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Prepayment Structures in Leveraged Finance: Balancing Borrower Flexibility With Lender Protections

Debt Retirement Provisions in Syndicated, Mezzanine and Second Lien Term Loans

TUESDAY, FEBRUARY 27, 2018

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Our Program

- Speaking Outline
  1. Debt prepayment provisions generally—borrower and lender considerations
  2. Cross Border/International Considerations
  3. Voluntary prepayments
  4. Mandatory prepayments
  5. Borrower Buy Back
  6. Prepayment Opt Outs - B Loan Lenders v. A Loan Lenders
  7. Prepayment Premiums
  8. Allocation of prepayments
  9. Prepayment in connection with a defaulted loan

Introduction
What We Will Focus On

- The panel will review these and other key issues:
  - A borrower and its creditors have competing concerns with regard to. The interplay between borrower and creditor goals regarding retirement of leveraged debt and market for **prepayment requirements and protections** in financing agreements.
  - The borrower wants to **avoid forced prepayment triggers** that restrict its ability to transact business. Its lender may want such triggers to prevent a borrower from taking actions that could affect the value of its assets or the borrower's ability to repay the loan. The borrower would like to be able to prepay the loan at any time, while the lenders may desire call protection.
  - Term loans commonly require a percentage of "excess cash flow" to be applied to prepayment. This allows the lender to share in the cash flow generated by the business' performance in a good year, as a hedge against performance in a bad year. A borrower has a substantial incentive to try to **shape the excess cash flow formula** in a way that minimizes the amount calculated.

Overview – Debt Prepayment Provisions Generally

- Optional vs Mandatory
  - Optional permits the borrower to voluntarily prepay part or all of the loan before the maturity date.
  - Mandatory require the borrower to prepay the loans with cash proceeds received from certain events.

- Prepayment provisions may also trigger reductions or terminations of loan commitments.

Overview – Debt Prepayment Provisions Generally

- Negotiated as to:
  - Amount of proceeds that must be applied to prepay the loans
  - What costs and expenses can be deducted when calculating the amount of cash proceeds
  - Sources of cash proceeds required to prepay the loans
  - Whether any of the cash proceeds can be reinvested in other assets and under what conditions
  - How the prepayments will be applied to the loans and whether loan commitments will be permanently reduced
  - Whether voluntary prepayments can be made without penalties, fees, or call premiums

Overview – Debt Prepayment Provisions Generally

- Optional Prepayments
  - Typically, these prepayments are permitted without penalty but there are exceptions, particularly on refinancings held by term B lenders.
  - Borrower usually has the right to direct application of voluntary prepayments, provided that all lenders holding the loans are paid on a pro rata basis.

Overview – Mandatory Prepayment Provisions

- Mandatory Prepayments
  - Highly negotiated depending on:
    - Whether borrower is a public company
    - The type of business borrower is engaged in
    - Creditworthiness of the borrower
    - Whether the transaction is a sponsor deal, non-sponsor leveraged loan, or middle market deal
    - Extent to which credit decision is based on assets of the borrower rather than its cash flow

  - Sources of proceeds include excess cash flow, equity issuances, debt incurrence, proceeds from asset dispositions, and casualty and condemnation recovery events.

Overview – Mandatory Prepayment Provisions

- Excess Cash Flow
  - Cash flow generated by the borrower after its obligations are satisfied and certain operating expenses are taken into account
    - Carve-outs highly negotiated
    - Purpose: capture a percentage of better-than-expected performance and repay the loan early.
    - Typically between 50-75% of excess cash flow required as mandatory prepayment
- Debt Incurrence
  - Debt not disallowed by the negative covenants of the loan agreement
    - To prevent borrower from becoming overleveraged, 100% of proceeds from additional debt often required to be used as a prepayment

Overview – Mandatory Prepayment Provisions

- Equity Issuance
  - Inclusion depends on whether entity is public or private.
    - If public, not included because equity issuance is a regular business occurrence.

- Asset Sales
  - Usually 100% of proceeds required to be a prepayment.
    - Most loan agreements give borrower the option to reinvest proceeds in new assets, instead of requiring them to prepay.

- Recovery Events
  - Generally, payments received from casualty insurance or damaged property must be applied to prepay loans.

Overview – Mandatory Prepayment Provisions

- Extraordinary Receipts
  - Money received from tax refunds, pension plan reversions, insurance proceeds, indemnity payments, acquisition purchase price adjustments, and litigation settlements and judgements are required to be used to prepay loans.
    - Rarely included and mostly seen in middle market and ABL loans.

Overview – Misc Prepayment Provisions

- Revolver Clean Down
  - Periodic repayment of amounts outstanding under a revolving facility.
  - Usually, amounts can be reborrowed after short waiting period

- Outstanding Obligations in Excess of Commitments
  - If outstanding loans exceed the commitment for those obligations then the loans will be repaid to the extent of the excess.

