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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, Asia Pacific Loan Market Association 11

General Chapters:

4 **An Introduction to Legal Risk and Structuring Cross-Border Lending Transactions** – Thomas Mellor & Marc Rogers Jr., Bingham McCutchen LLP 15

5 **Global Trends in Leveraged Lending** – Joshua W. Thompson & Caroline Leeds Ruby, Shearman & Sterling LLP 20

6 **Recent Trends in U.S. Term Loan B** – Meyer C. Dworkin & Monica Holland, Davis Polk & Wardwell LLP 26

7 **Yankee Loans – Structural Considerations and Familiar Differences from Across the Pond to Consider** – R. Jake Mincemoyer, White & Case LLP 31

8 **Issues and Challenges in Structuring Asian Cross-Border Transactions – An Introduction** – Roger Lui & Elizabeth Leckie, Allen & Overy LLP 36

9 **Acquisition Financing in the United States: Outlook and Overview** – Geoffrey Peck & Mark Wojciechowski, Morrison & Foerster LLP 41

10 **A Comparative Overview of Transatlantic Intercreditor Agreements** – Lauren Hanrahan & Suhrud Mehta, Milbank, Tweed, Hadley & McCloy LLP 46

11 **Oil and Gas Reserve-Based Lending** – Robert Rabalais & Matthew Einbinder, Simpson Thacher & Bartlett LLP 52

12 **Lending to Health Care Providers in the United States: Key Collateral and Legal Issues** – Art Gambill & Kent Walker, McGuireWoods LLP 56

13 **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 61

14 **Financing in Africa: A New Era** – Nicholas George & Pascal Agboyibor, Orrick, Herrington & Sutcliffe LLP 67

15 **LSTA v. LMA: Comparing and Contrasting Loan Secondary Trading Documentation Used Across the Pond** – Kenneth L. Rothenberg & Angelina M. Yearick, Andrews Kurth LLP 72

16 **The Global Subscription Credit Facility Market – Key Trends and Emerging Developments** – Michael C. Mascia & Kiel Bowen, Mayer Brown LLP 79

17 **Majority Rules: Credit Bidding Under a Syndicated Facility** – Douglas H. Mannal & Thomas T. Janover, Kramer Levin Naftalis & Frankel LLP 83

Country Question and Answer Chapters:

18	**Albania**	KALO & ASSOCIATES: Nives Shtylla	87
19	**Angola**	SRS Advogados in cooperation with Adjuris: Carla Vieira Mesquita & Gustavo Ordonhas Oliveira	94
20	**Argentina**	Marval, O'Farrell & Mairal: Juan M. Diehl Moreno & Diego A. Chighizola	101
21	**Australia**	Clayton Utz: David Fagan	109
22	**Bermuda**	MJM Limited: Jeremy Leese & Timothy Frith	117
23	**Bolivia**	Criales, Urcullo & Antezana - Abogados: Carlos Raúl Molina Antezana & Andrea Mariah Urcullo Pereira	127
24	**Botswana**	Khan Corporate Law: Shakila Khan	134
25	**Brazil**	TozziniFreire Advogados: Antonio Felix de Araujo Cintra	141
26	**British Virgin Islands**	Maples and Calder: Michael Gagie & Matthew Gilbert	147
27	**Canada**	McMillan LLP: Jeff Rogers & Don Waters	154
28	**Cayman Islands**	Maples and Calder: Alasdair Robertson & Tina Meigh	162
29	**China**	DLA Piper: Robert Caldwell & Peter Li	169
30	**Costa Rica**	Cordero & Cordero Abogados: Hernán Cordero Maduro & Ricardo Cordero Baltodano	177
31	**Cyprus**	Andreas Neocleous & Co LLC: Elias Neocleous & George Chrysaphinis	184

Continued Overleaf

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Country Question and Answer Chapters:

