Guidelines for Intercreditor Agreements in UK Commercial Real Estate Finance Transactions:

Some commonly negotiated provisions – the security package and enforcement rights

Ruth Harris
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GUIDELINES FOR NEGOTIATING INTERCREDITOR AGREEMENTS

PAPER 4 -
SOME COMMONLY NEGOTIATED POSITIONS -
THE SECURITY PACKAGE AND ENFORCEMENT RIGHTS

This is the fourth of a series of papers in which CREFC Europe members share their experiences in relation to some of the structures that are being used to finance commercial real estate and some of the commonly negotiated provisions found in intercreditor agreements. Our experiences are drawn from a variety of transactions, but it is clearly the case that the category of real estate asset, the leverage (and split between lenders) and the type of lender (debt fund, insurer, pension fund, sovereign wealth fund or traditional lender) as well as the funding structure, will all have bearing on the outcome of the intercreditor relationship.

The first paper in this series (Paper 1 - Structured Lending – Real Estate Finance – a glossary of terms and some example structures) describes some of the structures that are being used to finance commercial real estate, including senior/mezzanine, A/B loans and (undisclosed tranching of) whole loans and provides a glossary of terms of art that are often used, and often misunderstood, in relation to structured lending.

The second paper (Paper 2 - some commonly negotiated provisions – subordination and payment waterfalls) provides commentary on the subordination of payments to the junior finance parties to payments to the senior finance parties and in it we explore how deeply subordinated these should be. The concepts of property protection loans, senior headroom, cash trap (and cash sweep) events, junior payment stop events and escrow of monies that would otherwise have been available to pay amounts due to the junior finance parties (absent the junior payment stop event) are considered.

The third paper (Intercreditor arrangements in respect of whole loan transactions) discusses whole loan structures, in particular where the obligors themselves are not party to the intercreditor arrangements (for example a "behind the scenes" intercreditor arrangement or "agreement amongst lenders") and as such the tranching and pricing of the separate tranches, is not transparent to the obligors.

The focus of this paper is on the security package available to the junior finance parties and their enforcement rights in relation to the same, including "acquisition" rights and waivers of mandatory prepayment on change of control, use of control valuation events, release of guarantees, fair value and credit bidding. The rights of the hedge counterparty in relation to the taking of enforcement action are ignored for the purposes of this paper and for this reason we refer to the senior lenders (rather than the senior finance parties) in most instances.

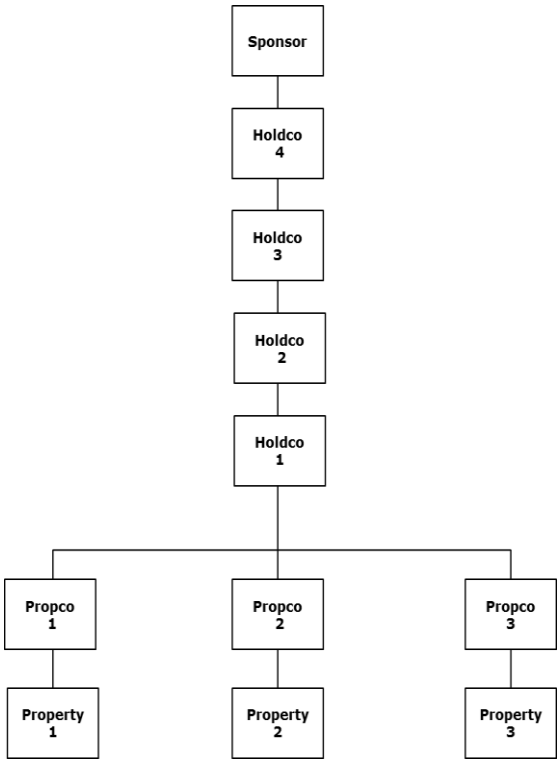
Subsequent papers will focus on:

- Voting rights for the junior lenders in relation to certain changes to the finance documents and also in relation to consents, waivers and amendments required or requested under the finance documents.
- Some of the other tools available to a junior lender including cure rights, the right to purchase the senior debt and options to purchase the property.
- Intercreditors that involve obligors not incorporated in the UK, or whose assets are not situs in the UK.
- How to deal with the acquisition right of the mezzanine lenders where there is more than one mezzanine lender.
- Intercreditor agreements where the underlying asset is a development site.
- Intercreditor agreements from the perspective of the hedge counterparty.

We would be interested to hear from readers as to any other areas of focus that may be of relevance.

Each paper focuses on the negotiating stance of the lenders, drawing on experience of CREFC Europe members and will also cover (where relevant) some of the tax and regulatory points that should be considered.

1. STRUCTURAL SUBORDINATION – THE MEZZANINE GUARANTEE AND SECURITY PACKAGE



1.1 In a typical structure that uses structural subordination (senior/mezzanine structure) in the real estate finance market, the senior loan is advanced to the property owning companies (the propcos) or their holding company (holdco) and the junior loan (known as the mezzanine loan) is advanced, pursuant to a separate loan facility agreement, to a structurally subordinate entity (being a holding company that is more removed from the assets held by the propcos, being higher up the corporate structure). This structurally subordinate entity (and its lenders, absent any overriding contractual agreement, such as a guarantee) only has recourse to the shares in its subsidiaries, and therefore whatever is left after the creditors of its subsidiaries have been paid.

1.2 Since the mezzanine lender will usually require the benefit of guarantees from the propcos and parent of the propcos, contractual subordination of the payment obligation under such mezzanine guarantee will be required by the senior lenders. The advantage to the mezzanine lender of having such a guarantee, which will usually be contained in the mezzanine facility agreement, is that (even though subordinated to the senior payment obligations) it gives the mezzanine lender at least equal ranking with the unsecured creditors of the propcos and parent of the propcos.

1.3 Such guarantee will usually be supported by a security package over the assets of the guarantors. This therefore gives the mezzanine lenders an enhanced position vis-a -vis unsecured creditors of the propcos on any insolvency and means that, once the senior lenders are repaid, the mezzanine lenders can enjoy a first secured position. This means that both senior and mezzanine lenders have the benefit of security interests from the same propcos and senior holdcos.

1.4 Such security over the properties (and property related assets) and security over the shares in the propcos (and, depending on the structure, the parent of the propcos) together with associated receivables security can be held either by:

(a) a common security agent (with rights to instruct enforcement governed by the intercreditor agreement) (i.e. the mezzanine security is on a subordinated lien basis) (the "**common security**" or "**common asset security"** package); or

(b) (where feasible in the relevant jurisdiction) a senior security agent with a replica second

ranking package given to a mezzanine security agent (i.e. a second ranking security package – "**mezzanine security**" or "**mezzanine common asset security**").

