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High Yield Bonds

An Issuer's Guide (5th European Edition)

If you have any questions about high yield bond offerings, please contact the author of this guide.

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Foreword

It has been almost four years since the publication of the 4th European edition of this guide in October 2016, four years that were mostly characterized by a generally robust economic environment (at least until the emergence of the Covid-19 pandemic in early 2020), ultra-low interest rates and a significant and rapid convergence between the large cap leveraged loan market and high yield bond market, with a very significant percentage (possibly up to around half) of all large cap, syndicated leveraged senior facilities agreements in Europe in 2019 potentially qualifying as so-called "high yield bonds in disguise". Because of these and other factors, high yield issuers have been able to successfully introduce countless innovations and gained much increased flexibility under their covenant packages in recent years, while investors have largely had to accept a significant erosion of traditional covenant protections. An update of this guide has therefore been long overdue.

At the beginning of the year, it seemed like the European leveraged finance markets were off to a flying start, with an exceptional issuance spike in January 2020, in particular, and also strong issuance in February 2020. In March 2020, however, both high yield bond and leveraged loan markets in Europe came to a grinding halt as a result of the emerging Covid-19 pandemic. With both markets still in the early stages of a gradual reopening at the time of publication of this latest edition and with investors likely not able to fully assess the impact of the pandemic on individual businesses and industries until after publication of financial results for the second quarter of 2020, it remains to be seen whether the economic fall-out from the Covid-19 pandemic will lead to a meaningful and sustained reversal of some of the trends and developments that have characterized the European leveraged finance markets in recent years.

As described throughout this latest edition, in the (much more active) US markets, a number of new trends and developments have already emerged which were directly inspired by the Covid-19 pandemic, including (i) certain novel call features, (ii) extended time frames for granting and perfecting security, (iii) temporary moratoria on making Restricted Payments, incurring Ratio Debt, granting certain Permitted Liens and/or designating Unrestricted Subsidiaries, (iv) additional leverage ratio-based conditions on making Restricted Payments and (v) post-dating of the start date of the Build Up Basket, to name just a few. However, many of these new features have yet to make their debut appearance in the European markets, and there does not seem to be any indication so far of a significant general tightening of covenants or of a general reversal of some of the issuer-friendly developments we have seen in recent years. On the contrary, most of the (still fairly few) issuers that have successfully tapped the European high yield market in recent weeks appear to have done so with terms substantially identical to those of their most recent, pre-pandemic bonds. Of course, this may well be because of the dearth of supply in the market and because most of the recent market activity can likely be characterized as opportunistic transactions by stronger and/or well-liked repeat issuers.

In any case, it is worth noting that most of those high yield issuers that are struggling at the moment will be in trouble because of the largely unforeseeable and unavoidable impact of the Covid-19 pandemic on their businesses, not because they had taken improper advantage of loose covenant terms. On the contrary, it might well take a crisis like the current one to highlight the key advantages of a traditional high yield bond that will ideally allow an issuer to weather even extended periods of disruption to its business without being forced to seek consents to amend its bonds or to even formally restructure. These advantages include the inherent flexibility of the traditional high yield covenant package, the absence of maintenance covenants, usually fixed interest rates at longer tenors, flexible redemption provisions that allow issuers to refinance and extent their debt maturity profiles during the good times and an opportunity, for the first-time issuer, to expand and diversify its investor bases and sources of capital. Even from an investor's perspective, distracting management's attention with requirements to solicit consents for potential waivers or amendments from creditors may serve little purpose where issuers are struggling as a result of macro-economic shock, rather than as a result of developments that are specific to the issuer's business and within management's control. Even in those recent instances where high yield issuers have taken advantage of available flexibility under their covenant packages, for example, to incur incremental priority debt (i.e. debt that is effectively and/or structurally senior to their high yield bonds) by employing various techniques, they will often have done so as a last resort and as the only option available to them to secure urgently needed liquidity in volatile markets and where defaults and/or insolvency (even less desirable for existing bondholders) might have been the only alternative.

As with earlier editions, this 5th European Edition of High Yield Bonds – An Issuer's Guide is primarily intended for first-time issuers, to help business owners, chief financial officers, treasurers, in-house lawyers and other key stakeholders evaluate the pros and cons of issuing high yield bonds. We therefore did not assume that users of this guide would have any prior experience with high yield bonds, and we have tried to explain relevant high yield bond concepts in simple, non-technical terms. However, other than in prior editions of this guide, we have also tried to put an increased emphasis on the latest trends and developments that may be of most interest to the more experienced reader. We therefore hope that other market participants (such as relevant team members at underwriting banks / initial purchasers, law firms or other financial and legal advisers) will also find the guide interesting and helpful.

And of course, this latest crisis has created, and likely will continue to create, many "fallen angels". Some of those fallen angels may well continue to be able to access the debt markets using their traditional investment grade-style (or at least "HY-lite") documentation, based on a market expectation of a speedy recovery post-pandemic. Other issuers, however, may face a much longer road to recovery or may, in fact, never fully recover or may continue to be burdened by a much higher leverage as a result of incremental debt they were forced to incur to cover losses and remain solvent during the pandemic. In addition, during the credit boom that preceded the pandemic, many "cross-over" issuers (i.e. issuers with a credit rating just below investment grade) might have found it fairly easy to access the investment grade markets, including by raising traditional bank financing, issuing *Schuldscheine* or issuing investment grade-style or HY-lite bonds. At least some of those issuers will likely struggle to continue to do so when forced to refinance or otherwise access the markets following further downgrades as a result of the pandemic.

Traditional Credit Facility vs. High Yield Bonds

The following table highlights certain major differences between traditional credit facilities and high-yield bonds. But see also "*Convergence between the European leveraged loan market and the high yield bond market*" starting on page 27 below.

Traditional Credit Facility	High Yield Bonds
• Maintenance and incurrence covenants	• Less onerous incurrence covenants only
• Typically tenor of 3 – 5 years	• Typically tenors of 5 – 10 years
• Term loan tranches traditionally amortizing; interim payments generally required by banks	• Bullet maturity
• Generally repayable at any time, with no or only very limited call protection	• Non-call period generally 2 to 5 years and thereafter decreasing prepayment / call premium – typical call features: 5nc2, 7nc3, 8nc4, 10nc5
• Amendments relatively common and uncomplicated	• Amendments require consent solicitation from investors, which can be costly and time-consuming
• Documentation relatively straightforward	• Documentation requires more time and expenses
• Senior and typically secured and guaranteed	• Potentially more flexibility; senior or subordinated and frequently unsecured
• Floating Rate	• Fixed or Floating Rate (and potentially even PIK option)
• Private reporting (monthly or quarterly)	• Public reporting (quarterly)
• Minimal public market awareness	• Creates awareness in public capital markets and benchmark that can facilitate further fund raisings, including possible IPO
• Rating not necessarily required	• Rating required (typically by Moody's and S&P)
• Investors are typically banks, institutional funds	• Investors are mutual funds, hedge funds, insurance companies, pension funds, private wealth management accounts
	• Potential prospectus liability

Introduction

WHY HIGH YIELD?

Traditional reasons for high-yield offerings include:

- established companies that do not carry (or have lost) an investment grade rating (i.e. rated Ba 1/ BB+ and below by Moody's and S&P, respectively);
- private companies looking to reorganize their capital structure; and
- financings for leveraged buy-outs.

Mutual benefits for issuers and investors include:

- issuers benefit from stable, long-term debt financing (at mostly fixed interest rates) with covenants that will normally be less onerous / more flexible than the standard covenants included in a typical credit facility; and
- investors benefit from higher interest rates with the added benefit of potential capital appreciation.

THE IDEAL HIGH YIELD BOND CANDIDATE

Other than investors in investment grade debt that may very much focus on an issuer's credit profile / metrics (e.g. leverage and credit ratings), high yield bond investors will also consider some of the same factors in making their investment decision as equity investors, such as the issuer's strategy and growth prospects.

The ideal candidate for a high yield bond exhibits some or all of the following characteristics:

- a stable and resilient business model and financial track record and/or a growth/recovery story;
- market leading positions and favorable industry trends / growth prospects;
- an experienced management team with a proven track record;
- solid cash generation and future deleveraging potential;
- financing needs of at least €200 million to €250 million and with limited bank financing available and/or a desire to diversify its sources of capital; and
- the proceeds of the offering are to be used for refinancing existing indebtedness, acquisition financing or (defined) general corporate purposes.

RANKING AND SUBORDINATION

Although high yield bonds can be deliberately structured to serve as, and often do constitute, the junior piece of a company's overall capital structure, a vast majority of high yield bonds in Europe (typically far in excess of 90%) continue to be marketed as either "senior secured notes" or as "senior notes", with only a very small minority expressly marketed as "subordinated", "second lien" or with a similar label that clearly indicates a junior ranking position in the capital structure.

It is therefore critical, for both issuers and investors, to look beyond the label and to understand where a particular bond actually sits within the overall capital structure and, equally important, to what extent that position in the capital structure is protected through relevant restrictions and limitations as part of the covenant package governing the bonds.

There are three potential forms of subordination:

- "express" contractual subordination;
- structural subordination; and
- "effective"/lien subordination.

Only "subordinated notes" have express contractual subordination provisions, while structural or lien subordination may be a feature of both "senior notes" and "subordinated notes". Many "senior notes", for example, may in fact constitute a junior piece of the overall capital structure, because (i) they may be "structurally junior" to other debt (bonds or loans), because they are issued at a (holding company) level further up in the corporate group structure, without the benefit of any (or only limited) upstream guarantees and/or (ii) there may be significant amounts of secured debt (including "senior secured notes") within the capital structure, which will have priority with regard to the enforcement proceeds from a sale of the assets securing such debt. In this context, it is also worth noting that a significant percentage of (unsecured) "senior notes" issued by European sub-investment grade issuers are so-called "**high yield lite**" notes which do not feature a full suite of traditional high yield covenants and therefore potentially leave the issuer with significant flexibility to incur further indebtedness that may be structurally senior and/or secured and therefore rank ahead of the "senior notes". Even "senior secured notes" often feature collateral packages that are not nearly comprehensive and, in many cases, only consist of very limited categories of financial assets, such as share pledges and / or certain account pledges.

Subordination, however, is not necessarily a bad thing and may, in fact, be a useful tool to allow the Issuer to incur more debt cost-effectively than it could if all its indebtedness ranked the same. One popular structure, for example, involves the issuance of "senior secured notes" and entry into a "**super senior**" secured revolving credit facility, where the obligations under both the notes and the facility are typically secured equally with first-ranking security over certain assets of the Issuer, but where any obligations under the facility (and other potential "super priority" obligations, such as certain priority hedging obligations and/or cash management liabilities) are satisfied first with any enforcement proceeds in accordance with the terms of the Intercreditor Agreement. See also "*Intercreditor Agreement*" on page 12 below.

Contractual Subordination

High yield bonds may be expressly subordinated by contract, which means that:

- upon a bankruptcy or liquidation of the Issuer, the holders of the bonds agree not to be paid until any senior debt is paid in full; and
- the holders of the bonds agree to pay to holders of any senior debt any amounts received until the senior debt is paid in full.

One way to achieve this result is the inclusion of so-called "**payment blockage provisions**" in the relevant documentation, whereby upon a default under the senior debt, no payments are permitted to be made on subordinated debt for a specified period of time.

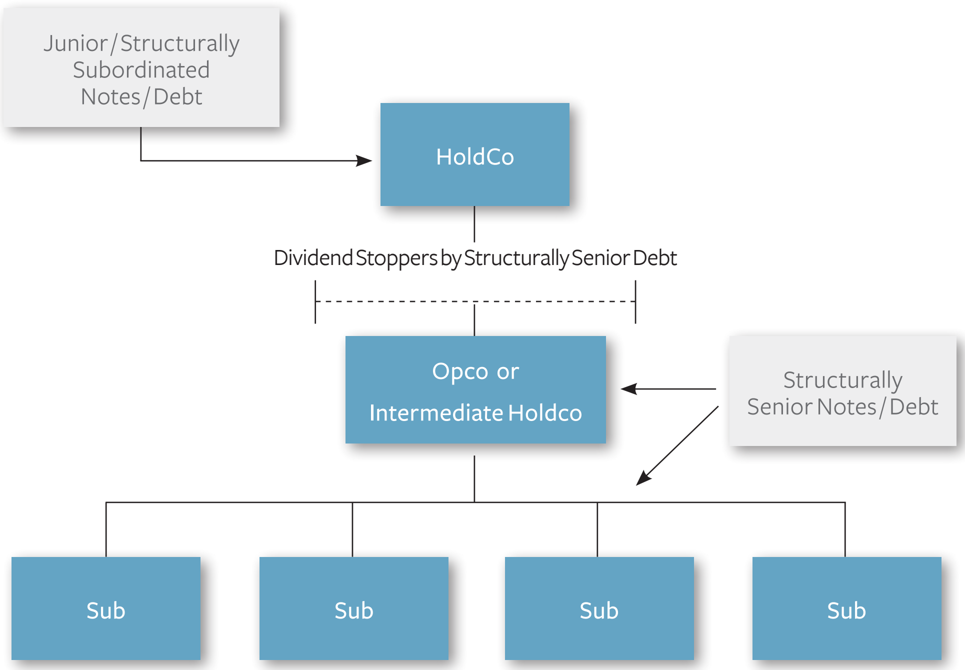
In addition, the relevant documentation will include so-called "**standstill provisions**" whereby holders of the subordinated debt must give notice to the senior lenders and wait for a certain period of time before accelerating the subordinated debt.

In the case of contractual subordination, it is possible to specify exactly which other indebtedness the bonds are subordinated to and they need not necessarily be subordinated to all other debt.

See also "*Intercreditor Agreement*" on page 12 below.

Structural Subordination

In the most common form of structural subordination, the high yield bonds are issued by a (top-level) holding company, whereas structurally senior debt is issued by a (lower-level) intermediate holding company or operating company further down the group structure, closer to where the operations and assets of the group are located. This senior debt will likely have restrictions on upstream payments, i.e. so-called "**Dividend Stoppers**". See also "*Limitation on Restricted Payments*" starting on page 62 below.



In this structure, the subordinated debt is "structurally" subordinated because the holders of the HoldCo debt have no direct access to the assets or cash of OpCo / Intermediate HoldCo or the various other operating subsidiaries. Instead, the only claim HoldCo creditors have on the assets and/or cash flows of the various entities further down in the group structure is through the shares of Opco / Intermediate HoldCo held by Holdco. In a bankruptcy or liquidation of OpCo / Intermediate HoldCo, this (equity) claim would be junior (i.e. subordinated) to the claims of any creditors of OpCo / Intermediate HoldCo and its subsidiaries, including the claims of unsecured creditors, such as subordinated debt holders or trade creditors. Stated differently, under applicable bankruptcy or insolvency laws, OpCo / Intermediate HoldCo would be required to repay all its creditors (including unsecured creditors, such as subordinated debtholders and trade creditors) in full before it would be permitted to distribute any remaining liquidation proceeds to its shareholders (i.e. HoldCo), which could then be used to satisfy obligations under the structurally subordinated debt issued by HoldCo.

To address / mitigate potential structural subordination issues in cases where "senior" notes are being offered to investors, it is customary for other (significant) entities in the Restricted Group (see "*Restricted Subsidiaries vs. Unrestricted Subsidiaries*" on page 16 below) to guarantee the Issuer's obligations under the bonds, which gives bondholders direct contractual claims against any such Guarantors in a potential insolvency. See also "*The Guarantors*" on page 15 below. In addition, the "Limitation on Indebtedness" covenant will typically restrict the ability to incur incremental debt to the Issuer and any Guarantors and/or limit the ability of non-Guarantor Restricted Subsidiaries to incur any debt.

Effective/Lien Subordination

To the extend the company's capital structure includes secured debt, bank debt will normally be " first lien debt", i.e. the bank debt (credit facility) will benefit from security interests (e.g. mortgages, pledges, charges, ….) over some or all of the assets of the company and its subsidiaries whereby the bank creditors get paid in full before any other creditors receive any proceeds from the sales of such assets in the case of a bankruptcy or insolvency.

High yield bonds may be either unsecured or secured and may be either first lien or second lien debt. If the high yield bonds are first lien debt, they will share *pari passu* with bank debt in the proceeds from the sale of any collateral, i.e. will not be subordinated to such bank debt with regard to the collateral. If they are unsecured or second lien debt with regard to the same collateral, they would receive proceeds from the sale of the collateral only after the first lien debt has been paid in full, i.e. they would be effectively subordinated to the first lien debt with regard to the collateral. If the high yield bonds are secured, the specific rights of the high yield bondholders *vis-à-vis* other groups of creditors and the limitations between different groups of secured creditors generally with respect to the collateral are typically spelled out in an Intercreditor Agreement. See "*Intercreditor Agreement*" on page 12 below. For more information about the security package if "secured" bonds are being offered, see also "*Security Package*" starting on page 12 below.

To address / mitigate potential lien subordination issues, the "Limitation on Liens" covenant, in conjunction with the "Limitation on Indebtedness" covenant, will limit the amount and nature of any (collateral-dilutive) incremental debt the Issuer and its Restricted Subsidiaries may incur that may potentially share the bond collateral in the form of "Permitted Collateral Liens", including any so-called "**priority debt**" that may receive any enforcement proceeds from the sale of any bond collateral ahead of the bondholders. In addition, it will limit the extent to which the Issuer and its Restricted Subsidiaries may grant "Permitted Liens" over "free" assets that do not form part of the collateral package securing the bonds, without granting equal and ratable security over the same assets to the bondholders. See also "*Limitation on Liens*" starting on page 74 below.

KEY DOCUMENTS

A high yield bond offering typically involves the preparation of the following key documents.

Offering Memorandum

The offering memorandum is a disclosure document intended to provide potential investors with all material information necessary to make an informed decision as to whether or not to invest in the bonds. In addition to a description of the terms and conditions of the bonds (typically referred to as the "**Description of the Notes**" or "**DoN**"), the offering memorandum will contain a description of the risks associated with an investment in the bonds, a description of the company's business (including the strengths and strategy of the company) and of the industry and markets in which the company operates, a section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" (**MD&A**), historical financial statements, biographies of officers and directors, information about their compensation, information about any significant pending or threatened litigation, a list of material properties, a description of material agreements, a description of related party transactions, a description of the tax consequences of an investment in the bonds under the US federal tax laws and the tax laws of the jurisdiction of the Issuer, a description of certain insolvency law considerations in the jurisdiction of the Issuer and any other jurisdictions in which any collateral may be located and any other material information.

In addition to providing potential investors with information about the proposed offering, the offering memorandum serves to protect both the Issuer and the Initial Purchasers from liability under applicable securities laws for alleged material misstatements or omissions in connection with the offer and sale of the bonds.

The term "**offering memorandum (OM)**" or "**offering circular (OC)**" is typically used in a high yield bond offering instead of the term "**prospectus**" to indicate that the bonds are being offered in a (private) transaction that relies on certain exemptions under applicable securities laws from the requirement to prepare a formal "prospectus" that has been reviewed and/or approved by the relevant securities regulator, as would be required in many jurisdictions (including the United States and the European Union) for a broadly marketed offering to the general public. See also "Introduction–Certain Securities Law Considerations" below.

The offering will be formally "launched" with a "**Preliminary Offering Memorandum**" (also referred to as the "**Prelim**" or "**Red**"), which can be identified through prominent legends on the cover page (in red color) indicating that the document is only a preliminary offering document that is not complete and may be changed. Typically, however, the only information missing from the Preliminary Offering Memorandum / subject to change is information that will only be determined at the "Pricing" of an offering, such as the coupon and aggregate principal amount of the bonds being offered, the gross proceeds of the offering and certain related information. This is because investors in the bonds will be expected to make their investment decision / enter into legally binding agreements to purchase the bonds based on the Preliminary Offering Memorandum and a (short) "**Pricing Supplement**". The Pricing Supplement will contain any previously missing information and will need to be prepared promptly upon Pricing, so it can be sent to investor by the Initial Purchasers together with any trade confirmations as soon as possible following Pricing and execution of the Purchase Agreement. Theoretically, the Pricing Supplement can (and sometimes does) modify and/or supplement other information in the Preliminary Offering Memorandum, for example, to reflect modifications to the proposed bond covenants in response to investor feedback or material recent developments affecting the Issuer during the roadshow or to correct errors that have only been discovered after an offering was launched. However, any such further changes can delay and potentially jeopardize Pricing, especially in volatile market conditions with short marketing windows, and should therefore be avoided, if possible. The Preliminary Offering Memorandum is not just a mere draft document, must be as complete as possible and, in particular, must not contain any untrue statements or omit any material information available at the time of its first use. The "**Final Offering Memorandum**" will only be prepared after Pricing.

In some (relatively rare) cases where the success and timing of an offering may be particularly critical / sensitive, the Issuer and Initial Purchasers may decide to "**pre-market**" the proposed offering and proposed terms of the bonds and/or structure of the offering with a select group of key / anchor investors to obtain (and possibly reflect in the Preliminary Offering Memorandum, in the form of changes of the proposed bond terms, structure or otherwise) feedback from such investors and/or to increase the level of confidence that the offering will be successful if and when it is formally launched / publicly announced. In such cases, the parties will prepare a "**Draft Preliminary Offering Memorandum**" (also referred to as a "**Pink**"), which will be identical to the Preliminary Offering Memorandum the parties would otherwise prepare, except for an additional legend page at the front of the document highlighting the "draft" nature of the document and except for the fact that the "prelim legends" on the cover page will appear in pink (instead of red).

Indenture and Global Notes

If the high yield bonds are governed by New York law, the issuer will be required to enter into a bond indenture (the "**Indenture**). The Indenture is the legal contract entered into among the issuer of the bonds (the "**Issuer**), any guarantors of the bonds (the "**Guarantors**") and a bond trustee (the "**Trustee**"), as trustee for the holders of the bonds from time to time. It contains the key terms of the bonds such as the interest rate, maturity date, pledge, promises, representations, covenants, and other terms of the bonds. The key terms of the Indenture will be summarized in the offering memorandum in the "Description of the Notes" section. The high yield bonds, when issued, will be represented by one of more "**Global Notes**" that will be issued under the terms of the Indenture and deposited with a custodian for the relevant clearing system(s) through which the relevant bonds will be settled.

If the high yield bonds are governed by a law other than New York law, the Issuer will be required to execute a similar document or series of documents customary for bond offerings under the relevant local law. Instead of entering into an Indenture with a trustee for the holders of the bonds, it may, for example, be customary for the issuer to enter into an "**Agency Agreement**" with a financial institution / fiscal agent that will agree to perform certain functions in connection with the bonds solely as agent for the Issuer, such as paying agent, calculation agent, transfer agent, registrar, exchange agent and/or notification agent, depending on the terms of the relevant notes. In the case of high yield bonds governed by German law, for example, the terms of the bonds will be documented in "**Conditions of Issue**" (*Anleihebedingungen*), which will be attached to the Global Notes, rather than in the body of an Indenture. In addition, the Issuer will separately enter into an Agency Agreement, any Guarantors will enter into a separate Guarantee Agreement and, to the extent relevant, the Issuer's parent company or other (non-guarantor entities) may be required to execute separate Undertakings.