32	**Czech Republic**	JŠK, advokátní kancelář, s.r.o.: Roman Šťastný & Patrik Müller	192
33	**Denmark**	Bruun & Hjejle: Jakob Echwald Sevel & Peter-Andreas Bodilsen	198
34	**England**	Skadden, Arps, Slate, Meagher & Flom LLP: Clive Wells & Paul Donnelly	205
35	**France**	Freshfields Bruckhaus Deringer LLP: Emmanuel Ringeval & Cristina Radu	215
36	**Germany**	Cleary Gottlieb Steen & Hamilton LLP: Dr. Werner Meier & Daniel Ludwig	224
37	**Greece**	KPP Law Offices: George N. Kerameus & Panagiotis Moschonas	235
38	**Hong Kong**	Bingham McCutchen LLP in association with Roome Puhar: Vincent Sum & Naomi Moore	242
39	**India**	Dave & Girish & Co.: Mona Bhide	253
40	**Indonesia**	Ali Budiardjo, Nugroho, Reksodiputro: Theodoor Bakker & Ayik Candrawulan Gunadi	259
41	**Italy**	Chiomenti Studio Legale: Francesco Ago & Gregorio Consoli	266
42	**Japan**	Bingham Sakai Mimura Aizawa: Taro Awataguchi & Toshikazu Sakai	274
43	**Korea**	Lee & Ko: Woo Young Jung & Yong Jae Chang	282
44	**Kosovo**	KALO & ASSOCIATES: Vegim Kraja	289
45	**Luxembourg**	Bonn & Schmitt: Alex Schmitt & Philipp Mössner	297
46	**Mexico**	Cornejo Méndez Gonzalez y Duarte S.C.: José Luis Duarte Cabeza & Ana Laura Méndez Burkart	303
47	**Morocco**	Hajji & Associés: Amin Hajji	310
48	**Mozambique**	SRS Advogados in association with Bhikha & Popat Advogados: Momede Popat & Gonçalo dos Reis Martins	317
49	**Netherlands**	Loyens & Loeff N.V.: Gianluca Kreuze & Sietske van 't Hooft	322
50	**Nigeria**	Ikeyi & Arifayan: Nduka Ikeyi & Kenechi Ezezika	330
51	**Peru**	Miranda & Amado Abogados: Juan Luis Avendaño C. & Jose Miguel Puiggros O.	337
52	**Portugal**	SRS Advogados: William Smithson & Gonçalo dos Reis Martins	346
53	**Russia**	White & Case LLP: Maxim Kobzev & Natalia Nikitina	352
54	**Singapore**	Drew & Napier LLC: Valerie Kwok & Blossom Hing	359
55	**South Africa**	Brian Kahn Inc. Attorneys: Brian Kahn & Michelle Steffenini	367
56	**Spain**	Cuatrecasas, Gonçalves Pereira: Manuel Follía & Héctor Bros	373
57	**Switzerland**	Pestalozzi Attorneys at Law Ltd: Oliver Widmer & Urs Klöti	381
58	**Taiwan**	Lee and Li, Attorneys-at-Law: Abe Sung & Hsin-Lan Hsu	390
59	**Thailand**	LawPlus Ltd.: Kowit Somwaiya & Naddaporn Suwanvajukkasikij	398
60	**Trinidad & Tobago**	J.D. Sellier + Co.: William David Clarke & Donna-Marie Johnson	405
61	**USA**	Bingham McCutchen LLP: Thomas Mellor & Rick Eisenbiegler	414
62	**Venezuela**	Rodner, Martínez & Asociados: Jaime Martínez Estévez	425
63	**Zambia**	Nchito & Nchito: Nchima Nchito SC & Ngosa Mulenga Simachela	430

LSTA v. LMA: Comparing and Contrasting Loan Secondary Trading Documentation Used Across the Pond

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Both the Loan Syndications and Trading Association, Inc. (the "LSTA") and the Loan Market Association (the "LMA") publish the forms of documentation used by sophisticated financial entities involved in the trading of large corporate syndicated loans in the secondary trading market. The LSTA based in New York was founded in 1995. The LMA based in London was formed in 1996. Both the LSTA and LMA share the common aim of assisting in developing best practices and standard documentation to facilitate the growth and liquidity of efficient trading of syndicated corporate loans. Over the past two decades, the use of these secondary trading forms has become widespread and customary by market participants.

Under LSTA trading documentation approximately $517,000,000,000 notional amount of loans traded in 2013 and $396,000,000,000 notional amount of loans traded in 2012.[1] Whereas, under LMA trading documentation approximately $67,000,000,000 notional amount of loans traded in 2013 through the first three calendar quarters and $66,000,000,000 notional amount of loans traded through the entire calendar year in 2012.[2]

The focus of this article is to give the reader a high-level overview of some of the important similarities and distinctions between LSTA secondary loan trading documentation and LMA secondary loan trading documentation.

Which Documents to Use - LSTA or LMA?

Typically whether the parties will use LSTA or LMA trading documentation will be decided by the parties at the time of trade. There are no formal requirements for selecting LSTA or LMA documentation, however, a number of informal factors contribute to the determination of the documentation to be utilised.

Governing Law. Where the credit agreement is based on law of the United Kingdom or another European jurisdiction, LMA documentation will be typically utilised. On the contrary, where the governing law of the applicable credit agreement is New York law or of another jurisdiction within the United States, usually LSTA documentation will be utilised. LMA documents are governed by English law whereas LSTA documents are governed by the laws of New York.

Borrower's Jurisdiction. If the organisation and principal location of the borrower is outside of the United States, LMA documentation will generally be used. LSTA documents will most likely be used if the borrower is principally located and organised in the United States.

Upstream Documentation. If a party purchased the loans utilising LSTA documents, such party will almost always want to sell the loans to its purchaser utilising LSTA documents (and *vice versa* if such party purchased on LMA) so as not to have a mismatch between the rights and obligations acquired when it purchased the loans as compared to the rights and obligations transferred when it sells the loan. The risks facing a party that buys and sells a loan using different types of form documentation (e.g., buy on LSTA and sell on LMA) will become more transparent below when discussing the different styles of representations provided by a seller using LSTA documentation versus LMA documentation.

Par or Distressed?

Both LSTA secondary trading documentation and LMA secondary trading documentation have different terms and conditions applicable to the trade depending on whether a trade is agreed to be a "par" trade or a "distressed" trade. As a general principle, the seller will be required to provide the buyer with more robust representations and warranties when selling on distressed terms as compared to par terms. Typically performing loans trade on par documentation while non-performing loans (or loans expected to become non-performing) trade on distressed documentation.

