PANORAMIC

ACQUISITION FINANCE

USA

Acquisition Finance

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GENERAL STRUCTURING OF FINANCING

Types of debt and junior capital

What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt? Are the providers of such acquisition financing typically lead arrangers, commercial banks or private debt funds?

In the United States, acquisition financings are a highly sophisticated, deep market with multiple products available for all targets of differing credit quality. Depending on the then-prevailing conditions, several financing options are available to match the entire spectrum of ratings quality of the targets involved.

At the highest end of the spectrum, for targets and transactions that are rated investment grade or 'high grade' (crossover credits), many acquisitions are financed with unsecured bank bridge debt, which is often short-dated and intended to be quickly refinanced with permanent financing in the high grade or investment grade securities markets. Private credit activity in this space is limited, as the yields are often not within their investment box.

For many corporate and private equity transactions that are rated non-investment grade, including most private equity-led buyouts, the debt package will typically include senior secured term loans (term loan B) arranged by bank or non-bank arrangers that are broadly syndicated to institutional investors (often CLO funds). Since the early 2000s, these term loan B transactions are often tranched into first- and second-lien tranches, which are distributed and syndicated by the lead arrangers to different groups of institutional investors. Some may take the form of stretch senior first lien term loan Bs, with junior capital in the form of preferred equity or senior unsecured notes.

In the last 10 years, private credit has increasingly become a viable alternative to syndicated term debt. We have seen the now almost US$2 trillion private credit asset class move upmarket into the billion-dollar range very quickly. These private credit term loans are typically unitranche facilities, in which the lenders provide the borrower with a single-tranche term loan. Many middle-market deals (and increasingly in large-cap transactions) have shifted from the broadly syndicated term loan product to the private credit unitranche asset class, especially since the covid-19 pandemic. Similarly, junior capital providers have increased their ability to provide viable alternatives to second lien debt and all private solutions are now common.

Traditionally, high-yield notes have been another financing source for non-investment grade acquisition financings. High-yield notes issued to investors via either a registered securities offering or, more commonly, a private placement under Rule 144A under the Securities Act of 1933, were often the main junior capital element for acquisition financings. In 2024, they are often primarily employed in the largest non-investment grade transactions. Typically, at the commitment and signing stage, the leads will provide bridge loans with the expectation that a best efforts security offering will be undertaken before closing to complement the term loans instead of that bridge.

Other forms of junior or mezzanine financing and hybrid products are now a significant alternative to high-yield notes.

For working capital reasons, most borrowers will also seek some form of revolving credit facility; either an asset-based lending (ABL) facility or a cash-flow revolving credit facility. In investment-grade transactions, these are often cash-flow facilities and are unsecured. In non-investment grade transactions, these are typically secured by all assets on an equal (*pari passu*) basis to the senior secured term loan or a senior basis to other financing (such as a second-lien term loan). ABL facilities are secured by a first-priority lien on borrowing base assets, often current assets such as receivables or inventory. If used alongside a term loan B, there will typically be crossing liens in which the term loans will be secured on a first-priority lien on assets not securing the asset-backed facility. In addition, in private capital transactions, some lenders will adopt first-out revolving credit facilities provided by commercial banks alongside the private term loan facilities provided by private credit lenders.

Law stated - 17 April 2024

Types of debt and junior capital
Are debt capital markets transactions (high-yield bonds) available to support acquisition financings in your jurisdiction? Are there restrictions applicable to such activities?

High yield remains an important component of the debt financing option set for acquisition financings in the US. In addition, other forms of junior capital including preferred equity are increasingly important to acquisition financings. Any debt securities offering in the United States must comply with relevant securities laws that govern the issuance and distribution of such securities and underwriters, and initial purchasers must comply with such laws including rules promulgated by the Securities and Exchange Commission (SEC).

Law stated - 17 April 2024

Types of debt and junior capital
Are private debt funds or direct lenders active in your jurisdiction to support acquisition financings? Do they provide unitranche debt facilities to buyers? Are there restrictions applicable to such providers and activities?

Private credit funds and direct lenders are very active in the United States. In 2023 they accounted for the vast majority of closed acquisition financings and have moved from the middle market to the large cap space with multi-billion-dollar unitranche debt facilities. The private credit market for unitranche facilities is largely unregulated.

Law stated - 17 April 2024

Types of debt and junior capital
Are private capital funds active in providing hybrid capital products (including debt-like preferred equity) in lieu of traditional subordinated or

mezzanine debt? Are there restrictions applicable to such providers and activities?

The primary product for private credit funds is the unitranche. Still, they are also opportunistically providing preferred equity, holdco facilities, mezzanine debt and junior capital positions to support acquisitions in the United States. If the product is a security, these are often private placements in which the issuer and initial purchasers rely on exemptions to the customary securities offering laws to place these securities privately.

Law stated - 17 April 2024

Choice of law

What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

The United States comprises multiple states' jurisdictions, and any agreement must specify the state law that will govern (as opposed to federal law). Typically, the law of the state of New York is chosen as the governing law for most sophisticated debt financing transactions in the United States, particularly for acquisition financings. This is the most common governing law for private debt unitranche deals, broadly syndicated deals and capital markets transactions, including bond financings. It is also common for New York law to govern acquisition financings of non-US acquisitions. While the laws of California and Illinois were historically used for lower middle market jurisdictions, the overwhelming majority of sophisticated debt documents are governed by New York law in 2024.

For acquisition agreements, the governing law may vary depending on the state or jurisdiction of the organisation of the target or merger counterparties. As many businesses in the US are organised in Delaware, the acquisition agreement is usually governed by Delaware law. For example, for acquisition financings governed by New York law backing the acquisition of a Delaware or California target, a split usually occurs in governing law and the exclusive forum to resolve disputes relating to the financing and the acquisition.

Subject to limitations and qualifications, courts in New York generally permit parties to choose the substantive laws of another jurisdiction to govern a contract, including the substantive laws of other states and/or jurisdictions outside the US. A few other states permit the choice of their law to govern a contract even in the absence of any contacts if the contract satisfies certain dollar thresholds. However, some US states may not respect this choice of law if litigated in such US states in the absence of a reasonable relationship to the chosen governing law.

The US is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which has been incorporated as Chapter 2 of the Federal Arbitration Act, 9 USC § 200 et seq. The US is not a party to any treaties for reciprocal recognition of foreign judgments; hence, foreign judgments are enforced pursuant to applicable state statutes, which generally follow the Uniform Foreign Money-Judgments Recognition Act, the Uniform Foreign-Country Money Judgments Recognition Act, or common law principles of international comity. Final and binding money judgments that are enforceable in the country where they were rendered are generally enforceable.

Subject again to limitations and qualifications, courts in the state of New York generally recognise both judgments from other states in the US, under article 54 of the New York Civil Practice Law & Rules and some international money judgments from outside the US, under article 53 of the New York Civil Practice Law & Rules. In the latter case, there are fraud and public policy exceptions. New York courts will reject a foreign country judgment rendered under a judicial system that does not provide impartial tribunals or procedures compatible with the requirements of due process of law, the foreign court did not have personal jurisdiction over the defendant or did not have jurisdiction over the subject matter.