Irrespective of the law governing the terms of the bonds and related documentation, however, most key commercial terms (most notably the covenants) will normally be substantially similar, subject only to certain mandatory provisions of the relevant governing law. See also "*What law should govern the bonds?*" on page 39 below.

Purchase Agreement and Engagement Letter

The Purchase Agreement is typically entered into very late in the offering process after the Issuer and the investment banks involved in the offering (the "**Initial Purchasers**") have completed the marketing of the bonds (i.e. the "road show") and the offering has "priced", i.e. the Issuer and the Initial Purchasers have agreed the exact principal amount, interest rate, maturity date, call features and certain other commercial terms of the bonds being offered. In connection with high yield offerings, the terms "**Purchase Agreement**" (rather than "**underwriting agreement**" or "**subscription agreement**") and "Initial Purchasers" (rather than "**underwriters**") are typically used to highlight that the bonds are being offered in a transaction that relies on certain exemptions under applicable securities laws. See also "Introduction–Certain Securities Law Considerations" below.

In the Purchase Agreement the Issuer agrees to issue and sell the bonds to the Initial Purchasers and the Initial Purchasers agree to purchase the bonds from the Issuer at an agreed price at Closing. For an indicative timeline and more information about timing of certain steps in the offering process, including Launch, Pricing and Closing, see "*Indicative Transaction Timetable*" starting on page 97 below. In addition, the Issuer makes numerous representations and warranties, including with regard to its business and the completeness and accuracy of the offering memorandum, and agrees to indemnify the Initial Purchasers for any losses as a result of a breach of the representations, warranties or undertakings, as a result of any actual or alleged material misstatements or omissions in the offering memorandum or as a result of any failure to issue and deliver the bonds to the Initial Purchasers on the Closing Date.

It is only with the execution of the Purchase Agreement, that the Initial Purchasers become bound to the Issuer, subject to a number of customary closing conditions and termination rights of the Initial Purchasers, to purchase any bonds and pay the agreed purchase price for the bonds at the Closing, i.e. "underwrite" the offering. On the other hand, the Initial Purchasers typically only earn any fees for their services upon completion of the offering at the Closing. Many Purchase Agreements expressly provide for an agreed fee, expressed as a percentage of either the aggregate principal amount of the bonds or gross proceeds from the offering. In some cases, the fee is divided into a base (non-discretionary) component and an incentive (non-discretionary) component. Under some Purchase Agreements, the Initial Purchasers earn their fees from the price difference (the "underwriting spread" or "underwriting discount") between the price they agree to pay the Issuer for the bonds and the public offering price at which the bonds will be (on-)sold by the Initial Purchasers to investors.

Although the Initial Purchasers will not be obligated to purchase any bonds from the Issuer until the Purchase Agreement is executed, the Initial Purchasers will typically insist that the Issuer also execute an "**Engagement Letter**" or "**Mandate Letter**" with the Initial Purchasers at some point prior to the official "Launch" of an offering, i.e. before the transaction is formally announced externally and the Initial Purchasers start approaching investors. The Engagement Letter will typically contain at least the following: (i) a description of the services to be provided by the investment bank(s) signing the engagement letter, (ii) an "exclusivity" provision (i.e. in return for their advice and assistance in connection with the preparation of the offering, the Issuer will guarantee the investment bank(s) signing the Engagement Letter certain formal roles in connection with the proposed high yield offering (or similar financings within a specified period) as well as a minimum percentage of the total fees / "economics", (iii) a description of the proposed fee structure, (iv) an agreement to reimburse the Initial Purchasers for certain expenses (e.g. legal expenses and costs for the roadshow), (v) provisions governing the (confidential) exchange of information and (vi) an indemnification provision substantially identical to the indemnification provision that will later be included in the Purchase Agreement as described above. The prospective Initial Purchasers will typically be interested in executing the Engagement Letter as early as possible in the process, i.e. before they expend significant time and resources and, for example, incur potentially significant legal fees for their own counsel. The Issuer, on the other hand, may have a legitimate interest in preserving at least some flexibility (e.g. to involve other banks or re-assign certain lead roles) by delaying the execution of the Engagement Letter until it has seen the prospective Initial Purchaser(s) "in action" and is better able to assess the quality and level of assistance provided by them during the process, e.g. in drafting the offering memorandum, negotiating the terms of the bonds or guiding the Issuer through the rating agency process. This may be particularly true for first-time Issuers and in situations without (or with only a limited) historic relationship between the Issuer and the prospective Initial Purchasers. At the same time, it may be difficult for the Issuer to expect an investment bank to devote significant resources and attention to its proposed offering over an extended period without any assurance from the Issuer that it will not be replaced (or its economics significantly diluted) through the involvement of other banks late in the process once most of the preparatory work for the offering has already been substantially completed. For the Initial Purchasers it is also critical that an executed Engagement Letter with appropriate indemnification provisions is in place prior to the "Launch" of the offering when the Initial Purchasers put their reputation behind the Issuer and the offering, i.e. by agreeing to the publication of an offering memorandum with their names on the cover page and by approaching their investor contacts on behalf of the Issuer. The exact time during the offering process at which the Engagement Letter should be signed depends on the specific facts and circumstances and is ultimately a commercial point to be agreed between the Issuer and the Initial Purchasers.

Intercreditor Agreement

The Intercreditor Agreement is entered into at or about the Closing between the main creditors of the Issuer and governs the common terms and relationships among the creditors in respect of the Issuer's obligations. Among other things, the Intercreditor Agreement will contain provisions that limit the ability of creditors to vary their respective rights and address issues such as voting rights, notifications of defaults as well as the order of applying the proceeds of any debt recovery efforts, including from the sale of collateral.

To the extent certain groups of creditors are subordinated to other groups of creditors, the Intercreditor Agreement will set forth the terms of subordination and other principles to apply as between the senior creditors and the subordinated creditors. See also "Contractual Subordination" on page 5 above.

Security Package

If "secured" bonds are to be offered, the lawyers involved in the transaction, including local counsel in every jurisdiction in which any collateral is located, will need to prepare appropriate security documentation (e.g. pledge agreements, mortgage deeds, security transfer agreements, charges, ……). Although mostly "technical" in nature, the preparation of these documents, the completion of any required filings and the preparation and negotiation of related legal opinions under local law can require significant time, effort and expense. If the proceeds of an offering are to be used to refinance other secured debt, it may also be necessary to negotiate and prepare any necessary documentation required for the release of any pre-existing security granted in favor of the creditors that are being repaid.

While the preparation of the security documentation may primarily be a technical exercise that can be largely entrusted to the lawyers involved in the transaction, the Issuer and the Initial Purchasers will need to agree, on a commercial level, the exact scope of the security package. On the one hand, it may appear obvious that at least a significant portion of the assets of the Issuer and its Restricted Subsidiaries should serve as collateral to be able to market a particular bond as "senior secured". The promise of a "comprehensive" security package may also be a significant potential selling point / important as part of the overall marketing message for a particular bond offering. In practice, however, the actual scope of the security package provided by different Issuers can vary dramatically and will depend on the particular facts and circumstances surrounding each offering, including the identity and business of the particular Issuer and its business, the nature and physical location of the Issuer's assets, prevailing market conditions in the bond markets around the time of the proposed offering, individual preferences and strategic priorities of the Issuer as well as the potentially very significant and sometimes disproportionate expenses (e.g. filing fees, notarial fees, stamp duties and/or local taxes) that may be involved in granting and perfecting a security interest over a particular asset in a particular jurisdiction.

Granting security over certain categories of fixed assets (such as property, plant & equipment), for example, may be less sensitive for many Issuers and less disruptive or administratively burdensome than granting security over current assets (such as inventory, raw materials, receivables or cash / bank accounts), which could potentially interfere with supplier or customer relationships or existing or proposed trade financing arrangements, such as existing or future ABS facilities or factoring programs. While it is customary for the Issuer to provide pledges over its shares in all Guarantors for secured high yield bonds in Europe, providing such pledges can be prohibitively expensive in certain jurisdictions, for example, because local taxes triggered by a share pledge may be calculated based on the amount of the secured obligation (i.e. the total principal amount of the bonds) rather than the value of the assets of the relevant Guarantor actually available to back the obligations under its guarantee. In some cases, compromises can be found to ensure that the cost of providing "standard" security is not disproportionate to the corresponding potential benefit to bondholders. For example, it may be possible to reduce the amount of local taxes triggered by granting a particular type of security by capping the amount of the secured obligation.

Ultimately, the scope of the collateral package for a particular offering and the circumstances under which security can potentially be released in the future will reflect the outcome of commercial discussions between the Issuer and the Initial Purchasers and, at least to some extent, a cost-benefit analysis. Of course, it is critical to ensure that the outcome of the commercial discussions is properly reflected / tracked through in the actual security documentation in all relevant jurisdictions (including local language documentation) and the relevant provisions of the Intercreditor Agreement and, if applicable, that boilerplate provisions in other agreements (e.g. in the Issuer's secured revolving credit facility) do not frustrate / override the commercial agreement reached by the parties in their negotiation of the security package for the bonds. To this end and to ensure that the preparation of the security package does not cause any delays or complications, it is important that the parties agree on the appropriate scope of the security package early in the process, give the lawyers and tax advisers sufficient time to properly analyze the relevant implications ahead of the launch of the offering and that the Purchase Agreement provides for a sufficiently long settlement period between pricing and closing to allow the lawyers to actually put the agreed security package in place.

Legal Opinions and Disclosure Letters

Under the U.S. securities laws, the Initial Purchasers can avoid potential liability to investors in the bonds for material misstatements or omissions in connection with the offering process if they can demonstrate that they have conducted a reasonable investigation into the affairs of the Issuer before selling the bonds (so-called "**due diligence defence**"). To support this due diligence defence, the Initial Purchasers, their lawyers and the lawyers of the Issuer in a Rule 144A offering will be required to conduct a thorough review of the affairs of the Issuer, including by reviewing certain legal documents as well as financial and business information of the Issuer and by attending due diligence meetings with the management of the Issuer and the Issuer's auditors.

In addition, the lawyers of both the Initial Purchasers and the Issuer will be required to provide certain legal opinions, for example, with regard to due organization of the Issuer and any Guarantors, due authorization of the bonds, the validity and enforceability of the bond documentation and the security package, no violation of any laws or agreements by which the Issuer is bound, so-called "fair summary" opinions with regard to descriptions of tax and other relevant laws in the offering memorandum and the availability of relevant exemptions under applicable securities laws. In case the bonds will be marketed to investors in the United States, U.S. counsel to both the Issuer and to the Initial Purchasers will also be required to provide so-called "negative assurance letters" / "[Rule]**10b-5 letters**" (in reference to the relevant liability provision under the U.S. securities laws), indicating that, in the course of their work on the offering and as a result of their own investigations, nothing came to their attention to cause them to believe that the offering memorandum was materially incomplete, inaccurate or misleading.

Comfort Letters

Comfort letters are typically provided by the Issuer's auditors at or immediately prior to "Pricing" (i.e. execution of the Purchase Agreement) and are another key component of the due diligence defence of the Initial Purchasers. In the comfort letter, which will follow a standard format prescribed by the relevant accounting body (e.g. Statement of Accounting Standards (SAS) 72 for U.S. comfort letters), the auditors of the Issuer will typically reaffirm their independence and that they stand by their audit opinion on the Issuer's audited financial statements included in the offering memorandum, describe any (review) procedures they have performed on any interim financial information included in the offering memorandum or on any internal management accounts for any "stub periods" between the date of the latest audited or reviewed financial statements of the Issuer and the date of the offering memorandum, describe any additional "agreed upon procedures" they have conducted with regard to the Issuer's financial information included elsewhere in the offering memorandum and provide "negative assurance" as to the absence of material changes with regard to certain specified financial line items since the date of the most recent financial statements included in the offering memorandum. At closing of the offering, the auditors will provide a so-called "bring-down" comfort letter to re-affirm, as of the closing date, that the original comfort letter is still valid. See also "*Rule 144A/Reg. S vs Reg. S only*" on page 18 below for information about the "**135-day rule**".

PARTIES

The following is just a brief overview of the various entities within the Issuer group that may be involved in a high yield bond offering and of their respective roles within the bond structure.

The Issuer

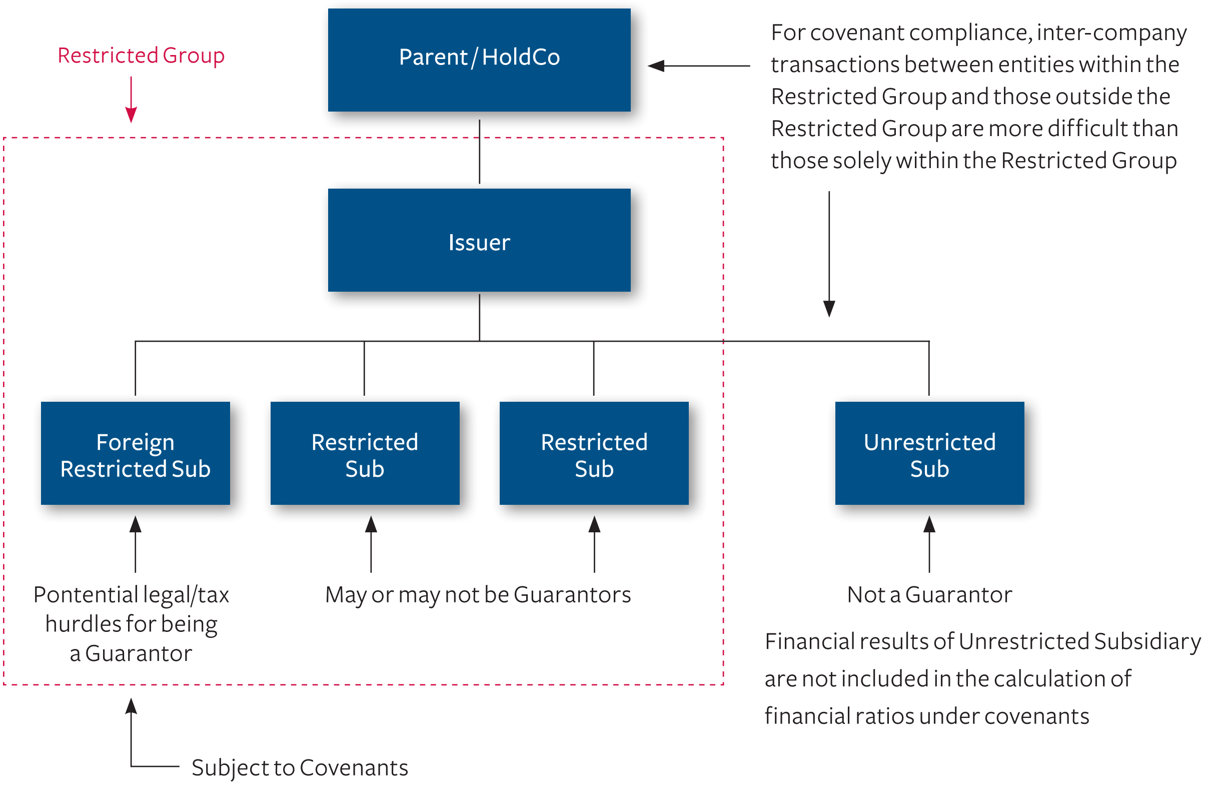
For public companies, the Issuer will likely be the public company itself. For private companies, the identity of the Issuer is less clear. Depending on what the overall capital structure of the company and any existing (senior) bank debt will permit, the Issuer could either be the ultimate parent (holding) company, an intermediate holding/operating company or a lower-level operating company. See also "*Structural Subordination*" on page 6 above.

The Guarantors

Frequently, "senior" high yield bonds will be guaranteed by most (if not all) "Restricted Subsidiaries" of the Issuer ("**up-stream guarantees**"). It is also customary in connection with the issuance of secured high yield bonds for the Issuer to pledge its shares in any Guarantors for the benefit of the bond holders and, in many transactions, the Guarantors will also provide asset security for the high yield bonds. This will give holders of the high yield bonds a direct claim against the relevant Guarantors and their assets in an enforcement / insolvency scenario and therefore brings the obligations under the bonds closer to the physical assets of the Issuer group, overcoming some of the structural subordination issues described above. If the Issuer is an entity other than the ultimate parent company of the Issuer group, there may also be a ("**down-stream**") parent guarantee. A high level of "**Guarantor Coverage**", expressed as the percentage of the Restricted Group's consolidated revenues and consolidated EBITDA generated by the Guarantors and the percentage of the total assets of the Restricted Group held by the Guarantors, can be one important component of the overall marketing message for an offering.

In most European jurisdictions, however, subsidiary-parent guarantees, in particular, can be potentially problematic / expose the management and directors of the subsidiary to liability under applicable corporate, fraudulent conveyance, insolvency or similar laws, depending on the extent to which the relevant subsidiary receives any proceeds from the offering or derives any other "corporate benefit" from the offering. In some jurisdictions, guarantees by foreign subsidiaries may also have negative tax consequences. As a general matter, the Issuer and Initial Purchasers must therefore consult local law experts and tax specialists early in the structuring process with regard to the feasibility of providing guarantees in any particular jurisdictions and/or with regard to appropriate "limitation language" in the relevant guarantees. The offering memorandum for "senior secured" notes, in particular, will also typically contain extensive disclosures about applicable local law restrictions and limitations in the various jurisdictions in which the Issuer's (guarantor) subsidiaries and/or collateral may be located, customarily in a separate section titled "Certain Insolvency Law Considerations and Limitations on the Validity and Enforceability of the Guarantees and Security Interests" (or similar title).

Restricted Subsidiaries vs. Unrestricted Subsidiaries



By default, all subsidiaries of the Issuer will be "restricted" in the sense that they are "in the system" (i.e. the so-called "**Restricted Group**"), unless they are specifically designated as "unrestricted".

Being a "**Restricted Subsidiary**" means that:

- all income produced by the relevant subsidiary will count for purposes of compliance with various covenants;
- the relevant subsidiary will be limited in its ability to take actions limited by the covenants; and
- the relevant subsidiary will be free to transact with other Restricted Subsidiaries.

"**Unrestricted Subsidiaries**", on the other hand, are ring-fenced in the sense that they are "outside the system" / the Restricted Group, which means that:

- income produced by the relevant subsidiaries will not count for purposes of compliance with various covenants;
- the relevant subsidiary will not be subject to the covenants and thus not subject to any restrictions on their activities; and

- the relevant subsidiaries will not be free to transact with the Issuer or Restricted Subsidiaries, i.e. any such transactions will be limited by the covenants, in particular the "Limitation on Affiliate Transactions" covenant and the "Limitation on Restricted Payments" covenant, because any "Investments" into an Unrestricted Subsidiary are potentially "Restricted Investments" as are "Investments" in any other third party.

Formation or designation of Unrestricted Subsidiaries may be useful, for example, if the Issuer plans a geographic or business line expansion that it plans to fund separately. It is possible to designate a subsidiary as unrestricted at a later date but the requirements for doing so can be onerous. These requirements and the consequences of such designation are described under "*Limitation on Designation of Restricted Subsidiaries or Unrestricted Subsidiaries*" starting on page 86 below.

CERTAIN SECURITIES LAW CONSIDERATIONS

The securities laws of many jurisdictions, in particular the United States, impose various restrictions on publicity and the release of information generally in connection with proposed offerings of securities. "**Publicity**" for this purpose can be construed very broadly and may include any form of communication, whether in written, oral or electronic form, that (i) relates to or concerns the offering, (ii) relates to the performance, assets, liabilities, financial position, revenues, profits, losses, trading record, prospects, valuation or market position of the Issuer, (iii) might affect an investor's assessment of the financial position and prospects of the Issuer, or (iv) otherwise has the purpose, or reasonably could have the effect, of "conditioning the market" in a particular jurisdiction (i.e. generating or promoting interest in the offering) or influencing or encouraging an investor's interest in the Issuer or the offering or a decision to purchase the securities in question. Failure to observe these publicity restrictions may result in prospectus publication, registration or similar requirements under the securities laws of various jurisdictions and adversely affect the offering, including by way of delays related to a "cooling off period" that may be imposed after improper publicity under the U.S. securities laws.

In addition, the release of information that is inaccurate, misleading or inconsistent with the offering memorandum to be published in connection with an offering is undesirable, may cast doubt on the accuracy of the offering memorandum and ultimately may result in liability for alleged material misstatements or omissions in the offering memorandum. It is important that all information released in connection with an offering should be verifiably accurate and consistent with the offering memorandum.

To ensure compliance with all applicable securities laws and regulations, the lawyers of the Issuer typically prepare "**publicity guidelines**" at the outset of a proposed offering, which will be reviewed by the lawyers of the Initial Purchasers and must be observed by all offering participants. In order to avoid the legal risks of uncontrolled communication with the public, it is often advisable to appoint one representative of the Issuer to serve as the initial point of contact with the press and securities analysts, and to serve publicity and other broad-based communications during the offering process in order to ensure compliance with the restrictions set out in the publicity guidelines. All representatives of the Issuer and other offering participants who are likely to be approached by, or come in contact with, the press or securities analysts should be familiar with the publicity guidelines and should ensure that no publicity is undertaken or permitted except in accordance with the publicity guidelines.

U.S. Securities Law Considerations

Section 5 of the U.S. Securities Act of 1933, as amended (the "**Securities Act**"), prohibits any sales or offers for sale of securities unless a registration statement (including a prospectus that meets statutory requirements) has been filed with the U.S. Securities and Exchange Commission ("**SEC**") or unless an exemption from such registration is available. Most securities offerings by European issuers are conducted in reliance on one or more exemptions from the registration requirement under Section 5 of the Securities Act. In particular, the vast majority of (true) high yield bond offerings in Europe are conducted as private placements to institutional investors in certain jurisdictions, including (i) in the United States exclusively to so-called "**qualified institutional buyers**" or "**QIBs**" in reliance on Rule 144A under the Securities Act ("**Rule 144A**") and (ii) outside of the United States in reliance on Regulation S under the Securities Act ("**Regulation S**" or "**Reg. S**").

"Rule 144A/Reg. S" vs "Reg. S only"

The vast majority of (true) high yield bond offerings in Europe continue to be structured as "Rule 144A/Reg. S" offerings, i.e. technically also permit potential offers and sales to QIBs in the United States, even if US investors are often not a key target investor group for the relevant offerings. In addition to mere historic "market practice" (i.e. because high yield bonds are originally a US product and because US investors historically did use to be a key target investor group even for European high yield bond offerings), the "Rule 144A" label can be an important marketing argument and give investors (including non-US / "Reg. S" investors) additional comfort that all offering participants have exercised the high(er) level of effort and scrutiny (e.g. in the form of comprehensive US-style / 10b-5 level due diligence, delivery of legal opinions, 10b-5 letters and comfort letters, ...) required for potential sales to US investors. As described in more detail below, it is important to note that it is market practice to provide disclosure in the offering memorandum for a Rule 144A offering that is substantially similar to the disclosure required to be included in the prospectus for an SEC-registered offering eligible for participation by US retail investors. Offering memoranda for Rule 144A / Reg. S high yield offerings in Europe are therefore typically drafted to an (often much) higher disclosure standard, in terms of scope, quality and level of detail, than would be required in even a prospectus approved by a competent authority in Europe for a public / retail offering that meets the requirements of the EU Prospectus Regulation as described under "*European Securities Regulations*" starting on page 21 below.