Pricing

Regardless of the type of documentation agreed upon by the parties in settling the secondary loan transaction, the LSTA and LMA both set forth substantially similar methodologies for determining the purchase price to be paid with respect to secondary loan transactions (whether traded on par or distressed). Under both LSTA and LMA trades, the buyer generally receives the benefit of any payments or distributions made with respect to the loans being sold from and after the trade date. The one material exception under both LSTA and LMA pricing conventions provides for the seller to retain the right to any accrued and unpaid interest on performing loans for the period of time up to (i) seven (7) business days after trade date ("T+7") for LSTA par trades or ten (10) business days after trade date ("T+10") for LMA par trades, or (ii) twenty (20) business days after trade date ("T+20") for both LSTA and LMA distressed trades. Both LSTA and LMA par and distressed trades further require for the buyer to pay seller interest based upon 1-month Libor (or 1-month Euribor) on the purchase price the buyer would have paid the seller had the trade closed on either (i) T+7 for LSTA par trades or T+10 for LMA par trades or (ii) T+20 for both LSTA and LMA trades. A detailed discussion of how pricing conventions work under LSTA and LMA documentation is beyond the scope of this article and the foregoing is meant as a simplified overview.

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A Trade is a Trade

A concept paramount to both LSTA and LMA secondary loan trading markets is the concept that a "trade is a trade". This maxim forms the bedrock for the hundreds of billions of dollars traded annually in the secondary loan trading market. Once the material terms of a trade are agreed to orally or in writing, a binding contract is formed. The material terms typically include: (i) the borrower name; (ii) the identity, type and amount of debt being purchased or sold; (iii) the purchase rate; (iv) whether settlement shall be par or distressed; and (v) whether it shall be subject to LSTA or LMA documentation.

With respect to trades done pursuant to LSTA documentation, the enforceability of oral trades was codified in New York in 2002 when such trades, subject to certain requirements being met, became exempt from the statute of frauds.[3] LSTA trade confirmations further provide that once parties have executed an LSTA trade confirmation incorporating LSTA standard terms to such loan trade, the parties to such confirmation agree to be bound to any other transaction between them with respect to the purchase or sale of bank loans upon reaching agreement to terms (whether by telephone, exchange of e-mail or otherwise).[4]

Similarly, case law in England demonstrates that oral agreements relating to loan trades may be enforceable once the material terms are agreed upon.[5] LMA documents also expressly provide in the standard terms for both par and distressed bank debt trades that a binding contract between the parties comes into effect between the parties "upon oral or written agreement" of the material terms on the date agreed upon.[6] Notwithstanding that under both New York law and English law oral or electronic communication between the parties may be enforceable without a formal written trade confirmation, enforcement of such communication may be difficult and will depend on an analysis of the facts and circumstances.[7] Parties are therefore encouraged to keep internal written records of all agreed upon trades and to endeavour to promptly formalise the terms of a secondary loan transaction pursuant to a written trade confirmation or by some form of electronic communication.

Since both LSTA and LMA trades may become binding upon oral or electronic communication prior to the signing of a formal written confirmation, a party looking to enter into a bank debt trade with a counterparty must be careful to do its diligence and homework upfront before agreeing to the material terms. A party must make certain that in communicating with a counterparty that it is referencing the correct borrower/obligor in the capital structure of a corporate family as well as be aware of the following: (i) whether any payment or non-payment default have occurred under the credit agreement; (ii) whether the credit agreement provides for collateral (and, if collateral is pledged or granted for the benefit of lenders, whether any costs will be imposed upon a party when acquiring such debt to remain properly perfected upon consummation of the trade)[8]; (iii) the status of an insolvency proceeding (if any) relating to the borrower/obligor; (iv) the transfer requirements imposed by the governing credit agreement (e.g., will the entity purchasing the loans be able to take legal title to the loans or will the parties be required to settle via participation or sub-participation); (v) the governing law of the credit agreement (e.g., certain jurisdictions may prohibit or have limitations on certain entities becoming lenders); and (vi) the jurisdiction of organisation of the borrower (e.g., depending on the jurisdiction of the borrower, a party may be subject to tax withholding on payments).

A buyer of loans does not want to learn of a material issue that would have affected its decision to enter into the trade, *after* it has committed to purchase a loan, such as, the transfer will require high expenses not anticipated (e.g., stamp taxes or expensive costs to perfect interest in collateral) or that it will not qualify to become a lender of record. Accordingly, it is important to complete the diligence prior to committing to a trade.

Confidentiality Agreements

Before committing to the material terms with a counterparty, both the LSTA and LMA provide for parties to utilise a form confidentiality agreement.[9] Such confidentiality agreement will typically allow for the seller to provide the buyer syndicate level confidential information relating to the loan, thus providing the buyer with an opportunity to perform diligence on the loan prior to committing to purchase. Both the LSTA and the LMA also have a master form of confidentiality agreement which allows for parties on subsequent loan trades to execute a schedule to the confidentiality agreement specific to the relevant credit agreement to which the underlying loan being sold or purchased relates.

