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Note Purchase Agreements and Private Placement Debt: Key Terms and Structuring Issues

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Today's faculty features:

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Note Purchase Agreements and Private Placement Debt:

Key Terms and Structuring Issues

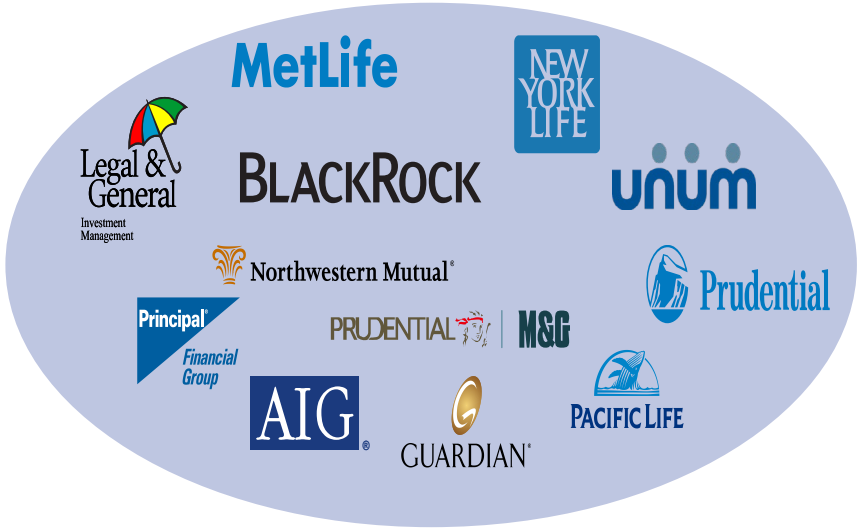
Presented by

Brian A. Bates, Morrison Foerster

Clinton W. Culpepper, Baker Botts L.L.P.

Market Participants

- Placement Agents
- Issuers Counsel – issuer counsel and pre-designated investor counsel
- Other market participants
- Investors



Model Forms

Almost total market acceptance of the so-called Model Forms X-1 and X-2

- Streamlines documentation process (template)
- Investors focus on departures from relevant Model Form and substantive issues that are outside the form (primarily covenant package)

Cross-border adaptation of Model Forms

- Model X Form adopted in September 2004
- Surprisingly few changes from domestic version, with particular emphasis on tax-related issues and certain “hot button topics” such as compliance with new U.S. anti-terrorism regulations
- Easily adaptable to multi-currency transactions and investor swap arrangements re non-USD tranches
- Model Forms X-1 and X-2 adopted in 2006 and recently updated

New Model Forms have been recently updated

- Mostly updates to sanctions provisions and delayed funding
- LMA has developed additional forms in loan and note format

Private Placement Process

- Standardized documentation
  - Model X Forms
  - Most transactions are documented pre-marketing
  - U.S. governing law (usually NY); English law is a regular alternative
  - Term sheets vary in detail
- Individual investor decisions – no “agent bank” equivalent
  - Due diligence – confidentiality preserved given limited number of potential investors
  - Bilateral negotiations pre-circle via placement agent(s)
  - Monitoring of the investment post-closing

Financing Continuum

Private Offering

Public Offering

- Private placement ("insurance" or "debt" private placement)

- 144A offering
- Tranche from a EMTN or GMTN
- Standalone 144A
- 144A "program"

- SEC Registration

  OR

- 3(a)(2) Offering (for banks)

