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Banking & Finance 2023

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USA: Law & Practice
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Shearman & Sterling

USA

Law and Practice

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1. Loan Market Overview

1.1 The Regulatory Environment and Economic Background

Following years of heightened leverage levels in the US loan market, and in connection with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in the aftermath of the 2008 global financial crisis, US federal regulators issued Interagency Guidance on Leveraged Lending (the "Guidance") in 2013.

The Guidance imposes certain requirements on regulated lenders and arrangers aimed at promoting sound risk management. Among other things, the Guidance requires regulated lenders to incorporate as part of their credit risk analysis a borrower's ability to deleverage its capital structure during the term of the loan, and to avoid loans that exceed specified leverage levels. As a result, less heavily regulated non-bank lenders and foreign financial institutions capitalised on this opportunity to increase their market share of the leveraged loan market given their ability to provide higher leverage levels and riskier loans.

Following record levels of loan issuance in late 2020 and in 2021, during 2022 and 2023, the increasing inflationary environment, combined with rising interest rates and macroeconomic uncertainty, has led to a material reduction in loan volume throughout 2022 and 2023 compared to prior years. While overall leveraged loan volumes in the US have continued to decline in 2023 compared to 2022, there has been a slight uptick in refinancings in 2023. The overall continued decline in loan volumes in 2023 has been partly driven by continuing decreased M&A activity. In particular, the volume of large committed syndicated loan financings has declined following a number of troubled larger syndications since mid-2022 in which arrangers were unable to sell such loans or such loans were sold at a steep discount.

In light of the regional banking crisis in March 2023 which affected several financial institutions in the United States, regulators have also unveiled plans which would require regional banks with at least USD100 billion in assets to, among other things, hold long-term debt to help absorb losses in the event of seizure by the government as well as requiring such banks to adhere to risk models which have been standardised for larger regulated banks in the industry.

1.2 Impact of the Ukraine War

The Ukraine war has led to increased political and macroeconomic uncertainty throughout the entire political system and has accordingly affected risk tolerance in the financial system. This has contributed to the lower loan volumes seen in 2022 and 2023 described above as well as a decrease in M&A volume in North America, with the value of deals in H1 2023 totalling approximately USD960.0 billion, a 28.5% reduction from H1 2022 levels.

With respect to US loan documentation, the uncertainty in the market has led to an increased focus on lender-protective provisions (including provisions intended to prevent future liability management transactions) which had been scaled back during prior years. The Ukraine war has also increased focus by lenders on representations and warranties and covenants relating to compliance with sanctions, anti-corruption and anti-money laundering laws.

1.3 The High-Yield Market

Companies when contemplating a capital raise have looked to both the loan and high-yield bond markets to meet their financing needs. Ultimately, borrowers will seek to obtain the correct mix

of debt instruments that offers the most favourable terms consistent with their capital needs. Further, given the rising interest environment in 2023, fixed interest rate debt instruments have become more attractive, but investors have been increasingly requiring security in these fixed-rate instruments evidenced by the increasing prevalence of secured high-yield bond issuances, which represented approximately 63.24% of total high-yield bond issuances in 2023. In addition, given the economic backdrop of the relatively high cost of capital compared to recent periods, companies have been issuing shorter maturity instruments to reduce the costs of redeeming such debt when the interest rate environment becomes more issuer-friendly.

Covenant terms and protections in the high-yield bond market have continued their long-term convergence with those of the leveraged loan market, which is demonstrated clearly by the proliferation of "covenant-lite" term loans, which represented approximately 92.41% of all new-money first-lien leveraged loan issuances as at the end of August 2023.

Certain differences remain between leveraged loan and high-yield bond terms. Loans continue to provide weaker "call" protection in connection with voluntary prepayments. Additionally, in capital structures with both leveraged loans and bonds, lenders typically continue to drive the guarantee and collateral structure and control enforcement proceedings given the increased focus on collateral from a loan perspective.

Providers of leveraged loans continue to push to restrict investments in non-guarantor subsidiaries more often than investors of high-yield bonds. Additionally, many loans contain "most favoured nation" (MFN) protections that require an interest rate reset upon the issuance of certain higher-yielding debt, subject to carve-outs which traditionally limit the duration of the MFN and other limitations on MFN as specifically negotiated in the credit documentation.

Finally, there are still a few respects in which loans contain more permissive terms than bonds, such as:

- the lack of a fixed-charge coverage governor on the usage of the "available amount" builder basket for restricted payments;
- allowing amounts in the "available amount" builder basket to build for positive cumulative consolidated net income in a given period without a corresponding deduction for negative amounts in other periods; and
- permitting the incurrence of debt by "stacking" based on priority (eg, by first incurring junior lien debt in reliance on a secured leverage ratio and then incurring first lien debt in reliance on a first lien leverage ratio), rather than the bond standard secured leverage governor applying to all such secured debt, regardless of priority (at least in the case of unsecured bonds).

1.4 Alternative Credit Providers

With private debt funds in North America raising more than USD500 billion since 2020 as well as the lack of regulatory restrictions on such funds, alternative credit providers have significantly increased their market share of the US loan markets.

Direct lending (in which loans are made without a bank or other arranger acting as intermediary) has grown dramatically over the last several years. Although these asset managers historically operated largely in the middle market and focused on smaller corporate borrowers, direct lenders have become financing sources for all

manner of top-tier transactions by providing, (i) "anchor" orders in syndicated facilities, (ii) "bought" second lien (or otherwise difficult to syndicate) tranches; and/or (iii) complete financing solutions to large corporate borrowers and private equity sponsors.