1.5 The mezzanine security agent will often also hold share security and other ancillary security at a level above the common security (the "**mezzanine only security**"). This security will generally consist of security over the shares in the mezzanine borrower (and any receivables owed by the mezzanine borrower to its holding company) and over the assets of the mezzanine borrower including the shares held by the mezzanine borrower in the relevant subsidiary holdco (and any receivables owed by the relevant subsidiary to the mezzanine borrower) and any bank accounts held by the mezzanine borrower. This security is granted so as to give the mezzanine lender (subject to the intercreditor agreement and matters of law generally) an opportunity to take control of the borrower group in certain circumstances. The circumstances in which control may be taken are discussed at section 5 below.

The effect may be that the mezzanine only security is limited to giving the mezzanine lender the opportunity to take control and protect the assets by effecting what is referred to in the LMA Intercreditor Agreement as the "**Acquisition**", but does not extend to any collateral value beyond that.

1.6 The circumstances in which the mezzanine finance parties are permitted to instruct enforcement of the mezzanine only security (if any restriction is indeed considered appropriate) or (where granted) the common asset security (or mezzanine common asset security) will be governed by the **intercreditor agreement**. The intercreditor agreement will also deal with the conditions for any agreed waiver of the right to require mandatory prepayment on change of control and of any events of default resulting from enforcement of the mezzanine only security.

1.7 The intercreditor agreement will need to deal with the following guarantee and security related matters:

(a) Restrictions on the rights of the mezzanine lender to demand payment under the guarantees given in their favour, such that the mezzanine lender is not able to call on such guarantees and precipitate an enforcement action at the senior (common) obligor/assets level.

(b) Restrictions on the rights of the mezzanine lender to instruct the common security agent to take any action under the common security (or where a mezzanine common asset security package is used, separate to that held by the senior security agent, to restrict the right to instruct the mezzanine security agent to take any action), either by (where the security is common security) providing that the common security agent should act on behalf of an instructing group - which except in certain circumstances, should be the senior lenders[1]- or (where there is separate mezzanine common asset security) by providing that no enforcement action can be taken pursuant to such security except in certain circumstances.

(c) The release of any security or guarantees given in favour of the mezzanine lender should the senior lenders decide to take enforcement action, giving the senior lender the ability to procure a release of the mezzanine security and the release of the guarantee liabilities. This should also

[1] Will we discuss in a later paper whether or not it is appropriate to expand to a senior creditor concept, so as to include hedge counterparties.

include a release of the rights of contribution/indemnity and subrogation. Care should be taken to ensure that such rights are not merely postponed to the senior discharge date, but are, particularly in cases where the enforcement is over the shares in an obligor, capable of being waived or released or otherwise disposed of (otherwise their ongoing nature will affect the price any purchaser is willing to pay for such shares).

(d) Cater for a refinancing of the senior loans and the ability for a new senior lender to benefit from the priority afforded to the original senior lender (if this is commercially agreed). The LMA REF ICA does not currently cater for this, but other LMA forms do.

(e) Turnover of any proceeds of enforcement of the mezzanine security to the senior lenders, and how proceeds are dealt with in the unlikely situation that the senior security fails but the mezzanine equivalent survives.

2. SOME COMMON QUESTIONS IN RELATION TO THE SECURITY STRUCTURE

2.1 How many companies are really needed to achieve the ideal structural subordinated position? Are two (senior) holdcos required in all circumstances?

Two (senior) holdcos are not required in all circumstances and borrowers will often push to have fewer holdcos where this is possible (not least due to maintenance and compliance costs, particularly where the holdco's are incorporated outside of the UK). The number of intermediate companies is dependent on deal specifics including jurisdiction of the parent of the propcos and the propcos and the number of propcos. This may be driven by, for example, a desire to have a single point of enforcement (over a holdco's shares rather than over a number of properties in different jurisdictions, or over a number of different propcos incorporated in different jurisdictions) and to avoid any other creditor having separate rights of enforcement over the same assets (for example mezzanine only security should not be granted by an obligor that is party to a senior or common security package).

The general rule is that the senior lenders will tend to require the option to enforce as a share sale (hence the need for holdco 1). Further, where there is more than one propco, and particularly where the propcos are incorporated in more than one jurisdiction, the senior lenders will require a separate holdco (holdco 2) to give a charge over the shares in holdco 1, such that an enforcement route by way of enforcement over one company's shares is possible (rather than multiple enforcement over multiple propcos). In addition, the senior lenders will prefer the mezzanine debt to be outside of the senior/common obligor structure, so necessitating holdco 3 (as mezzanine borrower). In addition the mezzanine lender may require a share charge over the shares in the mezzanine borrower to give greater flexibility on enforcement, so necessitating holdco 4. Where there is only one Property, it may be that the senior lenders can forgo holdco 2 without too much difficulty.

2.2 Can shareholder debt be injected directly into the propcos or senior borrower by the shareholders or mezzanine obligors? Or should shareholder debt always be lent via the mezzanine obligors and senior holdcos?

Shareholder/subordinated loans should preferably be advanced linearly through the mezzanine obligors and senior holdcos and not bypass the structure. This assists a clean share security enforcement

route for the senior lenders (including rights to waive, transfer or release such debt) without the need for security over receivables from, and consents to waivers or transfers to be granted by, an otherwise "mezzanine only" obligor being granted to the common (or senior) security agent. However, if this is not possible, any loans from subordinated creditors made directly to the propcos will need to be specifically regulated pursuant to the terms of the intercreditor agreement. In particular it is necessary to ensure that, whether by way of a security granted over such receivables or in the intercreditor agreement, such receivables can be waived, released or sold at the time of any enforcement action taken by the senior/common security agent.

2.3 **Scope of mezzanine only security: should there be any restrictions on the collateral available to the mezzanine lender that is not also available to the senior lenders? Or on the application of the proceeds of enforcement of such mezzanine only security?**

It is usually accepted by the senior lenders that the mezzanine lender have the benefit of security over the shares in the mezzanine borrower (and its bank accounts and any receivables owed by the mezzanine borrower to its holding company) and over the assets of the mezzanine borrower including the shares held by the mezzanine borrower in the relevant subsidiary holdco (and its bank accounts any receivables owed by the relevant subsidiary to the mezzanine borrower).

There is also sometimes sensitivity from the senior lenders in relation to the mezzanine lender exercising its rights over the mezzanine only security for any purpose other than to complete the Acquisition by transferring the shares to itself or a related entity. There may also be sensitivity to the mezzanine lender having any security over any other assets, or having the benefit of other collateral from the sponsors or other non obligors, as this could result in the mezzanine facility being repaid prior to the senior facility, and would be contrary to the principle of subordination of the mezzanine facilities. Paper 2 section 11(e) in this series discusses subordination and payment waterfalls in further detail. Some senior lenders are sensitive to the mezzanine loan being repaid prior to the senior debt even at a time where they are comfortable to release returns to equity (albeit that repaying the mezzanine loan would reduce leverage and the interest service burden).