However, there may be situations where "technical" obstacles or (legitimate) timing constraints exist that prevent a Rule 144A offering or cause the Issuer and Initial Purchasers (assisted by their outside legal advisers) to conclude that an offering to US investors is not advisable, for example, due to a higher risk of potential securities litigation based on actual or alleged material misstatements or omissions in the offering document. One such technical obstacle may, for example, include the lack of sufficiently recent audited annual or reviewed interim financial information to permit the auditors to provide "negative assurance" in their comfort letter for the offering. Under relevant US audit rules (SAS 72/AU 634), auditors can only provide full comfort (including so-called "negative assurance" with regard to the absence of material changes in certain line items of the issuers financial statements) if less than 135 days have passed between the date of the most recent financial statements that have been audited or reviewed, on the one hand, and the cut-off date of the comfort letter, on the other hand (so-called **"135-day rule"**). For US public companies, subject to SEC mandated quarterly reporting requirements, this is not normally an issue. In Europe, however, even publicly listed companies are technically only required to publish half-year interim financial statements under applicable EU rules. Although many (especially large, international companies) may publish quarterly financial information (voluntarily) anyway, the timing of the availability of those quarterly financial statements and the necessary "review" required to be performed by the auditors may not fit within the timeline of a particular offering.

In those instances where European high yield bond offerings are, for whatever reason, structured as "Reg. S only" (i.e. not eligible for offers and sales to QIBs in the US), the Issuer and the Initial Purchasers frequently decide to prepare a "Rule 144 look-alike" offering memorandum with disclosure as close to Rule 114A level disclosure as possible, and to also follow general market practice for high yield offerings, for example, with regard to due diligence, legal opinions and comfort letters. In those instances, the overall transaction expenses and the overall timing will likely be broadly similar to the expenses and timing involved in a Rule 144A / Reg. S offering.

However, there are also instances, where an Issuer may be tempted to consider a "Reg. S only" offering as an option to save both time and expense. In those instances it is important to fully asses (at the outset) the implication of a "Reg. S only" approach in light of the overall marketing plan for the offering, as certain traditional high yield investors (including non-US investors) may either not invest in Reg. S only offerings at all or at least challenge the Issuer and Initial Purchasers on the underlying reasons for the Reg. S only approach. Answers like "We did not want to spend the time preparing an offering memorandum with full Rule 144A level disclosure.", "We did not want to pay the lawyers to conduct due diligence." or "We did not want to pay our auditors to review our interim financial statements and to deliver a comfort letter." may be met with little sympathy.

At the same time, it is important to stress that there are many examples of Issuers in Europe with a sub-investment grade rating that do successfully conduct Reg. S only bond offerings. In some cases, the offering may target an industry-specific investor base (e.g. real estate investors or oil & gas investors), rather than traditional high yield investors. Other offerings may be targeted at investors with a regional and/or emerging markets focus, so that following high yield bond market practice may be less important. A very significant percentage of successful Reg. S only offerings of sub-investment grade rated bonds by European issuers are so-called "**HY lite**" offerings, in many cases by "cross-over" Issuers (i.e. Issuer's with a debt rating just below BBB/Baa3) and/or "fallen angels" (i.e. long-established, publicly listed issuers that have lost their investment grade (**IG**) rating, but have been able to continue to access the bond markets using their established IG-style documentation, possibly with just minor concessions). In some of these cases, Issuer's may also be able to capitalize on their status as "national champions", a potential government shareholder or other strong anchor investor, their strong brand presence or even a retail investor following in their home market(s). These HY lite offerings, which typically also do not feature a full suite of traditional high yield covenants, are often more influenced by investment grade bond market practices (including with regard to being "Reg. S only", general documentation and governing law) than high yield market practice.

Rule 901 of Reg. S contains a general statement of the applicability of the registration requirements of the Securities Act. It clarifies that any offer, offer to sell, sale, or offer to buy that occurs "within the United States" is subject to the registration requirements of Section 5 of the Securities Act while any such offer or sale that occurs "outside the United States" is not subject to Section 5. The determination as to whether a transaction occurs "outside the United States" will be based on the facts and circumstances of each case.

Helpfully, Reg. S also contains a number of more specific "safe harbor" provisions, including most notably the safe harbor provided by Rule 903 of Reg. S whereby an offer or sale of a security is deemed to occur "outside the United States" if (i) the offer or sale are made in "**offshore transactions**" and (ii) no "**directed selling efforts**" are made in the United States by the Issuer, the Initial Purchasers, any other distributor, any of their respective affiliates, or any person acting on their behalf. "**Directed selling efforts**" means any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the U.S. for any of the securities being offered in reliance on Reg. S, and it is therefore necessary for the U.S. securities lawyers involved in an offering to analyze any relevant activity or communication in terms of its audience, timing and content as well as in light of both the various exceptions included the definition of "directed selling efforts" and the relevant SEC staff positions.

The requirements that offers or sales are made in offshore transactions and not involve any directed selling efforts apply to any offering intended to fall within one of the safe harbors provided by Reg. S. However, in order to qualify for a given safe harbor, certain additional requirements (e.g. the implementation of additional offering restrictions and the imposition of a "distribution compliance period") may have to be met as well. These requirements vary depending principally on the status of the Issuer and are generally least restrictive when it is least likely that securities offered abroad will flow into the U.S. market (Category 1) and most restrictive when adequate information about the Issuer is not publicly available in the United States and existing potential U.S. market interest is sufficient (i.e. there is so-called "**substantial U.S. market interest**" or "**SUSMI**" with respect to the relevant securities) to suggest that offerings of the Issuer's securities outside the United States may not come to rest abroad (Category 3). When adequate information about the Issuer is publicly available in the United States (Category 2), the concerns about securities flowing into the U.S. market are reduced, and the restrictions fall between these two extremes.

Rule 144A provides a safe harbor that permits resales of securities (including resales by the Initial Purchasers in a securities offering) only to qualified institutional buyers in the United States. "**Qualified institutional buyers**" include various enumerated categories of sophisticated institutional investors with at least $100 million of securities of non-affiliates under management as well as SEC-registered broker-dealers owning and investing at least $10 million in securities of non-affiliates. In addition, to be eligible for the Rule 144A safe harbor, purchasers must be notified that a proposed sale is made pursuant to Rule 144A (typically by way of appropriate legends and disclaimers in the offering memorandum) and the relevant securities must (i) not be of the same class as securities listed on a U.S. exchange or quoted on a U.S. automated inter-dealer quotation system, (ii) not be convertible or exchangeable into listed or quoted securities with an effective premium of less than 10%, and (iii) not be issued by an open-end investment company. Finally, holders of the relevant securities and prospective purchasers designated by the holders must have the right to obtain from the Issuer, certain "reasonably current" information about the Issuer. As already mentioned above, because resales of securities pursuant to Rule 144A (like any other offers and sales of securities in the United States) are fully subject to the liability / anti-fraud provisions under the U.S. securities laws (including Rule 10b-5 under the U.S. Securities Exchange Act of 1934, as amended (the "**Exchange Act**")), it is market practice to provide disclosure in connection with a Rule 144A offering that is substantially similar to the disclosure required for an SEC-registered offering, both in terms of quality and scope. See also "*Legal Opinions and Disclosure Letters*" on page 14 above.

European Securities Law Considerations

Across the European Economic Area (the "**EEA**"), Regulation (EU) 2017/1129 of the European Parliament and of the Council of June 14, 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market (the "**Prospectus Regulation**") has harmonized the requirements for the preparation, approval and publication of prospectuses for securities offered to the public or admitted to trading on a "**regulated market**" situated or operating within a member state of the EEA.

In practice, almost all (true) high yield bond offerings in Europe are conducted as private placements to institutional investors so that any offers of the bonds in any member state of the European Union will be made pursuant to an exemption under the Prospectus Regulation from the formal requirement to publish a Prospectus Regulation-compliant prospectus for offers of the bonds.

In addition, to avoid a potential requirement that a so-called "**key information document**" (**KID**) be prepared with regard to the bonds on an ongoing basis pursuant to Regulation (EU) No 1286/2014 (as amended, the "**PRIIPs Regulation**"), high yield bond are typically not offered, distributed or otherwise made available to any "retail investor" in the EEA. For these purposes, a "retail investor" means a person who is one (or more) of: (i) a retail client as defined in point (11) of Article 4(1) of Directive 2014/65/EU (as amended, "**MiFID II**"); or (ii) a customer within the meaning of Directive 2016/97/EU (as amended or superseded, the "**Insurance Distribution Directive**"), where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or (iii) not a qualified investor as defined in the Prospectus Regulation. This is because of remaining uncertainty as to whether certain market standard features of high yield bonds, in particular the "make-whole" redemption option of the Issuer described under "*Optional Redemption/Make-Whole Redemption*" starting on page 42 below, could otherwise cause the relevant bonds to qualify as "packaged retail investment and insurance-based products" ("**PRIIPs**") for purposes of the PRIIPs Regulation.

Similarly, the required target market assessment in respect of high yield bonds as part of the product approval process of each "manufacturer" (i.e. the investment firms/Initial Purchasers involved in "creating, developing, issuing and/or designing" the bonds) under MiFID II typically leads to the conclusion (i) that the target market for the relevant bonds is eligible counterparties and professional clients only, each as defined in MiFID II; and (ii) that all channels for distribution of the relevant bonds to eligible counterparties and professional clients are appropriate.

Substantially all (true) high yield bonds in Europe are offered in minimum denominations of €100,000 and, <u>if listed by the Issuer within the EU at all</u>, are listed on "**unregulated markets**" (i.e. "**exchange-regulated markets**") only. Historically, the principal EU listing venues for European high yield bonds were the Euro MTF Market of the Luxembourg Stock Exchange or the Global Exchange Market (GEM) of the Irish Stock Exchange. This is because avoiding "**regulated markets**" saves the time and effort involved in getting the offering memorandum approved as a "prospectus" by the "**competent authority**" in the relevant EEA member state in accordance with the requirements of the Prospectus Regulation, a process which can easily take a month or more from submission of the first draft document, depending on the relevant member state's competent authority. The "competent authorities" for purposes of the Prospectus Regulation include the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg , the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) in Germany and the Central Bank of Ireland (CBI) in Ireland, to name just a few. For a mere listing on an exchange regulated market (or "**multilateral trading facility (MTF)**", like the Euro MTF or the GEM, the offering memorandum (which will also serve as the listing document) will only have to be reviewed by the relevant stock exchange for compliance with the relevant stock exchange listing requirements, which typically generates fewer comments and takes far less time (i.e. just a few days).

However, while a listing of bonds by the Issuer on the Euro MTF or the GEM, for example, suffices to keep an offering exempt from the requirements of the Prospectus Regulation, it will cause the Issuer to become fully subject to Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse ("**Market Abuse Regulation**" or "**MAR**"). As a result of the entry into force of the Market Abuse Regulation as of 3 July 2016, European market practice has therefore shifted. First-time issuers now almost invariably list their high yield bonds on The International Stock Exchange (TISE) (formerly: Channel Islands Securities Exchange) on Guernsey, and many established high yield bond issuers have since also moved the listing venue of both existing and new high yield bonds to the TISE. It is important to note that listing high yield bonds on the TISE does **not** give the Issuer license to commit market abuse (e.g. insider dealing or market manipulation) with regard to their bonds, but it does mean that the Issuer does not have to comply with certain technical requirements of MAR (e.g. ad hoc reporting of inside information, maintaining of insider lists, reporting of managers' transactions, ...), which especially smaller, privately held companies, which would not otherwise be subject to such requirements, may find onerous.

The exception proves the rule

While European high yield bond offerings are typically structured to qualify for exemptions under the Prospectus Regulation, the PRIIPs Regulation and the Market Abuse Regulation, it is important to stress that there are many examples of Issuers in Europe with a sub-investment grade rating that do prepare Prospectus Regulation-compliant prospectuses approved by the competent authority in their home member state, that permit offerings to retail investors and/or list their bonds on an MTF (or even a regulated market) within the EEA. As with "Reg. S only" offerings discussed under "*U.S. Securities Law Considerations*" on page 18 above, a significant percentage of these offerings are HY lite offerings by long-established, publicly listed issuers that may be producing Prospectus Regulation-compliant prospectuses for their other securities offerings and may be fully subject to the Market Abuse Regulation anyway, because of their shares being listed on regulated markets. A potentially significant percentage of retail investors among their shareholders and/or a strong brand presence may also cause them to target retail investors for their bond offerings in their home market(s). As the documentation for these HY lite offerings is also generally often more influenced by investment grade bond market practices, the relevant bonds may also not include typical high yield redemption features which could cause them to be classified as PRIIPs. See also "*Optional Redemption /Make-Whole Redemption*" starting on page 42 below.

The High Yield Covenant Package

This section provides a high-level overview of some of the general principles and key covenants that Issuers will have to understand when negotiating and agreeing a traditional high yield covenant package. However, it is critical that the Issuer's senior management team carefully reviews and analyzes (with the support of its legal counsel) the full contractual terms of any high yield bonds as described in the "Description of the Notes" section of the offering memorandum to ensure that the covenant package accommodates the specific strategic and operational requirements of the Issuer.

GENERAL OBSERVATIONS

What are the overall objective and process of negotiating a high yield covenant package?

The overall objective in negotiating a high yield covenant package is to ensure (i) appropriate protections for the future holders of the bonds while (ii) preserving the necessary strategic, operational and financial flexibility to allow the Issuer to execute its business plan. For most issuers, in particular first-time issuers, there may be little point in trying to negotiate the most "issuer-friendly" covenant package with flexibility the Issuer does not actually expect to use, when the result may be perceived as "off-market" and may therefore potentially not be acceptable to investors or only in return for a higher coupon.

To be able to tailor a covenant package effectively to each Issuer's individual circumstances, it is critical for all parties involved in the drafting process to analyze and be fully familiar with the Issuer's existing organization and capital structure and with the Issuer's business and strategy. In particular, it will often save significant time and energy during the negotiation process if the parties take sufficient time at the outset of a transaction to consider and explore all reasonably foreseeable transactions and activities that the Issuer may wish to engage in while the bonds will be outstanding and that might be restricted under the covenants, including (i) any potential future acquisitions, joint ventures or other investments, (ii) any future financing plans (including equipment financings, sale leaseback transactions, receivable financings or other secured debt transactions), (iii) any debt or debt-like arrangements incurred in the ordinary course of the Issuer's business, (iv) any desire to preserve flexibility to refinance or repay all or a part of the bonds early, (v) any requirements to pay dividends or make other distributions to the Issuer's shareholders, (vi) any plans for potential geographic expansion and/or new lines of business, (vii) any need for letters of credit or other credit enhancements, (viii) any expected intra-group funds flows and (ix) potential related party transactions.

In good times and in bad times

The process for soliciting consents from the required (super) majority of bond holders for potential waivers and/or modifications of the terms of bonds after the initial issuance will typically be significantly less straightforward (i.e. significantly more complicated, time-consuming and expensive) than an equivalent waiver or amendment process under a credit facility. This is because bonds will typically be held by a much larger and much more diverse group of investors than even broadly syndicated, institutional term loans. Because bonds are typically listed and are freely tradeable by investors (without any involvement of the Issuer), the Issuer will at best have an incomplete knowledge of the identities and exact holdings of its bond investors. In contrast, the agent under a credit facility will be involved in any transfers and assignments of loan participations and will therefore always know the identities and amount of participations of each lender. It has further become increasingly common in recent years for leveraged credit facilities to impose restrictions on transfers and assignments of loan participations (absent the existence of events of default), including borrower consent requirements, the prohibition of transfers to certain types of investors (e.g. no "distressed debt funds") or the inclusion of "black lists" or "white lists". In contrast, significant changes in the composition of bond holder groups post-issuance are not uncommon, in particular in distressed situations, where certain investors may prefer to just "cut their losses" and sell their bonds (at a discount), often to specialized distressed debt / special situations investors, potentially leaving the Issuer with a very diverse group of investors that may have bought their bonds are very different price levels and have very different levels of expertise and policies for dealing with distressed scenarios and related requests for waivers and/or amendments. "Net short" investors (i.e. bond holders that have bought credit protection with regard to a principal amount in excess of their bond holdings) may even benefit financially from an insolvency of the Issuer. See also "*Anti-Net Short Investor Provisions*" starting on page 91 below.

At the same time, high yield bonds (in particular fixed rate notes) will have "call protection" features which will restrict the ability of the Issuer to simply (threaten to) early redeem / refinance the bonds without paying a premium. This redemption premium can be significant, particularly during the initial years post-issuance. See also "*Tenor, Call Protection and Redemption*" starting on page 40 below. Unless the bonds are trading at a price above the redemption prices payable under the bond terms, even well-performing Issuers may therefore be forced to either (i) offer a significant consent fee, in addition to incurring the significant time, effort and expense involved in a bond consent solicitation, or (ii) refinance / redeem the bonds, at the redemption prices stipulated in the Indenture, should they run into any significant problems under the negotiated bond covenants.

Bearing all this in mind and given the relatively long tenors of 5-10 years of most high yield bonds, it is important to note that a carefully negotiated covenant package should not just work in a "best case" scenario (i.e. when all goes according to plan), but should also be robust enough to provide sufficient flexibility (e.g. in terms of providing incremental debt incurrence capacity) to allow the Issuer to navigate and respond to at least reasonably foreseeable downside scenarios in which one or more of the risks described in the "Risk Factors" section of the offering memorandum actually materialize. Even fundamentally sound and successful businesses do occasionally face (temporary) set-backs, industries may be cyclical and every bull market eventually comes to an end, sometimes with little or no notice, as demonstrated by the economic shock caused by the current Covid-19 pandemic.

Most traditional high yield covenant packages therefore give the Issuer a certain amount of "excess flexibility", for example, hypothetical flexibility to significantly increase leverage beyond the "opening leverage" disclosed in the offering memorandum by incurring incremental debt (irrespective of EBITDA) and potentially even "priority debt". See "The 'Permitted Debt' Exemptions" starting on page 57 below. Absent unusual and unforeseen circumstances (or unless doing so is part of the business plan / strategy communicated to investors in the offering memorandum), the Issuer normally would neither need nor want to use this "excess flexibility". This is because doing so, even though technically permitted under the relevant covenants, may impact the Issuer's credit rating and/or could damage its (sometimes hard-earned) reputation among investors, both of which are important when the Issuer eventually seeks, as is inevitable for most Issuers, to refinance the bonds.

This inherent flexibility, combined with the absence of maintenance covenants, long(er) tenors and flexible redemption provisions, should ideally allow an Issuer to weather even extended periods of disruption to its business, without having to amend or refinance its bonds (or even formally restructure its debt) and refinance / extend its debt maturity profile during the good times.

As a practical matter, counsel for the Initial Purchasers typically prepares the initial draft of the "Description of the Notes (DoN)" for the offering memorandum and also continues to hold the pen on subsequent drafts. The DoN will closely track (typically largely verbatim) the relevant contractual provisions that will later be included in the Indenture (if the bonds are governed by New York law), Terms & Conditions (if governed by English law), Conditions of Issue / *Anleihebedingungen* (if governed by German law) or corresponding document that establishes the terms of the bonds. Although Issuer's counsel will then take a leading role in "marking up" / commenting on the drafts prepared by Initial Purchasers' counsel, it is essential that senior management of the Issuer and its financial and accounting staff provide detailed input and are closely involved in this process as outside counsel cannot otherwise be expected to fully anticipate the extent to which it may be critical for the Issuer to preserve strategic, operational and financial flexibility in certain areas throughout the lifetime of the bonds. This is particularly important for first-time issuers in industries for which time-tested, directly comparable bond precedents are scarce or may not exist at all.

How are high yield covenants different from those contained in a traditional credit facility?

Other than a traditional credit facility, a traditional high yield covenant package will **not** include any so-called financial "**maintenance covenants**" which may require the Restricted Group, to maintain, for example, a maximum leverage ratio, a minimum cash flow coverage ratio, a minimum interest coverage ratio and/or a minimum level of liquidity. This is because the relevant metrics can be heavily impacted by factors outside the Issuer's control, including macro-economic events and other factors described in the "Risk Factors" section of a high yield bond offering memorandum. The argument for the inclusion of financial maintenance covenants in traditional leveraged loan facilities is that they can serve as an early-warning system that give the lenders a "seat at the table" and allow them to engage with the borrower early on, with a view to jointly agreeing a way forward. Often, this will involve waivers, forbearances and/or amendments to the credit agreement or even a formal debt restructuring. As discussed under "*In good times and in bad times*" starting on page 24 above, the process for soliciting consents from the required (super) majority of bond holders for potential waivers and/or modifications of the terms of bonds will typically be significantly more complicated, time-consuming and expensive than an equivalent waiver or amendment process under a credit facility. This, coupled with the significantly longer average tenor of high yield bonds, means that financial maintenance covenants are not normally appropriate in a bond context.

Instead, traditional high yield covenants impose restrictions on certain types of activities and, in particular, the transfer of value out of the Restricted Group. These "**negative covenants**" or "**incurrence covenants**" typically will only be triggered and tested if the Issuer or its Restricted Subsidiaries propose to take certain clearly defined types of actions that are fully within the Issuer's control. They are basically promises by the Issuer and its Restricted Subsidiaries to refrain (subject to numerous exceptions) from certain types of actions that could hurt the Issuer's ability to meet its obligations under the bonds. Even a significant increase in leverage due to a significant drop in EBITDA, for example, while likely reducing the ability of the Issuer to incur incremental debt, pay dividends, ...(i.e. take certain actions), should not, by itself, cause the Issuer to be in default under any such negative/incurrence covenants.

Convergence between the European leveraged loan market and the high yield bond market – "Covenant Lite"" / "High Yield Bonds in Disguise"

Even a few years ago, the flexibility of the traditional high yield covenant package and, in particular, the absence of financial maintenance covenants were key selling points in favor of a high yield bond vs. a syndicated leveraged loan, allowing the high yield product to gain significant market share in the (large cap) European leveraged finance market. Over the last few years, however, there has been significant and rapid convergence between the (large cap) leveraged loan market and high yield market. As a result, "**fully covenanted**" leveraged loans (with all (three) traditional financial maintenance covenants: a leverage covenant, a cash flow cover covenant and an interest cover covenant) and even so-called "**covenant-loose**" transactions (with just two of the traditional three financial maintenance covenants) had all but disappeared in the large cap syndicate loan market in Europe by the end of 2019. Especially in LBOs / sponsor-led transactions, this trend had even started to trickle down to the (upper end) of the mid-market. It remains to be seen whether the current crisis, triggered by the Covid-19 pandemic, will lead to a reversal of this trend (and certain other trends) or whether fully covenanted or at least covenant-loose transaction will remain confined to the mid-market and/or possibly certain specific industries.

For now, "**covenant-lite**" (i.e. just a single financial maintenance covenant, typically a leverage covenant) has become the norm in large cap leveraged loan transactions in Europe, and in most such transactions even the sole remaining covenant is typically included only for the benefit for the revolving credit facility lenders, but not for the benefit of any term loan tranches. In addition, it typically features significant headroom and takes the form of a "**springing**" covenant, which only gets tested once a specified percentage (typically 35% or 40%) of the revolving facility has been utilized.

