

New LSTA Trade Confirmations

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Evolutionary change continues in the U.S. secondary bank loan market. The most recent documentation change introduces revised forms of the trade confirmations used to evidence par and distressed corporate loan trades.

On February 6, 2009, The Loan Syndications and Trading Association, Inc. (the “LSTA”) officially released its revised forms of (i) Par/Near Par Trade Confirmation (together with the applicable Standard Terms and Conditions¹, the “2009 Par Confirmation”) and (ii) Distressed Trade Confirmation (together with the applicable Standard Terms and Conditions², the “2009 Distressed Confirmation”), each effective for LSTA trades entered into on or after that date³ (collectively, the “2009 Confirmations”). As with virtually all LSTA form documents, specific trade terms that vary from the LSTA's market conventions may be separately negotiated by the parties and described on the “face” of the 2009 Confirmations. Absent such negotiation, however, the default provisions found in the applicable “Standard Terms and Conditions” to the 2009 Confirmations will automatically apply.

In this brief memorandum, we discuss some of the more significant changes to the Confirmations⁴. Most of the revisions to the 2009 Confirmations address issues raised by market participants under the 2006 Confirmations, and reflect the LSTA's efforts to problem-solve based on market experience. The most striking change -- the

“Buy-in/Sell-out” (“BISO”) provisions found in the 2009 Par Confirmation -- is summarized in this memorandum, but is discussed more fully in a separate client note published simultaneously and available on the Richards Kibbe & Orbe LLP website.⁵

1. Changes to the Standard Terms and Conditions.

A. “Non-Recurring Fees” (Section 5).

The definition of “Non-Recurring Fees” found in Section 5 of the Standard Terms and Conditions addresses fees paid by a borrower outside the ordinary course of its business (such as amendment fees) in respect of the subject loans. As in prior practice, the 2009 Standard Terms and Conditions provide that, as between a seller and a buyer, these fees are property of the buyer. However, this definition has been broadened and clarified.

The 2006 Confirmations provided that Non-Recurring Fees included “amendment, consent, waiver and other similar non-recurring fees that are payable in connection with the Debt from and after the Trade Date.” (emphasis added). This language was often the subject of dispute as being too limited in describing the types of fees addressed. In addition, the term “payable” would, on occasion, prompt aggressive buyers to claim against sellers for Non-Recurring Fees that had not yet been paid.

In the 2009 Confirmations, the definition of Non-Recurring Fees now expressly includes “amendment, consent, waiver and other

¹ The Standard Terms and Conditions for Par/Near Par Trade Confirmations (Published by The Loan Syndications and Trading Association, Inc. as of February 6, 2009) (the “2009 Par Standard Terms and Conditions”).

² The Standard Terms and Conditions for Distressed Trade Confirmations (Published by The Loan Syndications and Trading Association, Inc. as of February 6, 2009) (the “2009 Distressed Standard Terms and Conditions,” and together with the Par Standard Terms and Conditions, the “2009 Standard Terms and Conditions”).

³ The prior LSTA form trade confirmations for secondary trades had been in effect since December 1, 2006 (the “2006 Confirmations”).

⁴ This update has been prepared as a service to clients and friends of Richards Kibbe & Orbe LLP to report on recent developments in the US secondary loan market that may be of interest to participants in that market. The information is therefore general and does not (i) constitute legal advice, or (ii) focus on issues relevant to specific facts and circumstances.

⁵ http://www.rkollp.com/2009/05/new_lsta_parnear_par_buyinsell.php.

Memorandum

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“[T]he revisions to the 2009 Confirmations address issues raised by market participants under the 2006 Confirmations, and reflect the LSTA's efforts to problem-solve based on market experience.”

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similar non-ordinary course fees that are paid in connection with the Debt pursuant to the Credit Agreement . . . from and after the Trade Date, and any other amounts paid in connection with the Debt pursuant to the Credit Agreement . . . from and after the Trade Date not constituting Interest and Accruing Fees⁶ or PIK Interest.” (emphasis added). With these revisions, the LSTA makes clear that the term “Non-Recurring Fees” captures more than just amendment, consent or waiver fees, which may be the most common, but which are not the only category of non-ordinary course fees paid under a credit agreement. In addition, the revisions make clear that the obligation of a seller to make payments to a buyer in respect of Non-Recurring Fees is triggered only when such fees are actually “paid” in connection with a loan.