Direct lenders are often willing to provide financing at higher leverage multiples or allow a portion of interest to be paid in kind as well as loan into parts of the capital structure that are not readily available in the broadly syndicated market, such as preferred equity, holding company (structurally junior) loans or unitranche facilities.

In addition, direct lenders offer faster execution speed and certainty of terms, since there is no marketing process and thus no requirement for a marketing period or modification of loan terms during syndication.

1.5 Banking and Finance Techniques

In recent years, as a result of intense competition among bank and non-bank lenders to lead financing transactions, there has been a marked increase in documentation flexibility – albeit with a recent pullback in the latter part of 2022 and during 2023. Private equity sponsors have been key drivers of this increased flexibility, as recurring customers in the syndicated and direct loan markets with increasing market sway, they have been able to push for more aggressive terms in each subsequent transaction. Often, borrowers require lenders to rely on underwritten borrower-friendly loan documentation precedents to ensure that the terms of the new financing are at least as favourable to the borrower as its most recent financing (often with "market flex" rights in syndicated financings to remove the most aggressive terms if necessary to achieve successful syndication of the loan). Lenders wishing to stay competitive in the leveraged loan market have been under pressure to be increasingly selective on the terms they resist in negotiations, even on the flex terms.

Given the past year's uncertainty in the market, however, there has been a pullback of the most aggressive terms seen in the market in 2021. There has also been an increased focus from lenders on provisions aiming to protect lenders against liability management transactions (as further explained below).

Another trend seen in the US market in recent years is the growth of debt financings at the Holdco level. Private equity sponsors' desire to be more competitive in auction processes, and non-bank lenders (as well as, in recent years, bank lenders) that are seeking to deploy additional capital at attractive returns, have contributed to the growth of these Holdco financings. Holdco financings often include a payment-in-kind interest construct which enables the opco structure to keep operating without the need to service additional cash interest and amortisation payments. The issuers of the Holdco loans or notes are structurally subordinated to any debt at the opco level and typically do not have recourse to the assets at the opco level. Therefore, the Holdco lenders are typically not party to any intercreditor agreement with the opco lenders. Another manner in which to accomplish a financing with similar features is through the issuance of preferred equity at the Holdco level.

1.6 ESG/Sustainability-Linked Lending

There has been a growing trend among participants in the US loan market to tether loan pricing with a borrower's ability to achieve predetermined ESG or sustainability-linked objectives. Certain borrowers perceive this tool as a means of accomplishing dual objectives: (i) building heightened sustainability profiles integrating

ESG-oriented goals that will appeal to investors and the public, and (ii) securing lowered interest rates and fees on their credit facilities.

Partly driven by mounting pressure to evidence the legitimacy of their sustainability and ESG credentials, borrowers will typically collaborate with a third-party sustainability structuring agent to develop precise ESG benchmarks that will be monitored throughout the loan's duration. Interest rate margins and fees will ratchet up or down depending on performance against pre-set sustainability and ESG targets. Over time, these benchmarks frequently evolve to become more rigorous. Increasingly, materiality of the margin ratchets has been criticised by participants who question whether it is significant enough to motivate the change.

2. Authorisation

2.1 Providing Financing to a Company

In the US, banks (and credit unions) have the option of being chartered by a state government or the federal government under a so-called dual chartering system. Banks which are chartered by state banking authorities are primarily subject to the regulations of the relevant state authority, and may also be regulated or supervised by the Federal Reserve and/or Federal Deposit Insurance Corporation (FDIC). Banks chartered by the federal government on the other hand are subject to regulation by the Officer of the Comptroller of the Currency (OCC) and are required to become members of the "Federal Reserve System". Under federal law, federal and state banks are also required to obtain insurance from the FDIC protecting depositors.

Although alternative credit providers, direct lenders and other non-bank lenders are primarily subject to Securities and Exchange Commission (SEC) rules and regulations, they may also be subject to regulation under the Investment Company Act (ICA) as an "investment company". However, such lenders are often exempt from many of the ICA's requirements and regulations.

3. Structuring and Documentation

3.1 Restrictions on Foreign Lenders Providing Loans

Foreign Lenders are subject to the (i) International Banking Act and (ii) the Foreign Bank Supervision Enhancement Act as well as regulated by the Federal Reserve, whose approval is necessary to establish foreign banking institutions in the US.

Also, foreign banking institutions are required to seek approval from the OCC or state banking supervisor to establish US branches and agencies.

In 2019, the Federal Reserve finalised new regulatory requirements for US subsidiaries of foreign banks. These provided relaxed capital and stress-testing requirements, while also imposing stricter liquidity requirements.

3.2 Restrictions on Foreign Lenders Receiving Security

Under US law, granting security interests to, or providing guarantees in favor of, foreign lenders generally does not differ from regulations that apply to domestic lenders.

3.3 Restrictions and Controls on Foreign Currency Exchange

The USA does not currently impose any foreign currency exchange controls affecting the US loan market, unless a party is in a country that

is subject to sanctions enforced by the Office of Foreign Assets Control (OFAC) of the US Department of the Treasury. OFAC administers and enforces economic and trade sanctions based on US foreign policy and national security goals.

3.4 Restrictions on the Borrower's Use of Proceeds

Loan agreements in the USA traditionally have negative covenants limiting the borrower's use of loan proceeds to specified purposes as set forth in the Loan Agreement.