Law stated - 17 April 2024

Restrictions on cross-border acquisitions and lending

Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

Special rules may apply depending on the specific industry and asset in question. Typical areas of regulatory approval for acquisitions (or financings thereof) include US antitrust regulations, foreign direct investment laws applicable to such industry and asset (for example Committee on Foreign Investment in the United States (CFIUS) approvals), along with customary sanctions, anti-money laundering and know-your-customer (KYC) rules that apply to lenders and persons acting in the US market generally.

Cross-border lending is generally common, subject mainly to customary sanctions, anti-money laundering and KYC rules that apply to lenders generally.

Law stated - 17 April 2024

Certain funds

Are there rules requiring certainty of financing for acquisitions of public companies? Have ‘certain funds’ provisions become market practice in other transactions where not required?

Unlike certain fund deals in the United Kingdom subject to the takeover code, there is no similar regime mandating limits on conditionality for US take-private transactions of public companies.

Generally, restrictions on permissible conditions to complete take-private transactions are governed primarily by market convention, negotiating leverage, regulatory requirements applicable to take-private transactions (including antitrust and merger control) and parties’ desire for deal certainty.

While not required by law, sophisticated parties will insist on ‘SunGard’ conditionality, which has been the market convention in the US for about two decades. ‘SunGard’ conditionality is named after the first transaction in the United States to adopt this level of conditionality and generally applies whether the target is a public company. While no cash confirmation by a lender is required, the convention provides that the conditions precedent to the acquisition financing are designed to closely mirror the conditions to the closing of the

related acquisition as outlined in the acquisition agreement. This is achieved by first, limiting representations that are draw stops to only those representations that are viewed as under the control of the buyer or provided by the seller to the buyer, and second, including limited customary documentary conditions dictated by market practice.

Law stated - 17 April 2024

Restrictions on use of proceeds

Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

Using proceeds to acquire (or carry) margin stock is subject to certain limitations and restrictions. This applies if the direct or indirect security for the acquisition financing consists of securities that are traded on an exchange in the US, or 'margin stock'. Such restrictions, often referred to as the 'margin regulations', limit the amount of loans that can be collateralised by such securities. The US margin regulations can also be implicated by arrangements that constitute indirect security over margin stock, such as through negative pledge provisions or other arrangements that limit a borrower's right to sell, pledge or otherwise dispose of margin stock. In addition, borrowers and issuers are restricted from using proceeds in violation of applicable laws, including anti-money laundering, sanctions and anti-corruption laws, and such restrictions are usually included in the financing agreement.

As a market convention, the use of proceeds for acquisition financing is often limited by contract to financing the acquisition (including purchase price adjustments), the refinancing of existing indebtedness and, to a limited extent, for initial working capital. Acquisition financings rarely permit additional special dividends, but earnouts and appraisal rights are often funded with proceeds of acquisition financings.

Law stated - 17 April 2024

Licensing requirements for financing

What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction? Are there licensing requirements for non-bank entities providing such financings? Are there any exceptions that permit non-bank entities to provide financings on a limited basis?

While no US federal regulatory framework applies to non-bank lenders that are engaged in commercial lending in the United States, a few US states require non-bank lenders to obtain a licence before engaging in commercial lending activities (ie, lending activities between corporate lenders and corporate or institutional borrowers for business or commercial purposes) under certain circumstances. The commercial lending licensing requirements of some of these states are generally triggered only when a commercial loan is secured by real property located in one of such states. However, in California, commercial lending licence requirements may be implicated regardless of whether a commercial loan is secured by real property located in the state. As such, California is the state most often implicated

in the commercial lending context due to the broad scope of California's commercial lender licensing requirement. The US states that may impose commercial lending licensing requirements (unless an exemption from such licensing requirements applies), generally include California, Florida, Nevada, North Dakota, South Dakota and Vermont.

While New York has a commercial lending licensing requirement, such requirement only applies to business and commercial loans in a principal amount of US$50,000 or less that also meet other specified conditions.

Non-bank lenders provide a large portion of the financings for sophisticated acquisition financing transactions in the United States, either directly through private debt deals or as the primary component of buyers of syndicated term loans, debt securities, or both.

Law stated - 17 April 2024

Withholding tax on debt repayments

Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes? Are there structures that facilitate lending to borrowers by non-bank lenders and funds?

Payments by US issuers or borrowers to US holders or lenders are not subject to withholding taxes under federal law.

The US federal government generally imposes a 30 per cent withholding tax on interest paid to a non-US lender on a debt obligation of a US person (and certain non-US persons engaged in a trade or business in the US). For this purpose, payments concerning any original issue discount, if not otherwise considered less than de minimis, are also treated as interest income and subject to said withholding tax. If the lender qualifies for the benefits of an applicable double taxation treaty between the United States and the country in which such lender receiving interest is resident, the withholding tax may be reduced or eliminated under the relevant provisions of such treaty.

Alternatively, a non-US lender may qualify for an exemption from US federal withholding on interest under the 'portfolio interest exemption'. To qualify for the portfolio interest exemption, the lender must not (1) be a controlled foreign corporation related to the borrower or a bank receiving interest on an extension of credit entered into in the ordinary course of its trade or business and (2) own (directly, indirectly or by attribution) equity representing 10 per cent or more of the total combined voting power of all voting stock of the borrower (or, if the borrower is a partnership, 10 per cent or more of capital or profits interest of the borrower). In addition, the portfolio interest exemption is only available for debt in 'registered form' for US federal income tax purposes.

Portfolio interest does not apply to certain contingent interest, such as interest determined by reference to (1) any receipts, sales, cash flow, income or profits of, (2) the fluctuation in the value of property owned by or (3) dividends, distributions or similar payments by, the borrower or a related person.

To claim an exemption or reduction available under an applicable double taxation treaty or the portfolio interest exemption, the beneficial owner of interest must generally submit a

properly completed IRS Form W-8BEN-E (or, if an individual, IRS Form W-8BEN). If interest paid to a non-US lender is effectively connected with such lender's trade or business in the United States, such interest will not be subject to US federal withholding as long as such lender submits a properly completed IRS Form W-8ECI but will generally be subject to net income tax in the United States and, for foreign corporations, branch profits taxes. Other exemptions may be available for foreign governments or governmental entities assuming they provide the applicable properly completed IRS Form W-8EXP. Withholding taxes may also arise in other circumstances, including the payment of amounts to a US person who does not demonstrate an exemption from US backup withholding tax by providing an applicable properly completed IRS Form W-9.

Law stated - 17 April 2024

Restrictions on interest

Are there usury laws or other rules limiting the amount of interest that can be charged?