Taking it even a step further, a very significant percentage (possibly up to around half) of all large cap, syndicated leveraged senior facilities agreements in Europe in 2019 can be characterized as so-called "**high yield bonds in disguise**". This term is used to refer to otherwise traditional facilities agreements (most often governed by English law) that have fully adopted a traditional high yield bond incurrence covenant package, except for a springing financial maintenance covenant for the benefit of the revolving credit facility lenders. Sometimes, the relevant covenants are incorporated into the main body of the credit agreement. But more often the various high yield covenants, related definitions and even certain events of default are included in one or more separate schedules, with such separate schedules often expressed to be interpreted in accordance with New York law, irrespective of the law governing the rest of the agreement. This approach makes a lot of sense (an likely originated) in capital structures that included both leveraged loans and (New York law governed) high yield bonds, where the Issuer would not really have been able to benefit from the greater flexibility afforded by the traditional high yield covenant package, had it also been required to comply with a separate (and possibly stricter) covenant package, including financial maintenance covenants, under its credit agreements, or been exposed to the risk of different interpretations of identically worded covenants under English and New York law, respectively. That said, it seems like most "high yield bonds in disguise" entered into today do not coexist with and/or just copy the covenants of high yield bonds issued by the same issuer/borrower, but have instead fully replaced high yield bonds in the relevant capital structures, with the relevant borrowers / sponsors opting for the faster transaction timetables, lower transaction costs and more flexible prepayment terms of a (floating rate) term loan over the longer tenors and typically fixed interest rate a high yield bond can offer.

In particular, high yield covenants are designed to restrict the Issuer's ability to take certain actions in order (i) to prevent the Restricted Group from becoming over-leveraged by either borrowing too much or decreasing its assets without concurrently decreasing its debt, (ii) to protect the position of the bondholders in the Restricted Group's capital structure by limiting the ability of the Issuer and its Restricted Subsidiaries to effectively subordinate the bonds through structural or lien subordination, and (iii) to preserve the assets of the Restricted Group and the Issuer's access to those assets and its ability to use cash generated within the Restricted Group to service the bonds.

The covenants therefore limit/restrict (but not prohibit outright) the ability of the Issuer and its Restricted Subsidiaries, among other things, to:

- incur additional indebtedness;
- pay dividends, buy back shares, prepay junior / subordinated debt, invest outside the Restricted Group or make certain other "Restricted Payments" that would result in value leakage out of the Restricted Group;
- grant security interests over their assets (securing indebtedness other than the bonds);
- engage in sales of assets and subsidiary stock;
- enter into affiliate transactions;
- issue guarantees of indebtedness of other members of the Restricted Group;
- engage in mergers or consolidations or sell substantially all the Issuer's or a Guarantor's assets;
- enter into transactions that would fundamentally alter the ownership structure of the Restricted Group; and
- agree to restrictions on distributions and transfers of assets within the Restricted Group.

Issuers that are finance subsidiaries will further be limited to acting in just that capacity. In the event that secured bonds are offered by a privately-held issuer, it is further common for the security package to include pledges of the capital stock of the Issuer held by a parent / holding company of the Issuer. This is to provide bondholders (and any other senior secured creditors) with a "single point of enforcement" should the Issuer ever become unable to meet its obligations under the bonds, i.e. the ability to sell the Issuer group as a whole, rather than having to rely on asset-level enforcement. In that case it is also not uncommon (but certainly not universal practice) for the relevant parent / holding company to agree to preserve its status as a (mere) holding company in accordance with a "Limitation on Parent Activities" covenant. The purpose of this covenant is to avoid situations where a sale of the Issuer in an enforcement scenario could be complicated or delayed because of potentially competing claims by other creditors (e.g. trade creditors) of the parent company.

How do baskets work?

The ability of the Issuer and its Restricted Subsidiaries to engage in the types of transactions that are restricted by a particular covenant will often depend on capacity available under so-called "**baskets**", i.e. one or more carve-outs which exempt certain categories of transactions (often subject to some form of monetary cap) from the general limitations imposed by the covenant.

While many baskets have traditionally been and, in many cases, continue to be "**hard-capped**" (i.e. expressed as specified fixed amounts in the currency of the bonds), most transactions also feature an increasing number of "**soft caps**" or "**grower baskets**" that are expressed as the "greater of" a fixed amount and a percentage of either Total Assets or Consolidated EBITDA. These soft caps can reward Issuers for strong financial performance and provide them with flexibility for growth over the lifetime of the bonds. This may be particularly helpful to the Issuer in the case of longer-dated bonds and/or where the Issuer is pursuing a growth strategy. At the same time, grower baskets can be perceived by investors as limiting their potential "upside", because the increased flexibility of the Issuer, for example, to incur more debt and/or make additional "Restricted Payments" may also mean a reduced likelihood that the Issuer will significantly delever over the lifetime of the bonds. In addition, it may be more difficult for investors to fully assess, for example, the potential for the incurrence of additional debt or the potential for "value-leakage" in the form of Restricted Payments with grower baskets than with hard-capped baskets. Particularly problematic, from a transparency perspective, can be transactions where the (supposed) "grower element" of a particular basket already gives more flexibility/capacity to the Issuer at the outset (i.e. as of the issue date of the bonds) than the fixed element. In many cases, an "innocent" explanation for this increasing phenomenon may be repeat issuers simply keeping both fixed amounts and grower elements in particular baskets unchanged in connection with (sometimes multiple) follow-on offerings. So even if the percentage level in the grower element of a particular basket may originally have been set to provide capacity at, or at least very close to, the level of the fixed element, subsequent increases in Total Assets or Consolidated EBITDA, sometimes over the course of many years, may have resulted in capacity under the grower element to significantly exceed capacity under the fixed element. Note that issuers are probably less likely to "forget" re-setting the grower element in connection with a new offering in case of a decrease of Total Assets or Consolidated EBITDA. In addition, there are certainly also examples of high yield bonds issued by first-time issuers, in particular in connection with LBOs / sponsor-led transactions, that feature generous rounding up of the percentage levels in grower baskets. Determining the true capacity under grower baskets can be made even more difficult for outsiders by (i) the wide-spread adoption of EBITDA-based grower baskets in recent years and (ii) the fact that the often heavily adjusted "**Consolidated EBITDA**" (as defined in the Indenture) used for determining basket capacity under the various covenants frequently significantly exceeds the "**Reported EBITDA**" (as disclosed by the Issuer in the offering memorandum and subsequent investor reports).

Just a few years ago, the grower element of most grower baskets in European high yield bond transactions (if present at all) was typically expressed as a percentage of Total Assets, while EBITDA-based grower baskets were commonly associated with, and largely confined to, "aggressive sponsor deals". This was not only because EBITDA is generally much more prone to fluctuations than Total Assets, but because EBITDA, a non-GAAP measure, is also much more susceptible to manipulation by management. This is especially true for transactions where, as has become increasingly common, the definition of "Consolidated EBITDA" may give management significant discretion to add back a whole range of items to a company's consolidated net income that go well beyond just "interest, tax, depreciation and amortization" as reported in the company's income statement. In recent years, however, grower baskets have not only generally become much more prevalent, but it has also become fairly common to see EBITDA-based grower baskets in otherwise fairly disciplined and conservative "corporate deals".

In many cases, there may be a strong economic rationale for the use of EBITDA-based grower baskets. For example, the Issuer may simply be in an industry were large balance sheets are just not that relevant and/or the Issuer's strategy (as described in the offering memorandum) may involve rapid revenue / EBITDA growth without a corresponding growth in Total Assets. The (growing) value of the Issuer's business may result from its growing goodwill / brand or its intellectual property or other (self-developed) assets which it may not be able to capitalize under applicable accounting rules, rather than from a capex-fueled expansion of its asset base. But even fast growing, traditional manufacturing businesses, with significant expansion capital expenditures may struggle to earn meaningful additional basket capacity under a Total Assets-based grower element, because of the (conservative) regular depreciation charges they are required to take under accounting rules in relation to their existing asset base.

Consolidated EBITDA

Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA) is among the most widely used financial metrics and relied on by companies themselves as well as investors across a broad range of investment products to evaluate a company's operating performance and debt service capacity. In the leveraged finance world (high yield bonds and leveraged loans alike), it is arguably the most important financial metric and used, among other things, as a numerator or denominator to calculate a company's leverage ratio, interest / fixed charge coverage ratio and cash flow coverage ratio. Even in high yield bonds or covenant-lite loans that do not contain maintenance covenants that reference these ratios, a company's leverage and fixed charge coverage ratio will typically have a significant impact on its capacity to incur incremental (ratio) debt and its capacity to pay dividends or make other Restricted Payments, either out of cumulative consolidated net income or in reliance on a leverage-based Restricted Payments basket. In covenant packages that feature leverage-based portability, whether or not the Issuer's leverage exceeds a particular threshold may also determine whether or not the Issuer's owners may effect a change of control without triggering the requirement to offer to repurchase the bonds at a premium.

Even in the absence of EBITDA-based grower baskets, understanding exactly how "Consolidated EBITDA" is to be calculated for the purposes of a particular covenant package is therefore critical for both the company as well as investors, arguably as important as the more superficial question as to the specific level / number / percentage at which a particular ratio or grower element is ostensibly set.

Of course, finance professionals will know that EBITDA is a "non-GAAP" measure. This means that there is no single "standard" method prescribed by applicable generally accepted accounting principles (such as IFRS, US GAAP, HGB or other local GAAP) or by some other independent standard-setting body or set of rules for calculating EBITDA that would ensure that the "EBITDA" reported or used by one company is at all comparable to "EBITDA" reported or used by another company, even if both companies are close competitors operating in the same industry.

Instead, the definition of "Consolidated EBITDA" (and related definitions) used in high yield bond covenant packages are typically complex, sometimes highly-negotiated and often uniquely tailored to the Issuer's business, industry, strategy and/or accounting practices. Although the starting point is generally "Consolidated Net Income" (itself a defined term which typically already reflects a series of adjustments and add-backs to the related GAAP measure), the add-backs, carve-outs and other adjustment permitted by the definition of "Consolidated EBITDA" invariably go far beyond just "interest, tax, depreciation and amortization" as reported in the company's income statement.

In addition to adjustments for certain extraordinary items and non-cash items, pro forma adjustments related to permitted investments, acquisitions or divestments and adjustments for related expenses as well as add-backs for certain financing expenses, there has been an explosion in recent years (especially in more aggressive sponsor-led transactions) of more or less broadly drafted add-backs that may give significant discretion to the Issuer's management (e.g. "….. expected (in good faith) to be achieved …..") to adjust "Consolidated EBITDA", for example, by adding back certain (actual) business optimization expenses, integration costs or ramp-up/start-up costs or by making pro forma adjustments to reflect not just actual, but also expected/projected cost-savings and synergies from certain (actual or proposed) operational changes, business optimization programs or even "other initiatives".

On the more aggressive / issuer-friendly side of what is a very wide spectrum of definitions, it is not uncommon to see definitions of "Consolidated EBITDA" that stretch across multiple pages. Although the relevant add-backs and other adjustments will invariably include all relevant adjustment made to any "adjusted", "modified", "pro forma", "run rate", ….. EBITDA disclosed in the offering memorandum for a particular bond offering, sometimes by express cross-reference to the relevant disclosure in the offering memorandum, it is important to note that the defined term "Consolidated EBITDA" for covenant purposes will almost always differ from (and typically include flexibility for additional add-backs and other adjustments to) any "EBITDA" disclosed in the offering memorandum and any "reported" EBITDA disclosed by the Issuer in its regular reports to investors. This is because, for liability reasons, the Issuer, the Initial Purchasers, and their lawyers will typically only want to include adjustments in the EBITDA disclosed in the offering memorandum or investor report, as applicable, that are capable of being corroborated (and ideally comforted by the Issuer's auditors), and will try to avoid publicly disclosing adjustments that rely heavily on management's (subjective) expectations or projections.

To impose at least a minimum degree of objectivity and reasonableness as well as a limit on the extent to which "**covenant EBITDA**" may differ from "**reported EBITDA**", even otherwise aggressive definitions of "Consolidated EBITDA" typically impose at least a time period limit (normally 12 -24 months) within which certain "run rate" expected cost savings, expense reductions, synergies, ….. must be expected (in good faith) to be achieved. At least for these types of adjustments, it is also not uncommon to see caps, for example, at 20%, 25% or even 30% of Consolidated EBITDA, calculated after fully taking into account the relevant (run rate) adjustments. Third party corroboration, however, is typically not required. More conservative transactions may also (hard) cap the amount of permitted add-backs, for example, even with regard to actual ramp-up or start-up costs and expenses.

Finally, it is worth noting that "Consolidated EBITDA" is typically determined on a rolling / last twelve months (LTM) basis, i.e. calculated for the most recently ended four consecutive full fiscal quarters for which consolidated financial statements of the Issuer are available immediately preceding the date on which the proposed event / action for which the relevant calculation is being made is proposed to occur / be taken, subject to certain *pro forma* adjustments, for example, to reflect the incurrence or repayment of indebtedness or any acquisitions or disposals since the beginning of the relevant period. Because the "Reports" covenant typically gives the Issuer up to 120 days to publish its fourth quarter / annual financial statements and up to 60 days to publish its financial statements for the first three fiscal quarters in each fiscal year, "Consolidated EBITDA" may therefore continue to be calculated based on a particular twelve months period long after the end of such period, and it may therefore take a long time to reflect event significant changes in the Issuer's results of operations, especially sudden disruptions such as the impact of the current Covid-19 pandemic on the businesses of many issuers. In very rare cases, typically by private equity-backed Issuers with aggressive growth strategies, "Consolidated EBITDA" will be calculated for the most recently ended two consecutive full fiscal quarters for which consolidated financial statements of the Issuer and multiplying that number by two.

There has been significant debate recently to what extent Issuers may / should be able to adjust Consolidated EBTIDA for at least some of the effects of the Covid-19 pandemic on their businesses. Frequently, this is being discussed under the label "**EBITDAC**" (earnings before interest, taxes, depreciation, amortization and corona virus / Covid-19). As always, whether a particular Issuer might be permitted to make certain related adjustments / take certain add-backs will depend of the specific wording of the relevant definition of "Consolidated EBITDA". Potentially relevant may be certain more or less common adjustments and add-backs including in relation to (i) "natural disasters", (ii) "extraordinary", "exceptional", "non-recurring", "one-time" and/or "unusual" charges / gains and losses, (iii) losses, costs or cost inefficiencies related to facility or property disruptions or shutdowns, (iv) losses associated with temporary decreases in work volumes and expenses related to maintaining underutilized personnel, (v) goodwill impairments, (vi) business interruption insurance proceeds ("to the extent actually received" / "to the extent expected to be received"), and (vii) expenses related to certain "business optimization" activities. In evaluating these and other potential adjustments and add-backs, it is important to carefully analyze the relevant wording and to carefully distinguish between "costs/expenses" vs. "losses". And while certain issuers appear to have started to report variations of EBITDAC as part of their ongoing reporting which also add back certain "lost revenue" as a result of the Covid-19 pandemic, such revenue-related add-backs are not normally permitted under even otherwise aggressive definitions of "Consolidated EBITDA". As of the date of this guide, the authors is only aware of a single recent US high yield bond transaction which included an express add-back for lost earnings due to the Covid-19 pandemic: " ...... *lost earnings due to (directly or indirectly) ..... the impact of COVID-19 not to exceed 25% of EBITDA after giving effect to the addback permitted by this clause ; provided that (i) such lost earnings are reasonably identifiable and factually supportable, (ii) no lost earnings shall be added* *pursuant to this clause* [...] *to the extent duplicative of any expenses or charges relating to such lost earnings that are included in any other clause of this definition of EBITDA*."

In the loan market, typically in the context of waivers and amendments to address breaches of applicable leverage ratio-based maintenance covenants as a result of the impact of the Covid-19 pandemic, we have seen a range of different approaches that are designed to provide temporary relief to the relevant borrowers. These approaches are neither open-ended nor do they give the borrower much discretion. They include (i) "deemed EBITDA" concepts whereby, for example, EBITDA for the second and third quarters of 2020 are deemed to be a specific amount, possibly based on some historic average, (ii) "historic EBIDTA" concepts whereby the historic EBITDA from corresponding prior-year periods is substituted for the actual EBITDA for certain quarters in 2020 and early 2021 that are expected to be significantly adversely impacted by the Covid-19 pandemic and (iii) "annualized EBITDA" concepts, whereby post-Covid-19, normalized "Consolidated EBITDA" will be annualized (rather than calculated based on a LTM basis) during a transition period.

In addition to the "greater of" grower element, it has also become common for many baskets in the Limitation on Indebtedness covenant to also permit the incurrence of (incremental) Indebtedness to cover "fees, underwriting discounts, premium and other costs and expenses" incurred in connection with refinancing of indebtedness under the relevant basket. This can be a very useful (and potentially critical) feature from the Issuer's perspective in a refinancing context, as transaction-related costs and expenses for either a high yield bond or leveraged loan (which do need to be funded somehow) can be significant, as they may include potentially very substantial items such as early redemption premium / breakage costs and/or swap-termination costs. Other, direct transaction expenses typically include legal fees, auditors fees and underwriting discounts.

Certain baskets may grow and get depleted over time (e.g. based on accumulated consolidated net income of the Issuer and Restricted Payments made, respectively, since the date of issuance of the bonds) and/or be "**refillable**". Other baskets may be "**one-time only**". The Issuer would naturally prefer to be able to refill baskets, for example, as Indebtedness incurred under a particular basket is repaid, and refillable baskets have become the norm.

In addition to specific baskets for specific categories of transactions, covenants also typically contain a so-called "**general**" or "**hell-or-high-water**" basket, which may, for example, permit a specified amount of Indebtedness to be incurred, Liens to be granted or Restricted Payments to be made for any reason or no reason at all. Issuers should guard the relevant baskets particularly carefully, as "hell-or-high-water" events tend to occur far more frequently during the lifetime of the bonds than the parties normally expect at the outset. As a general matter, it will always be more advantageous to the Issuer to rely on a exemption general (i.e. "non-basket" exemption) to a covenant for a particular transaction or on a basket designed for a specific category of transactions, rather than on a general basket.

Financial Calculations – At what time and how exactly will financial ratios or thresholds be tested?

Under the Limitation on Indebtedness covenant, the Limitation on Restricted Payments covenant and the Limitation on Liens covenant, in particular, whether or not a proposed course of action by the Issuer or a Restricted Subsidiary is permitted, such as the incurrence of Indebtedness, the making of a Restricted Payment or the granting of a Lien, will frequently depend on whether a particular financial ratio or threshold is met. It is therefore important to understand exactly how and at what time the relevant financial calculations are to be made.

As discussed under "*How are high yield covenants different from those contained in a traditional credit facility*?" starting on page 26 above, it is part of the very nature of an "incurrence covenant" that the permissibility of a proposed transaction is only tested once in connection with the relevant transaction, and that it does not impose any ongoing maintenance requirements.

As already discussed under "*Consolidated EBITDA*" starting on page 31 above, the calculation of the various financial ratios used in a high yield covenant package as well as their various component parts, such as "Consolidated EBITDA", will be governed by complex definitions with numerous add-backs and adjustments that can be as important in determining as to whether a particular financial ratio or threshold test is met as the level at which the relevant ratio or threshold is ostensibly set. And even if, as is the default position, compliance with a particular ratio or threshold were simply to be tested at the "time of incurrence" (e.g. the incurrence of a particular item of Indebtedness, the making of a particular Restricted Payment or the creation of a particular Lien), the relevant ratio and/or its component parts may, in the absence of more recent available financial statements of the Issuer, for covenant purposes be calculated with regard to a financial period that may have ended long before the relevant date of determination, albeit with certain (limited) *pro forma* adjustments.

Because exactly how and at what time a particular financial ratio or threshold should be calculated is not always straightforward, high yield covenant packages have always contained numerous related calculation provisions, both in the relevant definitions and in the body of the relevant covenants, in particular the Limitation on Indebtedness covenant.

Historically, most of these calculation provisions could properly be classified as reasonable and helpful clarifications, that merely addressed the economic realities of the relevant underlying transactions, without giving the Issuer much discretion or the ability to "game" the relevant calculation provisions. Examples of calculation provisions that fall in this category include (i) certain standard provisions with regard to the currency exchange rate to be applied in determining the principal amount of Indebtedness incurred and/or used to refinance Indebtedness, in each case in a currency other than the currency of the bonds / the currency in which the relevant ratios are expressed (i.e. typically the exchange rate in effect on the date the relevant Indebtedness was originally incurred), and (ii) provisions with regard to the determination of the amount of any Indebtedness deemed outstanding in respect of Indebtedness of a third party secured by a Lien on the assets of the Issuer or a Restricted Subsidiary (i.e. typically the greater of the fair market value of the relevant asset at the date of determination and the amount of the third party Indebtedness). Another useful clarification that falls into this category is that any ratio calculated in determining the permissibility of a particular debt incurrence is to be determined "after giving *pro forma* effect thereto (including *pro forma* application of the proceeds thereof)". This clarification is/was particular useful in connection with refinancing transactions, where the (new) Indebtedness to be incurred in order to refinance existing Indebtedness must logically be incurred first, i.e. before the proceeds can be used to redeem/repay the Indebtedness intended to be refinanced. The historically much longer minimum notice periods of no less than 30 days (rather than today's standard of no less than 10 days) in the optional redemption provisions of most high yield bonds, for example, effectively meant that up to a month might have passed between a new bond offering and the application of the proceeds of that offering to redeem existing bonds. See also "*Tenor, Call Protection and Redemption*" starting on page 40 below.

Another helpful clarification that has become standard in recent years expressly allows the Issuer to exclude any "Permitted Debt" (i.e. Indebtedness incurred in reliance on a non-ratio-based basket) incurred on the same date of determination for the purposes of calculating the relevant ratios for determining any "Ratio Debt" capacity. Most practitioners would view this as a mere clarification as incurring the Ratio Debt component first, immediately followed by a separate debt incurrence in reliance on available capacity under a Permitted Debt basket would clearly be permitted and achieve the same economic result. Insisting on artificially splitting what is economically a single financing transaction into two separate, successive transactions, however, would serve no purpose. Instead of in the body of the Limitation of Indebtedness covenant, this clarification is typically incorporated into the definition of "Fixed Charge Coverage Ratio", by cross-reference to which it is then typically also indirectly incorporated into the relevant (secured) leverage ratio definitions. Sometimes the relevant drafting works, either deliberately or incidentally, so that the concept also applies in connection with the calculation of relevant leverage tests for the purposes of determining capacity under leverage-based Restricted Payment baskets and even for the purpose of determining whether a Change of Control qualifies as a "Specified Change of Control Event" and therefore whether or not the Issuer's owners may effect a Change of Control without triggering the requirement to offer to repurchase the bonds at a premium. See also "*Change of Control and Portability*" starting on page 46 below. The answer to the question whether this is an appropriate outcome is less straightforward, and some may view such a feature as aggressive.

In addition to these types of mere clarifications and/or technical calculation provisions, there has been a proliferation of other, novel calculation provisions in European high yield bond covenant packages in recent years, some of which give the Issuer significant additional discretion with regard to the method and timing for calculating relevant ratios and thresholds. Probably the most prominent of these "new" calculation provisions is a provision typically discussed under the label "**Limited Condition Acquisitions**", but may also appear in covenant packages under heading such as "**Limited Condition Transactions**" or just "**Financial Calculations**". Only a few years ago likely a strong indicator of an overall aggressive, sponsor-style covenant package, different variations of this calculation provision are now widespread in European high bond transactions, including in otherwise conservative corporate deals.