Furthermore, US law restricts the use of loan proceeds that are in violation of the margin-lending rules under Regulations T, U and X, which limit financings used to acquire or maintain certain types of publicly traded securities and other "margin" instruments if the loans are also secured by such securities or instruments.

3.5 Agent and Trust Concepts

In US syndicated loan financings, an administrative agent is appointed to act on behalf of the lending syndicate to administer the loan. Further, in some secured transactions, a separate and distinct collateral agent is appointed to coordinate collateral-related matters. When financings involve numerous series of debt securities or multiple lending groups sharing the same collateral, security interests are sometimes granted to collateral trustees or other "intercreditor" agents to act on behalf of all creditors, with the trust or intercreditor arrangements setting out the relative rights of the various creditor groups.

3.6 Loan Transfer Mechanisms

In the US loan market, lenders have the option to transfer their interest under credit facilities to other market participants through either assignments or participations. An assignment is the sale of all or part of a lender's rights and obligations under a loan agreement, upon which the assignee replaces the assigning lender under the loan agreement with respect to the portion of commitments or loans assigned. As the new "lender of record", the assignee benefits from all rights and remedies available to lenders thereunder and takes on the obligations of the lenders.

Assignments will usually require the consent of the borrower, the administrative agent and – in the case of revolving facilities including letter of credit and/or swingline subfacilities – the letter of credit issuers and the swingline banks. Loan agreements often provide for some limitations on borrowers' consent rights during the continuation of any event of default – or, increasingly, only during the continuation of a payment or bankruptcy event of default.

Usually, borrower consent is not required in connection with assignments to another lender (or an affiliate or "approved fund" of such lender). Typically, in cases where borrower consent is required, in the absence of any objection from the borrower within a specified period of time (usually five to 15 business days), the borrower is deemed to have consented to such assignment. In some instances, deemed consent only applies to assignments in respect of term loans but not revolving facilities.

In contrast, participations involve a transfer of a limited amount of the lender's rights, which traditionally are focused on the right to receive payments on the loan and the right to direct voting on a limited set of "sacred rights". The transferee becomes a "participant" in the loan but does not become a lender under the loan documentation and has no contractual privity with the borrower. Participations rarely require notice to or consent from the borrower or any other party. However, some borrowers have sought to impose limi-

tations on these participation rights, including consent and notice requirements.

Increasingly, loan agreements restrict assignments and participations to "disqualified institutions", which generally include the borrower's competitors and certain financial institutions that the borrower deems undesirable.

3.7 Debt Buy-Back

Borrowers and their affiliates (including in some cases private equity sponsors) are able to purchase loans in the US syndicated loan market, subject to customary requirements and restrictions.

In addition, private equity sponsors and their affiliates (other than borrowers and their subsidiaries) are typically allowed to make "open-market" purchases of loans from their portfolio companies on a non-pro-rata basis. Once held by a borrower affiliate, these loans are normally subject to restrictions on (i) voting, (ii) participating in lender calls and meetings and (iii) receiving information provided solely to lenders.

Loans held by private equity sponsors and their affiliates are also subject to a cap of the aggregate principal amount of the applicable tranche of term loans which is traditionally in the range of 25–30%. Bona fide debt fund affiliates of private equity sponsors that invest in loans and similar indebtedness in the ordinary course are usually excluded from these restrictions, but are still restricted from constituting more than 49.9% of votes in favour of amendments requiring the consent of the majority of lenders.

3.8 Public Acquisition Finance

The US does not have specific rules or regulations requiring "certain funds" requirements with respect to financing acquisitions of public companies. However, financing commitments with respect to both public and private company acquisitions are generally subject to a limited set of "SunGard" conditions due to the absence of a financing condition in most acquisition agreements. The "SunGard" conditions typically include:

- accuracy of certain "specified representations" relating to the enforceability and legality of the financing itself;
- accuracy of certain material seller or target representations made in the acquisition agreement, the breach of which would permit the buyer to terminate the acquisition;
- absence of a material adverse change with respect to the target (on terms identical to the corresponding condition to the acquisition); and
- conditions relating to the timing required by arrangers to properly syndicate the loans in advance of acquisition closing (either in the form of marketing periods or an "inside date").

Given these dynamics, it is customary for buyers/borrowers and arrangers to execute commitment letters, including detailed term sheets that usually include the parties agreeing on precedent documentation, simultaneously with signing the acquisition agreement. This provides buyers with committed financing, subject to this customary "limited conditionality".

3.9 Recent Legal and Commercial Developments

In the recent economic climate, some borrowers who are facing adverse economic conditions have looked to execute liability management transactions (which need to be permitted by their credit documentation).

One recent example of such a transaction involves a borrower seeking the release of guarantors that are no longer wholly owned by the borrower (even if wholly owned by its affiliates). Following such release, the released entities would more easily be able to incur additional indebtedness. Lenders have increasingly sought protection from this type of transaction by permitting the release of a guarantee only in certain circumstances (eg, the guarantor becomes non-wholly owned in a bona fide transaction involving a third party without the intent of releasing the guarantee as part of the transaction).

Another recent example is the use of multiple-step processes (where each step is permitted under the investment covenant) to move valuable IP and other assets from guarantors to non-guarantor entities, thereby automatically releasing the lenders' security interest in such assets in the process. Lenders have, similarly, sought to limit or even completely eliminate this flexibility.

Furthermore, borrowers have increasingly used flexibility in the amendment section to make updates to credit documentation that allow for a majority of lenders to gain a benefit over the minority lenders. Recent transactions have allowed for a majority of lenders to subordinate, in both right of payment and on the liens, existing debt for new debt which the majority lenders are providing. Certain lenders have sought to limit this flexibility by modifying amendment provisions so that any priming debt is required to be offered to each lender on a pro-rata basis.