This therefore leads to a request that any cash proceeds of enforcement of the mezzanine only security should be turned over to the senior lenders, and the mezzanine lender being required to credit bid (i.e. use its secured debt claim as the "currency" by which it acquires the asset charged in its favour, rather than selling for cash).

Mezzanine lenders will usual assert that the senior lenders have undertaken their credit analysis in respect of the underlying assets rather than any other credit support from sponsors or non obligors and that (especially where there is no [material] event of default continuing) proceeds of the mezzanine only security, especially relating to cash that has been released as surplus cash flow from the senior/common obligor group, and is held in the bank accounts of the mezzanine only obligors, it should be collateral available to the mezzanine lenders and should not be required to be turned over to the senior lenders on enforcement by the mezzanine lenders.

2.4 **Why do the senior lenders sometimes object to the mezzanine lenders benefiting from security over the properties and property related assets?**

Some senior lenders are reluctant to allow the mezzanine lenders to benefit from asset level security, citing reasons such as the risk (in the case

of UK regulated banks) that the regulatory capital requirements for the senior lenders will be increased due to the emphasis on the security package contained within the relevant slotting rules. Categorising a real estate loan as "good" or "satisfactory" rather than "strong" impacts on the risk weight applied and therefore the required amount of regulatory capital. However some such lenders are comfortable that the existence of security in favour of the mezzanine lender itself does not cause slotting concerns and that by providing for contractual subordination and contractual restrictions on enforcement and contractual priority of security, slotting should not be affected by the additional security, and therefore there should be no effect on pricing of the senior debt. The focus may well be more on whether allowing the mezzanine lender the *right to enforce* over the common asset security (after a period of standstill) affects slotting and therefore pricing.

Clarity on approach and consistency of requirements across lender groups would be welcome so as to avoid regulatory arbitrage, however this is unlikely to be commercially practicable.

Other reasons cited for reluctance to allow the mezzanine lender to benefit from common asset security include concerns that the mezzanine lender can use such rights to cause mischief at the time of any proposed enforcement by the senior lender (for example in relation to the release of the security) by imposing delays on enforcement or imposing a requirement for consultation or worse still consent. A well drafted intercreditor agreement should allay any concerns of the senior lenders in this regard.

2.5 **Should the senior lenders be concerned that the mezzanine lenders benefit from upstream guarantees from the propcos and other senior obligors?**

As mentioned above, some senior lenders are reluctant to allow the mezzanine lenders to benefit from asset level security, and in the same vein they resist the senior obligors giving upstream guarantees to the mezzanine lenders. It may be difficult to see how upstream guarantees that are contractually subordinated to the senior liabilities can have an effect on the slotting requirements (if applicable) and regulatory capital, where such subordination includes full subordination, no security enforcement rights and full non-petition language, as the probability of default should not have increased. Each lender will have to apply its own analysis (and of course some lenders will be subject to different regimes to others).

The granting of upstream guarantees (or even covenants to pay in the security documents) will impact the leverage of the obligor group and the solvency analysis at any given time, should values decline or income be adversely affected. Depending on the jurisdiction of incorporation this may trigger certain directors' obligations, which cannot be contracted out of, such as filing for insolvency. Typically any such risk could be managed by the mezzanine lender agreeing limited recourse language stating that any claim by them is limited in recourse to the proceeds of enforcement of the assets at the relevant time.

Other reasons cited for a reluctance to allow the granting of upstream guarantees to the mezzanine lenders include:

(a) concerns that the mezzanine lender can use such rights to cause mischief at the time of any proposed enforcement over the shares of any propco or senior obligor , although as noted above, a well drafted intercreditor agreement should deal with any concerns the senior lenders may have in this regard; and

(b) concerns over a taxable credit arising in the senior obligors when the mezzanine guarantee obligations are released. This would be a concern where the shares in the relevant senior obligor are proposed to be sold as part of the enforcement action. However, it is worth noting that no taxable credit should arise where it is reasonable to assume that, without the release and associated arrangements, there is a material risk that the company would be unable to pay its debts in the next 12 months. Tax advice should be taken.

2.6 **Is a mezzanine common asset security package more suitable than a common security package, in some circumstances?**

A common security package is used in most circumstances and this is anticipated by the LMA Intercreditor Agreement. However, whether a common security package or a mezzanine common asset security package is used is most often simply down to specific lender preferences.

Since the security agent will act on the instructions of the relevant instructing group (in most circumstances the senior lenders), and the provisions of the intercreditor should deal with the authority being given by those not included in the instructing group, to enforce and to release of the security, any concerns as to the use of a common security package should be minimised through the provisions of the intercreditor agreement.

In some transactions the mezzanine lender may be connected to the sponsor. This may lead to reservations about the use of a common security package, due to concerns related to equitable subordination or (worse) debt re-characterisation. These are, however, unlikely to be significant concerns in most cases since equitable subordination tends only to be granted by the courts in the most flagrant of circumstances. Further, a lender (in its capacity as lender) should not generally be concerned (unless it exercises excessive control over the debtors operations) as the courts will generally only apply equitable subordination to fiduciaries of the debtor. Where a lender is related to a sponsor there may (depending on the nature of the relationship) be a concern that a fiduciary relationship will be implied. Where there is no fiduciary relationship, only the most outrageous of conduct would risk equitable subordination. Even then, it is likely that only the lender that was acting as fiduciary or acting outrageously would be subordinated, and that there should be no effect on the other (senior) lenders or the common security package more generally.

Another concern sometimes cited in relation to the use of a common security package where the mezzanine lender is connected to the sponsor, is that there are different standards and time periods prescribed in insolvency legislation to deal with reviewable transactions on insolvency where there are connected parties (as is the case under the Insolvency Act, for example).[2] In most cases, however, these concerns can be allayed as there will be new money (so the floating charge should not be called into question, as a condition to challenge is that no new consideration had been provided), the security will be granted in favour of a security agent (which is unlikely to be a connected party) so it is unlikely to be clawed back (at least not in relation to unconnected syndicate members) and it is generally accepted that the

[2] Reviewable periods are extended (for s245 Insolvency Act (re floating charges) and s239 Insolvency Act (re preferences)); there may be no requirement to demonstrate inability to pay debts at the date of the floating charge, insolvency is presumed (in relation to section 238 Insolvency Act (transactions at an undervalue)) and (in relation to preferences) desire to prefer is presumed.

granting of security will not amount to a transaction at an undervalue especially where the security is not given for existing indebtedness.