Federal law does not regulate the amount of interest that lenders can charge. Instead, usury laws are primarily regulated and enforced at a state level. Such usury limits typically consider the size and type of the loan and the nature of the lender or issuing institution. For example, many states exclude commercial loans from state laws regulating usury limits to the extent such loans comply with certain conditions regarding the minimum threshold principal amount or the purpose of such loans. State laws governing usury limits also regulate the calculation of interest to determine compliance with such restrictions (in particular, whether certain fees or other charges incurred in connection with a loan should be treated as interest and therefore be subject to the usury limits).

Most sophisticated acquisition financings in the US governed by New York law are exempted from New York state civil and criminal usury laws given that such laws do not apply to financings exceeding US$2.5 million. Below that threshold, the New York criminal usury statute generally limits the maximum interest to 25 per cent per annum.

Law stated - 17 April 2024

Indemnities

What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

Bondholders generally do not expect to receive indemnities from an issuer, but trustees and collateral agents would typically expect indemnities similar to those received by agents in credit agreements.

In syndicated credit agreements and private debt transactions, the loan parties would customarily provide a broad indemnity and hold harmless clause that would provide an express indemnity to the arrangers, agents and lenders (together with their related parties) from liabilities relating to the credit documentation. This indemnity would typically include claims brought by the borrower and typically covers legal expenses. Customary exceptions in each case include indemnification for gross negligence, bad faith, wilful misconduct or

material breach by the indemnified parties. Care should be taken to expressly and specifically detail what liabilities and claims are covered, including claims brought by the loan parties, as New York law typically construes these clauses narrowly.

Law stated - 17 April 2024

Assigning debt interests among lenders; syndication and distribution of debt

Can interests in debt be freely assigned, participated in or transferred among lenders? Are there restrictions to the syndication and distribution of acquisition-financing related debt?

For loan transactions, the administrative agent typically maintains a register of loans, and transfers are recorded by the administrative agent. Credit Agreements frequently limit who can become a lender either by entity type, net worth, or both and may also include a list of disqualified transferees. Consent of the administrative agent and, in some cases, the borrower may also be required. The maintenance of the register and adherence to transfer restrictions for loan transactions is an important hallmark of the loan market and distinguishes loans from securities. Many syndicated transactions can be heavily traded, but the transition to private credit has resulted in many loans becoming far more illiquid. Even in the most liquid syndicated transactions, significant trading restrictions typically apply in the secondary market, including a prohibition on the term loans being held by natural persons.

Unlike loan transactions, debt securities that are issued in a registered offering are generally freely transferable. Many high-yield transactions and private securities deals are privately placed or 144A for life. In such cases, transfers of these debt securities are subject to compliance with specific exemptions under the Securities Act of 1933. Most participants in the high-yield bond market and private debt securities deals are qualified institutional buyers and use that exemption to trade in securities. In contrast to loan transactions, consent of the issuer or trustee is not generally required.

Law stated - 17 April 2024

Requirements to act as agent or trustee

Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent? Are there licensing requirements to act in such capacities?

The lenders in a syndicate can and almost always do appoint an agent to act on behalf of the lenders. The agent will administer the loan and, in this capacity, the agent will hold security on behalf of the syndicate, including managing the enforcement of collateral securing the loan and applying any enforcement proceeds towards satisfaction of the obligations. In terms of process, the syndicate will appoint the agent to act as administrative or collateral agent in the loan documentation, thereby conferring upon the agent the right to take various actions in respect of the guarantee and collateral package on behalf of the syndicate.

For loan transactions, federal law and the laws of common jurisdictions, such as the state of New York, do not have express and specific laws governing acting as administrative or

collateral agents, or both, in the context of loan transactions. Most arrangers of syndicated loans will be willing to act as administrative or collateral agents, and many direct lenders also act in agency roles in private debt transactions.

In contrast to the loan market, the US securities laws, including the Trust Indenture Act of 1939, impose stringent requirements on trustees for debt securities transactions. For most high-yield transactions, one of an established group of trust companies set up to comply with applicable laws will be hired to act as trustee.

Law stated - 17 April 2024

Debt buy-backs

May a borrower or financial sponsor conduct a debt buy-back?

Yes. For the most part, issuers and borrowers, and their sponsors, are generally contractually permitted to buy back debt securities or loans, as applicable. Some lower middle market loan transactions may restrict buy-backs, but most sophisticated unitranche direct lending and syndicated loan transactions follow that general pattern.

For high-yield bonds and other debt securities, block trades and trades where broad general solicitations are undertaken may constitute tender offers, but open market purchases by issuers and affiliates (including sponsors) are permitted. Open market purchase trades are often handled by market makers or bilaterally. Tender offers are governed by the Securities Exchange Act of 1934 and related SEC rules.

For loan transactions, loan documentation has developed since the great financial crisis to permit non-pro-rata debt buybacks. All except the most lower middle market loan documentation will include customary provisions permitting Dutch auction buy-backs offered to all lenders. Many sponsors also insist on the ability to buy loans from lenders via 'open market repurchases', which may not expressly need to be offered to all lenders.

In each case, any analysis should be undertaken on a case-by-case basis.

Law stated - 17 April 2024

Exit consents

Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

Yes, in most cases. The general market convention is that buy-backs used to solicit most lenders to amend existing covenants in debt documents are contractually permitted by the loan documentation or indentures. However, any analysis should be undertaken on a case-by-case basis.

Law stated - 17 April 2024

GUARANTEES AND COLLATERAL

Related company guarantees

Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

US guarantees fall into three categories, namely (I) 'downstream' guarantees whereby a parent company guarantees the debt of its subsidiary, (2) 'upstream' guarantees whereby a subsidiary guarantees the debt of its parent entity and (3) 'cross-stream' guarantees whereby a subsidiary guarantees the debt of a sister company. US companies generally may guarantee and secure the obligations of another group member, subject to certain considerations and limitations.

To be enforceable, the guarantee must comply with certain general principles like receipt and sufficiency of consideration and, in some states, be in writing and duly executed by the guarantor to comply with the Statute of Frauds. However, showing direct corporate benefit to the guarantor is not necessary to determine the sufficiency of consideration where such an intercorporate guarantee benefits the group. In insolvency proceedings, corporate benefit consideration is relevant to whether such a guarantee can be challenged as a fraudulent transfer under the US Bankruptcy Code. This applies whether such guarantees are secured or unsecured.

In the case of upstream guarantees and other credit support from foreign subsidiaries in support of the indebtedness of a US debtor, deemed dividends may apply under US Federal tax law. Since 2019, limited tax law reform has reduced the impact of upstream guarantees and other credit support from non-US subsidiaries.

Notwithstanding the positive tax reform opening the door to more non-US credit support, as a general matter and except in rare occasions where it is critical from a credit perspective, non-US upstream guarantees and credit support are often excluded outright from the guarantee and collateral package of US debt financings, primarily on cost and complexity grounds.