B. Unreimbursed Fee or Expense Claims (Section 5).

The 2009 Confirmations reinstate the principle that a claim for unreimbursed fees or expenses related to a loan belongs to the buyer unless otherwise agreed by the parties. By way of background, when an administrative agent incurs expenses in its capacity as agent for the lenders, including legal fees, to the extent not reimbursed by the borrower, it is typically entitled to reimbursement from the lenders under the applicable credit agreement. If the borrower should later reimburse the lenders for these expenses following the sale of a lender’s loan position, the Standard Terms and Conditions dictate that such reimbursement, when paid, is for the account of the buyer, even if the seller had originally paid those amounts.

The 2006 Confirmations provided no guidance as to the treatment of unreimbursed fee or expense claims. The treatment set out in the 2009 Confirmations, however, reflects standard practice in the secondary trading market and had in fact appeared in versions of the LSTA form trade confirmations prior to the 2006 Confirmations. The specific provisions dealing with this issue were removed from the LSTA forms in 2003⁷ but are reinstated in the 2009 Confirmations.

C. Form of Transfer Documentation (Section 10) and Participations (Section 12/Par Confirmation and Section 15/Distressed Confirmation).

The LSTA has now published forms of participation agreements for both Par/Near Par and Distressed Trades. Accordingly, in the event a transaction is to be settled by participation, the 2009 Standard Terms and Conditions now provide default settings for the type of participation documentation to be used and address issues concerning voting rights, collateral posting requirements and, for par/near par trades only, the right to “elevate” to an assignment.

In Section 10 of the 2009 Standard Terms and Conditions, the parties now agree, when settling a transaction by participation, to execute a participation agreement substantially similar to the LSTA Form of Participation Agreement.⁸ In Section 12 of the 2009 Par Confirmation and Section 15 of the 2009 Distressed Confirmation, unless the parties have previously agreed otherwise, the buyer will not be required to post collateral with the seller for any unfunded portion of a revolving commitment in which the buyer participates (and the parties will specify “No” opposite “Collateral Annex Applicable” in the

⁶ “Interest and Accruing Fees” are defined in Section 5 as interest (other than PIK Interest) and accruing ordinary course fees (such as commitment, facility and letter of credit fees) payable in connection with the Debt pursuant to the credit agreement from and after the trade date.

⁷ It should be noted that in connection with the settlement of Refco, Inc. bank loan trades during 2005 and 2006, many sellers, concerned about losing this reimbursement right, informally delayed trade settlements, hoping that Refco, Inc. would reimburse the lender group before settlement. The LSTA, after canvassing market participants, issued an advisory which recommended, in a deviation from prior standard market practice, that the buyer reimburse the seller at closing for the relevant portion of these agent expenses and keep any subsequent reimbursement from the borrower, subject to a post-closing date “true-up” between the parties in the event the borrower’s reimbursement arrived after a certain date. While restoring this language gives clarity to the issue of which party is entitled to this claim, it does not specifically address the Refco trading issue.

⁸ Under Section 10 of the Standard Terms and Conditions to the Distressed Confirmation, if the settlement is to be on “proceeds” and the recommended conditions found in footnote 1 of the LSTA form of Chapter 11 Plan Proceeds Letter Agreement for Post-Effective Date Settlement of Distressed Trades (the “LSTA Form Proceeds Letter”) are met to the satisfaction of the parties, the parties agree to execute a proceeds letter substantially similar to the LSTA Form Proceeds Letter. The parties may opt out of default provisions by specifying such terms in the “Trade Specific Other Terms of Trade” section of the Distressed Confirmation.

“Transaction Summary” of such participation agreement). The parties may opt out of or elect to modify these default provisions by specifying such terms in the “Trade Specific Other Terms of Trade” section of the Confirmation.

The 2009 Par Standard Terms and Conditions further provide in Section 12 that, unless previously agreed otherwise, upon the request of either party, the parties to the participation will use commercially reasonable efforts to cause the buyer or any approved transferee to become a direct lender of record under the credit agreement (and the parties will specify “Yes” opposite “Elevation” in the “Transaction Summary” of the participation agreement). As with the voting rights and collateral posting provisions described above, the parties may elect to modify this elevation default provision by specifying such modifications in the “Trade Specific Other Terms of Trade” section of the Confirmation.

2. Additional Changes to the Par Confirmation.

A. Compensation for Delayed Settlement (Section 6).

The definition of “PIK Interest Loan” in Section 6 of the 2009 Par Standard Terms and Conditions, which directly affects the calculation and allocation of “Compensation for Delayed Settlement” between the seller and the buyer, has been revised to broaden its scope.