Cross Border / International Considerations

- Market Terms – Canada and the EU
  1. Revolver based on credit concerns; Term based on trigger events
  2. Project debt differs – to balance deny/ equity or cost to complete
  3. Mandatory – based on trigger and from the trigger event funds
  4. Pay all and cancel – or – a minimum plus stated increments
  5. Re-draw or not – revolving, revolving term and term – differences
  6. Break fees and penalties
  7. Notice and conditions and irrevocable
  8. Allocation across facilities

Cross Border / International Considerations

- Legal Considerations Enforcing Prepayment in Other Jurisdictions
  1. On the eve of insolvency – trigger issues
  2. Director liability and European problems
  3. Preferences and claw back claims
  4. Not using borrowed funds
  5. Use of funded accounts to bring timing issues
  6. Statutory restrictions have to be checked for

Voluntary prepayments

1. Typically permitted in all kinds of facilities, subject to prepayment premiums or soft call protection. Noncall protection is rare.
   - Unitranche facilities have less onerous call protections than second lien.
   - Requires prior notice, timing aligned with notice mechanics based on applicable conventions for relevant interest rates.
   - Often minimum amounts for partial prepayments, with multiples in excess delineated to avoid administrative hassles.
   - Notice of prepayment often irrevocable, trend is to allow rescission if event giving rise to the prepayment did not occur.
   - Alternatively, consider language in payoff letter.

Mandatory Prepayments

1. Unique to revolving facilities structure
   a) Debt outstanding exceeds the borrowing base. For multicurrency facilities, consider 5% or so leeway if the excess is due solely to movements in currency exchange rates.
   b) Clean down, less common. In cyclical industries where necessary to show revolver is not only method of sustaining the credit.

Mandatory Prepayments

2. Debt and Equity Issuances
    a) Sometimes limited to debt issuances only, since additional equity may be encouraged
    b) Typically require prepayment, after deducting underwriting costs and discounts, legal costs and expenses and other associated issuance costs. As a practical matter, the debt prepayment trigger, since usually involves debt that is not permitted, is merely path to refinancing.

Mandatory Prepayments

- Example:
  - c) Issuance of Debt. On the date of receipt by Holdings or any of its Subsidiaries of any cash proceeds from the incurrence of any Indebtedness of Holdings or any of its Subsidiaries (other than with respect to any Indebtedness permitted to be incurred pursuant to Section 6.1 [debt covenant]), Company shall prepay the Loans and/or the Revolving Commitments shall be permanently reduced as set forth in Section 2.14(b) in an aggregate amount equal to 100% of such proceeds, net of underwriting discounts and commissions and other reasonable costs and expenses associated therewith, in each case, paid to non-Affiliates, including reasonable legal fees and expenses.

Mandatory Prepayments

3. Asset Sales and Casualty Events
   a) General parameters: to protect lenders against substantial depletion of asset value of the loan parties that negatively affects credit-worthiness. Idea is to capture payments in excess of specified amounts if collateral is being sold (or in the case of a casualty event, if the collateral has been destroyed and insurance proceeds collected) and apply to the debt. The counter argument is that borrower may want to apply those asset sale proceeds to reinvest in the business
   b) Reinvest opportunity: time periods, limitations on amounts
   c) Deposit as cash collateral until end of LIBOR interest period to avoid breakage

Mandatory Prepayments

- Example:

  b) Insurance/Condemnation Proceeds. No later than the first Business Day following the date of receipt by Holdings or any of its Subsidiaries, or Collateral Agent as loss payee, of any Net Proceeds from insurance or any condemnation, taking or other casualty, Company shall prepay the Loans in an aggregate amount equal to 100% of such Net Proceeds; provided, (i) so long as no Default or Event of Default shall have occurred and be continuing, (ii) Administrative Borrower has delivered Collateral Agent prior written notice of Company's intention to apply the Reinvestment Amounts to the costs of replacement of the properties or assets that are the subject of such condemnation, taking or other casualty or the cost of purchase or construction of other assets useful in the business of Company or its Subsidiaries, (iii) the monies are held in a Deposit Account in which Collateral Agent has a perfected first-priority security interest, and (iv) Holdings or its Subsidiaries, as applicable, complete such replacement, purchase, or construction within 12 months after the initial receipt of such monies (or if a contractual commitment to reinvest is entered into within 365 days following receipt thereof, to be reinvested within 180 days thereafter), Holdings and its Subsidiaries shall have the option to apply such monies in an aggregate amount not to exceed $[TBD] in any Fiscal Year to the costs of replacement of the assets that are the subject of such condemnation, taking or other casualty or the costs of purchase or construction of other assets useful in the business of Holdings and its Subsidiaries unless and to the extent that such applicable period shall have expired without such replacement, purchase or construction being made or completed, in which case, any amounts remaining in the cash collateral account shall be paid to Administrative Agent and applied in accordance with Section 2.14(b) [prepayment provision].

Mandatory Prepayments

4. Excess Cash Flow
   a) Calculated for each fiscal year. Any prepayment is made annually, within a brief specified period of time after the annual financial information is due to be delivered. A percentage of excess cash flow, typically beginning with 50% with step downs and declining to zero when an agreed ratio is reached.
   b) Drafted to start with Net Income and add back non-cash deductions or to start with EBITDA and subtract non-cash additions.

