and (3) any conditions for financial assistance contained in the company's memorandum of incorporation have been satisfied.

The SA Companies Act also restricts the provision of financial assistance to a director or officer of the company or a related or inter-related company of the company granting the financial assistance. The requirements discussed above apply equally in these circumstances.

See question 2.5 for an explanation on the solvency and liquidity test under the SA Companies Act.

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?

South African law does recognise the concept of a trust. However, the security trustee structure recognised under English and New York law is not recognised under South African law. South African law requires that the security provider owe a valid principal obligation (not an accessory obligation) to the creditor. The security trustee structure does not meet this requirement.

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?

Where a security agent is used for the purpose of holding South African security, a parallel debt arrangement is normally used in order to ensure that the security can be validly given to the security agent. The security interest, however, vests in the estate of the security agent and as a result, lenders take insolvency risk on the security agent.

Another alternative structure commonly used in South African law-governed transactions entails the establishment of a separate special purpose vehicle (known as the security SPV) to act as beneficiary of the security granted by the security provider. The security SPV will provide a guarantee to the creditors for all of the secured obligations of the security provider, and the security provider will provide an indemnity to the security SPV. The shares in the security SPV are held by an owner trust which often pledges the shares it holds in the security SPV in favour of the creditors.

© 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?

Exchange control approval is required for a loan (whether in Rand or foreign currency denominated) made to a South African resident by a foreign lender, as well as the granting of security or a guarantee by the South African resident in favour of the foreign lender.

Any change in the foreign lender does not require fresh approval but must be notified to the exchange control authorities through the relevant authorised dealer.

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, interest payable to or for the benefit of a foreign lender is subject to withholding tax at the rate of 15% to the extent that the amount is regarded as having been received or accrued from a source within South Africa under the South African Income Tax Act, 1962 (the **SA Income Tax Act**), unless the levying of withholding tax is exempted under the applicable provisions of the SA Income Tax Act or the amount of withholding tax is reduced as a result of a double taxation treaty.

Under the SA Income Tax Act, the exemptions relevant to withholding tax on interest fall into three broad groups:

- the payor (i.e. the person paying the interest);
- the instrument (i.e. the instrument giving rise to the interest, for example the debt or the investment); and
- the recipient of the interest.

A foreign person is exempt from the withholding tax on interest if the debt claim for which interest is paid is effectively connected with a permanent establishment of that foreign person if that foreign person is registered as a taxpayer in South Africa.

It is not clear from the current wording of the withholding tax provisions of the SA Income Tax Act whether the proceeds of a claim under a guarantee representing any amount of interest under the loan would be subject to withholding tax. The current market view is that this is not the case.

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 South Africa.

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 liable to pay tax in South Africa by reason only of its entering into a loan or exercising its rights (including taking steps to enforce its rights) under a loan, guarantee or security agreement.

Unless an exemption under the SA Income Tax Act applies, a foreign lender may be subject to tax on income that has, or is deemed to have, its source in South Africa. Income is or will be deemed to have its source in South Africa if, for example, it relates to rental on property situated in South Africa. South African sourced interest which is received or accrued by or to a foreign lender is exempt unless the debt from which the interest arises is effectively connected to a permanent establishment of that foreign lender in South Africa.

See question 6.1 above for the application of withholding tax on payments of interest under a loan to a foreign lender.

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 is no stamp duty or other documentary tax payable under South African law on the execution of enforcement of a loan or guarantee.

See question 3.9 for fees associated with taking security in certain circumstances.

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 one of the lenders is connected to the South African borrower and a tax benefit has arisen, the South African borrower cannot claim, in terms of section 31 of the SA Income Tax Act, a deduction of interest on any portion of the financing that is not at arm's length (i.e. any excessive portion of the financing). There are essentially two requirements that must be met before section 31 can be applied: (1) the terms and conditions of the transaction must differ from what they would have been had the parties been independent persons acting at arm's length (i.e. unconnected persons); and (2) the transaction must result (currently or in the future) in a tax benefit being derived by a person that is a party to the transaction. 'Tax benefit' is defined in the Act as any avoidance, postponement or reduction of any liability for tax under the Act.

Further, the amount of interest that may be deducted by the South African borrower is limited under section 23M of the SA Income Tax Act if: (1) the lender is in a controlling relationship with the borrower or it has obtained the funding from a person that is in a controlling relationship with the borrower; and (2) the amount of interest is not subject to tax in South Africa in the hands of the foreign lender. If the interest paid to the foreign lender is subject to withholding tax, the provisions of section 23M do not apply. A 'controlling relationship' is one where a person holds (directly or indirectly) 50% of the equity shares in a company or at least 50% of the voting rights in a company.

The location of any unconnected lender has no other adverse consequences for a South African borrower (disregarding withholding tax concerns).

© 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?

South African law gives effect to the choice of law exercised by contracting parties, subject to certain exceptions. There are certain aspects which cannot be governed by the law chosen by the parties. Most notably, under South African law the formalities for establishing a valid security interest in an asset are the formalities of the law of the place where the asset is situated (*lex situs*). The proper law, therefore, for an agreement creating a security interest over an asset located in South Africa is South African 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 is not directly enforceable in South Africa but does constitute a cause of action and would be recognised and enforced by the South African courts without re-examination of the merits of the case provided:

- the court which pronounced the judgment had jurisdiction to entertain the case according to the principles recognised by South African law with reference to the jurisdiction of foreign courts;
- the judgment is final and conclusive in its effect and has not become superannuated;
- the recognition and enforcement of the judgment would not be contrary to public policy in South Africa;
- the judgment was not obtained by fraudulent means;
- the judgment does not involve the enforcement of a penal or revenue law of the foreign state; and
- the enforcement of the judgment is not precluded by the provisions of the Protection of Businesses Act, 1978. This Act requires that the consent of the Minister of Trade and Industry be obtained before certain foreign judgments can be enforced. The South African courts have interpreted the ambit of the Act restrictively and the current market view is that the ambit of the Act would appear not to include loans from, or guarantees to, foreign lenders.

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) A South African court will exercise jurisdiction in a contractual dispute notwithstanding the chosen law of the agreement being foreign, if the normal grounds for jurisdiction exist. A foreign lender, like any local lender, can initiate legal proceedings in a South African court by either action or motion procedure. The correct procedure to be followed will depend on whether there is likely to be a material dispute of fact between the parties: the action procedure should be followed where there a material dispute of fact requiring oral testimony is anticipated, whereas the motion procedure should be followed where there is no material dispute of fact and the matter can be determined through documentary evidence such as affidavits. The motion procedure is usually speedier and more cost-effective. If the court, however, is unable to make a determination based on the papers before it, it will refer the matter to trial.

If the action procedure is followed, the foreign lender will initiate legal proceedings by service of summons. The defendant has 10 court days from the date of summons to file a notice of intention to defend.

If the defendant fails to deliver such notice, the lender can apply to the registrar of the court for default judgment without further notice to the defendant. If successful, the lender can obtain judgment and execute against it within approximately four or five weeks from initiation of proceedings.

If the defendant delivers a notice of intention to defend, the foreign lender can apply for summary judgment if it believes (and is able to demonstrate to the court) that the defendant has no *bona fide* defence and has entered a notice to defend solely for the purposes of delaying action. The summary judgment procedure, if successful, takes approximately between six and eight weeks from initiation of proceedings. If, however, the defendant is able to demonstrate that it has a *bona fide* defence, the matter will proceed to trial and it is likely that the court will grant an adverse costs order against the foreign lender.

A full trial procedure usually takes between four and six months.

(b) A foreign lender seeking to enforce a foreign judgment in South Africa must first apply to a local court for an order recognising the judgment. In practice, the motion procedure is usually followed. If the foreign judgment satisfies the requirements for its recognition as discussed in question 7.2 above and the local court grants an order recognising it, the foreign lender can obtain a writ of execution and enforce against the judgment. This process takes approximately five weeks from date of initiation of proceedings.

A foreign lender may also seek to have the foreign judgment (which constitutes a liquid document) recognised and enforced by way of the provisional sentence procedure. This is an extraordinary remedy and, if granted, requires the defendant to pay the judgment amount before proceeding to defend the action if it seeks to do so. If successful, the lender can obtain judgment within approximately four or five weeks from initiation of 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?

In the case of foreclosing on a mortgage bond or a general notarial bond where the secured creditor is not in possession of the assets, the secured creditor would need to first obtain a court order before enforcement. This will have an impact on the cost and timing.

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?