Non-Standard Terms

To the extent a party is aware of a non-typical trade term that is important to such party or it wants to deviate from either the LSTA or LMA standard terms and conditions, such party should state, clearly and unambiguously at the time of trade, the non-standard conditions. As the secondary loan trading market has continued to expand and customs have become more entrenched, unless some reference to the conditionality of the transaction is expressly established at time of trade, it will prove difficult for a party to contend that a trade had not been agreed upon once the material terms of a trade are agreed upon. For example, if the trade relates to a sale of a revolving commitment (with future funding obligations) and the buyer realises that it may not be able to settle via assignment because of an inability to obtain borrower consent under the credit agreement, the buyer may want at time of trade to agree with the seller as to whether collateral will be required to be posted (and, if yes, how much collateral will be required).[10]

Further, if there is an important vote or decision to be made with respect to an upcoming amendment, rights offering or restructuring proposal and the buyer would like to direct seller as to how to act, the buyer should agree with the seller about such direction rights at time of trade. Without modification, neither LSTA nor LMA documents require the seller to take direction from the buyer with respect to amendments or modifications to the credit agreement occurring during the period of time after trade date and before settlement date.[11] However, it is often customary for a seller to consult with its buyer regarding such buyer's preference when a material action is occurring post-trade date but pre-settlement date with respect to a loan (e.g., extending maturity date, releasing collateral, waiver of default, etc.).

Trade Confirmations

Important distinctions exist with respect to the trade confirmations entered into in respect of LSTA secondary loan trades as compared to LMA secondary loan trades. When entering a loan trade pursuant to LSTA documentation, the parties will utilise either an LSTA par confirm or an LSTA distressed confirm. Whereas, under LMA secondary loan trades, the parties will utilise the same confirmation document with some different check box elections to memorialise whether certain provisions within apply depending on whether the trade will be treated as par or distressed.

Under both LSTA and LMA par transactions the only other operative document that will typically need to be agreed upon in finalising the transaction (outside of a funding memorandum setting

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forth the purchase price calculation) will be an assignment and acceptance agreement or transfer certificate in substantially the form set forth as an exhibit to the underlying credit agreement. Hence, on par trades, once the assignment agreement is executed and the purchase price is paid, the rights and obligations of the party to settle the transfer of the loan will be satisfied and performed.

The settlement process for distressed trades, however, differs on LSTA and LMA following the execution of a trade confirmation. An LMA trade confirmation serves two purposes: (i) to document the agreement to the terms of the trade on trade date; and (ii) to act as the purchase and sale agreement. Thus, with respect to an LMA distressed trade no subsequent LMA documentation generally needs to be executed after the trade confirmation. This is not the case under LSTA distressed documentation. An LSTA distressed trade confirmation specifically provides that the secondary loan trade shall be subject to "negotiation, execution and delivery of reasonably" acceptable contracts.[12] Notwithstanding the ability of parties to negotiate, the standard terms for an LSTA distressed confirmation requires the parties to use a supplemental purchase agreement substantially in the form of the LSTA Purchase and Sale Agreement for Distressed Trades as in effect on the trade date.

When a party signs an LMA confirmation without modification to the standard terms, such confirmation shall govern all of the representations, warranties, covenants and agreements that are made by the seller or buyer not only on the trade date but also on the settlement date of the trade. Thus, if an LMA trade confirmation has been executed and an event occurs prior to the settlement date but after the trade date, causing one party to request modifications to the LMA standard terms (because a standard LMA representation to be made by such party as of the settlement date shall no longer be true without modification), such party may be in a precarious position to the extent its counterparty is unwilling to allow for modifications to the standard terms after the trade confirmation has been executed. Hence, parties need to be especially careful prior to executing an LMA trade confirmation in situations where the parties are not consummating the loan trade on or around the same date as the trade confirmation is executed.

This is not the case for an LSTA distressed trade. As noted above for LSTA distressed trades, after an LSTA distressed trade confirmation is executed the parties will still be obligated to enter into a supplemental purchase and sale agreement which is subject to negotiation. Hence, in the event that something occurred between trade date and settlement date that one party felt required modification to the standard terms the opportunity expressly exists within the four corners of the LSTA document to negotiate such terms prior to settlement.

Predecessor-in-Title Representations v. Upstream Chain of Title

Where the LMA and LSTA secondary loan trading documentation differ most significantly is with respect to the use of predecessor-in-title representations. LSTA documentation generally does not provide for any predecessor-in-title representations to be made by a seller. In contrast, whenever a seller transfers loans pursuant to LMA documentation, certain representations and warranties are made by such seller not only on behalf of itself *but also on behalf of any prior seller* who held such loans dating back to the time when the loans were first extended to the borrower. This is true on LMA documentation for representations and warranties made by the seller whether the trade settles on par terms or distressed terms (although the breadth of such representations is greater for distressed trades).[13]

The specific representations and warranties provided by the parties under both LMA and LSTA documents are generally similar. For a par trade where the loan is performing and the risk of the loan subsequently becoming non-performing are low, the representations and warranties to be provided by a seller to its buyer are generally limited in scope. For both LMA and LSTA par trades, the seller will provide a good title representation and warranty to the buyer on the settlement date that the seller owns sole legal and beneficial title to the loans free and clear of lien, encumbrance or adverse claim against title of any kind.