Mandatory Prepayments

- Example:
  - "Applicable ECF Percentage" means, for any fiscal year of the Lead Borrower (commencing with the fiscal year beginning on January 1, 2016), (a) 50% if the First Lien Net Leverage Ratio as of the last day of such fiscal year is greater than 2.50:1.00, (b) 25% if the First Lien Net Leverage Ratio as of the last day of such fiscal year is less than or equal to 2.50:1.00 and greater than 2.00:1.00 and (c) zero if the First Lien Net Leverage Ratio as of the last day of such fiscal year is less than or equal to 2.00:1.00.

Mandatory Prepayments

- "Excess Cash Flow" means, for any period, an amount equal to
  a) the sum, without duplication, of
     i. Consolidated Net Income for such period,
     ii. an amount equal to the amount of all non-cash charges for such period to the extent deducted in arriving at such Consolidated Net Income, but excluding any such non-cash charges representing an accrual or reserve for potential cash items in any future period,
     iii. decreases in Consolidated Working Capital and long-term account receivables for such period (other than any such decreases arising from acquisitions or dispositions by the Lead Borrower and its Restricted Subsidiaries completed during such period or the application of acquisition accounting) and
     iv. an amount equal to the aggregate net non-cash loss on Dispositions by the Lead Borrower and its Restricted Subsidiaries during such period (other than Dispositions in the ordinary course of business) to the extent deducted in arriving at such Consolidated Net Income;
     v. minus

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b) the sum, without duplication, of

i. an amount equal to the amount of all non-cash credits included in arriving at such Consolidated Net Income (but excluding any non-cash credit to the extent representing the reversal of an accrual or reserve described in clause (a)(ii) above) and cash charges, losses and expenses excluded in arriving at such Consolidated Net Income by virtue of clauses (a) through (o) of the definition of Consolidated Net Income,

ii. without duplication of amounts deducted pursuant to clause (xi) below in prior fiscal years, the amount of Capital Expenditures, acquisitions and other Investments of intellectual property to the extent not expensed or accrued during such period, to the extent that such Capital Expenditures, acquisitions or other Investments, as the case may be, were financed with Internally Generated Cash,

iii. the aggregate amount of all principal payments of Indebtedness of the Lead Borrower or its Restricted Subsidiaries (including (A) the principal component of payments in respect of Capitalized Leases and (B) the amount of any scheduled repayment of Term Loans pursuant to Section 2.07(a) and any mandatory prepayment pursuant to Section 2.05(b)(ii), to the extent required due to a Disposition or Casualty Event that resulted in an increase to Consolidated Net Income and not in excess of the amount of such increase, but excluding (X) all voluntary prepayments of Term Loans and (Y) all prepayments of Revolving Credit Loans and Swing Line Loans) made during such period), to the extent financed with Internally Generated Cash,

Mandatory Prepayments

iv. an amount equal to the aggregate net non-cash gain on Dispositions by the Lead Borrower and its Restricted Subsidiaries during such period (other than Dispositions in the ordinary course of business) to the extent included in arriving at such Consolidated Net Income,

v. increases in Consolidated Working Capital and long-term account receivables for such period (other than any such increases arising from acquisitions or dispositions by the Lead Borrower and its Restricted Subsidiaries completed during such period or the application of acquisition accounting),

vi. cash payments by the Lead Borrower and its Restricted Subsidiaries during such period in respect of long-term liabilities of the Borrower and its Restricted Subsidiaries other than Indebtedness,

vii. the amount of Investments and acquisitions made during such period pursuant to the definition of "Permitted Investment" (other than clauses (a)(i), (c), (d), (g), (h), (j), (k), (l), (o), (p), (q), (r), (w), (x) or (y) thereof) to the extent that such Investments and acquisitions were financed with Internally Generated Cash,

viii. the amount of Restricted Payments paid during such period pursuant to 7.06(f), (g), (h), (i), (j) and (k), to the extent such Restricted Payments were financed with Internally Generated Cash,

Mandatory Prepayments

ix. the aggregate amount of expenditures actually made by the Lead Borrower and its Restricted Subsidiaries in cash during such period (including expenditures for the payment of financing fees) to the extent that such expenditures are not expensed during such period,

x. the aggregate amount of any premium, make-whole or penalty payments actually paid in cash by the Lead Borrower and its Restricted Subsidiaries during such period that are required to be made in connection with any prepayment of Indebtedness,

xi. without duplication of amounts deducted from Excess Cash Flow pursuant to clause (b)(ii) above and at the option of the Lead Borrower, the aggregate consideration required to be paid in cash by the Lead Borrower and its Restricted Subsidiaries pursuant to binding contracts or executed letters of intent (the "Contract Consideration") entered into prior to or during such period relating to Capital Expenditures, acquisitions, other Investments or acquisitions of intellectual property to the extent not expensed and expected to be consummated or made, in each case during the period of four consecutive fiscal quarters of the Lead Borrower following the end of such period, provided that to the extent the aggregate amount of Internally Generated Cash actually utilized to finance such Capital Expenditure, acquisition, other Investment or acquisitions of intellectual property during such period of four (4) consecutive fiscal quarters is less than the Contract Consideration, the amount of such shortfall shall be added to the calculation of Excess Cash Flow at the end of such period of four (4) consecutive fiscal quarters,