On liquidation, a *concursus creditorum* occurs and the estate of the insolvent is essentially frozen. The aim in liquidation is to realise the unsecured assets of the company for the benefit of creditors as a whole (save for secured creditors). All legal proceedings against the company are suspended until the appointment of a liquidator and any civil attachment of assets of the company after insolvency proceedings have been commenced is void. A secured creditor is not entitled to enforce its rights under its security agreement but must rather deliver any secured property held by it to the liquidator of the insolvent estate for realisation. There are limited circumstances in which a secured creditor may realise certain secured assets itself without the consent of the liquidator of the insolvent estate. These limited circumstances relate to where the secured property comprises marketable securities (i.e. property ordinarily sold through a stockbroker), financial instruments or bills of exchange. Any cash proceeds realised through any disposal of the secured assets would then have to be turned over to the liquidator unless an agreement is reached with the liquidator for the lender to retain the proceeds subject to paying the fees of the liquidator and Master of the High Court.

A company in "financial distress" may be placed into business rescue with the aim of rehabilitating the company by providing for the temporary supervision and management of the company's affairs and business by a business rescue practitioner. During business rescue, no creditor may institute any legal proceedings or take any enforcement action (including enforcement of any collateral security) against the company. In certain circumstances, proceedings may be brought against the company with the written consent of the business rescue practitioner or with the leave of the court.

The terms and effect of any reorganisation of a company (including whether any moratorium applies) by way of compromise with its creditors will depend on terms agreed between the company and all 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?

South Africa is a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, otherwise known as the New York Convention. In terms of local legislation, namely the Enforcement of Foreign Arbitral Awards Act, 1977, a foreign arbitral award can be made an order of court and enforced without re-examination of the merits, provided that the matter is arbitrable in South Africa. Matrimonial cases or matters relating to status are not arbitral in South Africa.

New proposed legislation (i.e. the International Arbitration Bill) does not alter this position.

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 secured creditor is not entitled to enforce its rights under its security agreement during insolvency proceedings but must rather deliver any secured property held by it to the liquidator of the insolvent estate for realisation. There are limited circumstances in which a secured creditor may realise certain secured assets itself without the consent of the liquidator. These limited circumstances relate to where the secured property comprises marketable securities (i.e. property ordinarily sold through a stockbroker), financial instruments or bills of exchange. Any cash proceeds realised through any disposal of the secured assets would then have to be turned over to the liquidator unless an agreement is reached with the liquidator for the lender to retain the proceeds, subject to paying the fees of the liquidator and Master of the High 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?

Certain pre-liquidation contracts can be set aside by a liquidator exercising anti-avoidance (or clawback) powers afforded to it under the SA Insolvency Act. Clawback could be available in relation to: dispositions (commonly known as impeachable dispositions) made not for value; dispositions having the effect of preferring creditors and not made in the ordinary course of business; dispositions made with intent to prefer creditors; collusive dealings; and dispositions in fraud of creditors.

The definition of a "*disposition*" in terms of the SA Insolvency Act is very wide, and is designed to cover every loss of rights to property, which includes the granting of security.

A disposition will only qualify as an impeachable disposition if it was made at a time when the debtor's liabilities exceed its assets or, in the case of a disposition at no value, the debtor's estate was rendered insolvent by the disposition. For this purpose, "insolvent" means that the insolvent's liabilities must exceed the value of his assets (fairly valued) at the date of the disposition.

Where a special notarial bond or mortgage bond is passed over assets to secure a debt and such bond is not registered within two months of the debt being incurred, and the debtor is liquidated within six months of the registration of the notarial bond or mortgage bond, no preference is recognised under the notarial bond or mortgage bond and the lender effectively loses its security.

Creditors in the insolvent estate are paid according to the following order of rank:

- costs of liquidation – this includes the costs of court application; the liquidator and master's fees; and sheriff's costs;
- secured creditors – payment is made to secured creditors from the proceeds of a sale of the secured assets (after the proportionate liquidation costs have been deducted from the proceeds of the realised secured asset). Where a secured creditor's claim is not secured in full, the unpaid balance is treated as a concurrent claim. Secured claims include: mortgage bonds over immovable property, which are satisfied in the order in which they are registered or recorded; pledges over movable property; special notarial bonds registered over movable property, which are satisfied in the order in which they are registered; and cessions over intangible movable property;
- preferential creditors – these are creditors who do not hold security for their claims but rank above the claims of concurrent creditors. They are paid from the proceeds of the unencumbered assets (the free residue) in a pre-determined order as follows:
  - the salary and wages of employees (and certain other amounts payable to, or on behalf of, employees);
  - certain statutory obligations (such as amounts owing to the workmen's compensation fund; any customs or sales tax due under the Customs Excise Act, 1964; any value-

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

added tax or penalty due under the Value-Added Tax Act, 1991; and any amounts owing to the unemployment insurance fund);
    - income tax; and
    - preferential claims arising from bonds giving preferences (i.e. general notarial bonds or special notarial bonds registered before 7 May 1993);
- concurrent creditors – these are creditors who are paid from the proceeds of the free residue that remains after preferent creditors have been paid in full in proportion to the amounts owed to them;
- subordinated creditors, if they have subordinated their claims to the claims of concurrent creditors; and
- shareholders (holders of preference shares generally take priority to holders of ordinary shares).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

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 lender and security provider may agree that the lender has a right (called *parate executie*) to sell the secured assets without an order of court by public auction to the highest bidder or in such manner as may be otherwise agreed between the parties.

The debtor may seek the protection of the court if, on any just ground, he can show that, in carrying out the agreement and effecting a sale, the creditor acted in a manner which prejudiced the debtor in his rights and is valid in respect of a security interest created over movable property.

An agreement in a mortgage bond entitling the mortgagee to resort to *parate executie* by taking possession of the property and selling it privately is, however, invalid.

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, submission to a foreign jurisdiction is legally binding and enforceable under South African law. However, the inherent jurisdiction of the South African courts cannot be ousted and a South African court may exercise its discretion not to take cognisance of the submission to foreign jurisdiction clause.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

In South Africa, any litigation against the South African government is governed by the State Liability Act, 1957. In terms of this Act, any claim against the South African government which would, if that claim had arisen against a person, be the ground of action, will be cognisable by any competent court irrespective of whether the claim arises out of any contract lawfully entered into or on behalf of the South African government or out of any wrong committed by an authorised servant of the South African government acting as such. Any property of the South African government, however, cannot be attached in execution but an amount required to satisfy the judgment may be paid out from the National or Provincial Revenue Fund.

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 as such is not a regulated activity in South Africa unless credit is provided to consumers (i.e. retail lending activity).

Under the Banks Act, 1990 (the **SA Banks Act**), however, no person may conduct "the business of a bank" unless such person is a public company and registered as a bank under the SA Banks Act. The business of a bank is widely defined and includes accepting deposits from the general public as a regular feature of the business in question. The SA Banks Act does not define nor offer guidance as to what constitutes the "general public" but it is generally understood to refer, with reference to the SA Banks Act, to any section of the public, irrespective of any pre-selective or pre-determinative criteria applicable to a particular group of persons. It would not include any private, domestic arrangements.

The South African Reserve Bank is responsible for bank regulation and supervision in South Africa. It is not, however, necessary under the laws of South Africa that a foreign lender is licensed, qualified or otherwise entitled to carry on business in South Africa to enable it to exercise its rights (including taking steps to enforce its rights) under any lending arrangements entered into with a South African borrower, or to enter into or perform its obligations under the lending arrangements.

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?

Under the Financial Advisory and Intermediary Services Act, 2002 (**FAIS**), no person may provide intermediary services or advice to clients in respect of financial products (including insurance products, bank deposits and securities) unless that person has been issued a licence under FAIS. Authorised financial service providers holding the requisite licence under FAIS are bound by principles and rules set out in the applicable codes of conduct created by the Financial Services Board, the regulatory body responsible for administering FAIS.

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

Foreign investors should also consider a recently enacted piece of legislation, the Protection of Investment Act, 2015. This Act was assented to by the President of South Africa in December 2015 but is yet to come into force (its effective date still needs to be proclaimed). This Act is intended to replace South Africa's bilateral investment treaties and provide for the protection of investors and their investments in South Africa in accordance with and subject to the Constitution of South Africa, in a manner which balances the public interest and the rights and obligations of investors.

Acknowledgment

The authors would like to thank Lauren Tunstall for her invaluable assistance in the preparation of this chapter.