3.10 Usury Laws

Nationally chartered banks may not charge interest exceeding the greater of (i) the rate permitted by the state in which the bank is located or (ii) 1% above the discount rate on 90-day commercial paper in effect in the bank's Federal Reserve district.

If the state where the bank is located does not prohibit usurious interest, banks may not charge interest exceeding the greater of 7% or 1% above the discount rate on 90-day commercial paper in effect in the bank's Federal Reserve district. In general, federal law will pre-empt any state usury law that prohibits state-chartered banks from applying the same interest rate as a nationally chartered bank.

Under New York law, with certain exceptions, charging interest in excess of 16% constitutes civil usury, and charging interest in excess of 25% constitutes criminal usury. However, loans in excess of USD250,000 are exempt from the civil statute, but remain subject to the criminal statute. Loans in excess of USD2.5 million, which include nearly all broadly syndicated loans in the US, are exempt both from New York's civil and criminal statutes.

3.11 Disclosure Requirements

There are no rules or laws in the US that prohibit certain disclosure of financial contracts, but in credit documentation there is traditionally a confidentiality section that prohibits the lenders from disclosing the nature of the financing other than in pre-agreed situations.

4. Tax

4.1 Withholding Tax

The US tax rules contain a complex withholding regime that imposes, in certain circumstances, a withholding tax of up to 30% on payments of interest to non-US lenders. In order to encourage international lending to US borrowers, however, the rules contain various exemptions from this

withholding tax. Under current law, the expectation is that lenders to a US obligor should generally be able to qualify for one or more of these exceptions, such that lenders are not subject to the withholding tax and obligors are not required to compensate lenders under a "gross up" provision in credit agreements. In order to benefit from these exemptions, however, lenders must provide certain certifications to borrowers or their agents, generally on tax forms published by the Internal Revenue Service (IRS), as discussed below. Parties to credit agreements with US obligors should ensure that such forms are appropriately addressed in loan documentation and furnished in practice.

This withholding tax regime may also apply to certain other payments and income arising from loans. If a loan is issued at a discount in excess of a de minimis amount (original issue discount, or OID), this discount is treated as interest income when paid, subject to the withholding tax. Certain fees may also be treated as OID for this purpose.

As mentioned above, there are several exemptions from the withholding tax on interest. The most notable exemption is the portfolio interest exemption, which is the basis for many non-bank lenders to eliminate withholding. In the case of banks and other lenders that do not qualify for the portfolio interest exemption, US tax treaties may eliminate withholding or reduce the rate. Finally, if non-US banks lend from their branch in the United States (a "US trade or business"), the withholding tax generally does not apply.

To qualify for one of these exemptions, non-US lenders are generally required to provide a US tax form to the borrower or agent – usually an IRS Form W-8BEN-E (for treaty benefits or the portfolio interest exemption) or IRS Form W-8ECI (if the interest is effectively connected with the non-US lender's US trade or business). Additional certifications and forms are required in certain instances involving flow-through entities or intermediaries.

Another withholding regime that may apply to certain payments of interest and OID is the "backup withholding" regime, which generally applies to domestic payments (currently at a withholding rate of 24%) in circumstances where a US lender fails to provide certain information and certifications required for purposes of the US information reporting regime. Backup withholding is usually eliminated by the provision of an IRS Form W-9 and, if it is imposed, generally can be recovered in the form of a credit on the lender's US tax return.

Principal payments and proceeds from a sale or other disposition of debt instruments are not subject to US withholding tax (except to the extent that such payments are treated as a payment of interest or OID). However, fee income that is not treated as OID may be subject to 30% withholding unless a treaty applies or the recipient is engaged in a US trade or business. The portfolio interest exemption may not apply to such fees because they may not be treated as interest for US tax purposes.

Finally, the Foreign Account Tax Compliance Act (FATCA) may impose a 30% US withholding tax on non-US banks and financial institutions (including hedge funds) that fail to comply with certain due diligence, reporting and withholding requirements. FATCA withholding tax applies to payments of US-source interest and fees, without any exemptions for portfolio interest or treaty benefits. Originally, FATCA was also intended to apply to payments of gross proceeds from a sale or other disposition of debt instruments of US

obligors. However, the Internal Revenue Service (IRS) and US Department of the Treasury issued guidance in 2018 stating that no withholding will apply on payments of gross proceeds. In the case of payments that are within FATCA's purview, the recipient must generally certify its compliance with FATCA in order to avoid a punitive 30% withholding tax (on the same IRS W-8 forms described above).

Many countries have entered into agreements with the USA to implement FATCA (Intergovernmental Agreements, or IGAs), which may result in modified requirements that apply to financial institutions organised in such countries.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Under Section 956 of the Internal Revenue Code, if a foreign subsidiary of a US borrower that is a controlled foreign corporation (CFC) guarantees the debt of a US-related party (or if certain other types of credit support are provided, such as a pledge of the CFC's assets or a pledge of more than two-thirds of the CFC's voting stock), the CFC's US shareholders could be subject to immediate US tax on a deemed dividend from the CFC.

Following regulatory changes published by the US Treasury and the IRS in 2019, US borrowers may obtain credit support from CFCs without incurring additional tax liability if certain conditions are met. However, despite these regulatory changes, the majority of loan documents today continue to maintain customary Section 956 carve-outs. This excludes CFCs from the guarantee requirements and limits pledges of first-tier subsidiary CFC equity interests to less than 65%.

