SELL DOWNS OR PARTICIPATIONS AS ALTERNATIVES TO SYNDICATIONS: CURRENT TECHNIQUES AND PROBLEMS

Comment by

GEORGE FORSTER

Freehill Hollingdale & Page
Solicitors, New South Wales

The way that the three of us have split up this topic this morning is that I will briefly outline the various forms that participations may take, Cam Johnston will then discuss the relevant withholding tax implications relating to those different forms of participation and Jeffrey Browne will discuss the advantages/disadvantages of those forms in light of the applicable commercial circumstances.

Before dealing with the various forms of participation it may be useful at the outset to define a number of the expressions frequently used in relation to participations. In defining these expressions, I believe that a number of the definitions used by Mr Yovard in his recent article on syndicated loans in Euromoney are applicable.

The first expression that I believe is worthy of consideration is that of "lenders". The "lenders" are usually described as "banks and other financial institutions". The latter expression simply means bankers who through some local gimmickry cannot call themselves "bankers" but do very nicely in spite of it.

Another expression that we need to consider is that of the "borrower". This is the person, firm, entity, corporation, government institution or otherwise, to whom the lenders actually lend their money. The theory being that it will be repaid at maturity. Borrowers fall into two categories: those who are creditworthy and who do not need the money, and those who are not and do.

The next expression that we cannot ignore is the "margin". This represents the difference between what it costs the lenders to get hold of the money and what they actually screw out of the borrower. This is also often known as "spread". The one thing that it must not be called is "profit", because bankers shudder at the suggestion that they do the whole thing for profit.

Having now determined who the parties are, and what the margin is going to be, we then have the "negotiation". This is what happens when the agent actually presents the draft loan agreement to the borrower. The ritual is very important. When asked if he likes the document, the borrower must always object to a number of clauses. It doesn't matter which ones. The agent then says "they are standard market practice". The borrower then always says "not to me they're not". The ritual then involves a noisy and sometimes acrimonious wrangle. Reason plays only a tiny part in determining who wins, since we all know that a fashionable borrower can get bankers to agree to the most ludicrous provisions while an unfashionable borrower has a much harder time.

Having now negotiated this loan agreement, it is worthwhile considering very briefly the contents of that loan agreement. First we have the "covenants". Now the only interesting parts of the "covenants" are the negative pledge provisions. These say that the borrower will not hock his assets, that is, if the syndicate is going to suffer, then at least everyone else should suffer as well. This clause occasionally becomes a bit more interesting, by a list of exceptions which is usually so long, that the syndicate usually realises, often at the signing ceremony, that a borrower is already hocked to the hilt.

The final term that I think is worthy of definition, is the "events of default" clause. Now this clause is marginally less boring than the other clauses, because it lists the occasions when the lenders can ask for their money back. The clause is often more interesting in terms of what is left out rather than what is put in. Too many paragraphs in this clause can convert a term loan into a demand loan.

But now that we understand the basic terms and expressions which are used in relation to syndications and participations which they relate to, I think we are in a position where we can move to the different forms of participation available.

I suppose the first form is that involving novation. This form is the simplest, in that it involves new documents being entered into which release the existing contracting lender from liability. There are two other forms of participation which are worthy of consideration.

The first type involves the funded participation approach. This is basically a back to back situation, where the contractual lending institution takes the necessary funds to fulfil its own lending requirements from one or more other institutions and where the proceeds of the loan itself are ultimately used to repay the incoming participants.

The other form of participation that I would like to refer to is one I call the "sold participation", and this is where the contractual lender assigns in whole or in part, his interest in an existing loan agreement.

Often participation agreements are not drafted to clearly establish the legal relationships and duties between the parties but rather from a viewpoint of simplicity and to accommodate the business relationships.

The consequences to the selling bank of inadequate drafting can often be drastic in terms of potential loss.

I was intending to deal in further detail with each of the forms of participation - however in the time allowed I am unable to do so. I would however, just make one more point if I may in relation to the sold participation format, because this is the one that is more frequently used.

Under New South Wales law, the "clearest" form of assignment is a "legal" form of assignment. However, as a commercial matter a legal assignment is not frequently used because it requires under section 12 of the New South Wales Conveyancing Act an assignment of the whole of the debt. Quite often lenders only wish to assign a part of their debt. In addition, section 12 requires notice to be given to the debtor for there to be an effective legal assignment. In relation to a silent participations, it may frequently be the case that the terms of a participation are that the borrower is not to be notified of a participation. For that reason, in such circumstances the parties would not implement their participation by way of a legal assignment but rather an equitable assignment.

There is no magical form that an equitable assignment needs to take in terms of wording. So long as there is valuable consideration and provided that the meaning is plain, the equitable assignment would be effective in equity to assign the relevant debt.