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Minority Lender Considerations

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By Nathan Parker
Partner | Fund Finance

Minority lender roles in transactions come up frequently and generally don't warrant specific comment where there is a diverse lender base or established lender relationships, but sometimes the facility holdings are such that one or a small group of lenders can constitute the majority for the purposes of consents and amendments. The amount of focus relative hold amounts and voting power receive from the lender or lenders with the minority position will vary depending on a number of factors, including the type of deal, size of hold, whether the majority lender is a bank or fund lender, the relationship with and reputation of the sponsor, the relationship with the majority lender(s), the identity of the agent and the complexity of the transaction.

Depending on these factors, the minority lender(s) may be comfortable with their position and the alignment of interests among the lender group generally and therefore with the level of control the majority lender has, or they may turn their minds to how they can ensure that they have a say on key decisions.

Ordinarily, protection for lenders on key points comes through the list of all-lender matters in the amendments clause which, in Europe, will cover detrimental changes to pricing, tenor and mandatory prepayment as well as release of security. These provisions will also regulate, as all-lender matters, other key intra-lender concepts such as the pro rata sharing mechanics, enforcement waterfall, matters prescribed as being "all lender" in the applicable provision and rules regarding the application of prepayments.

But in the context of a deal where one or a couple of lenders could constitute the majority, there are certain provisions that the minority lenders may want to consider beyond the standard all-lender matters. This is not to say that all will be relevant in every context. As mentioned above, depending on a number of factors, none or only a few of these may warrant negotiation. There will also be deal-specific considerations (and, indeed, considerations of more general application) beyond those discussed below, which aim to give lenders a flavour of the issues

they may want to consider when taking a minority position next to one or a small group of controlling lenders.

It is also worth mentioning at the outset that a large number of deals have a concept of not just majority and all-lender matters but also super-majority matters. Depending on the level, that majority lender is set at (66-2/3% is the traditional level for European deals, but we increasingly see a lower 50% threshold, particularly in NAV and pref deals) the super-majority threshold will be either 66-2/3% or a higher level around 80%. Super-majority levels may be used for decisions relating to the release of security, but sponsors are increasingly seeking to limit the acceleration right to super-majority rather than simple majority, and so the below considerations apply equally to decisions made under the super-majority regime.

With these different lender thresholds and the competing interests of the sponsor, the majority lender (who may rightly want to protect its own ability to make decisions given its higher exposure levels in the financing) and the minority lenders, there is clearly a balance to be struck and a shift to all-lender decisions for certain matters, which may be unworkable for the sponsor and undesirable to the majority more-highly-exposed lender, may not always be appropriate. One possible solution here is to have a half-way house where day 1 lenders (or a specified number of day 1 lenders) are given a say on certain matters to avoid elevation to full all-lender status.

In the context of the above dynamics, it is also important for a minority lender to pick its battles, looking for provisions key to the economics of the deal and areas where there is misalignment with the majority lender or where a majority lender could prejudice the minority as a distinct class − though the standard LMA-style all-lender matters should deal with most areas of the documentation that fall into the latter category. It is unlikely that either the sponsor or the majority lender will have a lot of tolerance for an over-reaching minority lender looking to take on a prominence in the transaction disproportionate to its exposure, and so a more surgical approach may yield a better result.

With this in mind, below is a summary of some of these key areas to consider.

Consent levels embedded in Agent discretions

Leaving aside the list of all-lender matters in the amendments clause, the finance documents will give the Agent discretion to approve or agree certain matters. Where a consent level is not specified and the matter is not prescribed as an all-lender matter, this will generally mean that the Agent can act on the instructions of the majority lenders in making its determination.

Although there will almost always be important deal-specific agent discretions that lenders all may want a say on, some of the more standard agent discretions we often see at majority-lender level that could warrant elevation to all − or prescribed − lender in the context of a minority-lender financing are decisions as to whether new investors or new assets should be allowed into the borrowing base or NAV calculations (as applicable) as either eligible investors or eligible investments, sweeper clauses in the negative restrictions that allow for indebtedness or security with the consent of the agent, or for the agent to agree to distributions or cash to be moved from secured accounts during a period when the account/distribution block has been triggered.

Another point that is sometimes overlooked are the impaired agent provisions. In European deals, where an agent (or its lender affiliate) is insolvent or fails to make a payment, the agent can be classified as an impaired agent, and the lenders and borrower can then make payments directly, rather than through the agent, in the period until a replacement agent is appointed. Appointment of a replacement agent is generally set at the discretion of the majority lenders where the agent is impaired, but if the agent role is being filled by the lender with the majority position, this may not be appropriate and lenders should consider disenfranchising the affiliated lenders of the impaired agent from the vote.