Mandatory Prepayments

xii. the amount of cash taxes (including penalties and interest) or the tax reserves set aside in a prior period, in each case to the extent paid in cash in such period to the extent they exceed the amount of tax expense deducted in determining Consolidated Net Income for such period,

xiii. cash expenditures in respect of Swap Contracts during such fiscal year to the extent not deducted in arriving at such Consolidated Net Income,

xiv. any payment of cash to be amortized or expensed over a future period and recorded as a long-term asset,

xv. any restructuring expenses, pension payments or tax contingency payments, in each case made in cash during such period to the extent such payments exceed the amount of restructuring expenses, pension payments or tax contingency payments, as the case may be, that were deducted in determining Consolidated Net Income for such period,

xvi. reimbursable or insured expenses incurred during such fiscal year to the extent that reimbursement has not yet been received and

xvii. cash expenditures for costs and expenses in connection with acquisitions or Investments, dispositions and the issuance of equity interests or Indebtedness to the extent not deducted in arriving at such Consolidated Net Income.

Mandatory Prepayments

i. No later than five days following the date on which financial statements have been (or are required to be) delivered pursuant to Section 6.01(a) for each fiscal year of the Lead Borrower (commencing with the fiscal year ending December 31, 2016) and the related Compliance Certificate has been (or is required to be) delivered pursuant to Section 6.02(a), the Borrowers shall cause to be prepaid an aggregate amount of Term Loans (other than Term Loans that are junior to the Term B Loans in right of security) in an amount equal to (A) the Applicable ECF Percentage of Excess Cash Flow, if any, for such fiscal year minus (B) the sum of (1) all voluntary prepayments of Term Loans during such fiscal year (in each case secured by the Collateral on a pari passu basis with the Term B Loans), (2) the amount actually paid (but in no event exceeding par) in respect of Term Loans (in each case secured by the Collateral on a pari passu basis with the Term B loans) purchased pursuant to Section 2.14 and Section 2.15 and (3) all voluntary prepayments of Revolving Credit Loans during such fiscal year to the extent the Revolving Credit Commitments are permanently reduced by the amount of such payments, in the case of each of the immediately preceding clauses (1) through (3), to the extent such prepayments are funded with Internally Generated Cash of the applicable Borrower(s) (the difference of (A) minus (B), the "ECF Prepayment Amount"); provided, however, that if at the time that any such prepayment would be required, either Borrower (or any Restricted Subsidiary of the Lead Borrower) is required to prepay or offer to repurchase any Incremental Equivalent Debt or any Refinancing Equivalent Debt, in each case that is secured by the Collateral on a pari passu basis, and pari passu in right of payment, with the Obligations under Term B Loans and Revolving Credit Loans, pursuant to the terms of the documentation governing such Indebtedness (such Incremental Equivalent Debt or Refinancing Equivalent Debt required

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to be so prepaid or offered to be so repurchased, “Other Applicable Indebtedness”) with any portion of the ECF Prepayment Amount, then such Borrower may apply such portion of the ECF Prepayment Amount on a pro rata basis (determined on the basis of the aggregate outstanding principal amount of the Term Loans (other than Term Loans that are junior to the Term B Loans in right of security) and Other Applicable Indebtedness at such time; provided, that the portion of such ECF Prepayment Amount allocated to the Other Applicable Indebtedness shall not exceed the amount of such ECF Prepayment Amount required to be allocated to the Other Applicable Indebtedness pursuant to the terms thereof, and the remaining amount, if any, of such ECF Prepayment Amount shall be allocated to the Term Loans (other than Term Loans that are junior to the Term B Loans in right of security) in accordance with the terms hereof) to the prepayment of the Term Loans (other than Term Loans that are junior to the Term B Loans in right of security) and to the repurchase or prepayment of Other Applicable Indebtedness, and the amount of prepayment of the Loans that would have otherwise been required pursuant to this Section 2.05(b)(i) shall be reduced accordingly; provided, further, that to the extent the holders of Other Applicable Indebtedness decline to have such indebtedness repurchased or prepaid, the declined amount shall promptly (and in any event within ten (10) Business Days after the date of such rejection) be applied to prepay the Term Loans (other than Term Loans that are junior to the Term B Loans in right of security) in accordance with the terms hereof.

Mandatory Prepayments

- Another Example:
  - “Applicable ECF Percentage” means, for any Fiscal Year, (a) 50% if the Leverage Ratio as of the last day of such Fiscal Year is greater than 3.20 to 1.00, (b) 25% if the Leverage Ratio as of the last day of such Fiscal Year is equal to or less than 3.20 to 1.00 but greater than 2.70 to 1.00, and (c) 0% if the Leverage Ratio as of the last day of such Fiscal Year is equal to or less than 2.70 to 1.00.
  - “Consolidated Excess Cash Flow” means, for any period, an amount (if positive) determined for Holdings and its Subsidiaries on a consolidated basis equal to:
    a) the sum, without duplication, of the amounts for such period of (i) Consolidated EBITDA, plus (ii) interest income, plus (iii) other non-ordinary course income (excluding any gains or losses attributable to Asset Sales), plus (iv) the Consolidated Working Capital Adjustment, minus (b)the sum, without duplication, of the amounts for such period of (i) voluntary and scheduled (but not mandatory) repayments of Consolidated Total Debt (excluding repayments of Revolving Loans except to the extent the Revolving Commitments are permanently reduced in connection with such repayments), plus (ii) Consolidated Capital Expenditures (net of any proceeds of (A) Net Proceeds of Asset Sales to the extent reinvested in accordance with Section 2.13(a), (B) Net Proceeds to the extent reinvested in accordance with Section 2.13(b), and (C) any proceeds of related financings with respect to such expenditures), plus (iii) Consolidated Cash Interest Expense, plus (iv) provisions for current taxes based on income of Holdings and its Subsidiaries and payable in cash with respect to such period.