Law stated - 17 April 2024

Assistance by the target

Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

The US is a very flexible jurisdiction from the perspective of financial assistance by the target, and no whitewash is necessary. Generally, the US has no restrictions on 'financial assistance' that would prohibit providing guarantees or security to support borrowings to finance the acquisition of a target company. However, transaction parties may need to consider regulatory issues when the guarantee or security provider is a specialisation or regulated entity. Fraudulent transfer issues are also relevant when guarantees or security are provided to support borrowings to acquire another company. The company and the lenders must be comfortable with the solvency of the guarantors and security providers, requiring solvency representations to this effect.

Law stated - 17 April 2024

Types of security

What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant? Are there limitations on security granted by a target to support its acquisition?

US law does not categorise grants of security as being 'fixed' or 'floating,' nor do those terms have a legal meaning, but by analogy, such grants are permitted and common. Under New York law and in the US more generally, grants of security over personal property security routinely cover both presently owned and after-acquired assets. Certain personal property collateral is excluded from article 9 of the Uniform Commercial Code (UCC), the body of law applicable to security interests in personal property, and thus obtaining a good security interest over those assets is more difficult. Security interests in real property typically take the form of a security instrument such as a mortgage, deed of trust, a trust indenture or a security deed (ie, a deed to secure debt), depending on the jurisdiction in which the property is located, with a mortgage being the typical security instrument used in New York.

Generally, for acquisition financings, a blanket lien on all assets, including future assets, is possible but is often limited by market convention to have customary exclusions. Typically, non-investment grade loan acquisition financing transactions are supported by 'all asset' or 'blanket' liens (subject to agreed exceptions) over the assets of the target and its subsidiaries and an equity pledge by a holding company in the top-tier operating company. By contrast, debt securities are often unsecured, but from time to time secured debt securities return to popularity.

Although collateral exclusions are negotiated on a deal-by-deal basis, common exceptions to an all-asset grant include assets for which a grant of security is subject to legal restrictions or consequences, such as margin stock or 'intent-to-use' trademarks; assets for which a grant or perfection is determined to be overly costly, such as mortgages for real property located in a 'flood zone' or assets subject to certificate of title statutes; and assets for which a grant of security would violate or impair other contractual relationships of the debtor, such as security interests in purchase money, or capital lease assets, or assets subject to securitisation financings. Often general exclusions exist for any assets in which the grant of security would violate any laws or regulations, would require third-party (including governmental) consents or for which the burden or cost of granting a security interest outweighs the benefits afforded thereby. Exceptions may also apply to the requirement to perfect security interests in certain collateral, particularly if the relevant perfection action is costly or time-consuming. Although these exceptions are common, the business context of any deal will dictate which exclusions are acceptable.

Other than margin stock rules, few legal restrictions apply to security granted by a target to support its acquisition. Market norms may, nonetheless, exclude several customary types and classes of collateral for cost and complexity reasons.

Law stated - 17 April 2024

Requirements for perfecting a security interest

Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral? Do stamp duties or similar taxes apply to taking a perfected security interest?

In the US, a lien may be created over real property land and improvements by execution of a mortgage, deed of trust or other security instrument under the applicable state law where the real property is located, and recordation of such document in the county land records where the real property is located. In the case of a deed of trust, the trustee is an independent third party, often the title company involved in the transaction or an individual associated with the title company involved in the transaction, that is granted legal title to the property and whose primary responsibility is to sell the property at a public auction if the loan includes an event of default that permits foreclosure of the lien of the deed of trust. In the case of a mortgage, the secured party or its agent would be the mortgagee. The creation and enforcement of the security interest in real property is governed by the law of the state where the property is located, so engagement of counsel in the jurisdiction where the real property is located is important to ensure that the necessary local law requirements are included in the security instrument.

Fixtures are a category of personal property and therefore security interests in fixtures attached to real property are governed by article 9 of the UCC (article 9), although an interest in fixtures may also arise under real property law of the jurisdiction where the fixtures are located. A security interest in fixtures may be perfected by an ordinary UCC-1 financing statement, but to ensure the priority of a security interest in fixtures over later-arising real property claimants, a fixture financing statement (fixture filing) must be filed in the land records in the county where the property is located. In nearly all jurisdictions, a mortgage or deed of trust may act as a fixture filing if applicable provisions are included in the mortgage or deed of trust. Common practice prescribes relying on the mortgage or deed of trust as a fixture filing in transactions where the real estate is not the sole or primary collateral instead of filing a separate fixture filing.

To create a valid security interest in personal property, including equipment, inventory, deposit accounts, investment property, instruments, intangibles, receivables and shares in companies (as well as the other categories of collateral governed by article 9), (1) a security provider (the grantor) must execute or authenticate a written or electronic security agreement that provides an adequate description of the collateral, (2) the grantor must have rights in the collateral or the power to transfer such rights and (3) value must be given. Although the last two requirements are mandatory, an oral security agreement may be sufficient if the secured party is in possession or control of the collateral; however, the absence of a signed and written security agreement would be rare in a commercial transaction. The security agreement is typically selected to be governed by the same law as the law of the state that governs the loan agreement, although the assets intended to be covered by such security agreement may be located outside of such state. The UCC is state statutory law, and each state of the United States has enacted its own version of it. Although a variety of relatively minor differences exist, article 9 is uniform across each state. Therefore, little concern typically arises about a debtor in one state granting a security interest under a security agreement governed by the law of a different state. The parties in commercial financings commonly choose the law of a single state (for example, New York law) to govern both the loan agreement and the security agreement, even if some or all the debtors (or their assets) are located in another jurisdiction. Although parties are generally

free to choose what law governs the creation or 'attachment' of the security interest, the choice-of-law rules governing perfection, including where to file a financing statement, are mandatory.

A security interest in most types of personal property collateral governed by the UCC may be perfected by the filing of a notice filing under the UCC (referred to as a UCC-1 financing statement) at the secretary of state of the 'location' of the debtor, although important exceptions apply. A UCC-1 is ineffective to perfect in deposit accounts, money or letter-of-credit rights as original collateral. Perfection in some assets is governed by US federal law (which pre-empts state law such as the UCC), including registered copyrights, aircraft and related assets, most ships and other vessels, rail cars and other rolling stock. Therefore, perfection in such assets requires compliance with the perfection scheme established by the applicable federal statute. Security interests in vehicles and other assets subject to certificates of title must be perfected by applicable state law certificate of title statutes. Security interests in real estate and other assets excluded from the scope of article 9 (such as insurance, as original collateral) require compliance with applicable state law governing such assets.

For debtors that are 'registered organisations' (which term includes most domestic corporations, limited liability companies and limited partnerships), the UCC-1 financing statement must be filed in the jurisdiction in which the grantor was formed or incorporated. Special rules apply to other types of organisations, including non-US entities, natural persons and other special types of debtors.