LMA par trades include additional representations and warranties by the seller to the buyer (and, thus, create greater exposure to the seller relative to LSTA par trades). Such additional representations and warranties include: (i) to seller's knowledge, the loans have not been accelerated by the lenders and no principal or interest payment defaults have occurred; (ii) neither seller nor any of its predecessors-in-title have executed any other documents which could materially and adversely affect the loans; (iii) neither seller nor any predecessor-in-title is in default with respect to any of its obligations in relation to the loans and related rights being sold; and (iv) the loans and the rights related to the loans are free from any set-off in favour of the borrower. None of the foregoing representations and warranties are generally provided by a seller when selling loans on par LSTA documentation. It is noteworthy, however, that all of the foregoing representations and warranties are provided by a seller (*on behalf of itself alone and not any prior seller*) transferring loans pursuant to LSTA distressed documentation (except for the representation relating to no payment defaults).

Since the seller under an LMA loan trade provides recourse to its buyer for all prior sellers of the loan with respect to certain representations, the buyer has recourse against its immediate seller for any breach of such representations regardless of whether such breach relates to an action (or inaction) or the status of the specific selling party. This method of documentation provides some advantages and disadvantages to buying parties as compared to LSTA trades. One obvious advantage to such buyer is that, with respect to distressed trades, a buyer acquiring loans under LMA documentation will have less diligence to conduct. Under LMA distressed documentation, the rights to predecessor transfer agreements are not transferred, so no other predecessor transfer documents will be provided to the buyer for its review. One disadvantage is that the buyer's recourse will be limited entirely to its immediate seller. Thus, to the extent the seller is not creditworthy, the predecessor-in-title representations will be of limited value. Generally, this will be more of a concern for market-makers/dealers purchasing from speculative hedge funds than for end buyers purchasing from a market-maker/dealer.

With respect to LSTA loan trades that settle pursuant to par documentation, a seller will not be required to make representations on behalf of any prior seller who owned the loans. The same is generally true for sellers transferring loans pursuant to LSTA distressed secondary trading documentation. Unlike LMA trades, LSTA distressed trading documentation provides for an upstream chain of title. Under such circumstances, a buyer purchasing distressed loans will receive a chain of title showing any transfer of the loans since the loans "shifted" to trading distressed from par.[14]

LSTA distressed sales settle on the basis of the delivery of predecessor transfer agreements and the assignment to the buyer of all of the seller's rights against prior sellers under such predecessor transfer agreements rather than the use of predecessor-in-title representations. Hence, to the extent the recovery received on the loan purchased by the buyer is impaired because of an action (or inaction) taken by an upstream seller in the chain, the buyer under

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LSTA distressed documentation may be able to seek recourse not only against its immediate seller but against a further removed prior seller. Although a buyer may have to conduct more diligence when settling a LSTA distressed trade as compared to a LMA distressed trade by reviewing prior transfer documentation, such buyer will have recourse against each upstream seller who sold the loans being transferred on distressed documents.

Since a seller transferring loans on LSTA documents will generally not have to be concerned about a buyer seeking recourse against it for actions taken by a prior seller, its exposure for any losses that the buyer may incur due to an issue in the chain of title is less than a seller transferring loans under LMA documents. Under certain limited circumstances, a party that settles a loan trade on par LSTA documentation after the credit has shifted to distressed will be required to provide the buyer with certain representations and warranties on behalf of not only itself but any predecessor-in-title who held such loans from and after the date the credit was deemed to have shifted from par to distressed.[15]

Outside of the different approaches to predecessor-in-title representations, the LSTA representations, warranties and indemnities for distressed trades are in and of themselves generally similar to those found in LMA documentation applicable to distressed trades. Both the LSTA and LMA distressed transactions provide recourse to the buyer in the event the buyer's rights with respect to the loans are impaired because (i) the selling party is an insider or an affiliate of the company, (ii) litigation is pending or, to seller's knowledge, threatened against the selling party, and (iii) there are set-off rights against the selling party.

The most important distressed representation provided under both LSTA and LMA documentation is the "no bad acts" representation.[16] This representation provides the buyer with comfort that the seller has taken no actions (or inactions) that will result in the buyer receiving less in payments or distributions or less favourable treatment than other lenders in the syndicate with respect to the same type of loans being sold. This representation is intended to act as a catch-all protection for a buyer purchasing distressed loans. For example, this representation would provide a buyer with recourse in a situation where other lenders instituted proceedings against the borrower or a professional advisor which the seller has not joined, with the result that the buyer does not share in the proceeds. Although there are differences in the aforementioned representations (including the timing of when certain representations and warranties are made), as previously mentioned, the most significant difference is that the seller under LMA distressed trades provides recourse to its buyer on behalf of itself and any predecessor in title.[17]

Credit Risk Part I - Counterparty Insolvency

One mutual goal of both the LSTA and the LMA is to expedite settlement thereby reducing exposure to counterparty risk. Loans do not settle electronically like securities and, therefore, require some time to settle. The goal of the LSTA and the LMA is to settle par trades within seven (7) business days and ten (10) business days, respectively, from the trade date and within twenty (20) business days from the trade date for distressed trades. Unfortunately, these targeted goals on average are generally not being met.[18] The credit risk issue for loan trade parties is that after trade date, but prior to settlement date, a counterparty will enter into an insolvency proceeding or will otherwise subsequently be unable to perform its obligations (e.g., pay the purchase price).