The 2006 Par Confirmation defined a PIK Interest Loan as “any Debt in respect of which the applicable Credit Agreement specifies that interest is to be paid as paid-in-kind interest.” This definition is important because PIK Interest Loans are treated analogously to non-performing loans for the purpose of calculating

“Compensation for Delayed Settlement” under Section 6 of the Par Confirmation.⁹ The LSTA, with extensive feedback from the secondary trading market, recognized that this definition was too limited, addressing only “100% PIK interest” facilities, and did not cover the majority of the PIK interest deals trading in the market, which provide that interest on the relevant loan tranches is payable partially in cash and partially as PIK interest.

In the 2009 Par Confirmation, a “PIK Interest Loan” is defined as “any Debt (or portion thereof) in respect of which the Credit Agreement (or an Adequate Protection Order) specifies that interest on such Debt (or portion thereof) is to be paid as paid-in-kind interest.” (emphasis added). The current definition now encompasses “partial” PIK interest loans, which have proven to be more prevalent in the market recently than the 100% PIK interest variety.

In addition, footnote 3 in Section 6 of the 2009 Par Standard Terms and Conditions further addresses partial PIK interest loans, making clear that in calculating “Compensation for Delayed Settlement”, the parties should bifurcate the loans being traded into a “PIK Interest Loan” component and a “Performing Loan” component. The addition of this explanatory footnote 3 should lead to more accurate pricing and fair settlements in the PIK interest loan context.¹⁰

B. Buy-in/Sell-out Provisions (Sections 16-19).

The BISO provisions in Sections 16-19 of the 2009 Par Standard Terms and Conditions establish the circumstances under which a “performing party”¹¹ may terminate its obligations under a trade confirmation and effect a cover transaction in respect of the loans. These provisions have been revamped and greatly expanded.

⁹ If the loan is a “PIK Interest Loan”, the buyer pays to the seller its “cost of carry” on the purchase price for the period from T+7 until the settlement date; if the loan is a “Performing Loan”, in most cases, the seller pays to the buyer “delayed compensation”, which is typically the applicable margin on the loan and any related ordinary course fees, for the period from T+7 to the settlement date.

¹⁰ It should be noted that footnote 3 clarifies the scenario in which the PIK interest loans constitute a discrete tranche under a credit agreement and thus can be easily bifurcated from any non-PIK interest tranche for purposes of calculating “Compensation for Delayed Settlement” pursuant to Section 6. However, the footnote fails to provide a calculation method for the scenario in which a single tranche of loans have both a cash interest and a PIK interest component.

¹¹ The “performing party” under BISO is the party that has performed its “Settlement Delivery Obligations” (i.e., (i) execution and delivery of the trade confirmation to the counterparty and (ii) execution and delivery of the assignment agreement to the counterparty, and if applicable, to the administrative agent) prior to the Trigger Date.

Section 16 of the 2009 Par Standard Terms and Conditions provides that BISO is applicable to assignment transactions only and may be exercised by the performing party following the “Trigger Date”-- generally twenty (20) business days after the trade date --by delivering to the “nonperforming party” at any time thereafter a written “BISO Notice” of its intent to (i) terminate its obligations under the Confirmation and (ii) effect a cover transaction in respect of the specified loans. The nonperforming party then has ten (10) business days following receipt of a BISO Notice to cure by performing its Settlement Delivery Obligations. If the performing party is the seller, it must hold the specified loans as of the date of delivery of the BISO Notice to the buyer. The performing party must enter into a cover transaction within ten (10) business days following the expiration of the cure period or the parties’ obligations under the Confirmation are reinstated.

Notwithstanding the foregoing, under certain circumstances, the nonperforming seller may assert a defense to a BISO Notice by meeting certain “Upstream BISO Obligations”, which entails (i) delivering to the performing party a buy-in trade confirmation (with pricing information redacted) for the applicable inventory with a trade date no more than five (5) business days after the trade date of the original sale trade, and (ii) certifying that the seller (A) has not used such buy-in trade confirmation for any other BISO defense and (B) will perform its obligations under the buy-in trade confirmation or, if necessary, effect a BISO procedure against the upstream seller.

3. Additional Changes to the Distressed Confirmation.

A. Adequate Protection Payments (Section 5).

Upon a payment default by a borrower, Section 5 of the 2009 Distressed Standard Terms and Conditions requires that Interest and Accruing Fees otherwise for the account of the seller pursuant to the Settled Without Accrued Interest (“SWOA”) trading

convention will instead be for the account of the buyer. Under certain circumstances, despite a bankruptcy filing by the borrower/debtor which would otherwise constitute a payment default, Adequate Protection Payments¹² made by the debtor during the bankruptcy case are entitled to SWOA treatment under the Confirmations. The LSTA has modified the standard for application of the SWOA convention to trades where such Adequate Protection Payments are being made.