  OR

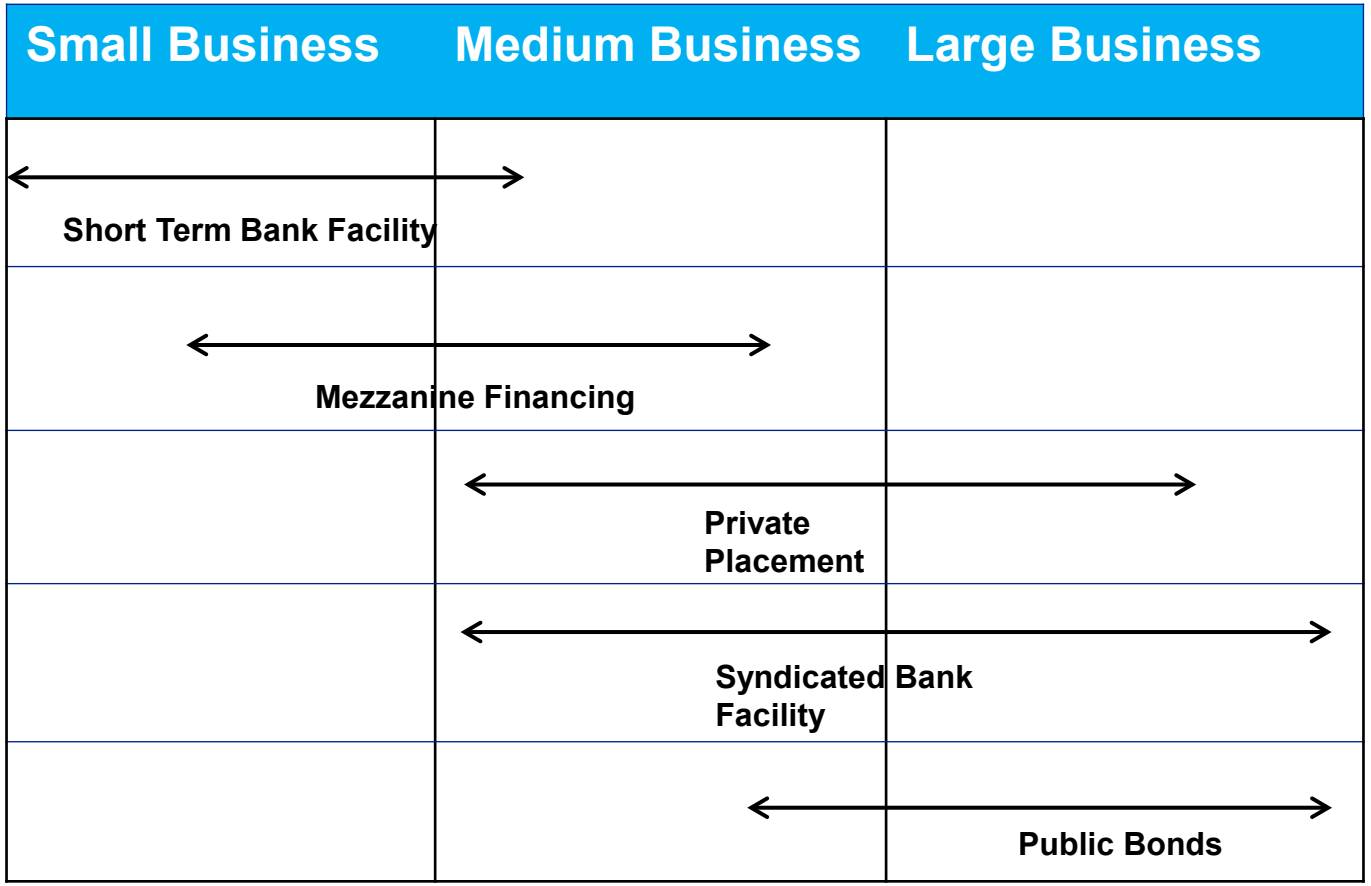
- Other Public Bonds

Less Liquid
Less time-consuming

More Liquid
More time-consuming

Capital Stack

Where do private placements fit in a company's debt capital stack?