Lionel Shawe
Allen & Overy LLP
6th Floor, 90 Grayston
90 Grayston Drive, Sandton 2196
South Africa

Tel: +27 10 597 9860
Fax: +27 10 597 9999
Email: lionel.shawe@allenovery.com
URL: www.allenovery.com

Lionel Shawe is a co-managing partner based in our Johannesburg office in the banking and finance sector and is seen to be "a phenomenal banking lawyer who works hard and sees the bigger picture" – *Chambers and Partners 2016*. Lionel has significant expertise in mining financing, aircraft financing, acquisition and leveraged financing, structured financing, property financing, preference share funding, securitisation, capital markets and debt restructuring. He has substantial experience and expertise in the complex area of derivatives (in particular, credit derivatives). Lionel has extensive experience in exchange-control issues and is regularly consulted and he regularly advises domestic and international financial institutions on complex transactions.

Lisa Botha
Allen & Overy LLP
6th Floor, 90 Grayston
90 Grayston Drive, Sandton 2196
South Africa

Tel: +27 10 597 9890
Fax: +27 10 597 9999
Email: lisa.botha@allenovery.com
URL: www.allenovery.com

Lisa Botha is a banking and finance partner based in our Johannesburg office. She is dual-qualified as both a South African attorney and a solicitor (England & Wales) and has experience of working in several jurisdictions outside of South Africa including the Middle East. She has acted for high-profile clients across both the domestic and international financial sectors and has developed a particular expertise in cross-border work. Lisa's practice covers general lending, restructuring, capital markets and private equity.

ALLEN & OVERY

Our ambition at Allen & Overy is to help the world's leading businesses both maximise the opportunities that globalisation presents and meet the potential challenges. Our teams across the world work together in a highly integrated manner to leverage their expertise and experience for our clients' benefit. We foster creative, independent thinking within a collaborative culture and, as a result, our lawyers are involved in many of the most influential cutting-edge commercial transactions, and are known for providing our clients with transformative solutions to the toughest legal challenges.

Allen & Overy's market-leading New York and English law global leveraged finance practice (comprising an integrated loans and high yield bonds practice) operates in all of the main financial centres throughout the world. 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. Our practice is supported by pre-eminent Private Equity, Equity Capital Markets, Debt Capital Markets, Securitization and Restructuring teams. This collective expertise combined with in-depth sector insights makes us one of very few firms with the ability to advise on complex cross-border leveraged finance transactions across the full spectrum of the capital structure, as well as on all types of "crossover" and emerging markets loan and bond transactions.

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

Chapter 57

Spain

Manuel Follía

CUATRECASAS

María Lérida

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

In 2016, the main trends in the Spanish financial sector were focused on keeping deleveraging activity by selling non-performing loan portfolios and distressed assets (including real estate assets) to international distressed and real estate funds. Likewise, refinancing and restructuring transactions, as well as corporate and acquisition transactions are increasing and, in particular, the hotel-based real estate sector is emerging.

On significant developments, it is worth mentioning that Spain experienced two government election processes in 2016, which certainly paralysed the expected legislative process in that year. Despite this lack of legislative activity, the Spanish banking regulation made substantial developments, taking significant steps to consolidate the banking sector. As such, the Bank of Spain (*Banco de España*) approved Circular 4/2016 on the financial information of credit institutions, which completely reformulates the guidelines for institutions on risk management. In a nutshell, such circular reinforces the accounting principles applicable to: (i) credit risk management; (ii) accounting classification of the transactions based on their credit risk; and (iii) the individual and collective estimations of provisions.

Furthermore, the European Court of Justice has ruled on the effects of the nullity of the so-called *floor clauses* (i.e., clauses setting a minimum interest rate for variable-rate mortgage loans) included in consumer mortgage loans, stating that this nullity (mainly arising from a lack of transparency) must have *ex tunc* effects (as of the date in which the loan was granted) and not as of the date of the first ruling of the Spanish Courts (dated May 2013).

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

It was a very good year in 2016 for the lending practice, where we have managed to solidify our experience in distressed debt and have continued strengthening our participation in many local and foreign financing transactions. Briefly, some significant 2016 lending transactions are as follows:

- Corporate refinancing and debt restructuring processes: For some years now, we have been actively participating 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), our participation in Madrid Highway Network (€4.58 billion), the restructuring of the San José group debt (€2.1 billion) and the Ibersotar group debt (€930 million) as well as the Comsa group refinancing (€719 million).
- Project 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. Aside from advising in relevant projects in Spain of certain corporates like KKH, Hispania Activos Inmobiliarios, Meridia Capital, etc., we would like to remark that our clients are increasing their activity abroad, having participated in large cross-border transactions worldwide, including projects located in Peru, Chile, Algeria, Saudi Arabia and South Africa. Regarding Saudi Arabia, we would highlight our involvement as Spanish counsel to FIEM in the Sadara project, a $19 billion transaction for the construction and operation of a petrochemical plant in Jubail.
- 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 advising on the sale of non-performing loans portfolio such as Project Carlit, Pirene, Corus, Tizona, Far, Ocean, Normandy, Firefox, Lane and Sil2, clearly showing the Spanish bank's interest in cleaning up its balance sheets and international investors' interest in Spanish assets.

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 company granting the guarantee or security or the group as a whole will obtain through such transaction.

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

Finally, subject to certain case law and according to Section 71.2 of the Spanish Insolvency Act, 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, the mere allegation of the generic interest to the group not being sufficient.

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 its 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

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 already been 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*) and therefore, belonging to listed companies, 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 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

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

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 – 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 of 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 or a legalisation from the relevant consulate or other competent body).

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:

- 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
- 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

(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.

© 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?

As stated in question 5.1 above, the appointment of an agent for Spanish security is usual market practice for cross-border financings.

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 2017. 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.

Additionally to the limitations set above, financial expenses, arising from transactions carried out between related parties, are not tax-deductible when the interests paid are not taxed because of the application of different legal qualification under local regulations (i.e. when those interests paid are considered as dividends under the lender's local regulations).

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 ("ETVEs") regime, 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.

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

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.

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 recast"), 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 recast 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 six 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 six 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.

© 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?

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.

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, which does not apply to public claims, 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 the security interest prior to liquidation (or reinitiate the formerly stayed enforcement proceeding as a result of bankruptcy declaration), it may lose control over the collateral if the liquidation plan sets forth the sale of the business unit as a going concern. In exchange for losing control to enforce the security interest on a stand-alone basis, secured creditors obtain a portion of the price equivalent to the weight of the collateral in the estate. If that percentage of the price is less than the value recognised in the proceeding for the security interest, secured lenders that initiated the enforcement proceeding prior to bankruptcy declaration, but did not reinitiate it after the one year automatic stay, have veto right as to the approval of the liquidation plan, unless 75% in value of the secured claims from the same class (financial, labour, public, commercial) were to consent to it.

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. Besides, public claims cannot be affected in any way by a "5 *bis*" notice.

Lastly, if the secured creditor fails to enforce prior to liquidation, it may lose control over the collateral, in which case it would get a portion of the price equivalent to the weight of the collateral in the estate. If the resulting price is lower than the value of the secured claim (ascertained pursuant to the law), at least 75% of the secured claims from the same class must consent to the liquidation plan that sets forth the sale of the business unit as a going concern. The claim comprising the difference between the resulting price and the value of the secured claim (the deficiency claim) will be classified as unsecured.

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 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 Brussels I recast (*supra* 7.2), except in cases where the rules on exclusive jurisdiction of the Regulation 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);

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

(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 Spanish Organic Law of the Judiciary such submission would be valid, unless the exclusive jurisdiction of the Spanish courts is violated (in general, the same cases described *supra* in (i) (a) to (e), with regard to Regulation Brussels I recast).

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 or local lenders or agents under a syndicated facility to be resident, licensed, qualified or entitled to do business in Spain to execute or enforce any rights in Spain under financing agreements or collateral agreements, provided that, in the case of foreign lenders (and where and if applicable), they are licensed, qualified or entitled to do business in their jurisdiction of incorporation. Consequently, there is no material distinction between domestic and foreign creditors for the purposes of granting loans or security. In any case, foreign lenders are subject to some formalities such as the obligation to obtain a Spanish tax identification number (*NIF*) (as explained in question 3.13 above).

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 questions. However, we take the opportunity to remark here that the Spanish Companies Act sets out the conditions under which a Spanish company (whether in the form of a public limited liability company (*sociedad anónima*) or in the form of a private limited liability company (*sociedad de responsabilidad limitada*)) may issue and guarantee debt securities. According to those amendments, limited liability companies are now allowed (as opposed to the previous regulations in this regard) to issue and guarantee bonds and other securities that create or recognise debt, except for convertible instruments (i.e., securities which can be converted into equity).