Separately, non-US lenders should closely monitor their activities within the USA to determine whether such activities give rise to a US trade or business or a permanent establishment within the USA. If so, they could be subject to US taxation on a net income basis.

4.3 Foreign Lenders or Non-money Centre Bank Lenders

The primary tax concerns that arise for non-US lenders to US obligors are those summarised in **4.1 Withholding Tax**; ie, withholding tax on interest, including FATCA withholding. To mitigate these concerns, it is important for non-US lenders and US obligors to ensure that appropriate tax forms are exchanged in order to establish any exemptions from these withholding regimes.

Although the US tax rules do not address non-money centre banks per se, the various regimes described in **4.1 Withholding Tax** (including IRS tax forms, the portfolio interest exemption and FATCA) apply differently and impose different requirements based on the particular circumstances and business activities of the lender.

5. Guarantees and Security

5.1 Assets and Forms of Security

The norm for secured financings in the US is that the collateral package consists of substantially all assets of the borrowers and their subsidiaries, with certain negotiated exceptions, which are typically meant to exclude assets with burdensome perfection requirements and/or where a pledge would lead to expensive or other negative consequences for the borrowers which outweigh the benefit to the lenders. Common exclusions include:

- leased real property and owned real property with a value below an agreed threshold;
- equity interests in certain non-guarantor subsidiaries, such as captive insurance companies and certain special purpose vehicles;
- contractual rights (including licenses) prohibited to be pledged by law or contract (although the proceeds thereof are generally included);
- assets requiring the consent of a third party or governmental agency to be pledged;
- assets with de minimis value;
- assets the pledge of which would lead to negative tax consequences for the borrowers
- assets subject to burdensome perfection regimes such as certificates of title (including motor vehicles, aircraft, railcars and maritime vessels); and
- "intent-to-use" applications for the registration of a trade mark.

The creation of security interests for most categories of personal property are governed by the Uniform Commercial Code (UCC). The requirements for creating enforceable security interests with respect to personal property under Article 9 of the UCC are the following:

- the lender must provide value to the grantor of the security interest;
- the grantor must have rights in the collateral or the power to transfer rights in the collateral to the lender; and
- either the grantor must execute a security agreement, which must be authenticated by the grantor and describe the collateral, or, in the case of certain types of collateral, the collateral must be in the possession or control of the lender.

To create a security interest in assets not governed by the UCC (eg, real property and certain kinds of intellectual property), the parties will typically create separate collateral documents or mortgages pursuant to applicable legal requirements in the jurisdiction governing the property.

Lenders must perfect such security interest to obtain priority vis-à-vis other creditors. The relevant perfection requirements under Article 9 of the UCC depend on the asset type, but generally Article 9 of the UCC provides the following four methods of perfecting security interests in domestic personal property:

- filing a UCC-1 financing statement in the appropriate jurisdiction (which is a short document setting forth basic information about the grantor and the secured party, and a description of the collateral);
- possession, in the case of certain tangible assets;
- establishing control, which may be effected by entering into control agreements in the case of deposit accounts, letter of credit rights, investment accounts and electronic chattel paper; and
- perfection upon attachment (ie, automatically upon the creation of the security interest), in the case of certain other personal property.

Perfection of security interests in federally registered copyrights (and, by custom, patents and trademarks) requires filing with the US Copyright Office (or the US Patent and Trademark Office), in accordance with federal law. Various state and federal laws govern perfection of security interests in motor vehicles, aircraft, ships and railcars, with separate registries and perfection steps required for such categories. Mortgages in real property are perfected by recording such mortgages (or equivalent documents) with the local (usually county-level) recording office where the real property is located.

5.2 Floating Charges and/or Similar Security Interests

Article 9 of the UCC permits the granting of a floating lien in the form of an "all assets" pledge, which can include all personal property owned by the grantor. Further, there is no distinction between floating and fixed charges in the US, so the granting of security interests over personal property normally covers both presently owned and later acquired assets. Importantly, however, "all assets" pledges apply only to personal property that is subject to the requirements of Article 9 of the UCC (with certain exceptions for asset types such as commercial tort claims, which must be described with more specificity). Other assets – such as real property and federally registered copyrights – cannot be subject to floating liens. For certain asset types, such as motor vehicles, creation of a security interest is governed by Article 9 of the UCC, but perfection is governed by state certificate of title laws, so perfection of security interests over such assets cannot be obtained by filing a UCC-1 financing statement.

5.3 Downstream, Upstream and Cross-Stream Guarantees

In the US, there are generally no limitations or restrictions on the provision of guarantees to related parties. However, in order to prevent a guarantee from being rendered unenforceable on the grounds of fraudulent conveyance, downstream, upstream and cross-stream guarantees should provide for a limit on the amount that is guaranteed; in order to avoid being a fraudulent conveyance, the guarantor must either receive adequate consideration or must not be rendered insolvent after giving effect to such guarantee. Customary limits contained in guarantees are designed to avoid the guarantor from being rendered insolvent. In addition, loan market participants often require borrowers and their subsidiaries to provide certifications as to their solvency at the time the loan and the guarantees thereof are made.