Funding Diversification

- Long term capital structure
- Reliable source of funding
- Maturity profile of debt / tranching
- Ability for delayed drawdown
- Fixed rate versus floating rate
- No minimum size (in contrast to other markets, i.e. Eurobond €300M minimum)
- Other currencies beside USD available
- Relationship lending versus public bonds

Tenor

Advantages of long-term funding

- Locked-in financing and pricing
- Less administrative time and effort than almost constant bank refinancing
- Planning
- Ability to match long, lived assets to debt liabilities

Disadvantages of long-term funding

- Potential make-whole for early prepayment
- Ability to achieve amendments

Pricing

- Impact of Treasury yields
- Spread
- No up-front lender fees
- Transaction costs – lower than some alternatives

Currency

- Desire for US Dollars
- Cross-currency swaps
- Swapped notes
- Ability of certain investors to lend directly in other currencies

£GBP

DCC
£70m tranche

Witan investment trust
£75m transaction

FORTH PORTS
£175m tranches

University of Brighton
£35m

arqiva
£300m transaction

Brookfield
£100m transaction

CAPITA
£97m tranche

€EUR

DCC
€85m tranche

SONIC HEALTHCARE
€110m transaction

Yoplait
€200m transaction

DRÄXLMAIER
€110m tranche

WERELDHAVE
€160m tranche

sage
€ tranche

AVR energy inside.
€220m tranche

BERENDSEN
€80m tranche

attero energiek met milieu
€114.5m tranche

Other Non-USD Currencies

DuluxGroup
$AUS40m tranche

Copenhagen Airports CPH
DKK(US$100m equiv.) tranche

Crescent Point ENERGY CORP
$CAD10m tranche

Brisbane Airport
AUS$ tranche

BERENDSEN
DKK654m tranche

RICHARDSON
$CAD87m tranche

Transaction Chronology

- Potential issuer, working with the placement agents, produces an Offering Memorandum (“Memorandum”)
- Memorandum contains Term Sheet and most often a draft of a Note Purchase Agreement
- Note Purchase Agreement drafted by issuer counsel but with the review and reaction of pre-designated investors’ counsel
- Deal is marketed to investors, often through a “roadshow”
- Issuer and investors agree a final Note Purchase Agreement
- Issuer sells Notes to investors

Benefits of Specialized Issuer Counsel

- Market expectation/desire
- Issuer can better control drafting of principal documentation
- Provides Issuer with objective, current market and legal expectations
- Effectively represents the Issuer’s interests during pre-documentation
- Smoother, more efficient transaction process

Pre-Designated Investor Counsel

What are they?

- Experienced special counsel for investors usually pre-designated by issuer with advice from placement agents and issuer special counsel
- Benefits of selecting an experienced pre-designated counsel include the following:
  - Knowledge of “the market” for documentation
  - Knowledge of the pre-designated counsel process
  - Smoother, more efficient transaction process

Pre-Designated Investor Counsel

Pre-Marketing Phase

- Reviews or prepares term sheet
- Often prepares Note Purchase Agreement
- Reviews issuer's bank facility
- Performs initial due diligence
- Advocates for "the market" on documentation and structural issues
- Identifies potential investor resistance points (structure, documentation or commercial) for the issuer and the placement agent to evaluate before going to the market
  - Primary issue for pre-designated investor counsel is that they do not yet have a client to resist specific points
- Limited review of the private placement memorandum, which is prepared by the Placement Agent

Pre-Designated Investor Counsel

Marketing Phase

- Placement Agent circulates the term sheet and private placement memorandum to potential investors
  - The circulation will note what counsel is pre-designated for the potential investors
- Interested investors reach out directly to the pre-designated counsel to put them on the circulation list
- Identifies important issues that arose in the pre-marketing documentation phase - Preparation of the issues memorandum
  - Rather than simply listing covenants and exceptions, investors prefer a more thoughtful explanation of issues
    - Focus on how the covenants fit with one another
    - Include rationale from the company
    - Don’t be over inclusive such that the memo becomes unhelpful to readers