This concern over counterparty risk became a real issue for many market participants with the bankruptcy filing of Lehman Commercial Paper Inc. ("LCPI") in 2008. LCPI is the Lehman entity which, among other things, traded syndicated loans in the secondary market. At the time of LCPI's bankruptcy filing, LCPI had hundreds of unsettled bank debt trades leaving its counterparties in a precarious position.[19] Under US bankruptcy law, counterparties of LCPI with unsettled LSTA bank loan trades were prohibited from terminating their trades or taking other enforcement actions against LCPI based upon the automatic stay of Section 362(a) of the US Bankruptcy Code.

In LCPI's US bankruptcy case, LCPI filed a motion with the Bankruptcy Court for a finding and/or Order that the unsettled open trade confirmations were "executory contracts" under the Bankruptcy Code.[20] Bankruptcy Code section 365 permits a debtor to reject or assume executory contracts. Certain counterparties to these open, unsettled trades objected to such motion on various grounds.[21] For parties that did not object to this motion, however, the Bankruptcy Court found and ordered that the unsettled secondary loan trades were executory contracts.[22] This allowed LCPI to assume unsettled trades that were "in the money" while rejecting "out of the money" contracts. Where LCPI rejected a loan trade, its counterparty was stuck with an unsecured claim against LCPI for any damages resulting from economic loss on the unsettled trade (e.g., loss of value related to increase in market value of the loan subsequent to trade date).

It is important to recognise that LSTA transactional documents do not have an *ipso facto* clause allowing a party to terminate the contract with its counterparty upon the bankruptcy filing of its counterparty, as such *ipso facto* clauses are generally not enforceable in the United States.[23] Under English law, however, *ipso facto* clauses are generally enforceable.[24] Under a contract governed by English law, a counterparty remains entitled to terminate the contract if the contract contains a right of termination upon the insolvency of its counterparty. This is a material difference from US bankruptcy law.

Prior to Lehman's bankruptcy filing, LMA documentation did not provide an *ipso facto* provision allowing a party to terminate its loan trade upon an insolvency event of its counterparty. Not surprisingly, in response to the bankruptcy of LCPI and the resulting negative effects for market participants, the LMA updated its standard documentation to try and alleviate counterparty insolvency risk by adding an *ipso facto* provision for unsettled loan trades.

The revised LMA documentation provides that if an "insolvency event" occurs in respect of either party prior to the settlement date of such transaction, the non-insolvent party may terminate the open trade by giving notice.[25] The LMA also allows for parties to elect that automatic termination shall apply instead of termination by giving notice. Following the termination of an open transaction, the non-insolvent party must calculate in good faith its damages as soon as practicable. The intention of this provision is to ensure that LMA loan trades do not remain open and outstanding without prospect of settlement during an insolvency case and provide a methodology for the non-insolvent party to establish an unsecured claim against its insolvent counterparty. Notwithstanding the contractual rights to terminate a trade upon the insolvency of a counterparty under LMA documentation, the ability of a non-insolvent party to actually close out and terminate a trade may be limited depending upon the jurisdiction of the insolvent party and the insolvency laws where the insolvency case is pending.

Credit Risk Part II - Participations

Credit agreements typically permit the sale of loans by participation as opposed to outright assignment. Both LSTA and LMA

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documentation generally provide that in the event the settlement of a loan by assignment is not possible the parties will settle the terms of the trade via participation or sub-participation. When settling a trade via participation as opposed to assignment, the borrower will continue to have obligations owed only to the seller/grantor of the participation and not the buyer/participant. The seller/grantor in turn will then be obligated to pass along or turn over an equivalent amount of payments or distributions received from the borrower to the buyer/participant. Thus, market participants use participations as an alternative method to acquire the loan when a direct assignment is not possible, or to preserve anonymity in the credit.

Owners of bank loan participations take on two types of credit risk: (i) the borrower's failure to pay the underlying bank loan (which is equally applicable to an assignment); and (ii) the occurrence of an insolvency event of the grantor of the participation or the inability of the grantor to perform its obligations under the participation agreement. A very important distinction between LSTA and LMA documentation that affects the second prong of such credit risk is the way in which the form LSTA and LMA participation agreements are structured. LMA style participations create a debtor and creditor relationship between the grantor and the buyer of the participation.[26] If the grantor becomes insolvent, the participant will be treated like an unsecured creditor of the grantor without having a beneficial interest in the underlying loan. In contrast, LSTA participations are intended to effect a true sale of the beneficial interest in the loan. In other words, under LSTA participations, the beneficial and economic interests in the loan are transferred from the grantor to the participant and not a part of the insolvent entity's estate. Under US law, a typical LSTA participation agreement results in the participant being considered the beneficial and economic owner of the underlying loan. The grantor's bankruptcy estate will be considered merely the owner of bare legal title to the underlying loan. Thus, the underlying economic interest in the loan that had been participated will not be considered part of the grantor's estate.[27]

A participant under an LSTA form participation agreement should have good grounds to seek relief from the automatic stay and elevate the participation to an outright assignment of the underlying loan (provided that the participant is eligible to hold the loan as a direct assignee under the underlying credit agreement or the applicable borrower consents).[28] Not uncommonly, end buyers entering into LMA participation agreements often seek to modify such documentation to provide for a transfer of a beneficial, economic interest in the loan to remedy this enhanced credit risk under LMA form documentation.