5.4 Restrictions on the Target

There are no rules in the US generally prohibiting a target company from guaranteeing or granting a security interest in its assets to provide credit support for a financing used to acquire its or any of its parent entities' shares. However, as is the case with guarantees and security interests generally, guarantees and security interests provided by a target company are subject to the rules on fraudulent conveyance and, in certain cases, may be subject to regulatory schemes that make such a guarantee and/or security interest impracticable even if legal. Subject to such limitations, lenders will typically require guarantees and security interests to be provided by the target company – along with delivery of any certificated securities of the target company – as a condition to the closing of an acquisition financing subject to any limits that "Sungard" provisions impose.

5.5 Other Restrictions

Anti-assignment provisions in commercial contracts pose difficult issues for lenders in secured financings. A statutory override of anti-assignment provisions in contracts is generally available under the UCC but, if the restricted collateral is critical to the collateral package, lenders are likely to require such third party to consent to the pledge as a condition to the loan so that there will be fewer complications if lenders need to enforce such pledge.

5.6 Release of Typical Forms of Security

Loan documentation in the US typically allows releases of the lenders' security interest in collateral in connection with dispositions of such collateral which are permitted under the loan

documentation. The release of all or substantially all of the collateral typically requires the consent of all lenders or, in some cases, a super majority thereof.

5.7 Rules Governing the Priority of Competing Security Interests

The relative priority of security interests held by different creditors in the same assets of a grantor is determined by the UCC of the applicable jurisdiction and is subject to the following rules:

- a perfected security interest has priority over a conflicting unperfected security interest;
- conflicting perfected security interests rank in priority according to the time of filing or perfection; and
- conflicting unperfected security interests rank in priority according to the time at which the security interest attached or became effective.

In addition, the UCC allows certain categories of collateral to be perfected by multiple methods, with priority determined based on the "preferred" method, regardless of the rules set forth above. With respect to investment property, securities accounts and certificated securities, perfection via "control" or possession has priority over perfection via filing a UCC-1 financing statement. Further, the UCC contains an exception for purchase money security interests under which a secured creditor with a purchase money security interest can obtain priority ahead of an earlier UCC-1 financing statement with respect to the purchased asset(s).

Lenders and borrowers are allowed to agree to modify the priority rules set out in the UCC and other relevant laws, by contract. The parties can also accomplish different lien priorities structurally.

Arrangements for lien subordination ordinarily provide that:

- junior creditors are subject to a "standstill" period prior to exercising enforcement rights or remedies with respect to shared collateral;
- payments from the proceeds of shared collateral received by junior creditors in violation of the agreement will be held in trust and turned over to senior creditors; and
- certain specified amendments to both senior and junior priority loan documents will be subject to agreed limitations.

Structural subordination arises where obligations incurred or guaranteed solely by a borrower are effectively junior to obligations incurred or guaranteed by a subsidiary of the borrower, to the extent of that subsidiary's assets. In such a situation, the subsidiary's creditors have the right to be repaid by such subsidiary (or out of its assets) as direct obligations of such entity in any insolvency scenario before creditors of the parent borrower – such subsidiary's equity holder – are repaid. Where the parent borrower is primarily a "holding company" for the equity interests of its operating subsidiaries, creditors of an operating subsidiary will be paid in priority to the holding company's creditors from assets of such subsidiary.

5.8 Priming Liens

Mechanic's liens arise when a contractor or mechanic performs work on property and is not paid. This lien is a security interest in the property. If the owner tries to sell the property, the debtor will have a secured interest in the portion of the proceeds needed to pay the debt.

Tax liens are placed against property by the local, state, or federal government, as author-

ised by statute, for delinquent taxes, including property, income, and estate taxes

A judgment lien is any lien placed on the defendant's assets as a result of a court judgment.

Possible structuring concerns will focus on properly conducting diligence on any possible liens, including conducting searches and other disclosure requirements as set forth in the credit documentation.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Loan and security documentation entered into in connection with a financing transaction generally provide a customary set of enforcement rights and remedies to secured parties, exercisable by such parties following the occurrence of a "default event" by an obligor.

From a statutory perspective, Article 9 of the Uniform Commercial Code (UCC) gives secured parties the right to proceed with several enforcement methods after a default event has been triggered by an obligor. These rights include:

- the right of a secured party to collect payments directly from a third-party obligor under accounts receivable, deposit accounts or with respect to certain other types of intangible assets;
- the right of a secured party to repossess collateral, either through the institution of judicial proceedings or through a non-judicial action; and
- the right of a secured party to dispose of the collateral through a public or private sale process.

However, in order to exercise such remedies under Article 9, secured parties also have an obligation to comply with certain statutory requirements. Such requirements are designed to protect obligors and generally provide that the time, place and/or manner of exercising such remedy must be commercially reasonable, that sufficient advance notice is provided to the relevant obligor and that certain other creditors who have an interest in the collateral are given adequate notice where such sale process involves a public sale or auction.

6.2 Foreign Law and Jurisdiction

Generally speaking, New York courts will permit parties to a loan agreement to select a particular foreign law to govern their contract. Notwithstanding this general rule, where the choice of law conflicts with public policy or there is no reasonable basis for the parties to choose such law to govern their contract (ie, the law selected has no real relationship to the parties or the transaction), the courts may decline to enforce the governing law selected by the parties.

In terms of conflict of laws rules, New York's rules will generally uphold foreign forum selection clauses so long as the jurisdiction selected by the parties has a reasonable relationship to the transaction – more specifically, a significant portion of the agreement was negotiated, or the agreement was substantially performed, in such jurisdiction.

In cases involving foreign states, the Foreign Sovereign Immunities Act will permit a waiver of immunity either explicitly or by implication.