Pre-Designated Investor Counsel

Marketing Phase cont'd

- Responds to inquiries from prospective investors regarding the term sheet, the issues memorandum, the proposed Note Purchase Agreement, the issuer's bank facility and other aspects of the transaction
  - Generally, in house counsel that have read the issues memo will either send an email with questions or ask to set up a call
- Based on responses, potential investors will submit their bids to the Placement Agent, which will include necessary changes to the documents
- Placement Agent will discuss the bids with the issuer
  - Generally, if the deal is over subscribed, minimal changes will be made to the Note Purchase Agreement

Pre-Designated Investor Counsel

Post-Circle Phase

- Company accepts bids to complete the book
- Placement Agent circulates a pricing confirmation to selected investors and pre-designated counsel
- Pre-designated counsel must perform a conflicts check on the selected investors
  - Any potential conflicts must be waived as appropriate
- Pre-designated counsel engages selected investors
  - Firms vary on approach
    - ACIC recommends an engagement letter, but that is not customary practice

Pre-Designated Investor Counsel

Post-Circle Phase cont'd

- Incorporate any comments that were agreed in the pricing confirmation
- Review and comment on closing deliverables
  - Certificates
  - Resolutions
  - Opinions
- Draft pre-designated counsel opinion
  - Generally, investors get the opportunity to comment
- Execution of the Note Purchase Agreement and the Notes
- Facilitate communication of requests between investors and the company

Significant Covenants in Most Transactions

- Model X Forms
  - Financial information and reasonable access to management and auditors
  - “Housekeeping” covenants
  - Maintenance of pari passu ranking of Notes and any guarantees
  - Change in nature of business
  - Arms’ length affiliate transactions
  - Mergers, consolidations, amalgamations
  - “OFAC” provisions
- Other Restrictive Covenants
  - Financial covenants usually based upon covenant package in existing bank facility (if any)
  - Asset dispositions
  - Emergence of “Most Favored Lender” provisions
- Limitation on “priority debt” (structural subordination)
  - Subsidiary external borrowings
  - Secured debt

Key Market Themes

- Covid-19 (Impact on existing PPs/amendments and new issuances)
- Increase in NAIC-1 equivalent credits
- Spreads and interest rate and yield curve environment
- Continued interest in real estate transactions such as social housing
- ESG – green and sustainability-linked notes
- Multi-currency transactions
- Delayed funding

Potential Drafting Concerns

ERISA Representations and Covenants

- ERISA representations and covenants appropriately reach to ERISA Affiliates in the model form
- Common comment from issuer counsel:
  - “The company doesn’t have any employees so we should limit these to the company or delete in their entirety”
- This comment is misplaced because affiliates of the issuer with ERISA plans could cause priming liabilities to the issuer
  - Because of this, pre-designated counsel should resist these changes, and if the changes are refused, this issue should be highlighted in the issues memorandum to investors

Potential Drafting Concerns

Sanctions Representations and Covenants

- Sanctions representations and covenants reach to the issuer and all “Controlled Entities”
  - This covers the issuer’s Affiliates and the affiliates of the parent
- Common comment from issuer counsel:
  - “Limit these representations and covenants to the issuer and its subsidiaries, since we cannot control affiliates”
- This comment is misplaced because if certain affiliates violate sanctions, it could cause the issuer liability
  - An appropriate compromise is to only include affiliates that are the in the parent chain (as opposed to sister companies)

Potential Drafting Concerns

Anti-Cookson Clause

- Goal is to prevent the issuer from using its lien basket for the purpose of granting security to its bank lenders unless the same is provided to investors
- Inclusion of this clause became customary practice after one issuer, Cookson Group plc, was able to grant security to its banks without the consent of its noteholders (whose debt was intended to rank pari passu with the bank debt) in reliance on the negative pledge basket and subsidiary guarantee test in its note purchase agreement
- Sample provision at end of general lien basket:
  - "provided that Liens securing Indebtedness under a Material Principal Credit Facility shall not be permitted under this clause unless the Indebtedness of the Obligors under the Notes is equally and ratably secured with all such Indebtedness pursuant to documentation in form and substance satisfactory to the Required Holder"