Conclusion

The foregoing overview highlights some important considerations that market participants engaging in secondary loan trades should be cognizant of when agreeing to utilise either LSTA or LMA secondary transfer documentation. Although there are a fair amount of similarities between the secondary loan transfer documentation used across the pond, there exist some substantive, material differences in the two types of documentation which affect the allocation of risk and the relative rights and obligations of both seller and buyer. The reader should be cognizant that the foregoing overview is intended to be introductory in nature. For detailed guidance relating to trading of syndicated bank loans in the secondary market, parties should obtain legal counsel with respect to same.

Endnotes

1 Such amounts are based upon information provided by the 4Q 2013 LSTA Secondary Trading & Settlement Study dated January 27, 2014. Out of such notional amounts, approximately $19,000,000,000 traded on LSTA distressed documentation in 2013 and $22,000,000,000 traded on LSTA distressed documentation in 2012 with the respective balances trading on LSTA par documentation. *Id.*

2 Such amounts are based upon Thomson Reuters LPC Secondary Loan Trading Volume Survey published on the LMA webpage. Based on such statistics, the total notional amount of loans traded on LSTA documentation is much greater than on LMA documentation (*six times as great* during the full calendar year of 2012). The percentage amount of distressed loans recently traded as compared to par loans, however, is significantly higher on LMA documents than on LSTA documents. This fact should not come as a surprise to market participants based upon the benign credit markets and low default rates for corporate borrowers in the United States as compared to the recent economic turmoil affecting corporate borrowers in Europe. Out of the $67,000,000,000 notional amount traded on LMA documentation for the first three calendar quarters of 2013, $17,000,000,000 notional amount was distressed with balance being par. *Id.* Note that the methodology for determining whether the loans traded on LMA were distressed or par was based upon whether the loans traded were categorised as distressed or par (and does not mean necessarily that LMA distressed or par documentation was utilised in settling such trades).

3 *See* N.Y. Gen. Oblig. Law § 5-701(b) (McKinney 2014).

4 *See LSTA Standard Terms and Conditions for Par/Near Par Trade Confirmations* (the "LSTA Standard Par Terms"), at ¶ 22, "Binding Effect"; and LSTA *Standard Terms and Conditions for Distressed Trade Confirmations* (the "LSTA Standard Distressed Terms"), at ¶ 26, "Binding Effect".

5 *See Bear Stearns Bank Plc v. Forum Global Equity Ltd.*, [2007] EWHC (Comm) 1576 (holding that buyer and seller had enforceable oral agreement where parties had agreed on, among other things, a firm price for the underlying notes).

6 *See LMA Standard Terms and Conditions for Par and Distressed Trade Transactions (Bank Debt/Claims)* (the "LMA Standard Terms"), at ¶ 2(a), "Contract Point".

7 Without "sufficient evidence", an alleged oral agreement to a trade may be left to the court in a cumbersome "he said, she said" litigation process. *See, e.g., Highland Capital Mgmt., L.P. v. Bank of Am., Nat'l Assoc.*, 2013 U.S. Dist. LEXIS 119935 (N.D. Tex. August 23, 2013) (analysing factual circumstances surrounding parties purported contract based upon electronic communication under New York law and holding that no binding contract existed). Plaintiff Highland Capital Management, L.P. has appealed the ruling of the District Court.

8 This is particularly relevant when the trade relates to purchase of a loan extended to a European borrower under a credit agreement governed by a European jurisdiction. Often perfection of security in European jurisdictions must be done by each individual lender in a syndicate and costs to perfect such interest in collateral may be expensive. Under LMA standard documentation the costs to perfect an interest in security related to a loan being transferred are borne entirely by the buyer. *See* LMA Standard Terms, at ¶ 18.2.

9 *See LMA Confidentiality Undertaking, March 24, 2011; LSTA Form of Master Confidentiality Agreement for Secondary Sales & Trading,* December, 2006.

10 Typically syndicated credit agreements will provide the borrower with consent rights prior to allowing a prospective assignee to become a lender in the syndicate. This consent

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right is understandably important to a borrower when the facility relates to a revolving commitment whereby the creditworthiness of a prospective lender will be important due to future funding obligations.

11 *See* LSTA Standard Par Terms, at ¶ 13, "Syndicate Information"; LSTA Standard Distressed Terms, at ¶ 20, "Syndicate Information"; and LMA Standard Terms, at ¶ 26.1.

12 *See LSTA Distressed Trade Confirmation* (the "LSTA Distressed Trade Confirm"), at 3.

13 *See* LMA Standard Terms, at ¶¶ 22.3 and 22.4.

14 Such determination of when a credit shifts from par to distressed is pursuant to a shift date poll mechanism. See LSTA Standard Distressed Terms, at ¶ 12, "Step-Up Provisions" (defining "Shift Date" and setting forth seller's obligations with respect thereto).

15 *See* LSTA Standard Distressed Terms, at ¶ 12, "Step-Up Provisions."

16 *See LSTA Purchase and Sale Agreement for Distressed Trades – LSTA Standard Terms and Conditions* (the "LSTA Standard Distressed Terms and Conditions"), at §4(h)(i):

"Seller has not engaged in any acts or conduct or made any omissions (including by virtue of Seller's holding any funds or property of, or owing amounts or property to, Borrower or any Obligor), that will result in Buyer's receiving proportionately less in payments or distributions under, or less favorable treatment (including the timing of payments or distributions) for, the Transferred Rights than is received by other Lenders holding loans or commitments of the same tranche, class or type as the Loans or Commitments (if any)."