Even though the risks are considered remote, some senior lenders remain reluctant to agree to a common security package in circumstances where the mezzanine lender is connected to the sponsor.

3. CROSS DEFAULT

3.1 Should a default in the mezzanine facility agreement be a default under the senior facility agreement?

Commonly, the mezzanine facility agreement is a replica of the senior facility agreement with only essential amendments made to distinguish between the two. The amendments of substance should be limited in the main to the name of the Borrower, the additional guarantors (being usually only the mezzanine shareholder in addition to the common obligors), the debt amount, the margin (and whether interest is current pay or not), the hedging provisions (often the mezzanine loan will not be hedged), the financial covenants, the cross default clause and a couple of additional bank account clauses to deal with the need to have a mezzanine finance account and a mezzanine general account through which the mezzanine waterfalls will run and to which the cash trap concept (if any) will attach. Further, the restrictions on assignment of the mezzanine loans may differ to that in relation to the senior loans (as too may the disenfranchisement provisions).

As such, the main events of default that should differ relate to payment default, insolvency of the mezzanine only obligors and breach of the mezzanine financial covenants. There are strong arguments as to why the senior lender should not be concerned to benefit from a cross default into the senior facility should any of these events happen. They have, after all, set their own level of financial covenant. However, there will be nervousness in allowing the mezzanine lender to benefit from an event of default that the senior lender does not also benefit from. This usually stems from the requirement to be able to control any enforcement action at the property asset level, such that if the mezzanine lender is threatening to enforce, there is also a senior event of default capable of providing the basis for enforcement action. One way to deal with this is to provide that the service of a mezzanine enforcement notice (which is required to be served before any mezzanine enforcement action can be taken, and starts the mezzanine standstill period) is itself a senior event of default. In addition, the LMA ICA does provide that the manner of enforcement (even if initiated by the mezzanine lender) is dictated by the senior lender.

To ensure that the mezzanine facility agreement is not amended post closing to provide for more onerous provisions than those contained in the senior facility agreement, which would give the mezzanine lenders the right to enforce beyond those in the senior facility agreement (if indeed the mezzanine lenders are given a right to enforce) the intercreditor agreement will contain provisions restricting any such amendments. Where the senior lender has included the service of a mezzanine enforcement notice as a senior event of default in the senior facility agreement, they may not be so concerned to control amendments to the mezzanine facility agreement as the borrower will act as a brake on any amendments that are more onerous. However in most cases, the senior lender may still be concerned as they may not want their hand forced in relation to enforcement.

This is one of the reasons why the senior lender will also be keen to ensure that there is a sensible headroom provided for in relation to the mezzanine financial covenants (just as there should be for the senior financial covenants).

If the mezzanine facility agreement is amended by the mezzanine finance parties in breach of the restrictions in the intercreditor agreement, the mezzanine lender may still have a valid event of default capable of enforcement action, however the senior lender will generally also have a cause of action for breach of contract (and hence a potential claim for damages) against the mezzanine lender.

3.2 **Should a default in the senior facility agreement be a default under the mezzanine facility agreement?**

A mezzanine lender will usually require that an event of default under the senior facility agreement will also be an automatic event of default under the mezzanine facility agreement. This is not usually a significant concession as both facilities should mirror each other (and usually all the senior obligors are also mezzanine obligors), so most circumstances triggering a senior event of default should also trigger an independent mezzanine event of default (particularly as the mezzanine financial covenants should be triggered before the senior financial covenants are).

To ensure that the senior facility agreement is not amended post-closing to provide for more onerous provisions than those contained in the mezzanine facility agreement, the intercreditor agreement will contain provisions restricting any such amendments. Where there is cross default in favour of the mezzanine lender, they may not be concerned to control amendments to the senior facility agreement, outside of the economics of the senior (i.e. they will certainly be keen to ensure that the amount of the senior liabilities and debt service is not increased or brought forward in time or indeed pushed back in time). Paper 5 focuses on the rights of the various lenders to amend their own finance documents, and so this is not covered in detail here.

If the senior facility agreement is amended by the senior finance parties in breach of the restrictions in the intercreditor agreement, the senior lender may still have a valid event of default in relation to which they can take enforcement action, however the mezzanine lender will generally also have a cause of action for breach of contract (and hence a potential claim for damages) against the senior lender. Depending on the drafting of the payment waterfalls, however, the mezzanine lender may struggle to establish loss, unless perhaps it can prove that the early enforcement reduced recoverability.

4. THE RIGHT OF THE MEZZANINE LENDERS TO ENFORCE OVER THE SHARES IN THE MEZZANINE BORROWER

4.1 It is generally accepted that the mezzanine lender should have the benefit of mezzanine only security (see paragraph 1.5 above) which gives them enforcement rights independent of the senior lenders' enforcement rights. Such share security is usually granted at a level structurally higher in the group than the senior obligors, for example the shares in holdco 2 and in holdco 3 (as mezzanine borrower).

4.2 However, the senior lender may wish to impose **conditions** on the enforcement of such security. The mezzanine lender will be keen to see that these conditions on enforcement do not apply to taking enforcement action in relation to for example bank accounts held by the mezzanine only obligors. See paragraph 2.3 above.

4.3 Such conditions and restrictions will be limited to the right to enforce over the shares, and the intragroup receivables. The types of conditions that may be imposed are discussed at section 5 below. Such conditions should more accurately be considered as conditions to a waiver of the provisions in the senior facility agreement that would otherwise require mandatory prepayment on change of control of the senior

obligors rather than absolute restrictions or prohibitions. However, in some cases they are drafted as restrictions so implying that the senior lender requires an absolute condition to the exercise of such enforcement rights, with the intention of obtaining a right to injunct any sale in breach of the condition or to a claim for damages for any such breach. Such actions would be unusual and might be difficult to commence and substantiate.

4.4 Any change of control waiver should be coupled with a re-setting of the change of control clause to refer to the permitted acquirer rather than the original sponsor (and any other consequential amendments to ownership representations and undertakings).

4.5 The conditions to any such waiver are usually linked to the identity of the new owner of the shares (see section 4.8 below) and completion of certain KYC matters, as well as confirmation as to certain contingent taxes not being triggered.

4.6 In addition, it will be in the interest of the mezzanine lender (or relevant purchaser of the shares) to ensure that any existing **events of default are remedied** at the time of the purchase of the shares, so that they are not buying a group that may be subject to enforcement proceedings soon after the purchase. Often the remedying of existing events of default, in particular ones that can be remedied by way of payment of an amount of money, is drafted as a condition to the enforcement of the share security by the mezzanine lender, although this need not necessarily be the case, since if not remedied the senior lender would retain the right to enforce post the sale of the shares in any case. Certainly vis a vis the borrower the events of default should not be treated as remedied, as the mezzanine lender will need an event of default to enforce upon in order to complete the Acquisition.