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- Notwithstanding anything to the contrary contained herein, without duplication of any amounts that have already been deducted or excluded, Consolidated Excess Cash Flow for any period shall exclude for such period, (i) all amounts used to pay Acquisition Consideration or out-of-pocket fees and expenses relating to or arising out of any Permitted Acquisition, Capital Expenditures, or other Investments permitted by the terms of this Agreement, in each case, to the extent funded with Internally Generated Cash, (ii) any amounts which are used to pay or are reserved to pay any actual or potential deferred purchase price adjustments in connection with any Permitted Acquisition, Capital Expenditure permitted under the terms of this Agreement, or other Permitted Investment, (iii) any prepayment, redemption, repurchase, or other retirement of Indebtedness (other than Indebtedness arising under this Agreement or any other Loan Document) and (iv) any amounts permitted to be used and actually used to pay all or any portion of the Loan Parties' obligations in respect of the Seller Note, in the case of each of clauses (i) through (iv), including such amounts that relate to transactions consummated during the period from the end of the relevant fiscal year through the date that such Consolidated Excess Cash Flow payment is due (each transaction consummated during the period from the end of the relevant Fiscal Year through the date that such Consolidated Excess Cash Flow payment is due, a "Stub Transaction"); provided, that any such amounts with respect to any Stub Transaction shall not be excluded from the

Mandatory Prepayments

calculation of Consolidated Excess Cash Flow for such Fiscal Year in which the payment is made to the extent such amounts were excluded from the calculation of Consolidated Excess Cash Flow for the prior Fiscal Year), minus the sum of voluntary prepayments of the Term Loans and permanent reductions of the Revolving Commitments during such Fiscal Year to the extent accompanied by a repayment thereof to the extent such prepayment is funded with Internally Generated Cash Flow.

- Covenant: Consolidated Excess Cash Flow. No later than 15 Business Days after the date on which the financial statements with respect to each Fiscal Year (commencing with the Fiscal Year ending on December 31, 2018) are required to be delivered pursuant to Section 5.1(c), to the extent that there shall be Consolidated Excess Cash Flow for any such Fiscal Year, Company shall prepay the Loans and/or the Revolving Commitments shall be permanently reduced as set in Section 2.14(b) in an aggregate amount equal to the Applicable ECF Percentage of Consolidated Excess Cash Flow.

Mandatory Prepayments

5. Extraordinary Receipts
    a) More likely in the middle market
    b) To capture receipt of money not contemplated by the other provisions, such as tax refunds or post-closing purchase price adjustments. 100% payable within short period of time of receipt, often with a minimum threshold amount so as to weed out immaterial payments.

Mandatory Prepayments

- Example:

  vii. "Extraordinary Receipts" means any cash received by the Parent or any of its Subsidiaries not in the ordinary course of business (and not consisting of proceeds described in Section 2.05(c)(v) or (vi) hereof [debt, equity issuances]), including, without limitation, (a) foreign, United States, state or local tax refunds attributable to the Parent's utilization of the net operating losses of the Parent and its Subsidiaries, (b) pension plan reversions, (c) proceeds of insurance (other than officers liability insurance and any insurance proceeds received (i) which are owed to a third party that is not an Affiliate of the Parent or any of its Subsidiaries in accordance with applicable Requirements of Law or with Contractual Obligations entered into in the ordinary course of business or (ii) as reimbursement for any out-of-pocket costs incurred or made by such Person prior to the receipt thereof directly related to the event resulting from the payment of such proceeds), (d) judgments, proceeds of settlements or other consideration of any kind in connection with any cause of action (but excluding proceeds from causes of actions relating to insurance coverage or indemnities thereof) to the extent such proceeds exceed the loss, damages, fees, costs and expenses incurred by the applicable Loan Party or Subsidiary in connection with any such matter, (e) condemnation awards (and payments in lieu thereof), (f) indemnity payments to the extent the amount received is not required to be remitted to any other Person (other than any Affiliate of the Parent or any of its Subsidiaries) and to the extent such proceeds exceed the loss, damages, fees, costs and expenses incurred by or actual remediation and replacement costs of the applicable Loan Party or Subsidiary in connection with any such matter and (g) any purchase price adjustment (other than a working capital adjustment) received in connection with any purchase agreement to the extent the amount received therefrom is not required to be remitted to any other party to such purchase agreement (other than any Affiliate of the Parent or any of its Subsidiaries) pursuant to the terms thereof and to the extent such amount exceeds the loss, damages, fees, costs and expenses incurred by the applicable Loan Party or Subsidiary in connection with any such matter. For the avoidance of doubt, Extraordinary Receipts shall not include any distributions or dividends received by the Parent or any of its Subsidiaries from their respective Subsidiaries.

