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In Practice

Author Michael Leadbeater

Super senior facilities: a recap on key documentary terms

In this In Practice article Michael Leadbeater considers the key documentary terms which will form the basis of facilities agreement negotiations in the context of a super senior/ senior financing.

INTRODUCTION

For more than five years a large portion of leveraged financings in the mid-market have been funded by direct lenders providing the "unitranche", with traditional banks often being left with the revolving credit facility (RCF). Whilst these direct lenders can offer large tranches of term debt on looser terms and without the need for any amortisation, most direct lenders are unable to provide RCFs.

This tends to be where bank lenders excel where internal lending constraints might otherwise rule them out of appearing on the ticket. However, the economics of these facilities are not particularly remunerative and the RCF provider will typically have its commitments dwarfed by the unitranche; the effective *quid pro quo* for this dynamic tends to be that the bank lender will require "super senior" status, meaning that it will be paid out in priority in an enforcement to reduce the risk profile and better reflect the economics.

SUPER SENIOR FACILITY TERMS IN PRACTICE

Which amendments or waivers require super senior consent?

The majority of decisions under the facilities agreement will require "Majority Lender" (ie those lenders holding ≥ 66⅔% of the total commitments) consent; the result being that the Super Senior Lenders (SSLs) will be unlikely to hold even a blocking vote and so "all Lender" and "Majority Super Senior Facility Lender" decisions will come into sharper focus.

The decisions on which the SSLs require voting powers will typically include:

- key definitions, including those delineating classes of Lender or decision-making thresholds;
- exit/sale provisions;
- transfer/assignment provisions;
- the order of priority or subordination under the intercreditor agreement;
- matters specific to the super senior facility, including economics, drawdown conditions, purpose, repayment, any super senior covenant and super senior acceleration; and
- delaying the delivery of key financial information for longer than a pre-agreed grace period.

Additionally, when considering voting thresholds in the context of a facilities agreement that permits the establishment of incremental super senior debt, the SSLs may seek additional protection of their voting rights by requiring that any super senior facility commitments held by the unitranche lenders be disenfranchised from any such consent matters.

"Material Events of Default"

Given the likely gulf in commitments held by the senior term lenders and the SSLs – coupled with the fact that the SSLs will be "first out" in an enforcement scenario – the senior term lenders will want to control any enforcement process.

The SSLs will only be able to take enforcement action following the occurrence of a "Material Event of Default" (MEoD). The list of MEoDs will be a sub-set of the events of default contained in the facilities agreement and will typically include:

- non-payment of super senior liabilities, often subject to a *de minimis* and with the key negotiating point focussing on whether that threshold applies to super senior principal and/or interest, or only other amounts owing;
- super senior financial covenant breach, subject to any cure right;
- breach of any undertaking to deliver key financials, subject to an additional remedy period;
- breach of certain core negative undertakings relating to the incurrence of indebtedness and the granting of security where that would result in additional indebtedness ranking ahead of, or *pari passu* with, the super senior indebtedness; and
- typical insolvency events of default, to the extent they relate to a borrower under the super senior facility or, in some cases, an entity which has entered into super senior hedging.

Super senior financial covenant

In most transactions the SSLs will benefit from the same leverage covenant as the senior lender but with an additional 10-15% headroom to account for the difference in risk profile. In other cases, the SSLs may be pushed to accept a minimum EBITDA covenant.

As a middle-ground, the SSLs may be asked to agree a "springing" covenant which will only spring into life and be tested if, at the end of the relevant testing period, the super senior facility is drawn above a certain threshold (typically between 30-50%). Such a covenant is not uncommon toward the upper segment of the mid-market, however well-advised SSLs will want to understand any carve-outs from the utilisations counted toward the "springing" element and seek a clean-down (through which the company would

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be required to repay the RCF to £nil for a period of, ordinarily, five business days per year) to avoid the testing regime being manipulated.

Enforcement

If an MEoD is continuing, the Majority SSLs may take the decision to issue an enforcement notice under the super senior acceleration provision in the facilities agreement.

The general position, though, is that the senior lenders will want to "drive the bus" and the SSLs will be the subject of a standstill period whilst the senior lenders determine what enforcement action to take. It is relatively well-accepted for a non-payment breach to result in a 90-day standstill period, 120 days in relation to a super senior covenant breach and 150 days for any other MEoD.

In practice, however, the SSLs will have "step-in rights" (whereby they can take the wheel after, typically, 180 days of serving an enforcement notice) and senior lenders will often also elect to invoke the provisions contained in the intercreditor agreement allowing them to buy out the super senior liabilities at par so as to take full control of the enforcement process such that the standstill period may become moot.

CONCLUSION

It may not be particularly glamorous, and it often is not all that remunerative, but banks remain the only financial institutions capable of offering "true" RCFs with the ability to carve-out ancillary lines (such as overdrafts and guarantees) and so the super senior carrot remains important.

In light of the current macroeconomic environment, the value of working credit lines remains as high as ever to many businesses and there is a need to keep these lenders feeling valued in the capital structure. Whilst there is no evidence to suggest this will result in a material shift in terms, it is becoming increasingly common for bank lenders to be offered a slice of super senior term debt (alongside any super senior RCF) as a sweetener and to help boost returns. It will be interesting to see whether this trend continues over the next 12 months, but one thing is for certain … bank lenders still have a key role to play in the leveraged finance mid-market. ■

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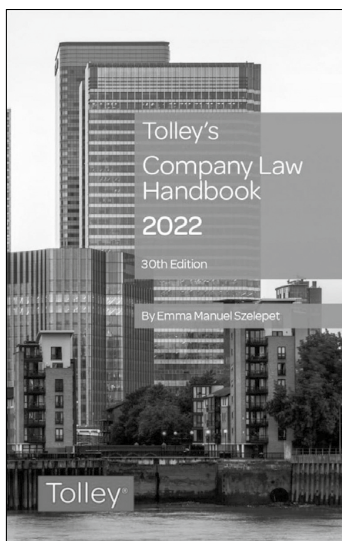

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