4.7 Where events of default subsist that are not remediable by way of the payment of a quantifiable amount of money, the mezzanine lender may request that a period, post acquisition, to be provided in order to "clean up" the group. It may be difficult for the mezzanine lender to ascertain how best to remedy any given event of default until it is in ownership of the shares, or to determine what a reasonable time period would be to do so. It is not uncommon therefore for the senior lender to be requested to act reasonably and in good faith in agreeing a remediation plan prior to (or subsequent to) the acquisition of the shares. Since this is in effect an agreement to agree it is doubtful as to how much value this provides, however it may serve to focus minds and record intentions.

As a related point, the mezzanine lender may ask that in relation to events of default that must be cured prior to the purchase of the shares, or within a period thereafter, that the definition of "continuing" in the senior facility agreement be amended or clarified, such that such event of default is not continuing if it has been remedied (and what will be treated as remedying), rather than requiring a specific waiver from the senior agent.

4.8 In relation to the **identity of the new owner of the shares post enforcement**, senior lenders often have differing views as to what is permissible in order to obtain a waiver of the requirement to mandatorily prepay the senior loan due to the occurrence of a change of control. Positions vary from restricting the identity of the new owner (the "**Permitted Acquirer**") to (i) just the original mezzanine lender; or (ii) extending to affiliates or related parties to the original mezzanine lender (including those owned/controlled/managed/advised by the original mezzanine lender or any of its affiliates or those that are managed or controlled by the same manager or investment advisor as the original mezzanine lender); or (iii) to

requiring that the new owner be an entity with sufficient financial backing and experience (and the meaning of such terms will be the subject of much debate and drafting). Much depends on whether the senior lender intends to allow the waiver of change of control solely so as to facilitate the mezzanine lender having the right to step in, or whether the senior lender will allow a sale to a third party and so an immediate extraction of value by the mezzanine lender (and consequently a prepayment of the mezzanine loan ahead of the senior loan).

4.9 Sometimes a blacklist or whitelist might also be used. There may also be a condition by reference to not exceeding any senior lender's internal concentration of exposure requirements or any regulatory requirements in relation to the same. This may not be palatable to the mezzanine lender as it may not be able to control which lenders become senior lenders, so there is a risk that one of the senior lenders has already reached its quota for exposure to the mezzanine lender and affiliated parties. Arguably the mezzanine lender can however monitor this situation.

4.10 Where the commercial agreement is to restrict the identity of the new owner to (or by reference to) the original mezzanine lender, the senior lenders may wish to ensure that the ultimate owner of the mezzanine lender is as expected (i.e. as at closing) and that the mandatory prepayment provisions in the senior facility are amended following any share enforcement to provide that such ultimate ownership remains the case. This prevents a share of the shares in the original mezzanine lender to a third party so frustrating the senior lenders' intentions.

4.11 **Other senior lender requirements**

Aside from the requirements relating to the identity of the new owner and the remedying of events of default, the following will also be required by a senior lender:

(a) **Know your customer checks** will need to have been completed in relation to the new owner. If this is to be the original mezzanine lender a certain amount of comfort can be given in the way of clearance at closing, however the senior lender will need to reserve the right to re-confirm all is in order at the time. Mezzanine lenders will be keen to ensure that only know you customer requirements that are required *by law* are required to be satisfied. Senior lenders may need to ensure that internal procedures and requirements are also adhered to. Some lenders in particular will have strict requirements relating to concentration of exposure which may necessitate special treatment.

Where there are drop dead dates for the mezzanine lender to complete the acquisition of the shares (for example where the senior lender is in a standstill period preventing them from taking their own enforcement action, or where the senior lender provides that a "sundown" applies to the acquisition right) it may be made clear that any delay in the senior lender accepting or rejecting know your customer information or requesting further information, should automatically extend such drop dead date.

(b) There may be a condition that any change of control will not result in a trigger of any **contingent tax liability**. Whilst the senior lender will rank ahead of HMRC in relation to the same, they may want to avoid any such liabilities, which if pursued by HMRC could force the senior lender's hand to commence an enforcement

action. The mezzanine lender may argue that the situation is no different to where a sponsor causes a change of control event, and as such any risk of contingent taxes being triggered should have been factored into the senior lender's model at the outset, as a change of control event is often one that cannot be controlled by the senior lender in any case.

(c) There may be a requirement that any change of control does not adversely affect the common security package. The focus here may be on change of control provisions in important contracts, which should be checked at the outset of the financing.

(d) There may be a requirement that **all of the relevant shares (and not some only)** are the subject of the acquisition. This may be driven by a desire for simplicity since if the mezzanine lender enters into a debt for equity swap for some but not all of the shares (or enforces over some but not all the shares by selling a portion to a third party) this would require a shareholders' agreement to be entered into between the mezzanine lender/purchaser and the original shareholder, which is likely to take some time to agree and may result in deadlock on important decisions. Unless the parameters of any such shareholders' agreement are agreed at closing, senior lenders may not be amenable to agreeing terms at the time of enforcement where the existing owners have failed to comply with the senior facility agreement.

Intercreditor agreements will also rarely provide for the situation where there is more than one mezzanine lender and either both desire to obtain shares or one does and the other doesn't. This is beyond the reach of this paper.

(e) Enforcement over the shares will usually be coupled with an enforcement over any intra-group receivables due by the relevant company to which the shares relate, to its parent, such that the purchaser of the shares also becomes a creditor of such receivables. Depending on the level at which such enforcement takes place, the purchaser will be required to **accede to the intercreditor agreement** as a subordinated creditor (and also accede to any separate subordination deed, if relevant). Alternatively such receivables could be waived or released.

(f) Depending on the value of the shares at the time of enforcement (i.e. (crudely) the value of the properties, less the amount of the senior debt and mezzanine debt) the mezzanine lender may not be required to treat all of the mezzanine loan as extinguished upon the purchase of the shares[3]. Much will depend on the nature of the enforcement, but for example, where the mezzanine lender has credit bid only 75 per cent of the mezzanine commitments in order to own the relevant shares, the remaining 25 per cent of commitments will still be owed by the mezzanine borrower. There may be an advantage in retaining some mezzanine commitments as (i) depending on the terms of the

[3] If the enforcement is over the shares in the subsidiary of the mezzanine borrower, the mezzanine borrower itself will be left "outside" of the new obligor group so if there is a requirement to keep some of the mezzanine debt "alive" the enforcement should be over the shares in the mezzanine borrower.

intercreditor deed such commitments may be transferable, so being a means to recoup value for the mezzanine lender;(ii) secured debt will retain an advantage over unsecured creditors on any insolvency that may occur in the future, and (importantly) (iii) it may be more tax efficient.