Mandatory Prepayments

- Within 3 Business Days of the receipt by any Loan Party or any of its Subsidiaries of any Extraordinary Receipts, the Borrower shall prepay the outstanding principal of the Loans in accordance with clause (d) below an amount equal to 100% of the Net Cash Proceeds of such Extraordinary Receipts to the extent the aggregate amount of Extraordinary Receipts received by all Loan Parties and their Subsidiaries shall exceed $250,000 in any Fiscal Year.

6. Term Lenders Right to Decline
   a) To preserve yield.
   b) Typically, portion declined is applied to the other lenders not declining on pro rata basis or to other debt holders in capital structure
   c) How do lenders know about an upcoming mandatory prepayment? Reporting covenants in credit agreements usually impose prior notice obligation on borrowers, and, sometimes include a certification showing the ECF or net proceeds to be received.

Mandatory Prepayments

- Example:

  vii. The Lead Borrower shall notify the Administrative Agent in writing of any mandatory prepayment of Term Loans required to be made pursuant to clauses (i) through (iii) of this Section 2.05(b) at least three (3) Business Days prior to the date of such prepayment. Each such notice shall specify the date of such prepayment and provide a reasonably detailed calculation of the amount of such prepayment. The Administrative Agent will promptly notify each Appropriate Lender of the contents of the Lead Borrower's prepayment notice and of such Appropriate Lender's Pro Rata Share of the prepayment. Each Term Lender may reject all or a portion of its Pro Rata Share of any mandatory prepayment (such declined amounts, the "Declined Proceeds") of Term Loans required to be made pursuant to clauses (i), (ii) and (iii)(y) of this Section 2.05(b) by providing written notice (each, a "Rejection Notice") to the Administrative Agent and the Lead Borrower no later than 5:00 p.m. one Business Day after the date of such Lender's receipt of notice from the Administrative Agent regarding such prepayment. Each Rejection Notice from a given Lender shall specify the principal amount of the mandatory repayment of Term Loans to be rejected by such Lender. If a Term Lender fails to deliver a Rejection Notice to the Administrative Agent within the time frame specified above or such Rejection Notice fails to specify the principal amount of the Term Loans to be rejected, any such failure will be deemed an acceptance of the total amount of such mandatory prepayment of Term Loans. Any Declined Proceeds shall be offered to the Term Lenders not so declining such prepayment on a pro rata basis in accordance with the amounts of the Term Loans of such Lender (with such non-declining Term Lenders having the right to decline any prepayment with Declined Proceeds at the time and in the manner specified by the Administrative Agent). To the extent such non-declining Term Lenders elect to decline their Pro Rata Share of such Declined Proceeds, any Declined Proceeds remaining thereafter shall be retained by the Borrowers (such remaining Declined Proceeds, the "Borrower Retained Prepayment Amounts").

Mandatory Prepayments

7. Funding Losses. A prepayment is triggered by an event, which may result in the Borrower prepaying on a date other than the last day of a LIBOR interest period. To avoid funding losses, there may be a mechanic whereby the borrower deposits the proceeds subject to the mandatory prepayment requirements in a cash collateral account, which are then paid out by the agent for application to debt when the then applicable LIBOR interest period ends.

Mandatory Prepayments

- Example:

  vii. Funding Losses, Etc. All prepayments under this Section 2.05 shall be made together with, in the case of any such prepayment of a LIBOR Loan on a date other than the last day of an Interest Period therefor, any amounts owing in respect of such LIBOR Loan pursuant to Section 3.05. Notwithstanding any of the other provisions of Section 2.05(b), so long as no Event of Default shall have occurred and be continuing, if any prepayment of LIBOR Loans is required to be made under this Section 2.05(b), prior to the last day of the Interest Period therefor, the Borrowers may, in their sole discretion, deposit the amount of any such prepayment otherwise required to be made thereunder into a Cash Collateral Account until the last day of such Interest Period, at which time the Administrative Agent shall be authorized (without any further action by or notice to or from either Borrower or any other Loan Party) to apply such amount to the prepayment of such Loans in accordance with this Section 2.05(b). Upon the occurrence and during the continuance of any Event of Default, the Administrative Agent shall also be authorized (without any further action by or notice to or from either Borrower or any other Loan Party) to apply such amount to the prepayment of the outstanding Loans in accordance with this Section 2.05(b).

Mandatory Prepayments

- Other Voluntary Devices to Reduce Debt Outstanding
  1. Reverse Dutch Auction
     a) Historically, non pro rata prepayments not a feature of the loan market, although present in the bond market. Financial crisis in 2007 changed that.
     b) Transparent process, offer is open to all lenders, at a stated price or range of prices, similar to tender offer for bonds. Feature still in documents, but used less than during and around the crisis.