6.3 Foreign Court Judgments

Subject to certain conditions being observed (including due process requirements and reciprocity), New York courts will generally rec-

ognise and enforce the judgments of foreign courts. However, although uniform laws have been adopted by many US states, when recognition and enforcement of foreign judgments is concerned, there is still significant diversity between the states when dealing with procedural and substantive considerations.

6.4 A Foreign Lender's Ability to Enforce Its Rights

A foreign lender's ability to enforce its rights under a loan or security agreement will depend on the facts and circumstances of each case.

7. Bankruptcy and Insolvency

7.1 Impact of Insolvency Processes

Automatically upon the filing of a petition to commence insolvency proceedings under the United States Bankruptcy Code, an "automatic" stay comes into effect, prohibiting perfection of interests, termination of contracts, and enforcement activities by creditors, with few exceptions. This stay prevents the proverbial creditor "race to the courthouse" and provides the debtor with a "breathing spell," typically to organise a sale or a plan of reorganisation or liquidation.

Lenders' enforcement rights are replaced with rights in the bankruptcy case, and lenders may seek repayment from sale proceeds or estate distributions, which may take a variety of forms, including payment of cash or equity, reinstatement of debt, and issuance of replacement obligations. In chapter 11, the reorganisation chapter of the Bankruptcy Code, individual creditors are entitled to recover the liquidation value of their claims regardless of how similar creditors placed in the same class vote. Classes of creditors may be bound to a plan when 2/3 in amount and more than 50% in number of the class approve. Class approval is not required however if the "cram down" standards are met, which generally prohibit distributions to junior creditors or equity where senior dissenting classes are impaired and require that secured creditors either receive their collateral, its proceeds or its "indubitable equivalent" value, or secured replacement notes. Chapter 7, the liquidation chapter of the Bankruptcy Code, has its own distribution rules.

Secured creditors also have the right to credit bid in a sale of their collateral, must consent to the use of cash collateral unless their security interest is "adequately protected", and may seek adequate protection against diminution of the value of their collateral, or relief from the automatic stay for cause.

7.2 Waterfall of Payments

The Bankruptcy Code recognises certain rights of lien and payment priority, which are set out in broad strokes below.

First, secured creditors are paid from the value of their collateral, subject to estate claims for the costs of maintaining such collateral.

Then come administrative claims, priority claims, general unsecured claims (including deficiency claims of undersecured creditors) and equity, in that order.

Administrative claims include expenses of administering the estate, operating the business on a post-petition basis, and certain statutorily designated items (eg, claims for goods delivered within the twenty days before the petition date and claims arising from a failure of adequate protection).

"Priority" general unsecured claims include, among other things, certain taxes and employee claims. Administrative and priority claims must be paid under a plan (some priority claims can be paid over time), and certain priorities apply within these categories.

7.3 Length of Insolvency Process and Recoveries

Case length depends on a variety of factors, with the most important being the level of advance planning and creditor agreement at the petition date.

In chapter 11 cases, if creditors are solicited on a "prepackaged" plan and certain notice periods are permitted to run prior to filing the case, a bankruptcy case can be as short as a day. More typically, prepackaged bankruptcies take 45-60 days from the petition date.

"Prearranged" plans, where requisite creditors have largely agreed to a plan framework but have not been solicited before the case is filed can also be expedited and completed within two to three months.

If a plan must be formulated after the filing, three to six months is more typical, and cases with more complex issues, litigation, and lack of consensual resolution can take significantly longer. There is no time limit for exiting bankruptcy, but the debtor may not maintain the exclusive right to file a plan for longer than 18 months after the petition date and or the exclusive right to solicit a plan for more than 20 months after the petition date. Cases may also be dismissed or converted to liquidation, particularly where there is no prospect of reorganisation.

Chapter 11 effectively preserves going-concern value and sizeable enterprises frequently reorganise successfully using this process. Additionally, there is a mature investor base specialised in acquiring distressed companies (or their debt or assets), which aids in supporting value. Companies that cannot reorganise may be liquidated under chapter 7.

7.4 Rescue or Reorganisation Procedures Other Than Insolvency

Where the borrower can obtain requisite consents to restructure debt or other contractual obligations, parties may restructure without proceedings. For example, borrowers and issuers may seek to exchange or amend existing debt to allow for covenant relief, extended payment terms or payment relief, and sometimes simultaneously solicit consents for a pre-packaged bankruptcy to be filed if requisite consents are not obtained. Carrots can be offered as well, such as improvements in collateral, guarantees, or other terms. Some deals involve incumbent lenders providing additional capital or other concessions to participating lenders in exchange for improvements in their priority position relative to other lenders or by lending against separate collateral. The ability under many agreements to effectuate such transactions without unanimous consent allows the architects of these transactions to propose coercive terms that leave non-participating lenders in a worse collateral, guaranty and/or covenant position, or to exclude some lenders from the opportunity to participate altogether.

For capital structures with a limited number of secured creditors and no need to restructure operations, consensual foreclosure or non-juridical foreclosure under Article 9 of the Uniform Commercial Code is relatively common. Some equity investors are also skilled at effectuating operational restructurings without the tools of bankruptcy.

7.5 Risk Areas for Lenders

Insolvency of an obligor creates risks of a change of control, degradation of the value of the obligors or their assets, and avoidance liability. In a bankruptcy, the company may be sold or transferred to creditors regardless of any constraints in loan documentation. In some scenarios, lenders, including secured lenders, may be given notes against the reorganised company. Additionally, lenders can be forced to accept virtually any distributional outcome that provides more than liquidation value if their class consents.