It is often discussed whether following the exercise of the acquisition right, the mezzanine lender should be treated as having extinguished their mezzanine commitments. The view of CREFCE Members that have commented is that there should be no need to extinguish the mezzanine commitments, but that many of the intercreditor rights of the mezzanine lender may fall away (see below). This makes sense, as the mezzanine lender will obtain an equivalent right through its ownership at equity level. Where the mezzanine lender does not have a majority voting right in the equity post acquisition its rights should not be extinguished. It is difficult however, in a scenario where there is one mezzanine lender, to see a situation where that mezzanine lender would convert its debt to equity and accept a minority voting position. This is explored further in a subsequent paper on how to deal with the acquisition right of the mezzanine lenders where there is more than one mezzanine lender.

Where the mezzanine lender is an affiliate of the mezzanine borrower it is likely that its rights to vote in the mezzanine facility agreement will be disapplied (this may happen automatically through the disenfranchisement provisions in the mezzanine facility agreement). So too will certain of its rights under the intercreditor agreement. This should not be of concern where the mezzanine lender has a majority vote as the new owner of the mezzanine borrower and as such it will control any requests for consents, waivers or amendments relating to the senior facility agreement, and will also control the ability to cure (through the borrower cure rights) so should not require its own separate cure rights. Similarly, it can repay the senior loans, so should not need the right to purchase them.

However the mezzanine lender may wish to provide that in circumstances where the mezzanine lender ceases to be connected to the borrower (or does not control more than a certain percentage of the shares in the borrower) it will retain (or regain) its rights under the intercreditor agreement. This ensures that the remaining mezzanine commitments are transferable and also provides for the situations where either (i) there may have been more than one mezzanine lender and only one elects to credit bid its commitments in exchange for shares and the other elects to keep its commitments; or (ii) the mezzanine lender on sells its equity holding (without triggering a change of control mandatory prepayment) but retains its mezzanine commitments.

(g) There may be a requirement to discuss the **business plan** of the purchaser of the shares with the senior lender (sometimes before and sometimes after the Acquisition).

4.12 **Mezzanine lender requirements**

To ensure that the right to take enforcement action at the mezzanine only security level is as effective as possible:

(a) the mezzanine borrowing liabilities must be capable of being accelerated, even if the mezzanine guarantees from senior/common obligors cannot be;

(b) the mezzanine lender must have the right to appoint an administrator or receiver if required to effect the enforcement over the mezzanine only security and manage the sale of the shares in the mezzanine borrower or the shares in its subsidiary;

(c) the mezzanine lender should have the ability to credit bid;

(d) non cash proceeds should be permitted pursuant to the enforcement of the mezzanine only security and should be carved out of any duty to turnover to the common security agent.

5. RESTRICTIONS ON ENFORCEMENT ACTION

5.1 Restriction on taking enforcement action – Mezzanine only security

From a mezzanine lender's point of view it is often argued that, because the mezzanine only security is outside of the common security package, and is therefore beyond what a senior lender would normally request as part of its security package (and indeed is beyond being caught by the senior negative pledge) the senior lender should not concern itself with enforcement at the mezzanine only security level and should rely on any concerns they might have being dealt with through the mandatory prepayment on change of control provisions. As such the mezzanine lender should be able to enforce the mezzanine only security without restriction, but if a change of control results, this would likely trigger a mandatory prepayment of the senior facility, unless special waiver provisions have been provided for in the intercreditor agreement (as discussed above).

The mezzanine lender will often emphasise its paramount requirement to be able to take "control" of the assets, without being clear as to what this actually means. Interestingly "soft" enforcement action, such as a change of directors, may not in some cases trigger a change of control in the strict sense nor be classified as "enforcement action" that is restricted. Replacement of asset managers, property managers or development managers can be achieved through well drafted duty of care agreements, but the senior lenders are unlikely to be willing to give carte blanche to the mezzanine lenders in relation to any such replacement.

The right to enforce over the shares in the mezzanine borrower or at the holdco 2 level is an essential tool in the mezzanine lender's kit (especially where the mezzanine lenders do not benefit from asset security, or have no rights to take enforcement action in relation to asset security) and as such it will request that such rights are not fettered in any way.

Certain senior lenders do not agree with this approach and instead prefer to regulate the enforcement of the mezzanine only security, sometimes even requesting their own senior cure rights (in addition to the borrower cure rights that may have been granted). They may be sensitive to the mezzanine lender using the mezzanine only share security to extract value (through a sale to a third party) and hence secure prepayment of the mezzanine loan prior to the senior discharge date, which would contravene the principle of absolute subordination. They may also be sensitive to distractions at board level within the obligors (particularly where the underlying asset requires significant asset

management) should such mezzanine only enforcement action be threatened.

If enforcement action is permitted, but solely for the purposes of effecting a transfer of the shares to the mezzanine lender or related party, senior lenders sometimes request that any cash proceeds received from enforcing over the shares by sale to an unrelated party are turned over to the senior lender.

The LMA intercreditor agreement provides some options to limit the availability of the right to enforce the mezzanine only security[4]. Where these restrictions are imposed the mezzanine lender may wish to consider ensuring such limitations still allow the right to enforce:

(a) where the senior lenders are threatening enforcement action (where the mezzanine lender would prefer to wait); or

(b) where the senior lenders have chosen not to enforce the asset security (while also not allowing the mezzanine lender to instruct enforcement or enforce the mezzanine common asset security) in circumstances where the mezzanine lender is concerned the assets will depreciate in value during the intervening period (whether or not a mezzanine **material** event of default is continuing).

Restrictions on the right to enforce the mezzanine only security are however contrary to the principle noted above that as the mezzanine only security is outside of the common security package, and is therefore beyond what a senior lender would normally request as part of its security package, hence the senior lender should rely on any concerns they might have being dealt with through the mandatory prepayment on change of control provisions.

5.2 **Restriction on taking enforcement action – Mezzanine lenders pursuant to the common security**

Where the security agent (acting for the senior lenders) also agrees to be the security agent for the mezzanine lenders in relation to the common asset security, the rights to instruct any enforcement of such security will be dealt with in the intercreditor agreement through the concept of the "**instructing group**". The default position will be that the senior lenders will be the instructing group, unless and until the mezzanine lender obtains rights to enforce.

While there are some technical differences in approach, the same philosophy can be applied where there are separate senior and mezzanine security packages with the mezzanine lender's rights to enforce being contractually restricted..

The mezzanine lender's rights to enforce will be limited and in some transactions the mezzanine lender will not benefit from any such right prior to the senior discharge date. In other transactions such rights will arise only after a period of time (a "**standstill**") following notice having been served by the mezzanine lender in relation certain mezzanine events of default. The length of such standstill may vary depending on the type of mezzanine event of default. Commonly, for payment defaults, 90 days, for financial covenant defaults, 120 days and (if relevant) for other events of default, 150 days.