As already suggested by its label, the original variation of this calculation provision only applied in connection with the entry into binding agreements with regard to acquisitions that are not conditional on third party financing, although more Issuer-friendly iterations of the concept now apply to any acquisition or even in the context of irrevocable notices of prepayment of other debt and/or Restricted Payments requiring irrevocable notice. In a growing number of transactions, the concept even applies in connection with the calculation of leverage ratios for the purpose of determining whether the Issuer must conduct a Change of Control Offer in connection with a proposed Change of Control, rather than just for determining (ratio-based) debt capacity, for example. See also "*Change of Control and Portability*" starting on page 46 below.

What the provision does is to allow the Issuer, at the Issuer's option, to calculate any relevant ratios on the date of entry into the relevant definitive agreements (or giving of irrevocable notice, as applicable), rather than on the (potentially much later) date of the actual debt incurrence (to fund the acquisition), the actual making of a Restricted Payment or actual Change of Control, as applicable. This clearly provides useful flexibility to Issuers as it provides certainty that debt capacity under a ratio-based basket that may be necessary for the Issuer to be able to finance a relevant transaction will not later disappear after the Issuer has contractually committed to a transaction (e.g. because of a drop in LTM Consolidated EBTIDA), while avoiding scenarios where the Issuer might otherwise be forced to unnecessarily rush to borrow / incur the required amount of Indebtedness (and start paying related interest), possibly (long) before even the entry into a binding purchase agreement or the actual closing date of the transaction and possibly even while the closing of the proposed transaction may still be subject to other (non-financing) conditions. From a debt / HY bond investor's perspective, however, the benefit of a provision that is most relevant in facilitating aggressively leveraged bolt-on acquisitions is less clear.

However, the author of this guide has assisted two corporate HY issuers with otherwise conservative and very disciplined covenant packages in negotiating first-of-their-kind variations of the "Limited Condition Acquisitions" concept that allowed those issuers to reserve debt capacity upon the entry into initial procurement contracts (with a value in excess of a specified threshold amount) in connection with certain multi-year, large-scale expansion projects, which were disclosed in the relevant offering memoranda as key components of the issuers' respective growth strategies. Without the relevant provisions, the relevant issuers would have been forced to either (i) incur the full (maximum) amount of Indebtedness expected to be required to complete the project (and start paying interest thereon) before the implementation phase of the project had even fully commenced, and possibly 1-2 years before the issuers would have been required to pay related invoices under engineering, procurement and construction contracts or (ii) risk running out of debt incurrence capacity to fund the remaining portion of what may already have been a very expensive and substantially (but not quite) completed project. Neither of these options is desirable, either from the Issuer's or from an investor's perspective, and the second option could potentially have a devastating impact, depending on the size of the project relative to the size of the Issuer's overall business. Instead, the inclusion of the relevant financial calculation provisions allowed the relevant issuers to enter into committed credit facilities to fund their investment projects at the outset of the relevant projects and to draw (i.e. "incur" the relevant Indebtedness) over the course of the relevant projects, i.e. if and when actually needed to pay related invoices.

Other increasingly popular calculation provisions that have appeared in Limitation on Indebtedness covenants in European high yield covenant packages in recent year include provisions pursuant to which (i) re-borrowed amounts previously repaid pursuant to cash sweeps, clean downs or deemed repayments under revolving credit facilities are deemed incurred on date the related Indebtedness was first incurred (ii) the Issuer is given the option to calculate ratio-based debt capacity for borrowings under (revolving) credit facilities on the date the relevant facility agreement was entered into (or commitments under an existing facility agreement were increased), rather than on the date of the actual debt incurrence, which effectively allows the Issuer to permanently reserve ratio debt capacity (i.e. a so-called "**Reserved Indebtedness Amount**") for utilization under particular credit facilities, and (iii) incurrence of refinancing Indebtedness with regard to items of Permitted Debt originally incurred in reliance on a grower element of a Permitted Debt basket are generally deemed not to exceed the relevant grower element. These and a number of similar calculation provisions can clearly come in handy for an Issuer. Investors, on the other hand, may be concerned that they may encourage issuers to make much more aggressive use of ratio-based and/or grower element-based debt capacity and test such capacity to the absolute limit, based on what may later turn out to have been "peak-EBITDA".

A final, increasingly popular provision provides for the automatic (rather than by conscious, albeit internal, decision of the Issuer) reclassification of certain items of Permitted Debt as Ratio Deb as soon as permissible. See also "*Classification and Reclassification – Which exemption/basket applies?*" on page 61 below.

How long will the restrictions under the covenants apply?

Generally, the covenants will apply for as long as the bonds are outstanding. As already discussed under "*In good times and in bad times*" starting on page 24 above, the process for soliciting consents from the required (super) majority of bond holders for potential waivers and/or modifications of the terms of bonds after the initial issuance will typically be significantly less straightforward than an equivalent waiver or amendment process under a credit facility. It is therefore particularly important to "get everything right" at the outset.

However, most high yield covenant packages in Europe contain a provision whereby certain "**fall away covenants**" (i.e. normally most of the key high yield covenants) will automatically "fall away" (or more accurately, be suspended), if and for as long as the bonds receive an investment grade rating from the relevant rating agencies (i.e. typically Moody's and Standard & Poor's) and no default has occurred and is continuing. In that case, only the basic (i.e. less restrictive) covenants customary for investment grade bonds would continue to apply, such as the Limitation on Liens, Limitation on Mergers, Change of Control and Reports covenants.

What law should govern the bonds?

High yield bonds originally developed in the United States and most true "high yield" bonds (including high yield bonds issued by European issuers) continue to be governed by New York law, although there is a growing body of precedents for "local law" governed high yield bonds in certain jurisdictions. Most notably, there is a significant and growing body of precedents for true German law governed high yield bonds by German issuers, with full, traditional high yield covenant packages and other documentation that is otherwise indistinguishable for that used for offerings of high yield bods governed by New York law. But there is also a broad universe of sub-investment grade or unrated bonds that are issued by European issuers under documentation that is more commonly associated with investment grade bonds (e.g. English law governed Eurobond-style documentation) and that lack some or all of the standard "high yield" covenants described below. Sometimes these bonds are referred to as "**HY lite**". See also "*Rule 144A/Reg. S vs Reg. S only*" starting on page 18 above.

Although New York law will be the default position for true "high yield" bonds in most situations, to the extent an Issuer has a strong preference for its bonds to be governed by the laws of another jurisdiction, the parties should discuss the legal and practical feasibility and implications of any such request at the outset of a transaction. Whether or not it is feasible and/or advisable to have the high yield bonds of a particular issuer be governed by a law other than New York law will depend on a variety of factors, including "marketability" considerations and the target investor audience for the particular offering. Because true high yield bonds are traditionally New York law governed, international high yield investors are familiar and comfortable with New York law and the jurisdiction of the courts in New York to decide disputes under the bonds. Due to the long history of high yield bonds and well established case law in New York, New York law does offer the real advantage over many "local laws" that it is "tried and tested" and therefore offers greater legal certainty to both the Issuer and investors, in particular in case it ever becomes necessary to restructure the bonds. On the other hand, many non-U.S. issuers may be reluctant to agree to the jurisdiction of the New York courts to decide potential future disputes with holders of their bonds and may generally be more familiar and comfortable with their own, local law. Of course, the choice of a governing law other than New York law and the jurisdiction of any local courts must not mean that investors give up protections that are standard under New York law governed high yield bonds or that it will be more difficult (either as a matter of law or in practice) for investors to enforce their rights under the bonds.

Irrespective of which law governs the bonds, the substance and wording of the typical high yield bond covenants as described below will be substantially similar, and it should therefore normally be possible to switch (i.e. change the governing law) without too much extra work at a later stage in the offering process, i.e. without the need to broadly revisit previously agreed commercial points. However, common provisions that may need to be modified / be impacted by (mandatory) statutory local law provisions, depending on which law governs the bonds, include provisions dealing with events of default and collective decisions by bond holders, for example, to accelerate the bonds following an event of default, to grant waivers or agree to amendments of the terms of the bonds. Those mandatory local law provisions relating to the process for calling bond holder meetings, quorum requirements and approval thresholds, for example, may differ significantly from relevant US statutory provisions and/or market practice.

TENOR, CALL PROTECTION AND REDEMPTION

Among the key commercial decisions the Issuer will be required to make and that will typically feature prominently even in its initial discussions with prospective Initial Purchasers, are the decision which bond tenor(s) it wants to achieve in a particular offering, whether it wants to issue fixed or floating rate notes and what "call protection" it is prepared to offer investors.

This section is merely intended to provide an overview of some of the most important considerations and key redemption provisions typically found in high yield bond terms. While fairly clear market standards exist for some of the provisions described below, the specific tenor(s) and redemption features for a particular high yield bond offering will ultimately always reflect, at least to some extent, the outcome of commercial discussions and be influenced by a variety of factors, including prevailing market conditions around the time of the offering, recent precedent transactions, the nature of the Issuer's business (e.g. cyclical or non-cyclical), the credit quality of the Issuer, whether or not the transaction is a "sponsor deal", the overall maturity profile of the Issuer's debt, the Issuer's business plan and strategic priorities and other factors.

As described under "*Why High Yield*?" on page 4 above, the mutual benefits of high yield bonds (compared to traditional credit facilities) for issuers and investors include (i) the ability of issuers to secure longer-term financing at (typically) fixed interest rates and (ii) the opportunity for investors to benefit from higher interest rates and from potential capital appreciation, i.e. a potential increase in the secondary market prices of their bonds, for example, as a result of an improvement in the credit quality of the issuer and/or a general decline in market interest rates. Fixed rate notes typically account for the vast majority of European high yield bond issuances in any given year, with floating rate notes historically accounting for only a relatively small percentage of overall issuances.

The downside, from the Issuer's perspective, of the ability to secure long-term financing at fixed interest rates, however, is that the terms of virtually all bonds (irrespective of whether they are documented using high yield or investment grade-style documentation) will impose limitations on the ability of the Issuer to prepay / refinance the bonds prior to their scheduled maturity date. The strength (or weakness) of the "call protection" afforded to investors of a particular bond, in particular the various redemption features described below, can significantly impact the overall economics for investors, as any additional flexibility afforded to the Issuer to redeem the bonds prior to the scheduled maturity date (i.e. at terms that would not fully compensate the investor for the loss of its right to receive the agreed interest payments until the stated maturity date) directly impacts the potential upside for bond investors, both in terms of potential loss of interest income and potential capital appreciation. Stated differently, without any call protection, the Issuer could just refinance the bonds at lower interest rates whenever it has an opportunity to do so, for example, as a result of an improvement in the credit quality of the Issuer and/or a general decline in market interest rates. Bond investors, on the other hand, would be locked into the "fixed" interest rate agreed at issuance of the bonds until the bonds mature (i.e. absent early termination of the bonds following occurrence of an Event of Default or the occurrence of a Change of Control), even if the credit quality of the Issuer subsequently deteriorates and/or market interest rates increase.

The vast majority of investment grade bonds in Europe will either (i) simply not include any optional early redemption provisions at all, which effectively means that the Issuer will have no contractual right whatsoever to early redeem the relevant bonds and would instead have to rely on bondholders voluntarily selling their bonds either in individually negotiated / market buy-backs or as part of a tender offer or exchange offer, or (ii) as is standard market practice in US investment grade bonds, will be "make-whole-for-life", i.e. will contain a (fairly expensive) "Make-Whole Redemption" option, similar to those described below, that will apply, and be the only redemption option, all the way through the maturity date of the bonds. In response to the introduction of the PRIIPs Regulation, as described under "*European Securities Law Considerati*ons" starting on page 21 above, some European investment grade issuers have even removed existing make-whole redemption features from their bond offerings in order to be able to continue to market their offerings to retail investors without triggering the requirement to produce KIDs.

For investment grade or cross-over issuers, not having any or only fairly expensive early redemption options is not normally a problem. This is because (i) investment grade-style bonds typically do not have many (if any) covenants that could cause problems for an issuer down the road, for example, in a distressed scenario, and (ii) they will also presumably generally be less likely to get distressed in the first place. Having the option to early redeem bonds, either to address / get rid off covenant restrictions that later turn out to be problematic or to make use of opportune market windows to refinance and/or extend the issuer's maturity profile, is therefore less important for these issuers. It is worth noting though, that because the documentation for HY lite offerings is generally often more influenced by investment grade bond market practices, most HY lite bonds in Europe are also "make-whole-for life", albeit with certain notable exceptions, which cherry-pick features from both worlds, i.e. the much more issuer-friendly, standard HY redemption options discussed below, without also including all (or any) of the standard HY covenant protections.

Rather than (i) an outright prohibition of any prepayments / early redemptions of the bonds prior to the scheduled maturity date, either expressly or by simple omission of relevant optional redemption provisions, or (ii) merely an expensive "make-whole-for-life" redemption option that effectively discourages early redemption by making it fairly expensive, typical high yield bond terms will contain call features that are designed to strike a balance. In particular, they will contain "**call schedules**" and different options pursuant to which the Issuer may redeem (or "call") the bonds, on any one or more occasions, at different redemption prices during different periods (so-called "**Optional Redemption**"). On the one hand, these standard high yield redemption features do provide a certain minimum level of "**call protection**" to investors for at least a number of years post-issuance. On the other hand, they give the Issuer an incentive (i.e. the ability to do so without any/significant penalties) to make use of available market windows / opportunities to refinance the high yield bonds ahead of the scheduled maturity date (and thereby extend its maturity profile), rather than take the risk of leaving a refinancing to the last minute, just to save costs. The resulting increase in the likelihood of a successful refinancing of the bonds, of course, is also in the interest of investors, especially given the "sub-investment / speculative grade" nature of investments in high yield bonds, the cyclical nature of the businesses of many high yield issuers and potential overall volatility of the leveraged finance markets.

To exercise its option to early redeem all or a part of its bonds, the Issuer must typically give holders of the bonds not less than 10 nor more than 60 days' prior notice, although certain bond terms may still provide for a minimum of 30 days' prior notice, in particular for exercise of the "*Equity Clawback Option*" described on page 43 below, consistent with historic standard market practice.

Optional Redemption / Make-Whole Redemption

All true high yield bonds will feature so-called "**non-call periods**" following the initial issuance of the bonds. Somewhat deceptively this does not mean that the Issuer will not have the option to redeem / call the bonds during this initial period at all, but merely that it may only redeem the bonds at a redemption price equal to 100% of the principal amount of the bonds that are being redeemed plus an "Applicable Premium" as well as accrued and unpaid interest and any "Additional Amounts" (see "*Early Redemption for Tax Reasons*" on page 45 below) to but excluding the redemption date (so-called "**Make-Whole Redemption**"). The "**Applicable Premium**" is intended to fully (i.e. effectively more than) compensate, or "make whole", investors for the loss of their fixed rate investment in the bonds prior to the end of the non-call period and is defined as the greater of (i) 1.0% of the principal amount of the bonds and (ii) the present value of (x) the scheduled redemption price at the end of the non-call period (as described below) and (y) all scheduled interest payments under the bonds until such date. Exercising this option can therefore be fairly expensive / unattractive for the Issuer, especially during the early parts of the relevant non-call period, as the redemption price payable upon redemption will not only include the principal of the bonds, but also an upfront payment equal to the present value of all future interest payments until the end of the non-call period. The "Applicable Premium" will invariably over-compensate investors (i) because of the 1.0% minimum redemption premium, which will apply even if the bonds are redeemed just a single day before of the end of the redemption period and (ii) because the (very low) discount rate used for the necessary present value calculations assumes that bondholders would re-invest the redemption amounts they receive upon redemption in investments with a yield that is just marginally (e.g. 50 basis points) above that of a relevant (risk-free) government benchmark bond (e.g. German Bunds for euro-denominated HY bonds) for the remainder of the non-call period.

The duration of the non-call period will differ depending on the tenor of the bonds, i.e. the longer the tenor of the bonds, the longer typically the non-call period. In the European market, the standard non-call periods for fixed rate notes were traditionally 2 years for 5 and 6-year bonds, 3 years for 7-year bonds, 4 years for 8-year bonds and 5 years for 10-year bonds, i.e. "5nc2", "6nc2", "7nc3", "8nc4" or "10nc5".

Following the expiration of the non-call period, the Issuer will have the option to redeem the bonds at different scheduled redemption prices that involve payment of different fixed premiums that apply during different time periods. The premium (if any) included in these scheduled redemption prices will be significantly lower than the "Applicable Premium" / full "make-whole" amount described above and (i) be expressed as fixed percentages of the principal amount determined at issuance by reference to a percentage of the coupon of the particular bond and (ii) decrease / "step-down" each year until the Issuer is able to redeem the bonds at par. Historically, the call schedule for 7-year bonds, for example, would specify a redemption price with a "first call premium" (i.e. for the year immediately following the expiration of the 3-year non-call period) of 75% of the coupon, which would step down to 50%, 25% and 0%, respectively, during years 5, 6 and thereafter. This standard, however, has gradually been eroded in recent years in two ways. First, a number of Issuers have been able to issue bonds with shorter non-call periods, for example, 5-year bonds with just an 18-month or even just a 1-year non-call period, or 8-year bonds with 3-year non-call periods. In addition, many bonds now (also) feature shortened call schedules. For example, many 7 and 8-year bonds now feature call schedules with a first call premium of 50% of the coupon, i.e. skipping the "75% step" and effectively removing all call protection for investors for several years prior to the scheduled maturity date.

Other than for fixed rate notes, the standard non-call period in the European market for floating rate notes is just one year, irrespective of the tenor of the floating rate notes. Until a few years ago, the standard call schedules for floating rate notes would then typically provide for optional redemption at 102%, 101% and 100%, respectively, of the principal amount of the notes to be redeemed in years 2, 3 and thereafter. The current European market standard is for the redemption price to step down immediately to 101% and 100%, respectively, of the principal amount of the notes to be redeemed in year 2 and thereafter. More aggressive floating rate note offerings may even feature a "straight to par" initial call price.

Equity Clawback Option

As a potentially important exemption from the general rule that the Issuer may only redeem fixed rates notes during the relevant non-call period by way of Make-Whole Redemption as described above, the terms of most fixed rate notes will provide that the Issuer may, during the non-call period, on any one of more occasions redeem up to a certain percentage (i.e. traditionally up to 35%) of the principal amount of the notes with the net cash proceeds of one or more qualifying "Equity Offerings" at par plus 100% of the coupon (rather than at par plus a full "make-whole premium"), provided (i) at least a minimum percentage of the principal amount of the relevant bonds (i.e. traditionally the balance / 65%) remains outstanding after each such redemption and (ii) the redemption occurs within a specified number of days (i.e. traditionally 90 days and sometimes 120 days) upon not less than 30 nor more than 60 days' notice (so-called "**Equity Clawback Option**").

The original rationale for this exemption, presumably, was to give the Issuer the ability and an incentive to conduct an equity offering (potentially an IPO) after the high yield bond issuance and to delever by replacing some of its debt with equity, which should improve the Issuer's credit quality/rating and thereby also benefit bond investors, i.e. by way of capital appreciation of their remaining bonds.

This former European market standard, however, has also gradually been eroded (from an investor's perspective) in recent years in a number of ways. First, a (significant) majority of European high yield bonds now cap the Equity Clawback Option at 40% of the original principal amount (rather than at 35%), with some bonds providing for an even higher cap (e.g. 45%). In addition, rather than requiring that at least the balance (i.e. 65% or 60%, respectively) of the original principal amount of the bonds remains outstanding after any redemption pursuant to the Equity Clawback Option, a number of bonds only require that 50% of the original principal amount remain outstanding. There are even (rare) example of transactions, mostly aggressive US sponsor transactions, that contain carve-outs if all the remaining (50% of) bonds are "redeemed substantially concurrently", which essentially allows the relevant Issuers to combine the Equity Clawback Option with the Make-Whole Redemption option during the non-call period, with the result of a potentially significantly lower average redemption price. Furthermore, an increasing number of European high yield bond terms contain expanded definitions of what constitutes an "**Equity Offering**" for purposes of the Equity Clawback Option. Rather than just a *bona fide* underwritten public offering of capital stock of the Issuer or of a parent company of the Issuer (the proceeds of which are contributed to the common equity of the Issuer), for example, such expanded definitions may include equity offerings of any other entity (including private equity affiliates / intermediate holding companies) and/or may not even be limited to actual equity offerings anymore, but also include offerings of "other securities" (i.e. may even include certain debt offerings). Finally, a significant minority of European high yield bonds have now extended the time period following completion of the Equity Offering during which the Equity Clawback Option is available to up to 180 days (rather than 90 days or 120 days).

Given the already very short, one year non-call period customary for European floating rate notes, which also results in much lower "Applicable Premiums", the terms of floating rate notes do not normally contain an Equity Clawback Option.

Practice Note: In response to the current Covid-19 pandemic, a number of recent high yield bond offerings, in particular in the United States, included a novel call feature modelled on the Equity Clawback Option. Under this novel feature, the relevant issuers may, during a specified period after the issue date of the bonds (e.g. during the first 90 or 120 days post issuance), redeem up to 35% (or 40%) of the notes at varying redemption prices (typically at a premium significantly less than a full annual coupon) with the proceeds from a "Regulatory Debt Facility" (or similar defined term), which captures funds raised under the various Covid-19 support programs set up by numerous governments to help their economies weather the current crisis. Whether we will see more wide-spread adoption of this novel call feature n Europe remains to be seen. In this regard it is worth noting that the German government loan programs administered by KfW, for example, do not normally allow the (subsidized) borrowings under these programs to be used for "refinancings", i.e. optional early redemptions / voluntary prepayments of outstanding debt, just because that debt might be more expensive.

10% at 103% Call Option

The "10% at 103%" call option is another potentially very significant exemption from the general rule that the Issuer may only redeem fixed rates notes during the relevant non-call period by way of Make-Whole Redemption. If included in the bond terms, this provision gives the Issuer the option to redeem, during each 12-month period during the non-call period, up to 10% of the original aggregate principal amount of the bonds at a redemption price equal to 103% of the principal amount of the Notes redeemed, plus accrued and unpaid interest and any Additional Amounts to but excluding the redemption date. The provision does not normally allow the Issuer to carry forward any unused amounts to any subsequent 12-month periods and it also should not normally extend beyond the end of the non-call period, but it still significantly weakens the traditional call protection for fixed rate notes.

The prevalence of the 10% at 103% call option in the European market appears to fluctuate significantly from year to year, depending on the overall strength of the high yield market. However, even in a strong market environment, its inclusion is still considered by many as "aggressive" and as characteristic of "sponsor deals". Its inclusion is therefore typically confined to a relatively small (but sometimes significant) minority of senior secured notes issuances.

Early Redemption for Tax Reasons

This standard provision, which is also a common feature of investment grade bonds, works in tandem with another standard provision which requires the Issuer, subject to certain customary exemptions, to make certain "gross-up" payments to bondholders (i.e. pay so-called "Additional Amounts"), if it is ever required to withhold or otherwise deduct, under the tax laws of certain "Relevant Tax Jurisdictions", any amounts from amounts otherwise due to bondholders. The "**Additional Amounts**" payable are intended to ensure that the net amounts actually received by bondholders after any such required withholding or deduction are equal to the respective amounts of principal and interest that the bondholders would have been entitled to receive in the absence of the relevant requirement to make a withholding or deduction. The "**Relevant Tax Jurisdictions**" typically include the jurisdiction(s) in which the Issuer and/or any relevant Guarantor(s), as applicable, are organized and any jurisdictions through which payments are made by or on behalf of the Issuer and/or any relevant Guarantor(s).