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

Manuel Follía
CUATRECASAS
Diagonal, 191
08018 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 with extensive experience in banking law and finance, having advised national and international clients on corporate and acquisition finance, real estate finance, the financing of infrastructures and projects, audiovisual and media financing, and debt financing. 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 borrowers and lenders, advises financial institutions, hedge funds and private equity funds, and is a reference for the main operators in the 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
Diagonal, 191
08018 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 with broad experience in banking law and finance.

Her career is mainly focused on giving 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.

With over 900 lawyers and a century of professional practice, Cuatrecasas is a leading law firm present in over 10 countries. We cover all areas of business law with a sectoral approach, focusing on all types of business. We maintain close, long-standing relationships with leading companies in every sector. 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*.

Our Finance Practice consists of near 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 the 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.

"Ranked as leading Firm (1st tier) in Banking & Finance, Project Finance, Capital Markets and Debt Restructuring" – (*Chambers & Partners*, 2016).

"25 lawyers ranked in Finance practices in Spain" – (*Best Lawyers*, 2016).

"Top 20 by volume for syndicated loan transactions (EMEA region)" – (Bloomberg, 2016).

"Only Iberian law firm among top 10 by volume for syndicated loan transactions (EMEA region)" – (Bloomberg, 2014) (*Thomson Reuters*, 2015).

"Standout in the category of Finance" – (FT Innovative Lawyers, 2013).

© 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 transfer must return what he or she has received if the company shows that the recipient 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 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 and as such only 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 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 therefore can 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 – as a general rule – 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 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.

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

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 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 and 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 infinite 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 infinite 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 borrower) for the purpose of funding such 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,

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

the agent may enforce any collateral security and apply the proceeds from such enforcement in order to satisfy the secured claims 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?

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 nor 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 final and conclusive judgment rendered by a federal or state court located in the State of New York would in principle neither be recognised nor 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, according to Swedish Supreme Court case law, judgments (i) that are based on a jurisdiction clause (the Swedish court may assess whether the jurisdiction clause validly appoints the foreign court), (ii) that were rendered under observance of due process, (iii) against which there lies no further appeal, and (iv) the recognition of which would not manifestly contravene fundamental principles of the legal policy of Sweden, can under certain circumstances form the basis for an identical Swedish judgment without a retrial on the merits.

A final, conclusive and enforceable judgment given by an English court would – pursuant and subject to the provisions of the 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 (recast) (the "2012 Brussels I Regulation") – be enforceable in Sweden without any declaration of enforceability being required.

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

Finally, it should be noted that Sweden has acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York, 1958 (the "New York Convention"). A final and conclusive arbitral award, which is enforceable in England or New York and has been duly served on the relevant party, rendered by an arbitral tribunal in England or New York, will be recognised and enforceable by the courts of Sweden, according and subject to the New York Convention and the Swedish Arbitration Act (*Sw. lag (1999:116) om skiljeförfarande*). In order to enforce an arbitral award under the New York Convention in Sweden, the concerned party must submit an application for enforcement (*Sw. exekvatur*) to Svea Court of Appeal (*Sw. Svea hovrätt*) and comply with the procedures of that court (as required).

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 2012 Brussels I 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.

The application for enforcement (*Sw. exekvatur*) of an arbitral award normally takes approximately three to six 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?

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?

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.

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 without reservation. Its provisions have been incorporated into Swedish law by the Swedish Arbitration Act. Please see questions 7.2 and 7.3 for further information.

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 auction not occurring earlier than four (4) weeks after the meeting for administration of oaths. Such 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 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 benefiting 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).

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

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 benefiting 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. 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 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 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 is a truly global law firm with 39 offices in 28 countries. Our diverse team of local, US and English-qualified lawyers advise clients on complex, cross-border transactions in almost every area of law. In both established and emerging markets, our lawyers are integral, long-standing members of the community, giving our clients insights into the local business environment alongside our experience in multiple jurisdictions. We work with some of the world's most respected and well-established banks and businesses, as well as start-up visionaries, governments and state-owned entities.

White & Case is a leading law firm in the Nordic region with a long-established and credible presence, having opened our Stockholm office in 1983 and our Helsinki office in 1992. As the only global law firm with offices in both Stockholm and Helsinki, we have significant transactional experience throughout the Nordic region and strong client relationships in each of Sweden, Finland, Denmark and Norway. Outside of Sweden and Finland, we maintain good connections with leading local law firms.

In Sweden, White & Case offers clients substantial experience in complex issues of Swedish law and regulation and we advise clients on a variety of transactions within Sweden, throughout the Nordic region as well as in Europe and beyond. Key practice areas include M&A, Banking, Capital Markets and Dispute Resolution. In Finland, we advise Finland-based and international clients on their Nordic and worldwide activities. We work in close cooperation with the Firm's other offices and specialised practice groups throughout the EMEA region, the Americas and Asia. Our core practice areas in Helsinki include M&A, Capital Markets, Banking and Real Estate.

© 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 in the context of the difficult economic environment for banks (financially and regulatory wise), 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 2016, one of the biggest lending transactions in Switzerland occurred in relation to the acquisition of Allergan plc's generics business by Teva Pharmaceutical Industries Ltd. The lending occurred through Swiss companies of Teva. A further huge financing took place when China National Chemical Corp. took over the Swiss seed and pesticide maker Syngenta AG for USD 43 billion. The transaction did not close yet. The green light from the European Union regarding the deal is still pending.

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 with 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.

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

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 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, are 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 are 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 timelines 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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), *Chambers Global 2012* (Banking and Finance) and *Chambers Europe 2012* (Banking and Finance), *Citywealth Leaders List 2012* (International Lawyer), 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

Chapter 60

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?

Low interest rates and difficult economic conditions remain the two major challenges that Taiwanese banks, like other financial institutions across the Asia Pacific region, are facing and trying to overcome. According to a report from Thomson Reuters in December 2016, Taiwan saw the biggest annual decline in 2016 in terms of syndicated loan volume, down nearly 27% as companies grappled with a slowing economy.

Nevertheless, Taiwanese banks, while continuing to battle the two problems, have been trying to seek and seize growth opportunities overseas for a long time. Moreover, slower growth in the domestic market, at a growth rate of 3% per year in 2014–2016, has long encouraged Taiwanese banks to look offshore. Instead of China, where banks' exposure to default risk is relatively high, the Taiwanese competent authority urged banks to diversify their loan exposures by bulking up elsewhere in the region, especially in Southeast Asia, such as Vietnam, Cambodia and the Philippines, where the exposure of Taiwanese banks to these markets grew 20% per year over 2015–2016.

In December 2016, the authority's strong desire to push into the growing Southeast Asia markets was signalled by the introduction of a "New Southbound Policy". Following its official launch on January 1, 2017, the Finance Supervisory Commission R.O.C. (Taiwan) later formulated a full set of measures to implement that policy. These measures include, mainly, provision of preferential financing and guarantee conditions, thus raising the preferential rate of premiums, and other regulatory relaxations in order to encourage local banks to increase their offshore lending. As a result, lending to the Southeast Asian nations is expected to grow at a pace of 8% per year from 2017 to 2020, according to Fitch.

Despite the above, a few significant lending transactions emerged in late 2016. Several analysts optimistically forecast that it is a sign of recovery in this lending market, and it is expected that the syndicated loan volume in Taiwan market in 2017 will exceed that of 2016. Such positive expectation is supported by both a potential growth of Taiwan GDP in 2017 and a global market recovery. However, due to possible political and economic changes and the situation in other parts of the world as well as the development of new technology, most Taiwanese companies remain conservative on their spending and needs for financing.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

(1) On October 11, 2016, Inotera Memories, Inc. ("Inotera") and Micron Semiconductor Taiwan Co. Ltd. ("MSTW"), as co-borrowers, entered into a syndicated loan agreement with Bank of Taiwan as facility agent, Mega International Commercial Bank as collateral agent, Taiwan Business Bank, as document management agent, and certain other financial institutions as lenders. The loan agreement provides for a secured delayed single-draw term loan facility, with a maximum aggregate borrowing amount of NT$80 billion (approximately US$2.54 billion). Proceeds of the loan under the loan agreement will be used by MSTW to pay a portion of the consideration and any related transaction costs for the share swap and to provide working capital for Inotera. The indebtedness under the loan agreement will be secured by liens over certain assets.