In addition to filing, a secured party may perfect its security interest in certain assets by taking possession or 'control' of such assets. Goods, instruments, tangible negotiable documents, certificated securities and tangible chattel paper are examples of collateral that may be perfected by possession. Obtaining 'control' of assets such as deposit accounts, investment property (including share certificates), letter-of-credit rights and electronic chattel paper perfects a security interest and may provide additional protections or priority to the secured party over perfection by filing. Certain collateral such as accounts (ie, receivables that are not evidenced by an instrument or chattel paper) and general intangibles (a residual category describing intangible collateral that does not fall into another UCC category) may only be perfected by the filing of a UCC financing statement. Article 12 of the UCC, which as of this writing has been enacted in some but not all US states, will permit perfection by control of digital assets, such as cryptocurrencies and NFTs, as well as certain electronic accounts and payment intangibles that exist in controllable form. In certain circumstances, a security interest may be perfected automatically without any further action, but in commercial transactions relying on such exceptions is unusual, and at a minimum, a financing statement would be filed. A secured party may perfect its security interest by multiple methods (eg, both by filing and by possession or control) and in the case of important assets such as certificated equity interests, a secured party will typically prefer to use every method of perfection available.

Perfection by possession or control is generally preferable to perfection by a UCC financing statement alone, as this entitles the secured party to higher priority, may protect the secured party from third parties acquiring better rights in the collateral and as a practical matter may facilitate enforcement on the asset in the case of a foreclosure.

In general, no documentary or stamp taxes are imposed in the United States. Recordation of mortgages or similar real property instruments can involve substantial recording taxes

or fees. Concerning personal property, most states impose only minor filing fees, although Tennessee and Florida are notable exceptions.

Law stated - 17 April 2024

Renewing a security interest

Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

An initial UCC-1 financing statement is valid for five years after filing. A UCC-3 continuation statement must be filed within six months before the fifth anniversary of the initial filing date, or else the initial UCC-1 will lapse and become ineffective. A continuation statement extends the effectiveness of the initial financing statement for an additional five-year period. An initial financing statement may be continued multiple times according to the same five-year renewal schedule.

Other forms of perfection (such as control or possession) generally remain in effect while the required conditions for perfection exist.

Law stated - 17 April 2024

Stakeholder consent for guarantees

Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

Not applicable. No similar concepts exist under federal law or New York law for the provision of guarantees or security by a company.

Law stated - 17 April 2024

Granting collateral through an agent

Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

For loan transactions, security can be granted to an agent (or other representative) for the benefit of all lenders. In terms of process, the syndicate will appoint the agent to act as administrative or collateral agent, or both, in the loan documentation, thereby conferring upon the agent the right to take various actions in respect of the guarantee and collateral package on behalf of the syndicate and other secured parties (for example non-lender hedge counterparties or cash management banks). As the holder of the security interest, only the agent needs to sign the applicable security documentation and take the necessary perfection steps. The appointment of the agent will commonly preclude the lenders in the syndicate from acting directly in their capacities in respect of any enforcement of the lenders' rights, and instead, they will only be permitted to do so by instructing the agent to take certain actions on their behalf (and such instructions will typically require majority lender consent).

Under the agency appointment, the guarantors and security providers typically provide the guarantees and grant security solely in favour of the agent (acting on behalf of all the lenders).

This is true for private debt transactions and secured notes offerings as well.

Law stated - 17 April 2024

Creditor protection before collateral release

What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

In general, the disposition of collateral will not release a lien (unless the secured party otherwise agrees). A variety of exceptions exist, including certain buyers in the ordinary course of business, transferees of funds from deposit accounts, holders in due course of negotiable instruments and protected purchasers of investment property, which, if they satisfy certain conditions, can take free of a security interest.

For loan transactions and secured notes, the secured parties will typically agree to certain releases of collateral in connection with permitted dispositions of collateral. However, the debt documentation often contains restrictions on releases of all or substantially all collateral without the affected lender or consent or all lender or holder consent. Recent case law and disputes have increased scrutiny of releases of assets upon dispositions, and debtholders commonly seek additional protections on dispositions to related parties and releases of collateral upon certain events. Now, negotiations usually focus on whether subordination of the agent's liens is permitted.

In the case of secured notes, the Trust Indenture Act of 1939 (TIA) may be implicated in the release of collateral. Secured notes are commonly structured as a second lien or otherwise junior in right of existing security, subject to an intercreditor agreement providing that releases of collateral, which are approved by the first lien lenders, shall be binding on the second lien noteholders and trustee. SEC no-action letters have indicated that releases in such situations would not violate the TIA.

Law stated - 17 April 2024

Fraudulent transfer

Describe the fraudulent transfer laws in your jurisdiction.

Fraudulent transfers of an interest in property of the debtor may be avoidable if they (1) are made with actual intent to defraud or deprive creditors of value or (2) are made when the debtor is insolvent or render the debtor insolvent, in each case for which the debtor receives less than reasonably equivalent value (ie, constituting constructive fraud).

In addition, a transfer may be a preference, if it is made on account of an antecedent debt made within the 90 days before the bankruptcy filing when the debtor was insolvent, and such transfers are avoidable if they permit the creditor to receive more than they would in a hypothetical liquidation under Chapter 7 of the Bankruptcy Code. The 90 days are extended

to one year for insiders, and there are a variety of statutory defences and safe harbours to preference claims.

In addition to preference and fraudulent transfer claims, the Chapter 11 estates would have the right to pursue any claims of the debtor, including claims for breach of fiduciary duty claims against directors and officers, such as for approving fraudulent transfers (to the extent available under applicable law).

Each state may also have its own fraudulent transfer statute, and some states have longer look-back periods (some as long as four years) than the Bankruptcy Code.

Law stated - 17 April 2024

DEBT COMMITMENT LETTERS AND ACQUISITION AGREEMENTS

Types of documentation

What documentation is typically used in your jurisdiction for acquisition financing? Are short-form or long-form debt commitment letters used and when is full documentation required? Are there market practices that require the use of particular types of documents or forms in your jurisdiction?

Typically, the sellers in most acquisitions insist on committed financing and do not agree to financing-outs in the related Acquisition Agreements. As such, buyers typically submit their bids with binding commitment papers, executed by the banks. If a bank or bridge structure is contemplated, there may also be an engagement letter and fee credit letter for the related permanent financing. The market convention for commitment papers has evolved and the general practice is that they are now almost exclusively based on the applicable sponsor's form (even in the middle market) and include very detailed documentation terms, either in the form of comprehensive term sheets or if an established market exists, short form commitment papers. There are no industry standard forms.

The typical documentation package for committed financing consists of (1) a commitment letter, with term sheets describing the transactions and the limited conditions precedent for the applicable transaction, (2) a fee letter, which may contain demand-related provisions if a bridge transaction is contemplated, (3) an engagement letter covering any permanent financing to take out the bridge and (4) a fee credit letter. Many syndicated transactions include flex rights within the fee letter that are available if successful syndication cannot be achieved. Direct lending transactions provided by private credit providers typically do not include any flex rights. Very often terms are incorporated by reference to an agreed documentation precedent that is made available to the parties, often based on a preferred prior precedent transaction.