Since subsequent (i.e. after the issue date) changes in tax laws or regulations are outside the Issuer's control and the payment of "Additional Amounts" could become prohibitively expensive, high yield bond terms will invariably give the Issuer the option to early redeem all (but not just a portion) of its bonds if it ever does become obligated to pay Additional Amounts.

Optional Redemption upon Certain Tender Offers; Drag-Along Right

Just a few years ago considered both a novel and aggressive feature, most European high yield bonds now contain a "drag-along" right in connection with any tender offer (including any Change of Control Offer as described under "*Change of Control and Portability*" below and any "Asset Disposition Offer" as described under "*Limitation on Asset Sales*" starting on page 80 below) in which holders of not less than 90% of the aggregate principal amount of the then outstanding notes of any particular series have validly tendered their notes. Assuming the 90% minimum tender threshold has been met, this feature allows the Issuer to redeem all remaining notes (i.e. "drag along" the minority of holders that have not tendered their notes) at a price equal to the price paid to each other holder in the relevant tender offer, typically by not less than 10 nor more than 60 days' notice, given not more than 30 days following the expiration date of the relevant tender offer.

CHANGE OF CONTROL AND PORTABILITY

The Change of Control covenant protects bondholders from fundamental changes in the ownership structure of the Issuer and any resultant changes in how the Issuer may conduct its business. Investors have traditionally insisted on a "change of control put option", because the presence (or absence) of any controlling shareholders and their identity (and track record/ reputation) may be a significant factor in the investors' overall investment decision. This can be particularly true for portfolio companies of well-known private equity sponsors that may be repeat players in the high yield or wider leveraged finance markets. In addition, a "committed"/"stable" shareholder (group) and/or the continuing, active involvement of one or more "founders", are often presented prominently as a key "strength" for many other closely-held (e.g. family-owned) companies.

Upon the occurrence of any of a series of specified Change of Control events, the Issuer is therefore typically required to make an offer to bondholders (a "**Change of Control Offer**") to repurchase the bonds at a specific percentage (typically 101%) of their principal amount.

The definition of "**Change of Control**" (i.e. the specific list of events that will constitute a Change of Control) can be heavily negotiated between the Issuer and the Initial Purchasers (especially where an IPO or partial sale of the Issuer prior to the scheduled maturity event are viewed as a realistic scenario), but will ordinarily include:

- the acquisition by a person or group of persons (other than "**Permitted Holders**") of more than a specified percentage of the Issuer's voting capital (which percentage may be significantly below 50% once the Issuer has become a public company);
- a change in the majority of the board of directors of the Issuer, unless approved by the outgoing directors; and
- certain dispositions of all or substantially all of the assets of the Issuer and its Restricted Subsidiaries.

While the identity of the Issuer's (controlling) shareholders may be an important factor for certain investors in their investment decision, the Change of Control covenant can, under certain circumstances, severely limit the ability of the Issuer and its owners, as applicable, to sell all or part of the Issuer, to raise additional equity from new investors (either to fund potential expansion projects or to support the Issuer during a period of economic hardship) or to engage in a strategic merger, to name just a few examples of transactions that could potentially result in a Change of Control. Of course, bondholders are far more likely to exercise their right to sell their bonds back to an Issuer in connection with a Change of Control Offer if the secondary market price of the bonds is below the mandatory (101%) redemption price payable by the Issuer in the Change of Control Offer, for example, because of a deterioration in the business and credit quality of the Issuer or because of a general increase in market interest rates. To be able to complete a potential Change of Control transaction under such circumstances, the Issuer would have to be prepared to potentially refinance all its outstanding bonds, either with the proceeds of a new bond offering or other debt or equity. This will not only potentially involve significant time, effort and expense for completing the necessary fundraising, but also refinancing the bonds at then prevailing (higher) market rates, i.e. if debt financing is available at such time at all.

The desire for "**portability**" of a bond (i.e. the ability to transfer control of the Issuer to new owners without the requirement to make a Change of Control Offer) can therefore be a key commercial point for many issuers and their owners. This may be particularly the case for private equity sponsors, who are in the business of buying and selling companies. As a result, there has been a growing trend in European high yield terms in recent years to include additional conditions (so-called "**Double-Triggers**") for when a Change of Control event triggers the requirement to make a Change of Control Offer, thereby providing Issuers and their owners greater flexibility to engage in certain Change of Control transactions / exit their investments.

These Double Triggers typically take the form of either (i) a condition that a Change of Control also results in a ratings decline or ratings withdrawal within a specified period following the Change of Control (so-called "**Ratings Decline Double Trigger**") or (ii) a condition that the Issuer also fails to meet a specified leverage test (so-called "**Leverage-Based Portability**"), both immediately prior to the relevant Change of Control event and immediately thereafter and giving *pro forma* effect thereto. From a drafting perspective, the relevant Double Trigger is often built into the definition of "**Specified Change of Control Event**" (or similar term) which is deemed not to constitute a "Change of Control", or the requirement for the Issuer to make a Change of Control Offer is tied to the occurrence of a "**Change of Control Triggering Event**", "**Put Event**" or similarly defined event, which also requires (i) in case of Leverage-Based Portability, the Issuer to fail the relevant leverage test or (ii) in case of a Ratings Decline Double Trigger, the occurrence of a separate "Ratings Event" or "Ratings Decline" as a result of and/or within a specified period after the occurrence of a Change of Control. Specific negotiating points in case of a Ratings Decline Double Trigger include (i) whether the relevant rating agencies need to expressly cite the relevant Change of Control as a reason for a (proposed) downgrade of the issuer and/or whether the relevant Double Trigger also gets triggered even if the rating agencies expressly cite a different reason, (ii) whether a downgrade by a single rating agency is sufficient or whether both rating agencies (in case there are ratings by more than one rating agency outstanding) need to downgrade the bonds, and (iii) during which time period following a Change of Control a downgrade must occur.

Originally fairly rare and almost exclusively limited to "sponsor deals", Double Triggers have been consistently included in a very significant minority (i.e. up to around 40%) of European high yield bond issuances in recent years, including in non-sponsor / corporate transactions. In almost all such transactions, the relevant bonds will be "**portable for life**". In contrast, when portability first appeared in European high yield bonds, it was typically limited to, for example, the initial 1-2 years post-issuance, and possibly included in anticipation of a very specific proposed change of control transaction. In addition, the relevant bond terms typically do not impose any further specific conditions, for example, with regard to the identity of the new owners / transferees or with regard to the capital structure of the Issuer following the Specified Change of Control Event or Change of Control Triggering Event, as applicable. Subject to the relevant leverage test or the non-occurrence of a relevant ratings decline, as applicable, this means that the Issuer and/or its owners may typically engage in a Change of Control transaction at any time during the lifetime of the bonds without being required to make a Change of Control Offer.

On the other hand, the vast majority of bond terms that do include Leverage-Based Portability typically permit only a single Specified Change of Control Event (i.e. Leveraged-Based Portability is typically "**one-time only**", rather than re-usable), so that any subsequent/ further Change of Control transactions would require a Change of Control Offer, irrespective of the leverage of the Issuer at that time. Historically, for many bonds that provide for Leverage-Based Portability, the leverage required to achieve portability also tightened/ stepped down (e.g. by half a turn) over time (e.g. after 18 or 24 months), which made it harder for the Issuer to "earn" portability and gave the Issuer and its owners an additional incentive to reduce leverage. Flat leverage tests (i.e. **no tightening / step down**), however, appear to have become the norm, with only a very small minority of transactions still featuring a step down. There are also a very significant number of transactions where portability did not need to be "earned" at all, i.e. where the bonds appear to have been either immediately portable at issuance or where portability appears to have at least been within easy reach, based on the relevant leverage tests and the disclosed opening leverage.

The prevalence of Ratings Decline Double Triggers vs. Leverage-Based Portability appears to fluctuate significantly with prevailing market conditions, with Leverage-Based Portability traditionally viewed by many investors as more aggressive and potentially more problematic as it may allow Issuers and their owners to take various actions to artificially reduce their leverage to or below the relevant level specified in their bond terms to avoid triggering the requirement for a Change of Control Offer. In particular, without appropriate protections in the relevant bond terms, sponsors may be able to (temporarily) reduce leverage on the relevant determination date to the required level by injecting equity or subordinated shareholder debt into the Issuer, solely for the purpose of meeting the relevant leverage threshold in the definition of "Specified Change of Control Event". Rather than permanently reducing leverage, the sponsors or new owners may then be able to extract the injected cash again shortly after the relevant Change of Control event / determination date (so-called "**round-tripping**"), by making "Restricted Payments" (e.g. in the form of a dividend payment or repayment of subordinated shareholder debt) using available capacity under the "Net Income Basket" / "Build Up Basket" or other (standard) baskets in the Restricted Payment covenant, such as the basket permitting certain Restricted Payments made out of the proceeds of a "substantially concurrent" equity contribution or subordinated shareholder debt, a leverage-based Permitted Restricted Payment basket or even a "general" Restricted Payment basket or basket for "Permitted Investments". See also "*Limitation on Restricted Payments*" starting on page 62 below.

Concerns about potential round-tripping are particularly valid where the definition of Specified Change of Control Event relies on a net leverage test. In such cases, there will not even be a need for the Issuer to use any newly injected cash to actually repay any Indebtedness. However, even if the definition of Specified Change of Control Event relies on a gross leverage test, so that the injected cash will actually have to be used to repay outstanding Indebtedness to reduce the relevant leverage ratio, the Issuer may be able to simply use the newly injected cash to temporarily repay and subsequently re-borrow amounts outstanding under an existing (revolving) credit facility.

One common (at least historically) form of protection against round-tripping is to simply reset the Build Up Basket to zero upon the occurrence of a Change of Control or at least upon the occurrence of a Specified Change of Control Event. See also *"The Net Income Basket / Build Up Basket Exemption*" starting on page 66 below). However, this form of round-tripping protection appears to have become less common and would also not prevent round-tripping through the use of any of the other Permitted Restricted Payment baskets described on pages 70-72 below, in particular the basket permitting Restricted Payments made out of the proceeds of a "substantially concurrent" equity contribution or subordinated shareholder debt. State-of-the-art round-tripping protection therefore prevents round-tripping via either the Build Up Basket or the "substantially concurrent" Permitted Restricted Payment basket. Under this alternative approach, "**Excluded Amounts**" are carved out / excluded from both baskets to the extent (i) such amounts were received in contemplation of, or in connection with, an event that would otherwise constitute a Change of Control, (ii) the purpose of, or the effect of, the receipt of such amounts was to reduce the relevant leverage ratio so that the Change of Control would qualify as a Specified Change of Control Event, and (iii) no Change of Control Offer is made in connection with the Change of Control. However, market practice is far from uniform on this point.

To the extent the Issuer and the Initial Purchasers agree that the terms of a particular bond should include Leverage-Based Portability, one potentially very important question (that may nevertheless be overlooked) is the determination date on which the relevant leverage ratio must be calculated for the purpose of determining whether or not the Issuer will be required to conduct a Change of Control Offer. This is because there may be a significant time-lag between the date an Issuer or its owners may be contractually committed to a proposed Change of Control transaction and the date on which all closing conditions (e.g. competition and other regulatory approvals or any required third-party consents) are satisfied and the Change of Control transaction is actually completed. The Issuer and its current and future owners, of course, would prefer certainty about the status of the bonds (i.e. whether they must conduct a Change of Control Offer, put sufficient committed (bridge) financing in place to fund potential redemptions in connection with a Change of Control Offer and/or potentially fully refinance the bonds) on the date on which definitive agreements with regard to the proposed Change of Control event are entered into. In up to half of those HY bond transactions that feature Leveraged-Based Portability, Change of Control transactions are therefore now also covered by the scope of the "Limited Condition Acquisitions" financial calculation provision, either expressly or by way of broad drafting. This allows the Issuer, at the Issuer's option, to calculate the relevant leverage ratio for the purpose of determining portability on the date of entry into the relevant definitive agreements in relation to a proposed Change of Control, rather than on the (potentially much later) date of the actual Change of Control. See also the discussions in relation to "*Limited Condition Acquisitions / Transactions*" under "*Financial Calculations – At what time and how exactly will financial ratios or thresholds be tested?*" on page 35 above.

"Disguised Portability"

No discussion of portability in high yield bonds would be complete without at least touching on what is sometimes referred to as "disguised portability". As the term already implies, rather than an open "feature" of a particular covenant package, disguised portability (if present in a particular covenant package) can be a stark reminder that it is crucial to also review and analyze all relevant defined terms to fully appreciate the exact scope of the limitations (or not) imposed by a particular covenant. Disguised portability is typically "hidden" in the definitions of "Change of Control", "control", "Beneficial Owner", "Permitted Holder" or related definitions. It can be the result of deliberate drafting, but can also be the result of simple drafting errors or oversights, especially in the context of repeat issuances by an Issuer where, for example, holding structures or the ultimate ownership structure may have changed over time or bonds may have been issued at different levels of the capital structure, in each case without those changes getting properly reflected in the drafting of the relevant defined terms. Examples of disguised portability include (i) examples where (mere) intermediate holding companies are either included in the definition of "Permitted Holder" and/or where the definition of "Change of Control" does not look through the relevant intermediate holding companies to the ultimate beneficial owners, which ultimately allows a complete change of the ultimate beneficial ownership of an Issuer, as long as the Issuer remains legally owned, directly or indirectly, by the relevant intermediate holding company and (ii) in the case of multiple original owners, where the definition of "Permitted Holder" may include even small initial minority shareholders (and their affiliates) which would later allow those initial minority shareholders or their affiliates to take control (or even become the sole owners) of the Issuer without any such change constituting a "Change of Control" for the purposes of the relevant covenant package.

Although not normally discussed in the context of "disguised portability", certain increasingly common features of the definition of "Consolidated EBITDA" can also make portability easier to achieve, for example, where the relevant definition allows the Issuer to make certain *pro forma* adjustments to Consolidated EBITDA to reflect cost-savings and synergies "expected (in good faith) to be achieved" from certain operational changes, business optimization programs or even "other initiatives" proposed to be implemented by the prospective new owners of the Issuer. See also "*Consolidated EBITDA*" starting on page 31 above.

Of course, many acquirers may actually want to actively redeem outstanding bonds of an Issuer they are acquiring, so may be more focused on the optional redemption features / call protection of any outstanding bonds, rather than on whether or not they may be required to conduct a Change of Control Offer. See also "*Tenor, Call Protection and Redemption*" starting on page 40 above. This may be because the new owner(s) may simply be able to access cheaper financing and/or because the Issuer's existing covenant package may prevent the new owner(s) from implementing their strategic plans with regard to the Issuer and/or be inconsistent with or inference with other financings of the new owner(s). In those cases, the Issuer and/or its new owner(s) may benefit from the increasingly popular drag-along feature which gives the Issuer or its new owner(s) the option to redeem any remaining bonds not tendered in a Change of Control Offer or other tender offer, assuming the relevant minimum tender threshold (typically 90%) is met. See also "*Optional Redemption upon Certain Tender Offers; Drag-Along Right*" on page 46 above.

LIMITATION ON INDEBTEDNESS

The purpose of the Limitation on Indebtedness covenant is to (i) limit the amount of incremental Indebtedness that may be incurred by the Restricted Group unless cash flow is sufficient to service all Indebtedness and (ii) control structural subordination by specifying which entities within the Restricted Group may incur any such incremental Indebtedness. See also "*Structural Subordination*" on page 6 above. The traditional high yield Limitation on Indebtedness covenant includes a general prohibition on the incurrence of Indebtedness unless (i) certain ratio tests are satisfied (so-called "**Ratio Debt**") or (ii) irrespective of any relevant ratio levels at the time of incurrence, the proposed debt incurrence is permitted pursuant to one or more baskets / exemptions from such general prohibition (so-called "**Permitted Debt**"). See also "*How do baskets work*?" starting on page 29 above and "*Financial Calculations – At what time and how exactly will financial ratios or thresholds be tested*?" starting on page 35 above for certain general trends affecting baskets and ratio calculations. For investors, the "day one" leveraging headroom under the Limitation on Indebtedness covenant (i.e. the quantifiable day one capacity of the Issuer to incur incremental Indebtedness either as Ratio Debt, based on the disclosed opening leverage, or as Permitted Debt), will be a key factor in their credit analysis / investment decision with regard to a particular bond.

"**Indebtedness**" is generally defined broadly to include not only indebtedness for borrowed money, bonds, debentures, notes or other similar instruments, but also guarantees, letters of credit, capital lease obligations, hedging obligations, disqualified stock of the Issuer, preferred stock of Restricted Subsidiaries, certain obligations to pay the deferred (for more than a specified maximum period) and unpaid purchase price of property (other than ordinary course trade payables) and even indebtedness of third parties that is secured by liens on any assets of the Issuer or any Restricted Subsidiary.

Practice Note: To avoid structural subordination of the bonds, frequently only the Issuer and those Restricted Subsidiaries that are also Guarantors of the bonds, rather than any Restricted Subsidiaries, will be permitted to incur Ratio Debt and/or the various items of Permitted Debt. At a minimum, most Limitation on Indebtedness covenants will at least impose a cap on the amount of Indebtedness permitted to be incurred by non-Guarantor Restricted Subsidiaries. If non-Guarantor Indebtedness was permitted at all, these caps historically tended to take the form of hard caps.

In recent years, however, there has been an increasing number of covenant packages under which non-Guarantors are permitted to incur Indebtedness under an ever increasing number of Permitted Debt baskets and even in the form of Ratio Debt, in some cases only subject to soft caps or even no caps at all on the amount of any such (structurally senior) non-Guarantor Indebtedness.

The "Ratio Debt" Exemption

Almost all Limitation on Indebtedness covenants of European high yield bonds, including both secured and unsecured bonds, use a "Fixed Charge Coverage Ratio" test to limit the capacity of the Issuer to incur an otherwise theoretically unlimited amount of incremental Ratio Debt. Leverage ratio tests (i.e. tests that reference a ratio of debt to EBITDA) either as the primary test or as an additional / supplemental test to determine capacity to incur even unsecured additional Ratio Debt are far less common in European high yield bonds, but may be particularly appropriate for Issuers in capital intensive industries such as telecommunications, cable or media. But see also "*Senior Secured Notes, Secured Leverage Ratio Test and Collateral Dilution*" starting on page 55 below, with regard to the additional leverage ratio tests that will normally apply if the Issuer wishes to incur incremental secured Ratio Debt.

Real Estate High Yield Bonds

Another industry-specific exception from the general rule that unsecured Ratio Debt capacity in European high yield bonds is typically determined solely based on a Fixed Charge Coverage Ratio test, are high yield bonds issued by real estate companies. Only a relatively recent phenomenon, there are now a number of precedents for high yield bonds issued by European real estate companies which apply an additional "**(Net) Total Loan-to-Value (LTV)**" ratio test, possibly even with a step-down of the relevant LTV level, to determine the capacity to incur any form (secured or unsecured) of Ratio Debt. In case the Issuer wishes to incur incremental (senior) secured Ratio Debt, lower (secured) LTV levels may be required to be met.

The reason for the use of these LTV tests to determine Ratio Debt capacity under high yield bonds issued by real estate companies are that LTV ratios will also be used in the traditional real estate financings of the relevant issuers that will, possibly to a significant extent, co-exist with the relevant high yield bonds. In addition, traditional real estate investors, which will likely be an important target investor group for the relevant high yield bonds, will rely on the relevant LTV ratios for their own credit analysis / investment decisions with regard to the relevant bonds. With most traditional "corporate" issuers, there will at most be a loose correlation, and possibly no correlation, between the cash generation and debt service capacity of a particular business and the balance sheet value of their assets. However, at least traditional real estate holding companies (rather than, for example, real estate developers, real estate management companies, ….) may, in many respects, have features similar to financial services / asset management companies, with their debt service capacity and (liquidation) value closely tracking the sum of the (market) values of the individual properties they own. The value of those individual properties, in turn, will largely depend on market interest rates and any excess rental payments each individual property is expected to be able to generate, after taking into account the tenor of existing rental agreements and the credit quality of existing tenants and after deducting the interest payments on any amounts of (secured) debt raised to acquire it as well as other running costs directly related to operating and maintaining the particular property. Most high yield bonds issued by real estate companies are also typically holding company financings that may rank both structurally and effectively junior to significant amounts of secured (mortgage) debt incurred at various property companies further down the corporate structure.

Under the Limitation on Indebtedness covenant, the Issuer and its Restricted Subsidiaries (or most often, only those Restricted Subsidiaries that also are Guarantors) will only be permitted to incur any Ratio Debt so long as the Fixed Charge Coverage Ratio is at least equal to a specified ratio level on a *pro forma* basis after giving effect to the proposed debt incurrence and the application of the proceeds thereof.

The "**Fixed Charge Coverage Ratio**" serves as an indication of the capacity of the Restricted Group to generate sufficient amounts of cash on an ongoing basis to service its fixed obligations, such as regular interest payment obligations under its outstanding Indebtedness, and it is typically calculated as of any relevant determination date by dividing (i) Consolidated EBITDA of the Restricted Group for the immediately preceding four quarters for which financial statements are available by (ii) the sum of the Fixed Charges of the Restricted Group for the same period and, in each case, by giving *pro forma* effect to the incurrence of Indebtedness proposed to be incurred on the determination date, the incurrence and retirement of other Indebtedness since the beginning of the relevant four-quarter period until the determination date as well as acquisitions and dispositions during the same period. For a discussion of "Consolidated EBITDA", see "*Consolidated EBITDA*" starting on page 31 above. "**Fixed Charges**" primarily include (i) interest expense (cash and non-cash), (ii) amortization of debt issuance costs and original interest discount, (iii) the interest component of capital leases (to the extent such concept still exists under applicable GAAP), (iv) dividends on preferred stock and (iv) net payments under hedging obligations. It may also include, for certain types of businesses, other charges or expenses. For example, for retail businesses, Fixed Charges could also include rental expenses. In any case, it is critical for the Issuer, its senior management and accounting staff as well as its legal advisers to carefully review all relevant definitions.