(2) On December 16, 2016, Tatung Co Ltd. ("Tatung") entered into a NT$25.2 billion syndicated loan agreement with Bank of Taiwan, as the agent, Mega International Commercial Bank and Taishin International Commercial Bank as mandated lead arrangers, and other banks as additional lenders. Tatung will utilise the proceeds of the loan to develop its business regarding a smart electric grid as well as other green and renewable energy.

(3) Innolux Corp ("Innolux"), Taiwan's largest LCD panel maker, on September 7, 2016 obtained a syndicated loan of NT$35 billion with 15 local lenders, including Bank of Taiwan and CTBC Bank Co. It is one of the largest loans arranged by a local electronics firm this year. Innolux plans to use the loan to repay debt, replenish operational spending and finance the development of new technology.

(4) On May 5, 2016, Formosa Plastics Group entered into a syndicated loan of US$2.1 billion with 25 local banks led by Hua Nan Bank to finance the capital expenditure of its steel plant in Ha Tinh, Vietnam. The term of the loan is seven years. In August, 2016, to further finance the capital expenditure of steel plant in Ha Tinh, Vietnam, Formosa Plastics Group entered into another syndicated loan of US$1.28 billion with seven foreign banks, led by Sumitomo Mitsui Banking Corporation. The term of the loan is five years.

(5) In August 2016, TCC International Holdings Limited entered into a US$540 million syndicated loan agreement with 17 banks, led by Hua Nan Bank, Mega International Commercial Bank, DBS Bank and First Commercial Bank to finance its working capital and to repay its current outstanding debts.

© 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, no company can 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 or 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, the guarantee 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 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 to revoke the guarantee if, due to the guarantee, the guarantor does not have 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"), the Ministry of Economic Affairs ("MOEA") with respect to 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 guarantor 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 Taiwanese 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

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

security. We will briefly advise on such requirements in our answers to questions 3.3 to 3.7.

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 plant, 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 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 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, registration with the competent authority is 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 Taiwanese 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 million. 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 Taiwanese 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.

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

However, it is worth noting that, according to the interpretation of the MOEA, a foreign company having no branch office in Taiwan, 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 answer 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 if the other sister company, together with its parent company, does not directly or indirectly hold more than 50% of the 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?

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

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

such 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 32 jurisdictions; namely, Australia, Austria, Belgium, Canada, Denmark, France, Gambia, Germany, Hungary, India, Indonesia, Israel, Italy, Japan, Kiribati, Luxembourg, Macedonia, Malaysia, the Netherlands, New Zealand, Paraguay, Poland, 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

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

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

(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 point (a) 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 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 cases 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 following 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

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

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?

There are no preference periods with respect to the security. The bankruptcy administrator may, within six months of the bankruptcy adjudication, apply to the court for the invalidation of the following acts of the debtor: (1) provision of security for outstanding debts within six months prior to the bankruptcy adjudication; and (2) repay the debts not yet due. In addition, the bankruptcy shall, within two years after declaration of the bankruptcy proceeding, file with the court to rescind the transaction which the bankrupt conducted with or without consideration before the bankruptcy proceeding if such transaction is deemed detrimental to the rights of the bankrupt's creditor and is revocable under the Civil Code.

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) the following labour claims will rank prior to unsecured creditors: (a) labour wages due and payable by the employer but overdue for a period of fewer than six months; (b) retirement payments payable by the employer pursuant to the Labour Standards Act but not yet paid; and (c) severance payable by the employer pursuant to the Labour Standards Act or Labour Pension Act but not yet paid; 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?

The following may apply for bankruptcy adjudication: (1) natural persons; (2) juristic persons; and (3) partnerships and any other incorporated association with a representative or an administrator. An unincorporated association without a representative or administrator is excluded from a bankruptcy proceeding, and there is no special legislation applicable to such entity. Banks and insurance companies are excluded from bankruptcy proceedings and will be subject to the proceedings provided under the Banking Act, Deposit Insurance Act and Insurance Act.

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. A creditor and the security provider may sign an agreement whereby the ownership of the mortgaged or pledged security will be transferred to the mortgagee or pledgee automatically when the debtor defaults. However, in the case of a mortgaged security, such agreement to transfer cannot be enforced against a *bona fide* third party, unless the mortgage is registered with the competent authorities.

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 Taiwanese 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 licensing 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/finance companies. Accordingly, currently it is not possible to set up a company to operate a lending business in Taiwan.

Since there is no particular licensing 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.

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

There is no particular licensing or other eligibility requirement or 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, a foreign company is not allowed to operate any business in Taiwan without being recognised and setting up a branch in Taiwan. Thus, if lending is the foreign company's business, making a loan to Taiwanese borrowers by the foreign company may violate the Company Act. Furthermore, as advised in our answer to question 2.6, in the case of a foreign loan to a Taiwanese borrower, the foreign exchange control 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. However, in practice, an agent is normally a member of the syndicate and the credit rights of the syndicate members are joint and several in order to allow the agent to claim the repayment/payment and the collateral on behalf of the other syndicate members.

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.

If a foreign lender provides a loan with a 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

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. She then 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 is a partner in the Banking and Capital Market Department. Her major practice areas are banking, capital markets, finance, M&A and general corporate law.

Hsin-Lan has advised on many offshore and onshore fund raising projects, finance projects, mergers and acquisitions, and asset sale and purchases. In addition to transactions, Hsin-Lan has provided general advice in the field of financial, investment, data protection and corporate-related inquiries.

Cyun-Ren Jhou
Lee and Li, Attorneys-at-Law
7F, 201 Tun Hua N. Road
Taipei, 10508
Taiwan

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.

Lee and Li, Attorneys-at-Law is now 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 to 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 and 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* (*IFLR*); it was 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

United Arab Emirates

Ayman A. Khaleq

Amanjit K. Fagura

Morgan, Lewis & Bockius LLP

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, the lending market in the UAE has made slow progress over the past 12 months with a minor credit crunch felt by borrowers. Factors such as a decline in oil prices and the Arab Spring have had an effect on investor confidence and market liquidity, and banks appear to have been more cautious when lending in the private sector, particularly with regards to real estate. Moreover, spending cuts in the Middle East have resulted in lower economic growth and lower credit demand, meaning that the cost of funding for banks has increased.

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. Nevertheless, 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.

On 29 December 2016, Federal Decree Law No. 9 of 2016 on bankruptcy (the "New Bankruptcy Law") came into effect, repealing the former insolvency regime and introducing the UAE's first standalone bankruptcy legislation. The law has sought to introduce restructuring and modernise insolvency procedures in the UAE, and applies more widely than the former regime, covering companies governed by the Commercial Companies Law (Federal Law No. 2 of 2015 concerning Commercial Companies) (the "CCL 2015"), some free zone companies, sole establishments and civil companies conducting professional business.

The New Bankruptcy Law has also introduced three main procedures for a business in financial difficulty: a protective composition; a restructuring scheme; and insolvency and liquidation. The implications of the New Bankruptcy Law on the lending market in the UAE are touched upon in this chapter, particularly with regards to the rights of secured creditors in enforcing their security interests during bankruptcy proceedings. The New Bankruptcy Law remains largely untested and we watch with interest how the legislation will apply in practice.

On 15 December 2016, Federal Law No. 20 of 2016 on the pledge of moveables as security for debt (the "New Pledge Law") was issued in the Official Gazette and is due to come into effect imminently. This is a significant new legislative development which substantially changes or regularises the manner in which a charge can be created over moveable assets. The New Pledge Law provides lenders with the ability to register effective pledges over tangible or intangible moveable assets that exist in the present or in the future, a problem both lenders and debtors have struggled with for some time. However, it is not yet clear to what extent the New Pledge Law will replace the current use of commercial mortgages, which also secures an interest over tangible and intangible assets.

The New Pledge Law changes the position of taking a pledge over moveable assets by removing the need to transfer the possession to the mortgagee or third party as bailee. A new electronic security register (the "Security Register") will be set up to record the rights of the parties under the pledge and to establish priority *vis-à-vis* competing creditors. Further detail on the practical effect and operation of the New Pledge Law should be clarified by executive regulations (the "Executive Regulations") which are due to come into effect in mid-September 2017. At the time of writing, no information has been released regarding the scope and effect of the Executive Regulations and the date on which we can expect the Security Register to be operational. We anticipate that the New Pledge Law will provide greater confidence to both lenders and borrowers in the UAE lending market, although we still have little insight as to how the Security Register will operate and to what extent the Executive Regulations will impact the legislation in its current form.