Unlike some other jurisdictions, no interim facilities agreement is included. Once it is clear the transaction is proceeding, full definitive documentation is prepared. This usually occurs after the signing of the acquisition agreement. In the case of a syndicated or securities transaction, marketing materials and rating agency presentations are prepared concurrently with the preparation of the draft definitive documentation. The typical definitive documents for a syndicated or direct transaction include a credit agreement and a guarantee and security agreement. To the extent the syndicated transaction is a first lien or second lien

deal or an ABL or cash flow split deal, separate credit agreements typically exist for each tranche, together with an intercreditor agreement. Some unitranche financings also include an agreement among lenders. A securities offering typically includes an offering document, an indenture, a purchase agreement and, if applicable, a guarantee and security agreement.

Law stated - 17 April 2024

Level of commitment

What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

Sellers typically expect no out-financings with fully underwritten debt financings. 'Best-efforts' financings have thus become rare. That said, some buyer sponsors choose to fully equity-bid for assets, using their fund lines and their LP commitments to bid on a fully equity, no-outs basis. In those instances, the buyers may agree subsequently to finance a portion of the purchase price with a best-efforts financing. This is often viewed as a show of confidence in the market.

Law stated - 17 April 2024

Conditions precedent for funding

What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

The current market standard is the 'SunGard' conditionality. This means that the bulk of the conditions are documentary in nature, and any non-documentary conditions precedent are limited to items the buyer has control over (for example, the payment of fees) or that are being provided by the seller to the buyer (for example, specified acquisition representations). The syndicated and bond markets typically require a marketing period, but the proliferation of private debt as a major (arguably primary) source of financing for most sponsors has meant that more often either a simple inside date is included or no marketing period condition exists. The primary negotiations centre around whether a target material adverse change condition will be included (this is largely contingent on the buyer negotiating the same for itself in the acquisition agreement) and around the size and composition of the equity check. For syndicated or bond transactions, the marketing period and related financials are also important.

Law stated - 17 April 2024

Flex provisions

Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

Historically, almost every set of syndicated commitment papers includes flex provisions. However, since the private unitranche market has become a large part of the acquisition

financing landscape, flex has become less common. Most US syndicated deals have some form of 'closed flex' (a list of terms that specify the limited changes that can be made to effectuate a successful syndication). Pricing is the most common and universal form of price flex, and spreads, floors, call protection and OID subject to flex terms are also commonly used. Other terms that are flexed vary depending on the underlying term sheet and the level of comfort of the lead arranger bank with their ability to syndicate the proposed transaction.

Law stated - 17 April 2024

Securities demands

Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

In commitment papers with a bridge loan component, it is standard to include a securities demand feature. While the formulation of the securities demand may differ from transaction to transaction, the most common formulation is for the broker-dealers affiliated with the banks holding most of the bridge loan commitments to be able to demand the issuer to issue debt securities on terms that are similar to the exchange notes described in the commitment letter, subject to a negotiated interest rate cap. The banks can typically exercise the securities demand a limited number of times beginning on the closing date of the underlying acquisition and for 12 months thereafter, though some transactions have different structures. If the issuer does not issue securities once the banks exercise the securities demand, the issuer will be subject to certain penalties, which may include items such as an increase in the rate on the bridge loans, call protection on the bridge loans, payment of a fee and loss of consent rights concerning assignments.

Law stated - 17 April 2024

Key terms for lenders

What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

Lenders are primarily focused on the conditions precedent, termination-related and liability-related provisions in the acquisition agreement. Representations and conditions incorporated by reference into the letters are, therefore, subject to scrutiny. In addition, given the acquisition agreement contains the covenants related to the business between signing and closing, some consideration is given to the content of those covenants. For broadly syndicated loans, the provisions of acquisition agreements that require the seller and target to cooperate with the buyer in connection with the marketing of the financing and related rating agency provisions are also an area of focus, as is the 'marketing period' or 'inside date' constructs, as for broadly syndicated financings, the loans (or notes) are expected to be syndicated (or distributed or placed) during the period between signing and the closing of the acquisition.

For the last 15 years, since the great financial crisis, market participants have aimed to include lender-protective 'Xerox provisions' in acquisition agreements (named for the original Xerox-ACS transaction). Xerox provisions fall into two broad categories: One set is jurisdictional and the second is liability limits. Jurisdiction-related Xerox provisions specify that all actions arising under the acquisition agreement involving the financing sources will be maintained in the same jurisdiction and using the choice of law (almost universally New York) specified in the financing papers, even if the acquisition agreement specifies different choices (often Delaware); trial by jury is waived. In addition, the liability limitations provide that the financing sources are expressly exempt from liability to the seller or target (and in some cases, that any provision limiting recourse to a reverse breakup fee payable by the buyer also protects the lenders). In addition, both sets of Xerox provisions can be relied upon and enforced by the financing sources. Typically, Xerox protections cannot be waived or amended without the consent of the financing sources.

In the past five years, termination provisions have also attracted focus. Some acquisition agreements provide tolling in the event of disputes and antitrust matters, while committed financing typically has a date certain where the commitments of the financing sources nonetheless fall away. Long-dated commitments may also cost more in terms of fees and flex to compensated financing sources for their greater risk.

Law stated - 17 April 2024

Take-private transactions

In the context of take-private transactions – what are the common issues relevant to acquisition financings in your jurisdiction?

Take private transactions are common in the US and given the limited conditionality that is typical for most private-to-private transactions, the commitment papers and conditionality related thereto are often not very different. Unlike many other jurisdictions, few unique features apply to take-privates, and no cash confirmations are required.

Law stated - 17 April 2024

Take-private transactions

What are the rules and procedures for 'squeeze-outs' in your jurisdiction? Before a 'squeeze-out', are there permissible restrictions on acts by the target? Is it possible to obtain security pending the completion of a 'squeeze-out'?

A take-private acquisition of a public company in the US is typically structured in one of two ways: (1) as a 'one step' transaction involving a statutory merger governed by the law of the state in which the target company is the organisation or (2) as a 'two-step' transaction involving a tender or exchange offer followed by a 'back-end' or 'squeeze-out' statutory merger (also governed by applicable state law) to acquire the remaining portion of the target that was not obtained in the tender or exchange offer.

A squeeze-out merger is generally accomplished pursuant to one of the following two state statutorily prescribed procedures: a short-form merger if the buyer owns a sufficient amount

of shares (which, in Delaware, is at least 90 per cent of each class of the target's outstanding voting shares after the consummation of its offer); or, in the case of a Delaware-incorporated target, a merger satisfying the requirements of section 251(h) of the Delaware General Corporation Law (DGCL), which include the requirements that (1) immediately following the consummation of the tender or exchange offer, the stock held by the buyer and its affiliates (including any shares being 'rolled over') would be sufficient to approve a long-form merger (ie, a majority of the outstanding shares or such higher approval threshold as may be included in the certificate of incorporation of the target), (2) shareholders receive in the merger the same amount and form of consideration as that received by shareholders in the tender or exchange offer and (3) the merger agreement permits or requires that a merger be effected under DGCL section 251(h) and that the merger will occur as promptly as practicable following consummation of the tender or exchange offer.