In European high yield bond transactions, however, the Fixed Charge Coverage Ratio required to be met for the incurrence of Ratio Debt has not normally been subject to much (if any) negotiation between the Issuer and the Initial Purchasers. Instead, it is most commonly set at 2.00 to 1.00 or sometimes at 2.50 to 1.00. In an overall market environment characterized by historically low and seemingly perpetually falling interest rates in recent years (and certainly ever since the European high yield market really took off in the aftermath of the global financial crisis of 2007-2008), agreeing to a "market" Fixed Charge Coverage Ratio level of 2.00 to 1.00 (or even 2.50 to 1.00) will not have seemed like much of a concession to most issuers as it would still leave them with ample initial headroom. Initial Purchasers and investors, on the other hand, were already fighting (and loosing) other seemingly more important battles with regard to increasingly issuer-friendly covenant packages. However, the recent jump in credit spreads and overall interest rate levels triggered by the Covid-19 pandemic, if sustained, may mean that the Fixed Charge Coverage Ratio will automatically become a much more meaningful limitation on the capacity of certain Issuers to incur incremental Ratio Debt, as interest payments under their credit facilities and other floating rate instruments increase and they may be forced to refinance maturing bonds with new bonds at higher fixed interest rates. For some issuers, this potentially very significant increase in "Fixed Charges" (see below) will coincide with a potentially dramatic collapse of Consolidated EBITDA. As discussed under "*The Net Income Basket/Build Up Basket Exemption*" starting on page 66 below, failure to meet the relevant Fixed Rate Coverage Ratio test will even impact the Issuer's ability to make certain Restricted Payments. However, whether these developments will have an impact on the Fixed Charge Coverage Ratio levels in new bond offerings remains to be seen. It is worth noting that, other than the Fixed Charge Coverage Ratio level, any LTV or (secured) leverage ratio levels used in the Limitation on Indebtedness covenant (see above and below) typically are heavily negotiated and, among other things, will depend on the relevant "opening" LTV/leverage ratio and the Issuer's strategic plans.

In a related development, a number of (distressed) high yield bond issuers in the US have recently issued bonds that include a strict temporary moratorium on the ability of the Issuer to incur any Ratio Debt and certain types of Permitted Debt, in particular Acquired Indebtedness. Given that the purpose of the related offerings would typically have been to provide emergency cash injections at a time of significant uncertainty about the exact impact of the Covid-19 pandemic on the businesses of the relevant Issuers, it may well have made sense to impose a temporary moratorium on the incurrence of incremental (potentially collateral dilutive) Indebtedness, possibly for a full twelve-month period or even just until publication the Issuer's financial statements for the second or third financial quarter of 2020. This will have ensured that the impact of the Covid-19 pandemic on the relevant Issuer's results of operation and financial condition will have become better known and, importantly, will also be reflected in the Consolidated EBITDA used to determine Ratio Debt capacity. Presumably, at the time of the relevant offerings, the relevant Issuers would have been able to reassure their investors that the additional liquidity raised in the relevant offerings was sufficient to cover the expended short- to mid-term liquidity needs. The temporary moratoria would have protected investors from further near-term offerings of potentially significant amounts of incremental Ratio Debt (based on historic/LTM Consolidated EBITDA which would not have reflected the impact of the Covid-19 pandemic at all), which Ratio Debt might then be issued with higher coupons, might significantly increase the relevant Issuers' leverage and potentially significantly dilute the investors' collateral. As with other recent developments in the US high yield market, it remains to be seen whether similar provisions will also appear in European high yield bond transactions.

Senior Secured Notes, Secured Leverage Ratio Test and Collateral Dilution

In addition to using the Fixed Charge Coverage Ratio test as the primary test to determine whether the Issuer is permitted to incur additional (unsecured) Indebtedness, the Limitation on Indebtedness covenants of a (very significant) majority of senior secured high yield bonds in Europe also contain some form of secured leverage ratio test (i.e. use some form of ratio of (secured) Indebtedness to Consolidated EBITDA) to determine whether the Issuer may incur incremental secured Ratio Debt. At least in theory, because any unsecured Indebtedness would effectively be subordinated to the senior secured bonds (and any other senior secured Indebtedness of the Issuer), at least with regard to the relevant collateral, raising any such incremental unsecured Indebtedness should be more (possibly prohibitively) expensive and may therefore be impractical, even if technically permitted under the Ratio Debt Exemption. The level of effective subordination of any unsecured Indebtedness, and therefore the price and ease at which the Issuer may be able to raise any such unsecured Indebtedness, however, will depend both on the amount of senior secured Indebtedness and on the nature of the collateral package that secures any such secured Indebtedness, including any senior secured bonds. As described in the "*Practice Note*" under "*Limitation on Liens*" on page 74 below, there has been a trend towards ever less comprehensive collateral packages for "senior secured" bonds in recent years. That trend, combined with the trend towards weakening protection against the incurrence of structurally senior Indebtedness, as described in the "*Practice Note*" under "*Limitation on Indebtedness*" on page 52 above, can raise serious questions as to the (potentially very limited) extent to which purportedly "senior secured" notes are, in fact, either structurally senior (i.e. they may actually be junior) or effectively senior (i.e. the relevant collateral may only constitute a small fraction of the assets of the Issuer) to any potential unsecured Indebtedness of the Issuer.

In any case, for many of the relevant Issuers, the relevant secured leverage ratio test (rather than the Fixed Charge Coverage Ratio test) has historically determined the true/practical limit of their ability to incur incremental Ratio Debt at commercially acceptable terms. This is particularly true if the Issuer proposes to incur incremental senior secured Indebtedness as Ratio Debt that is intended to rank *pari passu* with its existing senior secured Indebtedness, would benefit from "Permitted Collateral Liens" over the same collateral and would therefore be "collateral dilutive" to the existing senior secured Indebtedness (including the existing senior secured bonds) of the Issuer. In fact, the ability of the Issuer to incur incremental secured Ratio Debt and the ability to generally incur incremental collateral dilutive secured Indebtedness are inextricably linked as the definition of "Permitted Collateral Liens" typically includes any Liens securing Ratio Debt. See also "–Limitation on Liens - Permitted Collateral Liens" below.

While the majority of senior secured high yield bonds in Europe do feature a secured leverage ratio test to determine the ability to incur incremental, secured / collateral dilutive Ratio Debt, the level at which the relevant ratio is set can vary widely. The level at which the relevant ratios will be set in a particular covenant package will be negotiated between the Issuer and the Initial Purchasers and will depend on a number of factors, such as on the opening leverage of the relevant Issuer, prevailing market conditions, input from investors as well as any relevant requirements of the rating agencies. A secured leverage ratio test set at 4.0x or higher may be considered more "aggressive" by some and may be indicative of a sponsor deal.

How exactly the relevant secured leverage ratio is to be calculated, however, is potentially much more important than the more superficial question of the level at which it is ostensibly set. In its most conservative / traditional form, the secured leverage ratio would be calculated as the ratio of (i) the consolidated (gross) Indebtedness of the Issuer and its Restricted Subsidiaries that is secured by Liens (including "effectively senior" Indebtedness secured with Liens over assets that are not part of the collateral for the senior secured bonds) as of the end of the most recent quarter for which financial statements are available to (ii) the Issuer's Consolidated EBITDA for the immediately preceding four quarters for which financial statements are available. In some definitions, the numerator of the ratio may even contain any Indebtedness (including unsecured Indebtedness) of non-Guarantor Restricted Subsidiaries, as such Indebtedness would be "structurally senior" to the senior secured bonds. In such a "comprehensive" definition, the numerator of the secured leverage ratio would capture all Indebtedness of the Restricted Group that would potentially compete with (i.e. would be collateral dilutive or effectively or structurally senior to) the senior secured bonds in a potential insolvency of the Issuer. In recent year, however, there have been an increasing number of departures from this conservative benchmark. In particular, the terms of most senior secured bonds do not include the (structurally senior) debt of non-Guarantor Restricted Subsidiaries in the numerator of the secured leverage ratio definition, although the terms of the relevant bonds may generally prohibit (or at least limit) the incurrence of incremental Indebtedness by non-Guarantor Restricted Subsidiaries and there may not be any existing Indebtedness of non-Guarantor Subsidiaries. More importantly, the terms of a significant percentage of senior secured notes only include Indebtedness in the numerator of the ratio which is secured on a (*pari passu* / senior) first lien basis on the collateral that also secures the senior secured notes, but not any other (secured) Indebtedness that may be effectively or structurally senior. There are even examples of transactions that simply exclude (seemingly arbitrarily) certain items of Indebtedness from the numerator of the ratio formula, such as Indebtedness incurred pursuant to the Credit Facilities Basket. Finally, the terms of a very significant minority of senior secured notes use a net leverage ratio test where the numerator of the ratio is calculated net of (uncapped) cash and cash equivalents.

Even more important than the formula by which the numerator for the relevant secured leverage ratios are to be calculated in any particular covenant package, is the definition of "Consolidated EBITDA", which is used as the denominator in determining the relevant secured leverage ratios. As described under "*Consolidated EBITDA*" starting on page 31 above, the definition of "Consolidated EBITDA" (and related definitions) used in high yield bond covenant packages are typically complex, sometimes highly-negotiated and often feature extensive add-backs and adjustments uniquely tailored to the Issuer's business, industry, strategy and/or accounting practices.

Historically, Issuers did no typically have (much) "day one" capacity to incur incremental (secured) Ratio Debt, i.e. the relevant (leverage) ratio levels would typically be set at issuance so that the Issuer would either have to (i) "earn" any incremental Ratio Debt capacity (e.g. by deleveraging first through growing Consolidated EBITDA) or (ii) rely on other exemptions (i.e. one or more "Permitted Debt" exemptions) to incur incremental (secured) Indebtedness. In recent years, however, an increasing number of covenant packages appear to have given Issuers immediate (or at least very near term) capacity to incur incremental (secured) Ratio Debt from the outset, based on the opening leverage ratios disclosed in the relevant offering memoranda.

Because the Limitation on Indebtedness covenant, like most high yield covenants, is an "incurrence" covenant, it only tests the ratio at the time the Issuer or a Restricted Subsidiary proposes to incur any Indebtedness. Once properly incurred, any relevant Ratio Debt outstanding will continue to be permitted even if the Issuer's subsequent financial performance would have prevented the Issuer from incurring any such Ratio Debt at a later point in time.

The "Permitted Debt" Exemptions

In addition to Ratio Debt, the Limitation on Indebtedness covenant will also permit the incurrence of numerous categories / baskets of "Permitted Debt", regardless of the Restricted Group's financial performance or condition and without the Issuer having to meet the relevant Ratio Debt test(s) described above. Historically, most Limitation on Indebtedness covenants limited the ability to incur Indebtedness under the various Permitted Debt baskets to the Issuer and any Guarantors of the bonds or at least imposed a cap on the amount of Indebtedness permitted to be incurred by non-Guarantor Restricted Subsidiaries. However, see the "*Practice Note*" on page 52 above with regard to the increasing number of covenant packages in recent years under which non-Guarantors are permitted to incur Indebtedness under an ever increasing number of Permitted Debt baskets or even Ratio Debt.

The specific categories of Indebtedness covered by the various Permitted Debt exemptions will be negotiated between the Issuer and the Initial Purchasers. However, common Permitted Debt baskets include, but are not limited to:

- Indebtedness of the Issuer or any Guarantor incurred pursuant to and in compliance with a Credit Facility (so-called "**Credit Facilities Basket**");

> *Practice Note:* Historically, the Credit Facilities Basket was usually hard-capped at a fixed amount. However, see "*How do baskets work?*" starting on page 29 above for how soft caps / grower baskets have become the norm, as well as other general basket trends. In addition, capacity under the Credit Facilities Basket was frequently reduced to the extent any net proceeds of asset sales are used to permanently repay debt under a relevant Credit Facility pursuant to the Limitation on Asset Sales covenant (so-called "**Asset Sale Ratchet**"), a feature which has now become fairly rare. As in the case of the Ratio Debt exemption, it is a negotiated point whether the Issuer and all Restricted Subsidiaries, or only the Issuer and its Guarantors, may incur indebtedness under the Credit Facilities Basket. "**Credit Facility**" is typically defined

> very broadly to essentially include any type of Indebtedness, including even debt securities such as high yield bonds. On the other hand, in many structures, the Credit Facilities Basket is essentially meant to reserve capacity (and sized accordingly) for debt incurrence / drawings under the Restricted Group's (super) senior revolving credit facility, even (and especially) during periods of low EBITDA and high leverage, i.e. when the Issuer and its Restricted Subsidiaries may need to rely on drawings under their revolving credit facility (rather than operating cash flow) more heavily to fund working capital requirements, and Ratio Debt capacity may be unavailable. Both Issuer's and rating agencies therefore frequently reserve / block at least a portion of the Credit Facilities Basket for potential future RCF drawings, even though the definition of "Credit Facility" will invariably permit a broader use. See also "*Super Priority* Debt" on page 76 below on how most covenant packages will allow Indebtedness incurred pursuant to the Credit Facilities Basket to be secured with "Permitted Collateral Liens", possibly on a super priority basis.

- Intra-Group Indebtedness between and among the Issuer and its Restricted Subsidiaries, subject to certain conditions to mitigate potential structural subordination if the Issuer or any Guarantor is the obligor of any such indebtedness and the payee is not the Issuer or a Guarantor;
- Permitted Refinancing Indebtedness (i.e., certain indebtedness incurred to refinance Ratio Debt or indebtedness incurred under certain specified Permitted Debt baskets, such as the baskets that cover the various items of existing Indebtedness outstanding as of the issue date of the bonds or any Acquired Indebtedness);

> *Practice Note:* To protect the position of the high yield bonds within the overall capital structure of the Issuer, the "**Permitted Refinancing Indebtedness**" definition will typically impose a number of conditions with regard to the amount, maturity, amortization schedule, obligors, any collateral and the ranking of the refinancing indebtedness. The Issuer will therefore not be able to rely on the Permitted Refinancing Indebtedness basket, to give an extreme example, to replace subordinated and unsecured debt of the Issuer or a Guarantor with a maturity date after the maturity date of the bonds with a larger amount of senior secured indebtedness of a non-guarantor Restricted Subsidiary that matures before the maturity date of the bonds.

- Indebtedness existing on the issue date of the bonds which is not otherwise included within any other Permitted Debt exemption;

> *Practice Note:* This exemption frequently excludes Indebtedness outstanding on the issue date under the Issuer's revolving credit facility and/or generally Indebtedness that is permitted by the Credit Facilities Basket or other identified Permitted Debt exemptions so as to prevent the Issuer from freeing up capacity under such other baskets by re-designating the relevant Indebtedness as "Indebtedness existing on the issue date".

- Indebtedness represented by the bonds issued on the issue date and any related guarantees;
- Indebtedness under hedging obligations incurred in the ordinary course of business and not for speculative purposes (the "**Hedging Obligations Basket**");
- Indebtedness represented by "Capitalized Lease Obligations" or "Purchase Money Obligations" or other Indebtedness incurred or assumed in connection with the acquisition or development of certain property or assets, in each case subject to certain conditions and either a hard cap or, more and more frequently, a soft cap (the "**Capitalized Lease Obligations/Purchase Money Obligations Basket**");
- Indebtedness of a Restricted Subsidiary incurred and outstanding on the date on which such Restricted Subsidiary was acquired by, or merged into, the Issuer or any Restricted Subsidiary, other than indebtedness incurred in connection with, or in contemplation of the relevant acquisition (so-called "**Acquired Indebtedness**"), provided that at the time such Restricted Subsidiary is acquired by the Issuer or another Restricted Subsidiary, the Issuer would have been able to incur at least €1.00 of additional (unsecured) Ratio Debt after giving *pro forma* effect to the incurrence of the Acquired Indebtedness (the **"€1.00 of Additional Ratio Debt Test**");

> *Practice Note:* As a more Issuer-friendly alternative to the €1.00 of Additional Ratio Debt Test, Issuers are now frequently able to negotiate that Acquired Indebtedness will also be permitted to be incurred as long as the Fixed Charge Coverage Ratio of the Issuer would not be less than it was immediately prior to the relevant acquisition or transactions, again after giving *pro forma* effect to the incurrence of the Acquired Indebtedness.
>
> As part of a more recent trend, certain, mostly sponsor-led transactions also featured (i) true baskets for Acquired Indebtedness with either a fixed amount or even soft capped "freebie" amount of Acquired Indebtedness, irrespective of whether or not the €1.00 of Additional Ratio Debt Test (or other relevant ratio test) is met and/or (ii) cherry-picking between either the Fixed Charge Coverage Ratio of the Issuer not being lower or relevant leverage ratios of the Issuer not being higher than immediately prior to the relevant acquisition, merger, amalgamation or consolidation.

- Certain categories of ordinary course Indebtedness, such as letters of credit, self insurance obligations, workers' compensation claims, performance, surety, appeal or similar bonds, customs, VAT or tax guarantees or the financing of insurance premiums;
- Indebtedness incurred in certain "**Qualified Securitization Financings**", which will be defined to include, for example, customary (limited-recourse) factoring or ABS programs under standard market terms and documentation;
- Indebtedness in respect of guarantees of Indebtedness of joint ventures in which the Issuer or any Restricted Subsidiary has an interest, subject to a cap; and
- a "**General Debt Basket**" permitting the Issuer and its Restricted Subsidiaries to incur any kind of Indebtedness for any purpose, subject to a either a hard cap or soft cap.

Practice Note: As with most baskets, the specific size of the General Debt Basket will need to be negotiated between the Issuer and the Initial Purchasers. Historically, the General Debt Basket was typically hard-capped, but it has become more common for Issuers to be able to successfully negotiate for a soft cap / grower element. While the General Debt Basket is typically available to the Issuer and all its Restricted Subsidiaries (i.e. not just Guarantors), it is common for the General Debt Basket to separately cap the amount of indebtedness that may be incurred by non-guarantor Restricted Subsidiaries under this basket at an amount below the total basket size.

While many of these Permitted Debt baskets are "standard" in the European market, the exact scope and size of each basket can vary significantly. As with any other covenant, it is therefore critical for the Issuer and its senior management to be fully engaged in the negotiations of the various baskets to ensure the various baskets are sufficiently tailored to accommodate the Issuer's specific business, strategic plans and any particular industry practices. If relevant to the particular Issuer and its industry and consistent with the Issuer's business and strategy as described elsewhere in the offering memorandum, this may not only include unusually large caps for particular "standard" baskets (e.g., if the Issuer's business model involves regularly entering into a large number of joint ventures), but may also involve the inclusion of additional "bespoke" baskets, for example, for (subsidized) funding provided by export credit or development agencies or other public or quasi-public entities, which may be particularly relevant for certain industry sectors, for project financings or certain local currency financings or baskets for certain expansion projects, in the case of Issuers with a stated (greenfield) growth strategy that may (temporarily) result in increased leverage and reduced Ratio Debt capacity.

Contribution Debt

A significant majority of senior secured notes issued in sponsor-led transactions in Europe also feature a Permitted Debt basket that permits the incurrence of Indebtedness of the Issuer or any Guarantor in an aggregate outstanding principal amount up to 100% (in rare cases up to 200%) of the net cash proceeds received by the Issuer from the issuance or sale of certain types of qualifying equity and/or subordinated shareholder debt (so-called "**Contribution Debt**"). The Contribution Debt basket is typically not subject to any cap or any other conditions or restrictions, except that any relevant net cash proceeds from the issuance of equity or subordinated shareholder debt should normally be excluded, where relevant, in determining available capacity to make Restricted Payments under the Limitation on Restricted Payments Covenant. See also "*Change of Control and Portability*" starting on page 46 above with regard to potential "round-tripping" and "*The Net Income Basket / Build Up Basket Exemption*" starting on page 66 below.

A vast majority of the senior secured notes that feature a Contribution Debt basket, also feature a Permitted Collateral Lien that allows the Issuer to secure any Contribution Debt on a *pari passu* basis with Liens over the collateral that secures the bonds, without any further conditions or restrictions, such as compliance with a secured leverage test. From an investors' perspective, this flexibility for the Issuer means significant (i.e. theoretically unlimited) potential for collateral dilution. See also "*Senior Secured Notes, Secured Leverage Ratio Test and Collateral Dilution*" starting on page 55 above and "*Permitted Collateral Liens*" starting on page 76 below. More aggressive versions of the Contribution Debt basket may even allow Contribution Debt to be incurred by non-Guarantor Restricted Subsidiaries, thereby potentially permitting Contribution Debt that is structurally senior to the bonds.

Classification and Reclassification – Which exemption / basket applies?

To the extent the incurrence of a specific item of Indebtedness satisfies more than one exemption or basket, the Issuer will have the right under the Limitation on Indebtedness covenant to classify the relevant item of Indebtedness, i.e. designate the specific exemption or basket under which the relevant item of Indebtedness is deemed to have been incurred.

Practice Note: It will almost always be advantageous for the Issuer to designate, to the maximum extent possible, any Indebtedness as having been incurred pursuant to the Ratio Debt exemption, as opposed to a specific Permitted Debt basket. This is because any Indebtedness incurred in reliance on a Permitted Debt basket also reduces capacity under the Ratio Debt Exemption anyway (because of the related increase in Fixed Charges and the amount of Indebtedness outstanding used in the numerator of any secured leverage ratio) as well as using up capacity under the relevant Permitted Debt basket. But see also under "*Financial Calculations – At what time and how exactly will financial ratios or thresholds be tested?*" starting on page 35 above with regard to the (now) standard clarification that allows the Issuer to exclude any Permitted Debt incurred on the same date of determination for the purposes of calculating the relevant ratios for determining any Ratio Debt capacity.

In addition, the Issuer generally may, at any time, reclassify any item of Indebtedness (other than Indebtedness incurred under the Credit Facilities Basket, as discussed in the Practice Note below) that at such time meets the requirements of one or more exemptions or baskets. In particular, if the financial performance / Consolidated EBITDA of the Issuer improves (resulting in increased capacity under the Ratio Debt exemption), the Issuer will typically be permitted to reclassify Indebtedness initially incurred under one or more Permitted Debt baskets as Ratio Debt, thereby freeing up capacity under the relevant Permitted Debt baskets, which would then be fully available again in the future, even if the financial performance of the Issuer subsequently deteriorates again. A reclassification is also advantageous in the event of a refinancing of Permitted Debt. For example, refinancing debt with Ratio Debt need not comply with the limitations required by the definition of Permitted Refinancing Debt. As already described under "*Financial Calculations – At what time and how exactly will financial ratios or thresholds be tested?*" starting on page 35 above, an increasingly popular provision in recent years provides for the automatic (rather than by conscious, albeit internal, decision of the Issuer) reclassification of certain items of Permitted Debt as Ratio Deb as soon as permissible.

Practice Note: The Limitation on Indebtedness covenant will often provide that any Indebtedness outstanding on the issue date under the Credit Facilities Basket cannot be reclassified as Ratio Debt or other Permitted Debt. The terms of some bonds further prohibit even the reclassification of any future Indebtedness incurred under the Credit Facilities Basket. Without such a limitation, the Credit Facilities Basket may be "emptied out" (i.e. "refilled") by reclassifying any Indebtedness incurred under the Issuer's Credit Facility, for example, as Ratio Debt and thus create significant additional debt incurrence capacity. As both Ratio Debt and Indebtedness incurred under the Credit Facilities Basket is typically permitted to rank *pari passu* with and be secured with Permitted Collateral Liens over the same collateral that secures the Issuer's existing senior secured indebtedness (including the senior secured bonds), the ability to reclassify Indebtedness incurred under the Credit Facilities Basket as Ratio Debt potentially significantly increases the amount of "collateral dilutive" Indebtedness the Issuer may be permitted to incur. Although a very subtle point that can often get lost in the drafting of the Limitation on Indebtedness covenant, it can therefore be a very important commercial point.