Mandatory Prepayments

- Example:

  Section 2.14 Reverse Dutch Auction Repurchases.

  a) Notwithstanding anything to the contrary contained in this Credit Agreement or any other Loan Document, Holdings or any of its Subsidiaries may, at any time and from time to time, conduct reverse Dutch auctions in order to purchase Term Loans (each, an “Auction”) (each such Auction to be managed by an Auction Manager), so long as the following conditions are satisfied:

     i. each Auction shall be conducted in accordance with the procedures, terms and conditions set forth in this Section 2.14 and Schedule 2.14;

     ii. no Event of Default shall have occurred and be continuing on the date of the delivery of each Auction Notice and at the time of purchase of any Term Loans in connection with any Auction;

     iii. the maximum principal amount (calculated on the face amount thereof) of all Term Loans that the Borrowers offer to purchase in any such Auction shall be no less than $10,000,000 (unless a lower amount is agreed to by the Auction Manager);

     iv. the proceeds of Revolving Credit Loans shall not be used for a purchase of any Term Loans in connection with any Auction;

     v. the aggregate principal amount (calculated on the face amount thereof) of all Term Loans so purchased shall automatically be cancelled and retired by the purchaser thereof on the settlement date of the relevant purchase (and may not be resold);

     vi. no more than one Auction may be ongoing at any one time;

Mandatory Prepayments

vii. each Lender participating in any Auction acknowledges and agrees that in connection with such Auction, (1) the Borrowers then may have, and later may come into possession of, information regarding the Term Loans or the Loan Parties hereunder that is not known to such Lender and that may be material to a decision by such Lender to participate in such Auction ("Excluded Information"), (2) such Lender has independently and, without reliance on either Borrower, any of its Subsidiaries, the Auction Manager or any of their respective Affiliates, has made its own analysis and determination to participate in such Auction notwithstanding such Lender's lack of knowledge of the Excluded Information and (3) none of Holdings, its Subsidiaries, the Administrative Agent, the Auction Manager or any of their respective Affiliates shall have any liability to such Lender, and such Lender hereby waives and releases, to the extent permitted by law, any claims such Lender may have against either Borrower, its Subsidiaries, the Administrative Agent, the Auction Manager and their respective Affiliates, under applicable laws or otherwise, with respect to the nondisclosure of the Excluded Information. Each Lender participating in any Auction further acknowledges that the Excluded Information may not be available to the Auction Manager or the other Lenders; and

viii. at the time of each purchase of Term Loans through an Auction, the Lead Borrower shall have delivered to the Auction Manager an Officer's Certificate of the Lead Borrower certifying as to compliance with preceding clauses (ii) and (iv).

Mandatory Prepayments

b) The Lead Borrower must terminate an Auction if it fails to satisfy one or more of the conditions set forth above which are required to be met at the time which otherwise would have been the time of purchase of Term Loans pursuant to the respective Auction. If the Lead Borrower commences any Auction (and all relevant requirements set forth above which are required to be satisfied at the time of the commencement of the respective Auction have in fact been satisfied), and if at such time of commencement the Lead Borrower reasonably believes that all required conditions set forth above which are required to be satisfied at the time of the purchase of Term Loans pursuant to such Auction shall be satisfied, then the Lead Borrower shall have no liability to any Lender for any termination of the respective Auction as a result of its failure to satisfy one or more of the conditions set forth above which are required to be met at the time which otherwise would have been the time of purchase of Term Loans pursuant to the respective Auction, and any such failure shall not result in any Default hereunder. With respect to all purchases of Term Loans made by Holdings or any of its Subsidiaries pursuant to this Section 2.14, (x) Holdings or such Subsidiary (as applicable) shall pay on the settlement date of each such purchase all accrued and unpaid interest (except to the extent otherwise set forth in the relevant offering documents), if any, on the purchased Term Loans up to the settlement date of such purchase and (y) such purchases (and the payments made by Holdings or such Subsidiary (as applicable) and the cancellation of the purchased Term Loans, in each case in connection therewith) shall not constitute voluntary or mandatory payments or prepayments for purposes of determining compliance with Sections 2.05 or Section 2.13.

Mandatory Prepayments

c) The Administrative Agent and the Lenders hereby consent to the Auctions and the other transactions contemplated by this Section 2.14 (provided that no Lender shall have an obligation to participate in any such Auctions) and hereby waive the requirements of any provision of this Agreement (including, without limitation, Sections 2.05 and Section 2.13 (it being understood and acknowledged that purchases of the Term Loans by Holdings or any of its Subsidiaries contemplated by this Section 2.14 shall not constitute Investments by Holdings or any of its Subsidiaries)) or any other Loan Document that may otherwise prohibit any Auction or any other transaction contemplated by this Section 2.14.

Mandatory Prepayments

2. Open Market Purchases
   a) Expressed language required for borrower debt buybacks, since typically borrower or any other loan party is excluded from eligibility to purchase loan assignments.
   b) Loans acquired by borrower required to be retired.
   c) If necessary, agreement will prohibit the use of additional borrowing to pay for the debt retirement.