Although the LMA starting position is that the enforcement right for the mezzanine lenders in relation to the common security becomes available after any mezzanine event of default (and the expiration of the standstill), in practice the trigger to such enforcement action (after the expiration of relevant standstill) may

[4] Being (i) Mezzanine Standstill period (i.e. any Mezzanine Event of Default and notice has been served and the standstill period has not expired) (ii) Mezzanine Material Event of Default; or (iii) Distress Event.

only include the more material ones such as non-payment, breach of mezzanine financial covenants and insolvency and not any other more "minor" breaches, (however persistent). This is unlikely to be acceptable to the mezzanine lenders particularly in circumstances where they do not benefit from mezzanine only security.

Many senior lenders will be very reluctant to cede control of the asset level security to the mezzanine lender for reasons touched on above. Where a senior lender does agree to the mezzanine lender having common asset security rights it is likely to require a number of senior protections be dealt with in the intercreditor agreement. These include:

(a) where a mezzanine standstill period is running, the senior lenders themselves have the right to enforce. This can be provided for by including the service of a **mezzanine enforcement notice** (which itself triggers the mezzanine standstill period, and hence their eventual enforcement right) **as a senior event of default**. This is particularly important where there is no cross default from the mezzanine facility agreement to the senior facility agreement (see above);

(b) that the **manner of enforcement** must be as prescribed by the senior lender, even where the mezzanine lender is in a position to instruct enforcement action. This will include the identity of any receiver or administrator to be appointed;

(c) the mezzanine lender will not have any right to enforce where the value of the collateral (primarily the property) is not enough to cover the senior liabilities (including in some cases the hedge liabilities on a marked to market basis and any prepayment fee) with headroom. This is the so called "control valuation test" or "**collateral coverage test**". The required headroom may vary, but as a general rule headroom of at least [20 per cent.] is provided for to cover transaction taxes and disposal costs and any depreciation resulting from a distressed sale. The level will vary dependent on the type of asset and whether the transaction is a portfolio transaction or not;

(d) the mezzanine lender will not have any right to enforce if the senior lenders have instructed enforcement action; and

(e) that any enforcement is completed on a cash only basis and at arms' length value. The senior lender will be reluctant to allow credit bidding of the mezzanine debt as this sort of cash free transaction could leave them with no assets to repay their debt.

5.3 **Restriction on taking enforcement action – Mezzanine common asset security**

The approach to restrictions on a mezzanine lender taking action in relation to mezzanine common asset security should be the same as that in relation to the taking of action in relation to common security, however there will be differences in the implementation of the approach.

Where the mezzanine lender benefits from its own separate security package at the property asset level it is especially relevant to consider the kinds of action that should be restricted. This should include all soft enforcement action (such as blocking of accounts, sweeping of accounts, set-off, crystallisation of floating charges and controlling of voting rights and composition of board of directors etc.) as well as hard

enforcement action (such as appropriation of assets, commencement of insolvency procedures, appointment of receivers etc.).

Mezzanine lender may consider asking the senior lenders to waive the mezzanine lender's obligation to marshal its security.

5.4 **Restriction on taking enforcement action – Senior lenders**

The senior lenders are unlikely to accept any restriction on their right to take enforcement action except in the following limited circumstances:

(a) **Acquisition Right** - following the mezzanine lender having served an irrevocable notice that it has committed to enforce the security over the shares in the mezzanine borrower (by way of enforcement of the mezzanine only security) and to purchase the shares or procure the purchase by an entity that is a Permitted Acquirer;

(b) **Cure Right** - following the mezzanine lender having served an irrevocable notice that it has committed to affect a cure of the relevant senior event of default (the type of senior event of default that will be deemed remediable will be prescribed in the intercreditor); and

(c) **Purchase Right** - following the mezzanine lender having served an irrevocable notice that it has committed to affect a purchase of all of the senior loans and the hedging arrangements.

In each case a short standstill period may be granted, to give time for the mezzanine lender to effect such action.

Whilst senior lenders are cautious in granting any standstill period, comfort can be offered using the following techniques:

(i) **No rolling standstills** - any standstill will be carefully drafted so that it cannot keep being refreshed, for example by the issue of a further cure notice or purchase notice, based on the same or a new event of default.

(ii) **Protective enforcement action allowed** - the senior lender should be able to take protective enforcement action even within a standstill period (e.g. blocking accounts, sweeping accounts, set-off, crystallising floating charges, control of voting rights and composition of board of directors etc.).

(iii) **Material prejudice override** - any such standstill should be subject to a material prejudice override.

(iv) The standstill should provide enough time to enable the mezzanine lender to be put in any funds it requires to purchase the senior loans and hedging, or the shares in the mezzanine borrower (where credit bidding on a cashless basis is not feasible), and it is not uncommon for [**20 Business Days]** in total to be given). Such standstill period will commence from the relevant trigger event and will expire after the agreed period of time which commences on the mezzanine lender receiving notice from

the senior agent of the relevant trigger event having occurred.

(v) If there is a nervousness on the behalf of the senior lender as to whether the service of a notice to cure or purchase the shares (or senior loan) is just a delaying tactic, a **letter of commitment from an entity of substance** within the mezzanine lender group may offer comfort, and in some cases may also be acceptable as a method to extend the standstill to a more reasonable period to complete the cure or purchase.

(vi) A **collateral coverage test** being imposed on the exercise of such right to enforce, based on the collateral value at the relevant time as a proportion of the senior liabilities.

5.5 **Consultation with the mezzanine lender prior to the senior lenders taking enforcement action**

A mezzanine lender will sometimes request that the senior lender is under an obligation to consult with the mezzanine lender in relation to any enforcement process it is considering.

Any such consultation rights should be carefully negotiated, be limited in time, be clear on when such period commences (such as on the receipt of the notice of intention to enforce together with reasonable details of such proposed enforcement action), provide that the consultation period should be permitted to run concurrently with any senior standstill period, provide that the action will not be taken (subject to material prejudice override and the right to take protective enforcement action) until the end of the consultation period and without taking into account any comments or suggestions of the other party submitted during such period (without obligation to act on any comment, suggestion or direction of the mezzanine lender). It should be clear that that the senior lender will be able to take enforcement action at their own discretion at the end of the consultation period (acting on the instructions of the appropriate instructing group) without such action being called into question.

5.6 **At the end of the senior standstill period**

At the end of the senior standstill period, providing the relevant event of default is continuing the senior lender should be permitted to take the relevant enforcement action. If no such action is taken at that time, it is often discussed whether the mezzanine lender's right to cure or purchase the senior loans can continue or whether there is a **"sundown**" on such right.