Any circumstance that further stresses the business, creates a forced-sale dynamic, or delays the process can diminish recoveries. Dilution by other creditors, including priming financing and related fees, additional equity financing provided under a rights offering and related fees (often in the form of rights to acquire equity at a discount), distributions to senior creditors under a low valuation, and necessary payments to other creditors, as well as the costs of the process, are all potential causes of lost value.

Finally, depending on the timing and circumstances of their loan, some lenders may be subject to risks of avoidance of rights transferred to them or obligations undertaken by the estate. The most typical of these is preference liability for transfers to unsecured or undersecured creditors within the 90 days preceding the case on account of antecedent debt. Fraudulent transfer liability generally arises in circumstances where a debtor is insolvent or inadequately capitalised and does not receive reasonably equivalent value for a transfer or obligation, or where the transfer is intended to hinder creditors.

8. Project Finance

8.1 Recent Project Finance Activity

The project finance structure continues to be utilised in the United States, including in the renewable energy and mining industries, as well as in connection with public-private partnerships, though there is increasing use of "hybrid" project finance-corporate finance structures, portfolios of projects and other varied structures. For example, in the renewable energy sector, portfolios of projects are frequently grouped into a single secured financing where all the assets of the group are pledged as collateral. In the mining space, while alternative sources of funding such as streaming, royalty and/or prepay contracts are now commonplace, a portion of the project funding typically is provided under a traditional project finance structure.

8.2 Public-Private Partnership Transactions

Increasingly, projects in the US have been successfully procured as P3s, relying on a "user fee" or an "availability payment" model and utilised in transportation, social infrastructure, water/wastewater, energy (particularly at universities) and telecom/broadband sectors. While availability payment structures remain the most consistently implemented model, the influx of infrastructure funds and private equity to the infrastructure sector has incentivised more value creation through risk or commercialisation.

The Infrastructure Investment and Jobs Act is expected to support P3s by authorising USD550 billion of new federal investments in infrastructure projects, renewing the TIFIA, RRIF and WIFIA loan programmes, doubling the cap on PAB issuance to surface transportation projects and directing the Secretary of Transportation to

establish a programme to enhance public entities' technical capacity to facilitate/evaluate P3s.

8.3 Governing Law

While project documents are not required to be governed by local law in project financings in the United States, they often are. Construction law is state-specific and therefore best practice often leads to signature of construction contracts under local law. Project documents use a mix of submission to jurisdiction to local courts and arbitration to resolve disputes based on the characteristics of the project, bargaining power of the parties and other factors.

8.4 Foreign Ownership

There are various state and federal laws that limit or prohibit the acquisition of US real property by non-resident foreign persons or entities that are controlled by non-resident foreign persons or impose reporting requirements on foreign owners of US real estate. Many of these laws apply only to mineral resources or to agricultural property. In advance of any acquisition of real estate, a purchaser is advised to review the relevant federal laws that apply to the prospective purchaser and the type of property being acquired and to consult with counsel in the state in which the property is located for an understanding of the relevant state laws.

8.5 Structuring Deals

The main issue to consider is whether the transaction will be a limited recourse deal or whether there will be a completion or other form of guaranty from the sponsor. This is particularly relevant in energy transition deals, such as hydrogen deals, where limited recourse financing may not be readily available. Another key issue when structuring the deal is to consider whether tax equity will be used to finance the project, as this will impact the terms of the project finance debt. The laws relevant to project companies vary depending on the sector and include both federal and state laws. In the case of the energy industry, key federal statutes include the Federal Power Act, the Public Utility Regulatory Policies Act of 1978 (PURPA) and the Public Utility Holding Company Act of 2005 (PUHCA).

8.6 Common Financing Sources and Typical Structures

In their simplest form, project financings are provided by syndicates of commercial banks, often together with development financial institutions (DFIs) and export credit agencies (ECAs) for projects in emerging markets. These financings are structured as senior secured financings with a first lien on all project assets/equity with limited or no recourse to the project sponsors. However, project financings are becoming increasingly complex multisource financings in which commercial bank and DFIs/ECA facilities combine with private equity, commodity trader, strategic investor (OEMs), governmental entity, project bond, ESG and streaming/royalty company funding in the form of debt, pre-paid forwards, leases, concessionary facilities, grants and hybrid debt/equity facilities, to name a few available investment instruments.

8.7 Natural Resources

A key issue with developing natural resource projects, particularly mining projects, in the US at this time is the difficulties inherent in the permitting process – both the length of time to permit these projects and the likely challenges to any permits issued (which can take years to resolve). A key consideration associated with downstream projects in the sector is the availability for the particular project of benefits afforded by the Inflation Reduction Act, whether in the form of tax credits, grants or concessionary loans. The availability of such benefits can

significantly enhance the financial feasibility of a project.

8.8 Environmental, Health and Safety Laws

The principal environmental laws include:

- the U.S. Comprehensive Environmental Response, Compensation and Liability Act, which governs the clean-up of soil and groundwater contamination and includes a "lender liability exemption";
- the Resource Conservation and Recovery Act, which requires the "cradle-to-grave" management and disposal of waste;
- the Clean Air Act;
- the Clean Water Act; and
- the Emergency Planning and Community Right-to-Know Act, which requires industry to report on the storage, use and release of certain chemicals to federal, state and local governments; these are overseen by the U.S. Environmental Protection Agency, or EPA.

The principal health and safety law is the U.S. Occupational Safety and Health Act which is overseen by the Occupational Safety and Health Administration, or OSHA.

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