Cashflows and financial testing

These considerations are generally more pronounced on NAV and pref deals where the distribution cashflows are key to repayment of the facility and where the period after an event of default until repayment can be protracted while assets are sold.

Generally, the financial covenant and cashflow-related definitions will be heavily negotiated, with much attention paid to NAV adjustments, permitted retained amounts, and the timing and impact of detrimental investment events. Mandatory prepayments are often covered as all-lender matters, but where there is a stand-alone financial covenant (as opposed to the LTV-level impacting only on pricing and cash sweep), a minority lender should consider whether changes to the financial covenant or waivers of breach of that covenant are something on which they would like a say.

The financial definitions on which the financial covenant, cash sweep and margin ratchet are based are often omitted from the all-lender matters, and minority lenders may also want to make clear changes to these definitions are all − or prescribed − lender matters. Depending on the formulation of the amendments provision, there may be some protection for these definitions as, at least in the European LMA formulation, the casting of the all-lender matters clause is wide (being any amendment, waiver or consent that has “the effect of changing or which relates to” the list of enumerated matters). Given this breadth, if the financial covenant, cash sweep or margin ratchet are listed in the all-lender matters, there may be some protection for the financial definitions, as a change to those definitions could be argued to have the effect of changing or varying the covenant/ratchet itself. Despite this, given the focus these definitions receive in the negotiations, lenders may prefer to have these definitions specifically listed and to be clear that agent discretions need to be exercised on an all or prescribed lender basis.

Another point that plays out more usually in NAV and pref deals is agreeing any cure plan. Generally, this will be a majority-lender decision, and moving from this position may be hard for the sponsor and the majority lender as they will both want comfort that a cure plan to reduce the facility outstandings is agreed efficiently, without lenders with less skin in the game being able to disrupt the process. This is an area where minority lenders may take a view that there is sufficient commonality of interest between the minority and the majority lender position to allow the majority to make the determination that the plan is one that will deliver the desired outcome. It may also be that minority lenders are concerned that other minority lenders may block a worthwhile plan and frustrate the cure process. But minority lenders could consider shoring up their position by requiring that the plan is shared with them during the consultation period between the majority lender and the sponsor so they have visibility as to the likely direction of

the plan or by enhancing their say if the cure process involves a further plan if the initial one fails to result in disposals to pay off the facility in full.

Information flow

In circumstances where the agent is also the majority lender, there can be a concern that information may not flow to the minority lender(s) at the same time as the majority lender is made aware of it. To an extent, this is an unavoidable issue on any transaction, and lenders don't generally regulate the unofficial correspondence and "heads up" discussions between a borrower and the lenders in the lender group. There are two points for minority lenders to take comfort from and consider in this context. The first is that European agency provisions will generally have a positive obligation on the agent to provide any documents it receives from the obligors to all lenders promptly, and minority lenders should check that this provision is present in their deal. If there is a particular concern about the entity having the agent role, then minority lenders could also ensure that the timing for key decisions is based off the date on which that information is provided to all lenders, rather than the date on which it is provided to the agent. An example of this might be the "snooze" provision in the amendments clause, where lenders can rightly say that the "snooze" timing should only start once they have received the amendment request and not when the request is provided to the agent.

Disenfranchisement

The final consideration for this list is whether lender transfers to sponsor affiliates are permitted and, if they are, whether the sponsor is then disenfranchised from voting. To give this some context, the concern here is that the majority lender may be taken out by a transfer to the sponsor, leaving the sponsor with voting control on a large number of matters while the minority have no voice. Again, this is probably a more pronounced concern in the context of a NAV or pref financing where the exit route is not as clear-cut as a subscription facility. The LMA documentation provides various regimes to assist with this issue in their leveraged form, and these solutions can be applied equally to a fund finance facility. Options include blocking transfers to sponsor affiliates completely or, if permitted, disenfranchising the sponsor affiliate from voting. Another option may be to treat the sponsor transfer as a repayment of the debt (though this somewhat offends against the pro rata repayment concept) or to have a put right on transfers to a sponsor, such that if a majority lender wants to transfer to a sponsor, the sponsor must also be willing to accept a transfer from any other lender. The circumstances of a deal will dictate which of these options is most appropriate − there is certainly no "one size fits all."

Ultimately, taking on a minority position in a deal with a cornerstone lender or lenders will require some thought, but with a considered and measured approach, it should be possible to achieve the right balance for the sponsor, the cornerstone lender and the minority lender.