From a mezzanine lender's perspective it is difficult to accept that the rights fall away since a borrower itself is able to cure an event of default prior to acceleration of the loans and then maintains the right to repay prior to any enforcement of security has been commenced.

From a senior lender's perspective it will not want to be spending time and money on contingency planning only to find that the mezzanine lender has cured or purchased the senior loans and hedging at the last hurdle.

One potential solution to these tensions is to provide that a purchase of the loans and hedging at par, together with the payment of any make whole or prepayment fee that would have been paid on an enforcement is always allowed, but a cure cannot be made by the mezzanine lender once the senior lenders have served a notice of intention to take enforcement action on the mezzanine lender (or at least that the cure must also include a

reimbursement of all of the senior lender's fees, costs and expenses whether or not they are payable by the borrower in a situation where there has been no enforcement action actually taken).

6. RELEASES OF GUARANTEES AND SECURITY ETC.

6.1 Release of claims upon enforcement

The senior lender will require the right (by way of enforcement) to transfer the property and property related assets and/or shares in any property owning entities, free of any security interests and (where the shares are being sold) free of any claims against the relevant obligor and its subsidiaries.

Where common security is used, the release of security will be dealt with by way of giving the common security agent the right to deal with assets and release the security on the instructions on the "instructing group" (see above). Where separate mezzanine common asset security is given, release of the mezzanine security over the asset being enforced against should not be problematic when the prior ranking security is being enforced. The principle of overreaching avails itself to the senior secured party, so translating the second ranking security into an interest in the surplus proceeds.

However, where the enforcement is in relation to **share security**, additional care needs to be exercised in the drafting of the release rights where separate mezzanine common asset security is granted. The secured parties will need to ensure that they also have the ability to release, transfer or waive all borrowing liabilities/guarantee liabilities (including mezzanine guarantee liabilities)/rights of indemnity/contribution of the entity that is being disposed of (and any of its subsidiaries) in addition to the release of any security granted by such entities (including mezzanine common asset security) to ensure that such rights do not have an adverse effect on the enforcement proceeds attainable from such sale, since the purchaser would need to discount for the potential that such claims may be pursued in the future. Rights of subrogation will also need to be dealt with.

However the mezzanine lenders (and any other subordinate lenders, for example the intra-group debtors) will be keen to ensure that their rights are not written off where (all things being equal) there would have been a pay out on liquidation, and as such the waterfalls should work in a way that ignores the fact that the liabilities had in fact been reduced or sold.

Care should also be taken not to release any borrowing liabilities that may benefit from additional collateral. Since such borrowing liabilities will usually (for a structurally subordinated mezzanine) be outside of the senior obligor group, it is unlikely that the senior lenders will be looking to release the mezzanine borrowing liabilities in any event.

Where the mezzanine lenders benefit from additional collateral outside of the common security, such mezzanine liabilities should not be released such that the collateral can be maintained; in this way, if the concept of turnover and subrogation is available to the senior lenders, it may improve senior recovery. This would rely on the senior lenders either being empowered to take enforcement action on behalf of the mezzanine lender or to be able to require the mezzanine lender to take such action, which is not always a power that they have.

6.2 Fair Value

The LMA Intercreditor Agreement provides that the security agent must [take reasonable care to] obtain fair market value[5] on an enforcement. It

[5] There is an option to choose "fair price" so potentially limiting consideration to cash.

further provides that, provided one of a selection of prescribed methods are used to sell the assets, fair value will be implied. In addition to the receivership and administration, these prescribed methods include (i) the delivery of a fair-value opinion from an independent financial adviser[6]; and (ii) the use of an auction or "other competitive sales process".

The concept of fair value is aimed at protecting a mezzanine lender from being squeezed out however it is widely drafted such that usual methods of enforcement are deemed as acceptable and "fair". The additional prescribed methods beyond receivership and administration ensure that the senior lenders are not too restricted and have options available (with prescribed parameters).

These provisions only go so far to protect a mezzanine lender, however. It is unclear, for example, whether or not mezzanine creditors would be allowed access to the fairness opinion. Additionally, there are no prescribed terms for the basis of valuation and no approval or consultation right for mezzanine creditors in relation to the appointment of the financial adviser. There could also be disputes as to what constitutes a competitive sales process. It is also unclear what "fair from a financial point of view" actually means.

It is thought that the Fair Value concept is perhaps of more relevance in certain jurisdictions where the relevant protections are not embedded in a legal framework, or in relation to leveraged finance where value is less easy to establish.

6.3 **Cash Proceeds**

The security agent commonly has the power to accept non-cash consideration (e.g. senior commitments) upon enforcement. This allows the senior lenders to credit bid[7] their commitments on an enforcement in a way that may potentially squeeze out the mezzanine lenders. The decision as to whether to accept non-cash consideration; whether to realise it for cash prior to distribution; and the identity and terms of appointment of a financial adviser to carry out a valuation of such non-cash consideration are all within senior lender's control.

6.4 **Release of the senior lenders' security interests**

If the mezzanine lenders are granted enforcement rights at the property asset level, any enforcement proceeds would first be applied to pay the prior ranking debt, where upon the prior ranking security would be released. In any case, the rights of the mezzanine lender to enforce is usually subject to a collateral coverage test such that on any such enforcement the proceeds will be sufficient to discharge the senior liabilities. Therefore it would not be logical for a mezzanine lender to enforce if it was unlikely that there would be sufficient proceeds to cover the senior debt as there would equally be no proceeds to apply to the mezzanine liabilities.

7. **CONCLUSION**

We hope that you have found this paper an interesting account of the discussions that commonly take place around the mezzanine security package and enforcement rights in relation thereto. There is no one size fits all and much will depend on the underlying assets, the nature of the senior lender and the mezzanine

[6] The opinion should state that the proceeds are "fair from a financial point of view". However there is no clear guidance as to what this actually means.

[7] Credit bidding more often than not refers to a commercial objective rather than a specific technical mechanic or procedure. Credit bidding involves finding some way for a secured lender to use its secured debt claim as the "currency" by which it acquires the asset charged in its favour, rather than using cash. If the senior lenders debt is worth more than the asset you can be pretty sure of trumping all other potential bidders. If you bought the debt at a 50% discount then so much the better.

lender and the pricing of the transaction.

We want to encourage an interactive discussion in relation to these issues and for other issues relating to intercreditor agreements to be shared where possible. Accordingly, we have set up a Linked In Group and we would like to encourage CREFC members and others to share questions and experiences. Please contact either Ruth Harris at Ashurst, Paul Gray at DLA or Phil Abbott at Fieldfisher if you would like to be a member of this Linked In Group. The link is: https://www.linkedin.com/groups/7071074.