If a short-form merger or a merger under DGCL section 251(h) is not available and the parties must pursue a long-form merger, the target's assets generally cannot be used to secure a loan to finance the tender or exchange offer before full ownership of the target, and the US federal margin rules limit the buyer's ability to use the target's stock purchased in the tender or exchange offer as collateral. Considering these factors and other considerations, most leveraged acquisitions in the US have been structured as one-step transactions.

The standard (and typical requirement under applicable state law) for any take-private acquisition in the US is to involve a merger agreement negotiated between the buyer and the target, and these merger agreements may and commonly include covenants that restrict the target from taking specified actions without the buyer's consent from and after the signing of the merger agreement.

Law stated - 17 April 2024

Public filing of commitment papers

Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

It depends on the parties and their filing status. Private buyers and private targets do not face a public filing requirement. For public reporting companies, on the other hand, entry into a material definitive agreement not made in the ordinary course of business triggers a filing requirement. If one or more of the buyer or the seller is a public filer, the acquisition agreement and the commitment letter (but often not the fee letter, engagement letter or related fee credit letter) may need to be disclosed in a Form 8-K and the definitive document may need to be attached as an exhibit to a Form 8-K or Form 10-Q /10-K, if the transaction is deemed material. For many take-privates, the seller may decide that the commitment letter may not need to be filed if the seller or target is not a party to the commitment letter.

Law stated - 17 April 2024

ENFORCEMENT OF CLAIMS AND INSOLVENCY

Restrictions on lenders' enforcement

What restrictions are there on the ability of lenders to enforce against collateral? Can lenders engage in self-help through foreclosure or the exercise of remedies under stock pledges or control agreements?

Remedies are available for a valid security interest immediately upon the occurrence of a default or an event of default on the secured obligations, subject to any contractual agreements to the contrary and application of the 'automatic stay' if the grantor is subject to a bankruptcy proceeding. The definitive documentation under commercial financings usually rigorously defines what constitutes a 'default' or 'event of default' (or like term) after which the secured party may exercise remedies against the collateral. Although creditors that are secured parties generally have the option of judicial enforcement, out-of-court 'self-help' options are available under the UCC, which are cheaper, faster and therefore much more common than resorting to judicial remedies. Among other self-help remedies, a secured party may commence collection activities concerning deposit accounts, receivables or other rights to payment, repossess or sell collateral and exercise rights of set-off. Any exercise of remedies or enforcement by a secured party must not result in a breach of the peace and, in general, must be commercially reasonable. The UCC also requires various notices in connection with the exercise of certain remedies such as sales of collateral, but market practice has also imposed various contractual limits (usually contained in the applicable collateral agreement) on the enforcement of security without additional notices or grace periods.

Commercial financing commonly includes an equity pledge of the borrower and its subsidiaries, and if an out-of-court foreclosure sale is contemplated, a sale of some or all the equity of the company group is an attractive option. Before or in connection with such enforcement, the secured party may wish to exercise voting or other rights inuring to the holders of such equity interests, including replacing the board of directors or other governing body of the borrower, but any such voting or proxy rights must be specifically negotiated in the security agreement and may be subject to limitations under the borrower's organisational documents.

The vast majority of secured lenders in respect of commercial financing agreements do not exercise self-help remedies, as a debtor will typically seek the protection of the Bankruptcy Code before lenders are capable of exercising such remedies. Alternatively, lenders and a debtor may reach a consensual out-of-court agreement whereby the debtor will peacefully transfer collateral to the lender in exchange for consideration such as releases and/or residual equity, etc (ie, a tip).

Law stated - 17 April 2024

Debtor-in-possession financing

Does your jurisdiction allow for debtor-in-possession (DIP) financing?

Yes, DIP financings are not uncommon in connection with proceedings under the US Bankruptcy Code with the approval of the court. If a DIP financing is approved by the court, it will likely be secured on a basis that is 'priming' or senior to prepetition liens. As with the use of cash collateral, a debtor is required to provide adequate protection to the relevant secured lenders as a condition to the DIP financing that is secured by liens that are senior to

or *pari passu* with the liens of such lenders or obtain the consent of such lenders. Given the foregoing requirements, existing lenders often are the most likely to provide DIP financings.

Law stated - 17 April 2024

Stays and adequate protection against creditors

During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

The filing of a bankruptcy case under the Bankruptcy Code will result in an automatic stay that prevents lenders (and all creditors) from enforcing any security without prior relief from the bankruptcy court or otherwise taking affirmative action against the property of the debtor's estate (including terminating contracts, etc). Relief from the stay is available upon application and a showing of cause, including based on the lack of adequate protection of a lender's interests in its collateral. Lack of 'adequate protection' means a lack of security to protect against the diminution in value of the secured lender's collateral during the bankruptcy case (eg, from the debtor's use or dissipation of such collateral). Any property acquired after the date of the filing of a bankruptcy petition is not subject to a secured party's after-acquired property provisions of its security agreement and the security interest will not attach to such property, though lenders will frequently receive liens on after-acquired property as adequate protection.

Secured lenders may be 'under-secured' or 'over-secured' in a Chapter 11 bankruptcy. An over-secured creditor (ie, where the value of creditor's collateral exceeds the amount of its debt) is entitled to interest, fees and related charges as part of its allowed secured claim in a bankruptcy case – whereas an under-secured creditor (ie, where the value of creditor's collateral does not exceed the amount of its debt) may not.

Given the requirement that adequate protection is a condition to a priming DIP financing, this is a central area of focus during most bankruptcy proceedings in which substantially all the assets of a Chapter 11 debtor are otherwise encumbered by senior secured debt and insufficient collateral is available for junior DIP financing. Also given the difficulty in demonstrating adequate protection, a non-consensual priming DIP financing is extraordinarily rare.

Law stated - 17 April 2024

Clawbacks

In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders. What are the rules for such clawbacks and what period is covered?

The primary focus in the case of avoidance actions would be on preferences and fraudulent transfers, and the primary beneficiary of any avoidance action would be unsecured creditors. Notably, preferences and fraudulent transfers can be brought both under applicable state

law as well as under the Bankruptcy Code, and the particular requirements of each may vary (including the length of the statute of limitations).

First, transfers on account of an antecedent debt (that is, debt that precedes the creation of the security interest) made within the 90 days before the bankruptcy filing when the debtor was insolvent are avoidable as preferences if they permit the creditor to receive more than they would in a hypothetical liquidation under Chapter 7 of the Bankruptcy Code. The look-back period for insiders is one year as opposed to 90 days, and there are a variety of statutory defences and safe harbors to preference claims. Exemptions do, of course, exist – for example, if the security interest in question is granted substantially contemporaneously with the incurrence of the debt being secured and is perfected within 30 days of its creation, then it is generally exempt from attack as a preference.