From an Islamic finance prospective, many leading Islamic banks and financial institutions, including Dubai Islamic Bank, Emirates Islamic Bank and Abu Dhabi Islamic Bank, announced increased profits in 2016 largely due to increased *sukuk* issuance and innovative

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

new banking technology. The asset-based nature of asset financing is well suited to the principles of Islamic financing, and there is a growing trend of *Shari'a*-compliant financing in the aviation, shipping and infrastructure industries. *Ijara* arrangements are often used to replicate conventional lease agreements, providing a viable *Shari'a*-compliant alternative to conventional aircraft and shipping financing. *Istisna'* contracts are also useful in in circumstances where aircraft are purchased directly from the manufacturer and the financing is put in place before such aircraft are delivered.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

A few noteworthy transactions are listed below:

Meydan Group LLC ("Meydan"), a UAE government-related entity, issued a AED 1 billion ($272.3 million) *Shari'a*-compliant Ijara financing through a club of banks led by Abu Dhabi Islamic Bank. The deal, which closed on 4 April 2016, was one of the largest local real estate-focused bank fundings of the year. It was structured in two tranches: a *Shari'a*-compliant bond, or "*sukuk*", and a syndicated facility tied by a common terms agreement, with the *sukuk* tranche constituting the largest floating rate issued by a government-related entity in the Middle East. Meydan, a major developer of hospitality and entertainment facilities in Dubai, will use the funding to support investment in new projects.

Investment Corporation of Dubai issued US$1 billion of trust certificates under its US$2.5 billion trust certificate issuance programme at the start of 2017. The trusts certificates, which were issued in a single tranche maturing in 2027, were offered pursuant to Regulation S and are listed on the Nasdaq Dubai and on the Irish Stock Exchange, and have a profit rate of 5% *per annum*.

In May 2016, the Islamic Development Bank Group agreed to loan Indonesia up to US$5.2 billion for development programmes until 2020. IDB will work with other donor institutions as well as multilateral lenders, including World Bank, Asian Development Bank and China-backed Asian Infrastructure Investment Bank, to offer additional resources for financing priority projects. This agreement is reflective of a trend where Asian and South East Asian governments are seeking more and more funding from the Middle East 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)?

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). Guarantees must be in writing and specify the amount secured by the guarantee.

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.

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 to which directors should adhere, including a restriction on guaranteeing any loan agreement with a board member and third party (CCL 2015 Article 153) and entering into 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. The DIFC's Companies Law (DIFC Law No. 2 of 2009) (the "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, 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) for 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.

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

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, no governmental consents or filings are 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 guarantee's form and substance should satisfy the requirements of the Civil Transactions Law (Federal Law No. 5 of 1985, as amended) (the "Civil Transactions Law") and the Commercial Transactions Law (Federal Law No. 18 of 1993) (the "Commercial Transactions Law"), as applicable. Practitioners should also consider that offshore companies may have their own legislation that governs such form and substance.

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, the 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 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.

The New Pledge Law is intended to govern the taking of security over a wide variety of moveable property located onshore in the UAE, both tangible and intangible. The law has alleviated the more cumbersome aspects of taking security over movable property, which was previously governed by the Civil Transactions Law and the Commercial Transactions Law. The old system will continue to apply to the taking of security over assets which do not fall within the parameters of the New Pledge Law, including land and shares.

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. In relation to the DIFC, the creation, perfection and enforcement of security is governed by the DIFC Law of Security (DIFC Law No. 8 of 2005) and the Security Regulations, and the DIFC Real Property Law (DIFC Law No. 4 of 2007). Such regulations more closely mimic common law-based regulations governing the taking of security.

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

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

separate agreements wherever possible. Further, as certain security documents may have to be notarised and registered with different government entities, particularly in relation to land and shares, 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, the land mortgage agreement (generally pre-printed documents prescribed by the relevant authorities) must be: (i) executed in writing in the presence of a public notary or the relevant land department in Arabic; and (ii) 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 amount (see the response to question 3.9). This can be onerous on the borrower if they are covering the costs of the transaction. Furthermore, 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 aircraft, 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.

Offshore

Interests in land in free zones are normally subject to their own regulations. The DIFC, for example, is governed by the DIFC Real Property Law, 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

The New Pledge Law will apply to the creation of security over receivables from third parties. The law provides that security may be created over receivables so long as the parties enter into a written agreement that complies with the requirements of the Executive Regulations, which are due to be introduced in mid-September 2017. The security interest will be effective against third parties upon registration on the Security Register, which is also yet to be established. At the date of writing, there has been no information on when the Security Register will be set up. In addition to registration, it will also be necessary to notify any possessor of the secured property of the security interest being created if the relevant property is not in the possession of the security provider.

Offshore

Such an assignment is permissible in offshore transactions. Specifically, security in the DIFC is governed and permitted by the DIFC Law of Security. 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

The New Pledge Law will govern the taking of security over funds deposited in a UAE licensed bank. The law provides that the security shall be created by the parties entering into a written agreement which complies with the requirements of Executive Regulations. The security will need to be registered on the Security Register once

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

it is established. The New Pledge Law provides that future property may be secured, which is particularly relevant in respect of security over cash deposits. The previous position was that the credit balance had to be fixed and identifiable, i.e. no floating charge, which in effect meant that the borrower had to maintain a blocked account. This resulted in some foreign lenders also requiring that additional security be taken over offshore accounts where floating security is recognised and enforceable. The New Pledge Law should therefore be a welcome development to banks when taking local law account pledges.

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.

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

The New Pledge Law is intended to govern the validity and enforceability of security over, *inter alia*, raw and primary products and commodities, equipment machinery and work tools. The formalities of registration are as set out above, and the security will have to be registered on the Security Register once established. As the law remains untested, we are yet to understand how the enforceability of such security shall operate.

Currently, security can be taken over machinery and trading stock by way of a commercial mortgage. To register a commercial mortgage, it has to be executed in writing and the agreement has to be notarised and registered in the commercial register of the relevant Emirate's Department of Economic Development. Notice of the mortgage is to 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). It is not yet clear to what extent pledges under the New Pledge Law will replace the current use of commercial mortgages.

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.

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

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.

We are yet to know if the Executive Regulations, once issued, will provide further information on fees in relation to security over moveable property.

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 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. It is hoped that the introduction of the Security Register for the registration of security over moveable property will alleviate some of this uncertainty. Furthermore, 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 may need to be taken into account. Further, any security against government-owned assets or certain individuals within government organisations will require consent.

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.

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. On 28 April 2016, the UAE Ministry of Economy issued guidance, by way of Ministerial Resolution No. 272 of 2016, confirming that the financial prohibition will not 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.

© 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?

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 their 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.

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 advanced 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, 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). However, a value-added tax (VAT) regime is due to be introduced to the UAE, and other Gulf countries, from the beginning of 2018 at a rate of 5%. It is reported that companies with annual revenues above AED 3.75 million will be obliged to register under the GCC VAT system from 2018 and that eventually all companies will be obligated to register regardless of revenues. Similar to Western markets, it is intended that if a company is engaged in the supply of goods or services that are subject to VAT (including at the zero rate), the company will be entitled to reclaim VAT that it incurs on its costs. Where the company is engaged in activities that are exempt from VAT and it cannot reclaim VAT incurred on costs, VAT will be a cost to its business (as suppliers will charge VAT that cannot be reclaimed). The Government's reported intention when introducing VAT is to focus more on taxing discretionary spends by consumers. Further information on the likely structure of the VAT system is expected to be published in the coming months.

No withholding tax is currently payable in relation to principal, interest payments and other fees associated with the granting of loans. 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.

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.

© 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.?

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, as amended) (the "Civil Procedures Law"), 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.

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 (amongst others). 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.

However, a recent decision in the DIFC could impact the manner in which foreign judgments are enforced onshore going forward. The DIFC Court of Appeal in the case of *DNB Bank ASA v Gulf Eyadah* [CA-007-2015] (25 February 2016) held that a foreign judgment which has been granted recognition in the DIFC Courts becomes a judgment of the DIFC Courts and therefore should be treated as such by the Dubai Courts (onshore Courts). This case involved the recognition of an English Commercial Court judgment in the DIFC Courts using the Memorandum of Guidance between the English Commercial Court, Queen's Bench Division, England and Wales and the DIFC Courts. There is also a system for enforcement between the DIFC Courts and the Dubai Courts (onshore) without review of the merits of the claim. This decision has therefore made apparent

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

the potential for the DIFC Courts to be used as a "conduit" for an enforcement action in the Dubai Courts (onshore) against assets which are also onshore even where the parties have no connection with the DIFC. However, the practical effect of this decision will not be understood until the enforcement stage and there is currently no certainty as to how the Dubai Courts (onshore) would respond with respect to an enforcement action against assets if this process was followed.

