KING & SPALDING

Private Credit & Special Situations Investing

WHAT IS IT?

Refinancing Provisions in Credit Documentation

Summary

For years, provisions in credit documentation allowing the refinancing of a borrower's existing debt have been viewed as plain vanilla (almost boilerplate). Current market dynamics, however, have driven some borrowers to exploit documentation loopholes as liability management tools in distressed situations. Lenders and other credit institutions should be vigilant to ensure that these provisions do not give borrowers the ability to undercut the senior lending group's position or otherwise engage in transactions that the parties never anticipated would be permitted under the credit documentation. ***Failure to draft these provisions carefully can open the door to unexpected layering risk as seen most recently in AMC*** How did they do it? AMC Entertainment 2020 Bond Exchange

What are Refinancing Provisions?

Refinancing provisions vary from deal to deal, but it is fairly common that credit documentation will include the following:

1. Provisions permitting the partial refinancing of the existing senior credit facility debt; and
2. Provisions that allow the refinancing (in whole or in part) of other exiting debt of the borrower.

Any refinancing will be subject to certain conditions that the Borrower will need to satisfy. Common conditions include the following: (i) such refinancing debt cannot be in a greater principal amount (plus interest, fees and expenses) than the refinanced debt, (ii) such refinancing debt cannot have a maturity date or weighted average life to maturity that is shorter than the refinanced debt and (iii) any secured debt being refinanced must be subject to an intercreditor agreement reasonably satisfactory to the agent for the senior lenders.

Refinancing Provisions in Credit Documentation (cont'd)

Loopholes and documentation errors

1. **Ranking.** Recently AMC Entertainment announced that it would be offering to exchange its subordinated notes for 2nd lien secured notes. This development had many practitioners wondering how the company was allowed to do this under its credit documentation. Essentially, a fairly common condition in its refinancing debt provision was missing: namely, that any refinancing debt have the same ranking in the capital structure as the debt being refinanced. This allowed the company to engage in an uptier exchange transaction that the secured holders never anticipated was permitted under their credit documentations.

2. **Different Terms.** Refinancing provisions should specify that the refinancing debt must be on substantially the same terms as the debt being refinanced. Without this limitation, borrower's could essentially circumvent the negotiated conditions/terms required in the debt baskets under their credit agreement. ***This is particularly worrisome in deals where refinancings can be partial and need not be offered to existing lenders ratably.***

3. **Issues Unique to Incremental and Incremental Equivalent Debt**. To the extent credit documentation permits Incremental and Incremental Equivalent Debt, the provisions allowing the refinancing of such debt must in some respects mirror the conditions to incur the debt in the first instance. For instance, if Incremental debt is subject to (i) a "most favored nation" pricing provision, (ii) a right of first refusal in favor of existing lenders or (ii) limitations on the sponsor or other equityholders providing such debt, then the refinancing provisions should also contain these limitations in order to protect against a situation in which the borrower incurs the debt and then immediately refinances it without complying with these requirements.

4. **Partial Refinancing of Senior Credit Facilities.** Some (but not all) credit agreements allow a borrower to partially refinance the senior credit facilities. In this situation, it is important that the borrower is not able to offer a refinancing on different terms to some lenders, but not others. In order to avoid that, the documentation should make it clear that the refinancing must be offered to all lenders on the same terms. If this provision is not included, then any more restrictive terms on the borrower must only be permitted after maturity of the non-refinancing debt and the refinancing lenders must not be able to take greater than their pro rata share of payments.

Practice Pointers

- Be vigilant when reviewing and discussing refinancing provisions with counsel.
- Ensure that refinancing provisions will not allow borrowers to engage in transactions that were no permitted by the underlying debt basket that was used to incur the debt in the first instance
- Of particular importance, where credit documentation allows the partial refinancing of the senior credit facility, ensure that any refinancing offer is made to all Lenders on the same terms