Second, transfers of an interest in the property of the debtor may be avoidable if they (1) are made with actual intent to defraud or deprive creditors of value or (2)are made when the debtor is insolvent or render the debtor insolvent, in each case for which the debtor receives less than reasonably equivalent value (ie, constituting constructive fraud).

In addition to preference and fraudulent transfer claims, a debtor in possession or any Chapter 11 estate may pursue any claims of the debtor, including claims for breach of fiduciary duty claims against directors and officers, such as for approving of fraudulent transfers (to the extent available under applicable law).

Proceeds of avoidance actions are unencumbered assets available for unsecured creditors. As a matter of practice, an unsecured creditors' committee will seek to prevent a post-petition DIP lender, especially one that is a prepetition secured creditor, from obtaining DIP liens over avoidance actions, and bankruptcy judges will often side with the creditors' committee on this point.

Law stated - 17 April 2024

Ranking of creditors and voting on reorganisation

In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

Yes. Creditors in a bankruptcy proceeding are ranked.

Under the absolute priority rule, secured parties are generally paid before unsecured creditors, including administrative claims that arise during a bankruptcy proceeding. Among secured parties, they are classed into each group of similarly situated creditors and depending on their relative priority in the assets, comprising collateral they receive and the proceeds of collateral when realised. Among unsecured creditors, post-petition administrative and priority claims listed in statute (eg, taxes) will be paid first before other unsecured claims, and a Chapter 11 debtor may not be able to reorganise under the Bankruptcy Code if such administrative and priority claims are not paid in full (or unless the creditors holding such claims agree otherwise). The claims are then followed by other general unsecured or under-secured claims.

Creditors are divided into 'classes' of similarly situated creditors, and the bankruptcy code sets out rules determining how each class of creditors are deemed to support a plan – which requires consent from at least one impaired class of creditors by (1) over half, by

number of claims and (2) two-thirds, by dollar value of the class. Once proposed (and rules apply regarding who may propose the plan depending on the timeline of the case), a reorganisation plan under Chapter 11 can be approved by the court with the consent of one 'class' of impaired creditors as long as, among other things, it is fair and equitable, does not discriminate unfairly, is feasible and does not violate the absolute priority rule (which ensures that junior creditors cannot recover before senior creditors without such senior creditor consent). A 'cram-down' like the foregoing is often the means through which a plan is approved, over the objection of other dissenting classes of impaired junior creditors. A 'cram-up' involves an impaired junior class approving a plan over the objection of a senior class of creditors.

Law stated - 17 April 2024

Intercreditor agreements on liens

Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

Yes. Contractual lien (and payment) subordination is permitted under New York law and is generally respected by the bankruptcy code. A secured party entitled to priority under the UCC may subordinate its security interest to the security interest of another secured party and a creditor may also contractually agree to subordinate its right of payment.

The Bankruptcy Code specifically provides for the enforceability of 'subordination agreements.' The general view is that intercreditor and subordination agreements are generally enforceable in bankruptcy to the same extent that they are enforceable under applicable state law. The consensus is that bankruptcy courts respect many (although not all) of the waivers of rights under the Bankruptcy Code that junior secured parties typically agree to in second-lien transactions. In some instances, junior creditors have subsequently challenged contractual clauses, and as bankruptcy courts are courts of equity, overly aggressive waivers have been successfully challenged.

Law stated - 17 April 2024

Discounted securities in insolvencies

How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

OID is the discount in price from a loan or debt security's nominal face value at the time of first issuance. Generally, a portion of the OID deemed attributable to post-petition periods may be treated as 'unmatured interest' and can be disallowed if the claim is under-secured. Exceptions exist, and the facts of each case should be carefully considered. For example, courts have previously found that debt issued in fair value exchanges may not be discounted for OID in bankruptcy.

Law stated - 17 April 2024

Liability of secured creditors after enforcement
Discuss potential liabilities for a secured creditor that enforces against collateral.

A secured party seeking to enforce a loan, guarantees of the loan or a security interest securing such obligations, or both, must comply with any legal requirements under applicable law, primarily article 9 for personal property and applicable real property law for real property, and any enforceable terms of the underlying loan documentation. The UCC provides debtors with various protections that cannot be waived by the debtor before default (eg, the right to receive a pre-foreclosure notice and the right to have any sale of the collateral conducted in a commercially reasonable manner). There are also overarching doctrines of good faith and fair dealing imposed by state law.

A secured party who fails to comply with the requirements of the UCC risks losing some or all its deficiency claim and could be liable for damages. Also, a secured party who takes control of a company through enforcement of an equity pledge (for instance by replacing the company's board of directors or other governing body) before foreclosing on the shares may have its appointed directors, etc, owe fiduciary duties to the company (and, depending on applicable law, potentially other constituencies in interest in the company).

Generally, a lender is not liable under environmental laws for the actions of a borrower or other security provider. A lender whose only relationship to a contaminated site is that it has lent to the owner or has taken a security interest in the land will not be primarily or secondarily liable under environmental laws for the actions of the owner. However, if a lender exercises management over the property beyond that of a traditional lender, then there may be some risk of liability. Similarly, if a lender forecloses on a contaminated property to enforce its security interest and becomes the owner thereof, there is a risk that it may thereby subject itself to liability.

In bankruptcy, certain claims, such as environmental liabilities, will run with the asset even after bankruptcy. Creditors should therefore take care in these contexts to avoid accepting unwanted liabilities. This issue is particularly in focus for industries that are heavily regulated or that may require regulatory approval before a change of control (including by exercise of remedies by lenders).

Law stated - 17 April 2024

UPDATE AND TRENDS

Proposals and developments
Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports. Are there any other current developments or trends that should be noted?

As of December 2022, loans based on Term SOFR have become the norm. It has become common for minor amendments for legacy deals to include provisions changing from LIBOR to Term SOFR.

On 13 July 2022, the Uniform Law Commission approved the final draft of its joint proposal with the Emerging Technology Committee of the American Law Institute for amendments

to the Uniform Commercial Code regarding digital assets. After the adoption of the final proposal, which itself will take some more time, it will be up to each state to individually enact legislation adopting the final proposal (and any state-specific variations).

In 2022, especially the second half of 2022, the portion of acquisition financings supported by direct lenders increased significantly in both deal number and dollar amount, as the high-yield debt markets faced challenges. Direct lenders also teamed up with traditional syndicated lenders to provide acquisition financing. While it remains to be seen whether these trends will continue, direct lenders likely will continue to be a significant source of debt capital for acquisition financings for the foreseeable future.

Law stated - 17 April 2024

LAW STATED DATE

> **Correct on:**
> Please state the date on which the law stated here is accurate.

17 April 2024.

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