A further development has been the creation of the Judicial Committee under Dubai Decree No. 19 of 2016 forming the Judicial Committee of the Dubai Court and the DIFC Courts. The Decree came into immediate effect on 9 June 2016. The Judicial Committee has been created to resolve conflicts of jurisdiction between the DIFC Courts and Dubai Courts (onshore). The Judicial Committee determines any jurisdictional disputes between the Courts and also conflicting judgments of the DIFC and Dubai Courts (onshore) involving the same parties on the same subject matter. The Judicial Committee can also suggest rules and regulations to avoid jurisdictional conflicts arising. The Head of the Judicial Committee is the Chief Justice of the Court of Cassation in the Dubai Courts (onshore) and the other six members of the Judicial Committee are made of judges from both the DIFC Courts and Dubai Courts (onshore). Where there is a conflict between the DIFC Courts and the Dubai Courts (onshore), either a party to the dispute or the public prosecutor can make a request for the Judicial Committee to decide which court should hear the case or, if there are conflicting judgments, rule on which judgment should be enforced. Once a case has been referred to the Judicial Committee both courts must stay proceedings and the Judicial Committee's decisions will be binding and cannot be appealed.

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 (subject to the provisions of the New Pledge Law) certain moveable 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 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) Whilst enforcement of security previously required a court order, the New Pledge Law also introduces the concept of self-help remedies in relation to certain types of security (for example, secured bank accounts and bonds or endorsable instruments). Articles 28 to 33 of the new law provide additional mechanisms that will allow the secured party to enforce its security without recourse to a public auction through the courts. The court does, however, have the right to choose the method of sale or to stipulate a minimum limit to the sale price. Certain collateral that does not fall within the parameters of the New Pledge Law, such as real estate and shares, 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.

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

On 29 December 2016, the long-awaited New Bankruptcy Law came into effect. The new law introduces a protective composition process (where the debtor is in financial difficulty but not insolvent) and a restructuring scheme (as part of bankruptcy procedure), both of which are court-driven processes. Once the court has agreed to initiate proceedings for either the protective composition or the restructuring scheme, a moratorium applies to prevent claims against the creditors. Secured creditors will thereafter have to obtain the court's permission to commence enforcement proceedings.

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

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

Enforcement actions over secured assets prior to the initiation of the protective composition or restructuring scheme (or the issuance of a bankruptcy judgment) are permissible if: (i) the underlying debts are due; and (ii) the court approves such enforcement. However, once the court has approved the composition or the plan, the trustee becomes entrusted with the sale of assets in line with the restructuring plan. The New Bankruptcy Law clarifies that sale proceedings must first be used first to prepay the debts due to secured creditors. However, if a secured asset is essential to the continuance of the business, the court may provide that the secured assets be substituted with other assets, provided that it does not prejudice the rights or interests of the secured creditors.

Should the preventive composition or restructuring scheme prove unsuccessful and the debtor is declared bankrupt, all debts become due and the debtor's assets must be sold in order to repay the secured creditors. If the sale does not occur within one month from the date of the bankruptcy judgment, the secured creditor may request to approve the enforcement over the secured assets.

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. Secured creditors will have priority to be paid from the proceeds of the liquidation of the subject assets. It should be noted that the New Pledge Law provides that the date and time of recording the pledge in the Security Register will be effective as against all parties and seek to establish priority *vis-à-vis* competing creditors.

Following payment to secured creditors, costs and expenses incurred in respect of the liquidation process will be payable, prior to unpaid end of service gratuity, wages and salaries of employees of the debtor.

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 New Bankruptcy Law applies to all commercial companies (except for certain financial free zones), traders/merchants and civil partnerships (set up in accordance with the Civil Transactions Law). Individuals remain outside the scope of the New Bankruptcy Law.

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?

As mentioned in the response to question 7.4, the New Pledge Law introduces the concept of self-help remedies in relation to certain types of security. The direct enforcement of moveable assets is generally permissible by private sale, subject to prior agreement,

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

notification by relevant parties and no other security interest existing. A pledge over claims and receivables may be set off if the pledgee is a bank and by claim if the account is held at another bank. Bonds and certain written instruments may be directly enforced through delivery or endorsement if their value is equal to the right of pledge, while written papers (e.g. bills of lading) may be directly enforced by application to the summary judge for the issuance of an urgent order.

In order to initiate direct enforcement, the pledgee must notify all concerned parties. There is currently no time limit for such notice. The New Pledge Law also grants authority to summary judges to issue orders for enforcement of a registered pledge.

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 responses 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 Courts 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. Article 3*bis* explicitly states that no debt or financial obligation against the Ruler or the Government may be collected by means of detainment, public auction sale or possession by any other legal procedures of the properties and assets of the Ruler or of the Government whether such debt or financial obligation has received a final and conclusive judgment or not. 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 AED 2,000. 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 partnerships; 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. Nonetheless, the New Pledge Law, although untested, should attract more foreign investment to the region and instil more confidence in lenders as the once grey area of taking security onshore should now be more akin to more developed jurisdictions' security perfection regimes in protecting lenders' interests.

Further, limitations arise when the relevant financiers and/or borrowers are *Shari'a*-compliant. However, most of the major international lenders now 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 Rebecca Kelly, Victoria Mesquita Wlazlo and David McDonald for providing input and reviewing the content of this chapter.

Rebecca Kelly, Partner
+971 4 312 1800, rebecca.kelly@morganlewis.com.

Victoria Mesquita Wlazlo, Senior Associate
+971 4 312 1850, victoria.mesquita@morganlewis.com.

David McDonald, Associate
+971 4 312 1930, david.mcdonald@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: ayman.khaleq@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: amanjit.fagura@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 30 offices in the US, Europe, the Middle East and Asia, including financial centres such as New York, London, Paris, Moscow, Frankfurt, Dubai, Singapore, Hong Kong, Shanghai, 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, please see the discussion regarding "Alternative Lenders" below); 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, to 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 by raising interest rates in late 2015 (the first increase since the start of the financial crisis in the United States) and again raising interest rates in late 2016. 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 since prerecession levels and continued overall growth in the United States economy, 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 and then another such increase in December of 2016 by 0.25 percentage points. It is anticipated at the time of the writing of this article that the Federal Reserve will likely continue to gradually increase short-term rates in the United States throughout 2017, and if the proposed economic stimulus policies of the new Republican administration increase the risk of inflation, the Federal Reserve may move faster in increasing short-term rates. Such interest rate moves by the Federal Reserve suggest a gradual decline of the "easy-money" conditions that resulted from the United States financial crisis.

Certain Trends in Loan Documentation. 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 points, including leverage levels, spreads and covenants 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. Leveraged loans typically have more restrictive covenants than high-yield bonds (although the gap has narrowed substantially) 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, including incurrence-based covenants, no caps on dispositions, and greater flexibility for restricted payments.

Covenant-Lite Loans. When demand for leveraged loans is high (and borrowers have more leverage in negotiations) the trend is toward "looser" bond-like 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, but have made a comeback in recent years and are now seen with greater frequency in middle market deals. In 2016, according to Moody's Investors Service, the overall covenant quality of leverage loans in the United States has decreased to levels lower than were seen in 2007 immediately prior to the start of the credit crisis.

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

The Power of Equity Sponsors. Equity sponsors drive much of the volume of leveraged loans and continue to exercise their market power and push the market towards more borrower-favourable terms. "SunGard" provisions continue to be standard in commitment papers. SunGard provisions allow equity sponsors who require acquisition financing to compete with strategic buyers who do not need such financing, by aligning closely the conditions in financing commitments to the conditions in the acquisition agreement. Equity sponsors increasingly 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. It has also become common for sponsors to prepare initial drafts of loan documentation. But perhaps no development is more controversial than sponsors "designating" acceptable counsel for arrangers and lenders. As discussed in more detail below, increased regulatory pressure has made it more difficult for bank lenders to make and hold highly leveraged loans and such regulatory pressure, when combined with other factors, has created a market environment in which lenders began to see somewhat increased leverage in loan documentation negotiation with equity sponsors. However, with non-bank lenders increasingly replacing bank lenders (as discussed below) many equity sponsors remained successful during 2016 in negotiating for borrower-friendly provisions in loan documents, including continuing to negotiate for middle-market borrowers to have the benefit of less restrictive loan document provisions which had previously only been offered by the market to large-cap borrowers.