LMA Standard Terms, at § 22.4(c):

"*No bad acts*: neither it nor any of its Predecessors-in-Title has engaged in any acts or conduct, or made any omissions, independently of the other Lenders (or, if this is a Claims Trade, of other creditors of the Obligors holding claims of a similar nature to the Traded Portion) that would result in the Buyer receiving proportionately less payments or distributions or less favourable treatment in respect of the Purchased Assets or Purchased Obligations than any other Lender holding advances or a participation (of a similar nature to the Traded Portion) and similar claims under the Credit Documentation (or, if this is a Claims Trade, than such other creditors) or result in any Purchased Assets, or any part thereof, being subject to a Claim Impairment and, in particular, neither it nor any of its Predecessors-in-Title has set off any amounts against the Purchased Assets."

17 *Compare* LMA Standard terms, § 22, *and* LSTA Standard Distressed Terms and Conditions, at §§ 4, 5 (whereas LMA representations and warranties are made as of either the "Trade Date", "Settlement Date", or "Seller Representation Date", LSTA representations are made as of the "Settlement Date", unless otherwise noted.

18 *See, e.g.,* The Q4 2013 LSTA Secondary Trading & Settlement Study, January 27, 2014, at 36, 41 (noting that for LSTA par and distressed trades, the median number of business days between trade and settlement date in Q4 2013 was 15 and 49 days, respectively). The reasons for these delays include, among other things, agent delays, a credit freeze, delays in obtaining borrower consent and an upstream party not owing the loans being sold. The LMA does not currently provide data with respect to settlement times.

19 *See Debtor's Motion for an Order Pursuant to Section 365 of the Bankruptcy Code Approving the Assumption or Rejection of Open Trade Confirmations*, November 14, 2008, Case No. 08-13555, Docket No. 1541 (the "LCPI Assumption Motion"), at ¶ 8.

20 *See* LCPI Assumption Motion. An "executory contract" is not defined under the US Bankruptcy Code, however, case law indicates that an executory contract is a contract on which performance is still required on both sides. *See, e.g., In re Penn Traffic Co.*, 524 F. 3d 373, 379 (2d Cir. 2008).

21 *See, e.g., Counterparties' Objection to Debtors' Motion for an Order Pursuant to Section 365 of the Bankruptcy Code Approving the Assumption or Rejection of Open Trade Confirmations*, November 26, 2008, Case No. 08-13555, Docket No. 1841, at ¶ 1 (arguing that LCPI Assumption Motion amounted to impermissible effort to profit from downturn in financial markets in 2008); and *Limited Objection of Tennenbaum Entities to Debtors' Motion to Approve Assumption of Trade Confirmations and Prohibit Setoffs of Prepetition Claims*, November 26, 2008, Case No. 08-13555, Docket No. 1848, at ¶¶ 8-9 (arguing that trade confirmations at issue were not "executory" because only remaining obligations were "ministerial and non-material").

22 *See Order Pursuant to Section 365 of the Bankruptcy Code Approving the Assumption or Rejection of Open Trade Confirmations*, December 16, 2008, Case No. 08-13555, Docket No. 2258.

23 There are certain exceptions to this rule which permit parties to transactions involving a swap agreement, securities contract, forward contract, commodity contract, repurchase agreement, or master netting agreement the ability to terminate its contract and establish damages owed upon the filing of bankruptcy of a counterparty. See 11 U.S.C. § 562 (establishing method for determining damages arising from termination of swap agreement, securities contract, forward contract, commodity contract, repurchase agreement, or master netting agreement). Such exceptions do not exist for secondary loan trades.

24 *Compare Perpetual Trustee Company Ltd. & Anor v. BNY Corporate Trustee Services Ltd. & Ors*, [2009] EWCA (Civ) 1160 (holding so-called "flip provision" enforceable under English law), *and Lehman Bros. Special Fin. Inc. v. BNY Corporate Tr. Servs.* (*In re Lehman Bros. Holdings Inc*.), 422 B.R. 407 (Bankr. S.D.N.Y. 2010) (holding same provision to be unenforceable *ipso facto* clause).

25 The definition of "insolvency event" is substantially similar to the definition of "bankruptcy" used in Section 5(a)(vii) of the ISDA Master Agreement. *Compare* LMA Standard Terms, at ¶ 1.2 *and 2002 ISDA Master Agreement, at § 5(a)(vii).*

26 *See LMA Funded Participation (Par/Distressed) (March 2014)*, at ¶ 6.1(b) (stating that under an LMA participation the relationship between the grantor and participant is that of debtor and creditor with the right of the participant to receive an equivalent amount of payments received by the grantor with respect to the loan participated).

27 *See* 11 U.S.C. § 541(d) (stating that "[p]roperty in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest" only results in the debtor's estate having an interest in such property to the extent of its bare title and not any equitable interest).

28 *See Order Pursuant to Sections 105(a), 363(b), 363(c), and 541(d) of the Bankruptcy Code and Bankruptcy Rule 6004 Authorizing Debtor to (a) Continue to Utilize its Agency Bank Account, (b) Terminate Agency Relationships, and (c) Elevate Loan Participations,* October 6, 2008, Case No. 08-13900, Docket No. 11.

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