Potential Drafting Concerns

Make-Whole Amount

- Loan provision intended to compensate the investors if the issuer repays the Notes before maturity
  - Intended to deal with a loss of investors' anticipated yield
- Based on recent case law (including Ultra Petroleum), bankruptcy courts will carefully consider specific language of the make-whole clause
  - For example, if investors want make whole to be included upon repayment after an event of default, the clause should specifically say as much
    - And the clause should specify when the make-whole calculation begins upon an event of default
- Because of recent case law, this language is becoming quite verbose
  - Example language follows on the next slide

Potential Drafting Concerns

Make-Whole Amount cont'd

- Example provision:
  - If the Notes are prepaid following an acceleration pursuant to the preceding paragraph, any premium (including without limitation, the make-whole amount) shall be **paid as if the Notes were prepaid on the date of the applicable notice of acceleration** (or on the automatic acceleration of the Notes pursuant to the preceding paragraph). The issuer shall pay any premium (including without limitation, the make-whole amount) as compensation to the holders for the loss of their investment opportunity and not as a penalty, **whether or not an Event of Default specified in clause (g) or (h) of Section 12 has occurred** and (if an Event of Default specified in clause (g) or (h) of Section 12) without regard to whether the event causing such Event of Default is voluntary or involuntary, or whether payment occurs pursuant to a motion, plan of reorganization, or otherwise, and without regard to whether the Notes and other Note Obligations are satisfied or released by foreclosure (whether or not by power of judicial proceeding), deed in lieu of foreclosure or by any other means….

Potential Drafting Concerns

Excess Cash Flow Exceptions

- Note Purchase Agreement may contain an annual mandatory prepayment with a percentage of Excess Cash Flow from the prior year
- Common comment from issuer counsel:
  - A deduction from excess cash flow “any restricted payment or investment made during such year”
- This comment is misplaced because it gives the issuer unilateral control of the amount of excess cash flow, which can result in a lower prepayment to investors
  - Investors could consider permitting investments as a deduction, but not restricted payments, since those cause cash to leave the system to the owners ahead of the investors