The Borrower's Desire for Flexibility: Unrestricted Subsidiaries, Equity Cures, Builder Baskets, Incremental Facilities and Reclassification. 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 common in leveraged loan documentation. These provisions 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. 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 an increasing number of cases (and now even in certain middle-market credit facilities) an uncapped amount of additional debt, so long as certain *pro forma* leverage ratios are satisfied. Borrowers are also requesting the ability to first utilise fixed dollar baskets in the context of certain negative covenants (for instance, debt, lien, investment and restricted payment negative covenants) and, if the borrower's financial condition later improves, to subsequently reclassify amounts incurred or paid under a fixed dollar basket such that these amounts are deemed incurred or paid under a leverage-based basket instead. The result of such a reclassification is that the borrower's fixed dollar basket for a negative covenant is then freed-up, so that the borrower can then incur or pay additional amounts under the fixed dollar basket, even if the borrower's financial performance should subsequently decline.

The Regulatory Environment. 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 increases lending costs as lenders re-evaluate their internal policies and programs and tighten their underwriting standards. "Risk retention rules" and the "Volcker Rule" impact CLO managers and banks that structure, warehouse and make markets in CLOs. The final Volcker Rule was released on December 10, 2013, and limits 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, have had a chilling effect on CLO issuances in the United States, with CLO issuance continuing to decline in 2016 for the third straight year. Although the new Republican administration has generally indicated that it will loosen various federal regulations that have curbed in recent years the participation by CLOs and traditional bank lenders in the United States loan markets, it remains uncertain at the time of the writing of this article to what degree such regulations will be rolled-back and some loan market participants predict that the new administration may instead simply reduce enforcement efforts as opposed to actually changing existing regulations.

Sanctions and Anti-Corruption Laws. Federal regulators have in recent years 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. The Foreign Account Tax Compliance Act ("FATCA"), which became effective with respect to interest payments on July 1, 2014, was a major revamp of the US withholding tax regime. FATCA imposes a 30% gross withholding tax on certain amounts, including interest and, effective January 1, 2019 , 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 government of that jurisdiction agrees to report similar information. This sweeping law has a potentially significant impact on loan payments and receipts where it applies and has prompted loan parties to manage FATCA risk (express allocation of risk set forth in

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

loan documentation, operation of gross-up clauses, etc.). In the US loan market, for example, loan agreements now almost universally contain provisions whereby any FATCA withholding is exempt from a borrower's gross-up obligation, and a borrower may request information from a lender to determine whether such lender is in compliance with FATCA.

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 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 has continued since the release of the report. 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 and Ongoing Trends 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 innovations include the following:

The Unitranche Facility. One innovation that remained popular in 2016 (and which is now firmly established in middle-market lending in the United States and is also now becoming more prevalent in European markets) 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). In 2016, the United States loan markets continued to see increased complexity in unitranche structures and in the terms of AALs. Borrowers and their equity sponsors have had some success in requiring disclosure of terms of AALs, especially with respect to voting, and in some instances the borrower now executes the AAL by signing an acknowledgement to the document. The United States Bankruptcy Court for the District of Delaware implicitly recognised the court's ability to construe and enforce the provisions of an AAL (to which the borrower is not a party) in March 2015 in the *In re RadioShack Corp.* bankruptcy, positively signalling to lenders that AALs should be enforceable in bankruptcy.

Bank Lenders Versus Alternative Lenders. The Guidance on Leveraged Lending has curbed the leveraged lending activities of traditional banks in recent years. At the same time, it has helped to open the door wider for non-bank lenders (commonly known as "Alterative Lenders") to become a "go to" source of capital for equity sponsors and borrowers in the leveraged-lending markets, especially for middle-market borrowers, given that such Alternative Lenders are not subject to the same regulatory constraints. Alternative Lenders are typically speciality finance companies, organised as business development companies ("BDCs") or funds, and also include the "direct lending" business of large alternative asset managers. Alternative Lenders have greater flexibility than banks to hold leveraged loans on their balance sheets, which provides borrowers with greater deal certainty, since Alternative Lenders, unlike banks, may not need to condition deal terms based on their ability to syndicate a loan. Alternative Lenders also often invest at different levels of a borrower's capital structure, such as by making an equity investment at the same time as providing a credit facility, which provides added benefit to equity sponsors and borrowers seeking to raise capital. Alternative Lenders appear to be winning the battle with traditional banks for market share, especially in the middle-market leveraged lending space. However, some market participants point out that the relationship is actually more symbiotic in nature; for example, banks provide debt financing to Alternative Lenders and underwrite equity issuances by Alternative Lenders and also have analysis that "follow" equity of BDCs.

Litigation Finance. While more commonplace in countries such as Australia, the business of litigation finance has gained traction in the United States and is growing rapidly. 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.

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*: Power Solutions International, Inc. (June 28, 2016) and Brown-Forman Corporation (May 6, 2016); *Equity Cures*: Blue Bird Body Company (December 12, 2016) and MasterCraft Boat Company, LLC (May 27, 2016); *Builder Baskets*: Blue Bird Body Company (December 12, 2016) and Revlon Consumer Products Corporation (September 7, 2016); *Unrestricted Subsidiaries*: Michaels Stores, Inc. (May 27, 2016) and Claire's Stores, Inc. (September 20, 2016); *Incremental Facilities*: Nuance Communications, Inc. (April 15, 2016) and NCR Corporation (March 31, 2016); and *Reclassification:* AdvancePierre Foods, Inc. (June 2, 2016) and Ball Corporation (March 18, 2016).

© 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)?

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.

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).

© 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?

Yes, please see question 2.2.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Generally, no. Though 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 or otherwise providing credit support for 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 voting 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.

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.

© 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. 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. 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 a New York or 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 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 timeframe, 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.

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

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 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 guarantee 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.

© 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?

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 in question 1.1 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.

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 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 in New York courts or 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

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

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 less, 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.

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

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

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.

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 of your 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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 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. In general, regulated banks do not need to be separately licensed under state law as lenders, but nonbank lenders must be aware of, and comply with, applicable lender licensing laws. These licensing laws are much more stringent in the consumer or "small loan" lending area than in the commercial or corporate lending area (where few states require the licensing of corporate nonbank lenders, California being a notable exception), although in any event nonbank lender licences are typically easier to obtain than a "banking licence".

In general, the applicability of state licensing laws is triggered by the solicitation of loans with, or the making of loans to, residents of that state. Therefore, whether a lender is a U.S. or non-U.S. lender generally has no bearing on whether that lender must be licensed under the laws of a given state. 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 manifold, from securities law concerns to the preference of the borrower to only deal with sophisticated financial institutions should the loan be sold.

© 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 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, Charles Horn, James Moore, Charles Bogle, Alan Beloff and Marcus Marsh for their review and contributions to sections of this chapter.

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, and is co-chair of the firm's Latin America Practice. 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*.

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 30 offices in the US, Europe, the Middle East and Asia, including financial centres such as New York, London, Paris, Moscow, Frankfurt, Dubai, Singapore, Hong Kong, Shanghai, 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 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 and political crisis. Recent major lending transactions are mostly restructurings and supplemental financing in the oil sector, particularly though joint venture companies chartered by PDVSA (a Venezuelan national oil company) and foreign oil companies, in which PDVSA owns the majority of the shares.

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 may 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 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. A change was to be made in such system pursuant to Article 17 of Exchange Agreement 35 of March 10, 2016, but it has not occurred yet. There is no prohibition of 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

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

establishment, credit rights, intellectual property rights, shares and other securities.

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-creditor 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.

© 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)?

Mortgage documents must be registered. Registration must be done in the registry office with jurisdiction given by the location 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 except 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 originating 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

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

0.60% of the value of the security interest (Article 83 of the Public Registry and Notary Act).

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? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? 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 interest payments to foreign financial institutions, a 34% tax rate on net income of non-bank lenders (absent a tax treaty provision) and a 40% tax rate applies on net income of 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 between 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 types 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. He 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 practise in 1983. He teaches International Trade Law in the Postgraduate School of UCAB (since 1988) and is the author of multiple articles published in various domestic and international law reviews. He has been a speaker at conferences and seminaries 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 Investigations
- Corporate Recovery & Insolvency
- Corporate Tax
- Data Protection
- Employment & Labour Law
- Enforcement of Foreign Judgments
- Environment & Climate Change Law
- Family Law
- Fintech
- 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
- Vertical Agreements and Dominant Firms

glg global legal group

59 Tanner Street, London SE1 3PL, United Kingdom
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255
Email: info@glgroup.co.uk

www.iclg.co.uk