Mandatory Prepayments

- Example:
  Section 2.15 Open Market Purchases.

  a) Notwithstanding anything to the contrary contained in this Credit Agreement or any other Loan Document, Holdings or any of its Subsidiaries may, at any time and from time to time, make open market purchases of Term Loans (each, an "Open Market Purchase"), so long as the following conditions are satisfied:

     i. no Event of Default shall have occurred and be continuing on the date of such Open Market Purchase;

     ii. the aggregate principal amount (calculated on the face amount thereof) of all Term Loans so purchased shall automatically be cancelled and retired by the purchaser thereof on the settlement date of the relevant purchase (and may not be resold); and

     iii. the proceeds of Revolving Credit Loans shall not be used for a purchase of any Term Loans in connection with any Auction.

Mandatory Prepayments

b) With respect to all purchases of Term Loans made by Holdings or any of its Subsidiaries pursuant to this Section 2.15, (x) Holdings or such Subsidiary (as applicable) shall pay on the settlement date of each such purchase all accrued and unpaid interest, if any, on the purchased Term Loans up to the settlement date of such purchase (except to the extent otherwise set forth in the relevant purchase documents as agreed by the respective selling Lender) and (y) such purchases (and the payments made by Holdings or such Subsidiary (as applicable) and the cancellation of the purchased Term Loans, in each case in connection therewith) shall not constitute voluntary or mandatory payments or prepayments for purposes of Sections 2.05 or Section 2.13.

c) The Administrative Agent and the Lenders hereby consent to the Open Market Purchases contemplated by this Section 2.15 and hereby waive the requirements of any provision of this Agreement (including, without limitation, Section 2.05 and Section 2.13 (it being understood and acknowledged that purchases of the Term Loans contemplated by this Section 2.15 shall not constitute Investments by the Borrowers)) or any other Loan Document that may otherwise prohibit any Open Market Purchase by this Section 2.15.

Prepayment Opt Outs

- Term B Lenders more likely to opt out than Term A
  - Typically Term B are institutional investors with a long-term investment strategy and do not want their loans to be repaid early
- If a Lender declines, the amount is often reallocated among the non-declining lenders but may be used to prepay other loans or remain with the borrower.
- If there are multiple loan tranches, the borrower is usually required to allocate ratably among tranches.

Prepayment Premiums

- Also known as call protection, a make-whole or a prepayment penalty. A penalty assessed against a borrower who elects to pay off a debt before its maturity date. This amount can potentially be quite significant.
  - In bank loan financings, certain loan agreements require that a prepayment premium (or call premium) must be paid by the borrower to prepay all or part of the loans. This fee can be payable on all prepayments or only on prepayments made as part of a refinancing of the loans. Prepayment penalties are more common on refinancings of loans held by term B lenders but can be based on refinancings of the entire loan facility.

Prepayment Premiums

- Soft call are only paid when the loan is refinanced or repriced, while hard call are paid on mandatory repayments, such as from asset sale proceeds.
- Soft call prepayment premiums continue to be incorporated in large corporate loan agreements, with premiums of 1% in the first year of the loan being common.
  - Becoming more common in middle market deals, as more institutional investors, seeking higher yields, are investing in middle market loans.
  - Middle markets deals may now include provisions prohibiting voluntary prepayments in the first year (no call provisions), with a 3% premium in the second year and 1% step-downs in each of the following two years.

Prepayment Premiums

- Hard call prepayment premiums are less common in large corporate loans than in middle market deals.
- Recent: some sponsored borrowers are now negotiating carve-outs for prepayment premiums that are payable in connection with a borrower change of control, which allow sponsors to sell portfolio companies and repay their ;loans without paying call premiums.

Allocation of Prepayments

- Borrower v. Market preferences
  1. Term, Overdraft, Revolver - practices and approaches differ
  2. Inverse order, next payment or pro rata
  3. Allocation to least or most expensive – cost of interest, penalty and breakage
  4. Hedging facility v. Cash Flow facility
  5. Cash receipt trigger event – ability to use or not

Allocation of Prepayments

- Internal – Proportionate, Last payment or First Payment
  1. First dollar next owed or last installments (inverse)
  2. The case for pro rata – when and why
  3. Senior only or subordinate participation
  4. Credit support products and what happens – LC, Hedge
  5. What else comes out of the cash receipt trigger amount before the prepayment

Allocation of Prepayments

- Insurance proceeds
  1. Requires payment of 100% or ability to use to repair and replace
  2. Set percentage of proceeds or discretion
  3. The effect of shut down, requirement for quality if replace
  4. On the eve of insolvency
  5. Security over proceeds before application

Prepayment with a defaulted loan

- Usual basis for prepayment when loan is in default
  1. How does it fit with acceleration – making it clear
  2. What is the prepayment bonus – if a penalty may be an issue
  3. Breakage – how does that fit, is it collectable
  4. Can you set different terms – such as increase collection from trigger events
  5. How does payment fit with realization

Prepayment with a defaulted loan

- Allocation of payment requirements
  1. Most or least expensive becomes important
  2. Can you switch from first allocation to term to first to revolver
  3. Can you revise to last dollars

Prepayment with a defaulted loan

- Enforceability
  1. Insolvency protections for the borrower may eliminate the penalty
  2. Can you separate and protect breakage as liquidated damages
  3. Does a liquidated damages based waiver o protection work

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