Potential Drafting Concerns

Permitted Tax Distributions

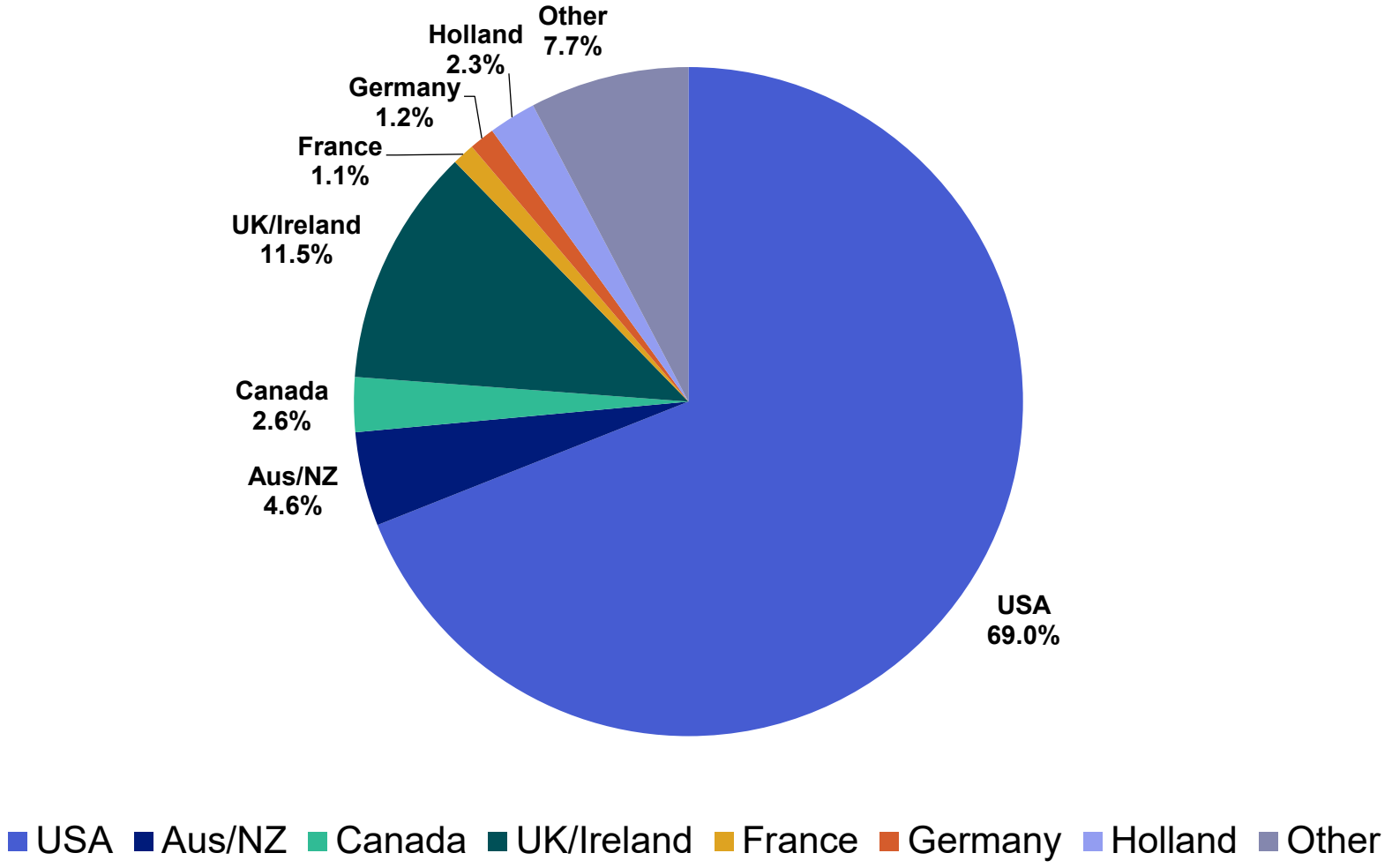
- For issuers that are treated as partnerships, the equity holders will want a consistent dividend to pay tax liabilities from issuer income
- Permitted tax distributions are common exceptions to Restricted Payment covenants, but language varies
  - Some directly refer to the relevant provision in the operating agreement
  - Others calculate tax liability as if all owners live in California (even though no owners may be based in California)
  - Some will cap the tax rate amount
- When can the issuer make a permitted tax distribution?
  - At all times
  - Only if no Event of Default exists
  - Only if no payment or bankruptcy Event of Default exists
- The issuer must be careful not to violate the requirements of its organizational documents

Potential Drafting Concerns

Transactions with Affiliates

- Covenants restricting transactions with affiliates are necessary to avoid cash leakage in favorable deals with sponsors and parents
- Common comment from issuer counsel:
  - An exception for “any transaction permitted pursuant to the Management Services Agreement”
- This comment may be acceptable, but additional protection is needed
  - In theory, the investors can get comfortable with the transactions contemplated by a specific agreement as of the closing date, but they need comfort that the agreement won’t change in an adverse manner
- Material Agreements Covenant – “Issuer shall not amend or modify…or any Management Service Agreement in any manner that is adverse to the issuers”

2020 USPP Volume by Country (%)



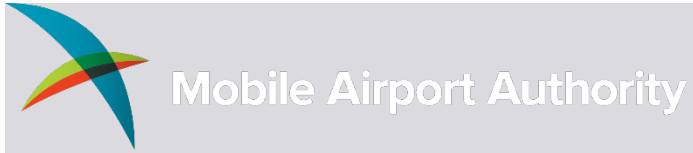
Issuers: Power/Infrastructure/Project Finance

Issuers: Industrials

Issuers: Real Estate

Issuers: Consumer/Retail

Issuers: Aviation



Issuers: Other

Questions or Comments?

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