The 2006 Distressed Confirmation provided, simply, that if a buyer and seller agree on SWOA interest treatment and a debtor makes Adequate Protection Payments in accordance with an adequate protection order, then “any such Adequate Protection Payments shall . . . be allocated on a [SWOA] basis and treated as if such payments were Interest and Accruing Fees.”

U.S. Bankruptcy Court adequate protection orders have become more complex and varied in their terms over the past few years. As a result, the imprecision of Section 5 in the 2006 Distressed Confirmation has led to many disputes and delayed settlements over whether a particular adequate protection order meets the criteria necessary for the trade to settle on an SWOA basis. For example, an adequate protection order may provide for the debtor to make a one-time lump-sum payment of adequate protection to the secured lenders that, while not clearly marked by the bankruptcy court as a pre-petition interest make-whole, not coincidentally equals the amount of pre-petition interest owed to such lenders under the credit agreement. This scenario technically qualifies that adequate protection payment for SWOA treatment. However, many buyers have argued that the intent of these provisions in Section 5 is to capture only those adequate protection orders that essentially mirror the payment terms found in the pre-petition credit agreement, which is not the case in this example.

In response, Section 5 of the 2009 Distressed Confirmation provides that only if Adequate Protection

¹² “Adequate Protection Payments” are defined in Section 5 as amounts (other than PIK Interest) authorized and/or ordered to be paid in respect of the Debt as adequate protection for Interest and Accruing Fees on the loans and obligations owed under the credit agreement under an adequate protection order.

Payments are being made by the debtor “as and when due” under the applicable adequate protection order “no less frequently than as required for payments of Interest and Accruing Fees under the Credit Agreement as in effect immediately prior to the Filing Date”, will such Adequate Protection Payments be treated as Interest and Accruing Fees and remain allocated between the parties on an SWOA basis. Should any Adequate Protection Payment fail to meet this enhanced standard, then such payment will be deemed to have defaulted and, if and when paid, will be for the account of the buyer.¹³

B. Compensation for Delayed Settlement (Sections 5 and 6).

In addition, the LSTA has clarified the application of the settlement date crediting provisions for Interest and Accruing Fees in Sections 5 and 6(b) of the 2009 Distressed Standard Terms and Conditions.

Section 6(b) of the 2006 Distressed Confirmation provided that a seller will credit a buyer at closing, if the trade was done on an SWOA basis, for any Interest and Accruing Fees allocable to the period between T+20 and the settlement date (the “Delay Period”). The LSTA originally added those provisions in order to reduce the need for post-settlement adjustments in cases where the seller later receives accrued interest on the loans for the Delay Period.

However, in situations in which the parties traded on an SWOA basis and the borrower fails to pay interest prior to the settlement date, certain sellers would refuse to credit buyers at closing for such amounts on the grounds that the amount of the credit would later have to be returned pursuant to the terms of Section 6 (b).¹⁴

The 2009 Distressed Confirmation, in Sections 5 and 6 (b), now states that, where the parties have agreed on SWOA but the conditions for a seller to retain Interest and Accruing Fees accrued but unpaid before the settlement date have not been met¹⁵ (and therefore any such payments, if and when paid, belong to the buyer), the seller no longer will be required to credit the purchase price for such Interest and Accruing Fees (or Adequate Protection Payments, if applicable) accrued on the loans during the Delay Period.

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If you would like more information on the revised LSTA forms of Par/Near Par and Distressed Trade Confirmations or have any questions on the foregoing, please feel free to call us at 212-530-1800.

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¹³ It should be noted that this modified Adequate Protection Payments/SWOA language does not address variations in either payment amounts or other material terms, as compared with the interest provisions under the applicable pre-petition credit agreement, increasingly found in adequate protection orders; therefore, such variations from the terms of the applicable pre-petition credit agreement would likely cause any Adequate Protection Payments to fail to meet this revised SWOA standard.

¹⁴ Section 6(b) requires the buyer, on the seller’s demand, to return such credited Interest and Accruing Fees (or Adequate Protection Payments, if applicable) upon a default by the obligor to make such payments to the seller.

¹⁵ Section 5 of the Standard Terms and Conditions, in the definition of “Settled Without Accrued Interest”, provides that a buyer owes to a seller Interest and Accruing Fees accrued but unpaid before the settlement date “so long as such amounts are received by Buyer (a) on or before the due date thereof or the expiration of any applicable grace period, each as specified in the Credit Agreement as in effect on the Trade Date (or, if no such grace period exists (other than due to any acceleration of the Debt pursuant to the Credit Agreement following the Filing Date (as defined below)), the expiration of thirty (30) days from such due date), and (b) before a default by any obligor(s) in connection with any other payment obligations of the obligor(s) under the Credit Agreement. “

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