Other Covenants that Might be Relevant

In evaluating whether the Limitation on Indebtedness covenant provides sufficient flexibility for the Issuer, the Issuer and its advisers must also consider the following covenants:

- *Limitation on Liens.* The mere (abstract) ability to incur any particular item of Indebtedness under the Limitation on Indebtedness covenant may be useless in practice if the Limitation on Liens covenant does not also include either (i) a corresponding "Permitted Lien" that would allow the Issuer to secure such Indebtedness (e.g. a Purchase Money Obligation) with liens over particular (non-collateral) assets on an exclusive basis, without having to secure the bonds equally and ratably with such Lien or (ii) a "Permitted Collateral Lien" that would allow the Issuer to secure such Indebtedness equally with first-ranking liens over the same collateral as the bonds, so that it ranks *pari passu* with the bonds. In capital intensive industries, in particular, companies may rely heavily on certain secured financing arrangements with customers or suppliers in the ordinary course of business.
- *Limitation on Restrictions on Distributions from Restricted Subsidiaries.* The Limitation on Restrictions on Distributions from Restricted Subsidiaries covenant may also be relevant, since the terms of any additional Indebtedness may include contractual restrictions on dividends, asset transfers and other payments by the borrowing subsidiaries.

LIMITATION ON RESTRICTED PAYMENTS

The Limitation on Restricted Payments covenant prevents cash and assets from being transferred outside the Restricted Group (also referred to as "leakage"), subject to certain exemptions, unless the Restricted Group's positive financial performance or improved financial condition justify its ability to make such transfers. This protection is important to bondholders because it is intended to protect the Issuer's ability to repay its Indebtedness as well as to preserve the assets of the Restricted Group with a view to any potential future insolvency or bankruptcy.

The covenant can typically be divided into three main component parts: (i) the definitions of "Restricted Payment", "Investment" and "Permitted Investment", (ii) the so-called "Net Income Basket" or "Build Up Basket" exemption, and (iii) a typically fairly extensive list of specific "Permitted Restricted Payments" exemptions / baskets describing instances when certain Restricted Payments may be made even if there is no or insufficient capacity under the Net Income Basket / Build Up Basket.

Definitions of "Restricted Payments" and "Permitted Investments"

"**Restricted Payments**" are typically defined as including any of the following actions by the Restricted Group:

- the payment of cash dividends or making of other distributions of assets to shareholders, provided that dividends paid in capital stock of the Issuer (other than disqualifying stock) and dividends paid by a Restricted Subsidiary to the Issuer or another Restricted Subsidiary are excluded (i.e. are either not Restricted Payments or are otherwise permitted exemptions);
- the purchase, redemption or other acquisition for value of any capital stock of the Issuer or any parent of the Issuer held by Persons other than the Issuer or a Restricted Subsidiary;
- subject to certain exemptions, the purchase, repurchase, redemption, defeasance or other acquisition for value, prior to the scheduled maturity or scheduled repayment of any Indebtedness of the Issuer or any Guarantor that is contractually subordinated to the bonds;
- any payment on or with respect to, or to purchase, redeem, defease or otherwise acquire or retire for value any "Subordinated Shareholder Debt"; and
- the making of any "Investments" outside the Restricted Group (including, for example, in any 50/50 joint ventures), other than "Permitted Investments".

The term "**Investment** " is defined very broadly and consists generally of:

- purchases of equity or debt securities of another entity;
- capital contributions to any entity; and
- loans to or guarantees or other credit support for the benefit of any person or entity.

"**Permitted Investments**" generally include:

- Investments in the Issuer, any Restricted Subsidiary (sometimes limited to Investments in Guarantors), or any entity that becomes a Restricted Subsidiary (or Guarantor) as a result of the Investment;
- Investments in Unrestricted Subsidiaries or entities engaged in a "Related Business", such as joint ventures, subject to either a hard cap or a soft cap with a grower element, typically linked to Total Assets ("**Unrestricted Subsidiaries/Joint Venture Basket**");

- certain Investments received from a debtor in connection with certain settlement, legal, enforcements or insolvency proceedings;
- Investments existing on the issue date of the bonds or made pursuant to legally binding commitments in existence on the issue date;
- cash and certain cash equivalents;
- Investments that constitute non-cash proceeds from an asset sale permitted by the Limitation on Asset Sales covenant;
- hedging transactions entered into and guarantees provided in compliance with the Limitation on Indebtedness covenant;
- Investments acquired in connection with the acquisition of entities not prohibited by the Limitation on Merger, Consolidation and Sale of Substantially All Assets covenant, provided the relevant investments were not made in contemplation of any such acquisition;
- the acquisition of assets solely in exchange for capital stock of the Issuer (other than disqualified stock) or subordinated shareholder debt;
- certain loans or advances to directors, officers, employees or consultants of the Issuer, a Restricted Subsidiary or a parent company of the Issuer, for example, in respect of travel, entertainment or moving related expenses or to fund any such person's purchase of capital stock or subordinated shareholder debt of the Issuer or, subject to a (typically modest) hard cap, general loans and advances to such persons ("**Management Advances**");
- Investments in connection with customary cash management, cash pooling or netting or setting-off arrangements entered into the in ordinary course of business; and
- other Investments, subject to either a hard cap or a soft cap with a grower element, typically linked to Total Assets (the "**Permitted Investments General Basket**").

Investments in any person other than a member of the Restricted Group are generally treated as Restricted Payments because, like dividends or other distributions, they typically involve cash or other assets of the Issuer or its Restricted Subsidiaries being transferred to a party outside the Restricted Group which is not subject to the covenants / restrictions imposed by the terms of the bonds. Because Investments may be both Permitted Investments and Restricted Payments, it is important to remember that the Issuer is permitted to aggregate multiple baskets when making an Investment.

Practice Note: Permitted Investments are specifically excluded from the definition of Restricted Payments. As such, because they are not Restricted Payments, they do not count against the Net Income Basket as described below. Consequently, an Issuer will prefer that an Investment be permitted as a Permitted Investment rather than merely as a Permitted Restricted Payment.

While many of the types of Investments included in the definition of "Permitted Investment" are "standard" in the European market, the exact scope and particularly the sizes of each basket do vary. As with any other covenant, it is therefore critical for the Issuer and its senior management to be fully familiar with the definition and its potential implications for the future conduct of the Issuer's business and the Issuer's strategic plans. If relevant to the particular

Issuer and its industry and consistent with the Issuer's business practices and strategy as described elsewhere in the offering memorandum, the Issuer may not only want to negotiate for increased flexibility under one or more "standard" baskets (e.g. the Joint Venture Basket), but also for the inclusion of one or more "bespoke" baskets. For example, the author of this guide has represented an emerging markets issuer active in the agricultural sector. To enable/encourage the (fairly poor) local farmers in the areas around its processing facilities to grow the desired crops and to sell their harvest to the Issuer, the Issuer was required to provide a large number of small loans to local farmers at the beginning of the planting season, as a kind of advance in respect of the next harvest. Preserving the ability of the Issuer to make such loans and advances (i.e. "Investments") in the ordinary course of business, either by increasing the size of the Unrestricted Subsidiaries/Joint Venture Basket or by introducing a separate category of "Permitted Investment" (in either case no impact on the Build Up Basket) or by introducing an appropriate "Permitted Restricted Payments" basket (utilization of which may reduce capacity under the Build Up Basket), was therefore critical and should also not be objectionable to investors.

The Limitation on Restricted Payments covenant does not restrict acquisitions of companies that become Restricted Subsidiaries, capital expenditures and most intra-group loans and guarantees as all of these transactions represent Investments within the Restricted Group.

The "J. Crew Trap Door" and "J. Crew Blockers"

Named after the (now insolvent) retailer J. Crew Group, which first employed this now infamous technique in 2016/2017, references to the "**J. Crew Trap Doo**r" or to existing senior secured creditors being "J. Crewed" are to a series of transactions by a (distressed) issuer/borrower that involve the transfer of assets (possibly even assets that constitute collateral for the senior secured creditors) out of the Restricted Group and into unrestricted, non-Guarantor subsidiaries, with the intention of raising (secured) debt at the level of the relevant Unrestricted Subsidiaries.

There are now a number of examples of transactions by other high yield issuers and borrowers that used different variations of what is now commonly referred to as the "J. Crew Trap Door". In the original example, J. Crew used capacity under its Permitted Investments General Basket combined with capacity under a separate Permitted Investments basket that permitted Investments in Unrestricted Subsidiaries to the extent financed with the proceeds received from initial Investments in non-Guarantor Restricted Subsidiaries to transfer (i.e. make an Investment of) key intellectual property (which constituted collateral for the benefit of its senior secured creditor prior to such transfer) to an Unrestricted Subsidiary. The relevant Unrestricted Subsidiary later raised debt that was effectively and structurally senior to J. Crew's existing senior secured debt to refinance J. Crew's (structurally, temporally and effectively junior) holdco PIK debt. Questions around the proper valuation of the relevant IP and certain EBITDA addbacks employed by J. Crew to met relevant leverage tests added to the controversy surrounding this particular transaction.

As a result of the J. Crew transaction and a number of similar transactions by other issuers/ borrowers, the definition of "Permitted Investment" has become the subject of significantly increased scrutiny by investors, in order to plug actual or perceived loopholes and to protect senior secured creditors from getting "J. Crewed" in future distressed situations. To protect investors against similar transactions / asset-stripping, an increasing number of transaction now even feature express "**J. Crew Blocker**" language in the Limitation on Restricted Payments covenant along the lines of the following:

"*Notwithstanding anything else set forth in this covenant or in the definition of Permitted Investments, no Restricted Payment or Investment* (*other than an Investment in the Company or a Guarantor*) *of* [*Collateral*] *or material intellectual property owned by the Company or a Guarantor will be permitted under the indenture.*"

The Net Income Basket / Build Up Basket Exemption

Under the Limitation on Restricted Payments covenant, members of the Restricted Group are typically prevented from making any Restricted Payment unless:

- no Default or Event of Default shall have occurred and be continuing or would result from such Restricted Payment;

  Practice Note: In a minority of transactions, capacity under the Build Up Basket can still be used to make Restricted Payments, even if a (mere) Default has occurred and is continuing, as long as that Default does not yet matured into an "Event of Default", for example, because an applicable grace period has not yet expired. However, this is likely still considered "off-market" / "aggressive" by most.

- the Issuer is able to incur at least €1.00 of additional (unsecured) Ratio Debt under the Limitation on Indebtedness covenant (i.e. pursuant to the traditional 2:00 to 1:00 Fixed Charge Coverage Ratio test) on a *pro forma* basis after giving effect to the Restricted Payment (the "**€1.00 of Additional Ratio Debt Test**"); and

  Practice Note: In an even smaller minority of transactions, this traditional, market standard condition to the ability to use capacity under the Build Up Basket to make Restricted Payments has been removed, but such absence of the €1.00 of Additional Ratio Debt Test is certainly off-market.

  Interestingly, in what may well be an emerging trend as a result of the Covid-19 pandemic, a number of (distressed) high yield bond issuers in the US have recently issued bonds that included an additional (secured) leverage ratio test (i.e. in addition to the traditional €1.00 of Additional Ratio Debt Test), in some cases even combined with a temporary moratorium on Restricted Payments out of the Build Up Basket and certain other types of Restricted Payments. However, it remains to be seen whether this additional condition will be adopted more widely, and whether similar provisions will also appear in European high yield bond transactions.

- the aggregate amount of such Restricted Payment and all other Restricted Payments (subject to certain exemptions discussed at the end of the section with the heading "*Permitted Restricted Payments*" starting on page 70 below) made subsequent to the issue date of the bonds does not exceed the sum of the following (collectively, the "**Net Income Basket**" or "**Build Up Basket**"):
  - 50% of cumulative Consolidated Net Income (or in the case of a loss, minus 100% of the loss) for the period from the beginning of the quarter either immediately prior to or after the original issue date of the bonds until the end of the most recent quarter for which consolidated financial statements for the Issuer are available; plus

> *Practice Note:* It is important to note that the definition of "Consolidated Net Income" for purposes of the Build Up Basket typically contains a series of detailed, negotiated adjustments or add-backs to the related GAAP measure. See also "*Consolidated EBITDA*" starting on page 31 above.
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> In addition, profitable Issuers will typically want to, and have long been able to, negotiate for an "early" start date for the Build Up Basket, so that any (positive) Consolidated Net Income for at least the current quarter (i.e. the quarter during which a particular bonds are being issued) already counts towards building Restricted Payment capacity under the Build Up Basket. This is not normally controversial or a particular reason for concern.
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> However, it has now also become increasingly common (i.e. almost standard) for Issuers to have significant "day one" Restricted Payment capacity under the Build Up Basket. In some transactions, this is achieved by "priming" the Build Up Basket by way of inclusion of an express "**Starter Amount**", typically expressed as a fixed amount in the currency of the bonds. Often, the rationale for the inclusion of a Starter Amount may simply be to preserve existing Restricted Payment capacity the Issuer may already have "earned" under the Build Up Basket pursuant to the Limitation on Restricted Payment covenant or equivalent covenant of its pre-existing bonds or other financing arrangements. The Issuer would argue that if it would have been entitled to make a particular Restricted Payment (e.g. pay a dividend) immediately before the proposed issuance of new bonds), it should not loose the relevant capacity solely as a result of the proposed new issuance, i.e. effectively be "penalized" for not paying a dividend before the issue date. A different and significantly more common, albeit less transparent, way to achieve the same result (i.e. to carry over existing Build Up Basket capacity) is to simply use the same start date for the Build Up Basket as the start date used in the Build Up Baskets of other bonds of the Issuer that may already be outstanding. The problem with this (standard) approach, from a transparency perspective, especially if applied consistently over many years and across multiple bond offerings, is that the Build Up Basket may feature a start date that may lie many years in the past. As a result, to be able to determine the potentially very significant "day one" Restricted Payment capacity under the Build Up Basket (if not disclosed in the offering memorandum), investors would have to reconstruct any consolidated

net income (and losses), any of the types of transactions described in the following bullets as well as any past Restricted Payments that may have reduced Build Up Basket capacity, in each case since the relevant start date.

Irrespective of whether an Issuer manages to negotiate for "day one" capacity under the Build Up Basket through using an earlier start date or through an express Starter Amount, it is important to note that any such capacity may decrease not only through subsequent Restricted Payments, but also through potential subsequent negative Consolidated Net Income (i.e. losses) of the Issuer. To the extent the objective is to reserve capacity for a particular purpose (e.g. for a particular dividend payment, for the redemption/repayment of a particular item of (subordinated) Indebtedness that may be maturing or for a particular Investment), rather than trying to preserve existing Build Up Basket capacity as described above, that objective will be better served by negotiating related Permitted Investment baskets as described on pages 63-63 above or a related Permitted Restricted Payment basket as described on pages 70-72 below, which will be available "hell-or-high-water", i.e. irrespective of any potential future losses.

Finally, it is worth noting two novel features that have appeared in covenant packages of a number recent US bond offerings by Issuers that had become distressed as a result of the Covid-19 pandemic. As already mentioned above, a number of covenant packages for these bond offerings feature an additional (secured) leverage ratio test (i.e. in addition to the traditional €1.00 of Additional Ratio Debt Test) as a further condition to availability of capacity under the Build Up Basket, in some cases combined with a temporary moratorium on certain types of Restricted Payments, including Restricted Payments in reliance on the Build Up Basket. The rationale for these moratoria presumably was twofold. First, the purpose of the related offerings would have been to provide additional liquidity to allow the relevant Issuers to weather the expected fallout from the Covid-19 pandemic, i.e. to cover expected heavy losses over the current and potentially several upcoming financial quarters. Any actions by the Issuer that would result in non-essential cash-leakage from the Restricted Group (including most forms of Restricted Payments) would have been inconsistent with that purpose. Second, especially if an earlier start date is still used for the Build Up Basket and/or an additional leverage ratio test is imposed for use of the Build Up Basket, in each case as described above, it does make sense to impose a temporary moratorium, possibly for a full twelve-month period or even just until publication the Issuer's financial statements for the second or third financial quarter of 2020, which will ensure that the (full) impact of the Covid-19 pandemic on the Issuer's results of operation and financial condition will have become known and, importantly, also be reflected in the Consolidated Net Income / Consolidated EBITDA used to determine capacity under various baskets.

A second novel feature in some recent US bond offerings has been a late (rather than early) start date for the Build Up Basket. In some of the relevant transactions, the Build Up Basket will only start growing (or decreasing) with a specific future quarter (e.g. January 1, 2020 / the first quarter of 2020), presumably after the (worst) losses associated with the Covid-19 pandemic are expected to lie in the past. Other transactions go even a step further and provide that cumulative Consolidated Net Income of the Issuer will only start impacting the Build Up Basket with the first quarter after the issue date for which the Issuer does not record a deficit / loss. Both variations only benefit the relevant Issuer as they prevent potentially negative Build Up Baskets as a result of expected losses due to the Covid-19 pandemic, which losses would otherwise have to be made up / covered by subsequent (positive) Consolidated Net Income before the Issuer would be able to earn capacity under the Build Up Basket again.

- 100% of the aggregate net cash proceeds (and often also the fair market value of assets, property or marketable securities) from sales of the Issuer's capital stock (other than disqualified stock) and capital contributions received subsequent to the issue date of the bonds (other than net cash proceeds from a sale of the Issuer's capital stock to a subsidiary or an employee share plan) or the issuance or sale of subordinated shareholder debt (other than to a subsidiary of the Issuer), but excluding any net proceeds used to redeem bonds; plus

Practice Note: To avoid double-counting, investors will want to make sure that if capital contributions or equity proceeds are a separate basis for making a Permitted Investment or Permitted Restricted Payment, any capital contribution or equity proceeds used for those specific exemptions do not also increase capacity under the Build Up Basket.

100% of the aggregate net cash proceeds (and often also the fair market value of assets, property or marketable securities) received by Issuer or any Restricted Subsidiary upon the sale or other disposition of any Investment made pursuant to the Build Up Basket; plus

- 100% of the fair market value of any Restricted Investments in entities that subsequently become Restricted Subsidiaries; plus
- in the case of a guarantee by the Issuer or a Restricted Subsidiary, upon the release of such guarantee an amount equal to the amount of such guarantee to the extent the guarantee reduced the capacity to make Restricted Payments under the Build Up Basket; plus
- to the extent that the capacity to make Restricted Payments under the Build Up Basket was reduced as the result of the designation of an Unrestricted Subsidiary, the portion (proportionate to Issuer's equity interest in such Subsidiary) of the fair market value of the (net) assets of such Unrestricted Subsidiary received by the Issuer or a Restricted Subsidiary or the Issuer's Restricted Investment in such subsidiary at the time such Unrestricted Subsidiary is re-designated as a Restricted Subsidiary or is merged or consolidated into the Issuer or a Restricted Subsidiary, or the assets of such Unrestricted Subsidiary are transferred to the Issuer or a Restricted Subsidiary; plus

- 100% of any cash dividends or distributions received by the Issuer or a Restricted Subsidiary after the issue date of the bonds from Unrestricted Subsidiaries, to the extent not otherwise included in the Consolidated Net Income of the Issuer; plus
- 100% of the net cash proceeds (and often also the fair market value of assets, property or marketable securities) from any issuances of *pari passu* or senior debt of the Issuer and its Restricted Subsidiaries subsequent to the issue date of the bonds which is converted or exchanged (other than by a subsidiary of the Issuer) into capital stock of the Issuer (other than disqualified stock) or subordinated shareholder debt.

As with any other covenant, the exact calculation and scope of the Build Up Basket can vary and is subject to negotiations.

Practice Note: As discussed in more detail under "Change of Control and Portability" starting on page 46 above, it was historically common to reset the Build Up Basket to zero upon the occurrence of a Change of Control, or at least upon the occurrence of a Specified Change of Control Event / Change of Control Triggering Event to protect investors against potential "round-tripping" in the event the relevant bonds provide for Leverage Based Portability. More recently, some bonds have relied on an alternative approach to prevent round-tripping via the Build Up Basket or the "substantially concurrent" Permitted Restricted Payment basket (as described below) by carving out / excluding from both baskets certain "**Excluded Amounts**".

Permitted Restricted Payments

Certain Restricted Payments are always permitted, irrespective of whether there is capacity under the Build Up Basket or whether the other conditions for its use at met. Common "**Permitted Restricted Payments**" exemptions/baskets include, but are not limited to:

- the payment of any dividend within 60 days after the date of declaration thereof, if at such date of declaration such payment was permitted under the Build Up Basket Exemption;
- the purchase, repurchase, redemption, defeasance or other acquisition or retirement of capital stock or subordinated shareholder debt made by exchange for, or out of the proceeds of the "substantially concurrent" sale of, capital stock of the Issuer (other than disqualified stock, capital stock issued or sold to a subsidiary or to certain employee stock ownership plans and, sometimes, other than Excluded Amounts), subordinated shareholder debt or a substantially concurrent contribution to the equity of the Issuer (other than by a Subsidiary of the Issuer);
- the purchase, redemption or other acquisition for value of capital stock in connection with the obligations under employee or management stock option agreements or other agreements to compensate management or employees, subject to a hard annual cap;

Practice Note: Often the Issuer can negotiate that any unused amounts in any calendar year may be carried over to the immediately following calendar year but not any subsequent calendar years.

- if not already excluded from the definition of "Restricted Payment", *pro rata* dividends or distributions of Restricted Subsidiaries that are not wholly-owned subsidiaries to their other holders of capital stock;
- so long as no default has occurred and is continuing (or would result therefrom), following an IPO of the Issuer, the declaration and payment by the Issuer of dividends on its common stock on a pro rata basis, in an amount not to exceed in any fiscal year the greater of (a) a specified percentage of the net cash proceeds received by the Issuer from the IPO and any subsequent public equity offering and (b) an amount equal to the greater of (i) a specified percentage of the Issuer's market capitalization and (ii) a specified percentage of its IPO market capitalization, subject to the Issuer meeting a leverage test after giving pro forma effect to any such dividends or distributions (so-called "**IPO Basket / Public Company Dividend Basket**");

> *Practice Note:* The rationale of the IPO basket is to give the Issuer the necessary flexibility to adopt an appropriate / attractive dividend policy in connection with a proposed initial public offering (IPO). Enabling a successful IPO is typically also in the interest of bondholders as it may provide the Issuer with an opportunity to broaden its investor base and to use all or a portion of the proceeds from the IPO to deleverage.

- so long as no default has occurred and is continuing (or would result therefrom), any Restricted Payment, subject to the Issuer meeting a leverage test after giving *pro forma* effect to any such dividends (so-called "**Leverage-Based Permitted Payments Basket**");

> *Practice Note:* Considered by many as "aggressive" or a "sponsor term" only a few years ago, Leverage-Based Permitted Payments Baskets that permit (theoretically) unlimited cash leakage from the Restricted Group in the form of Restricted Payments, subject only to a leverage ratio test, have become a standard market feature of European high yield bonds. Although their prevalence fluctuates with changing market conditions, Leverage-Based Permitted Payments Baskets now regularly feature in the vast majority of European high yield bonds, including in corporate / non-sponsor transactions. The level at which the relevant leverage ratio is set in those transactions can vary widely. However, in a majority of cases, the relevant leverage ratio is now calculated on a net basis (i.e. the numerator of the ratio is calculated net of (uncapped) cash and cash equivalents), even where other leverage-based exemptions in the relevant bond terms use a gross leverage test.
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> Traditionally, Restricted Payment capacity under the Leverage-Based Permitted Payments Basket had to be "earned", and in most transactions, deleveraging of 1.0x Consolidated EBITDA or more is still required. However, there is also a significant number of transactions where the relevant leverage threshold is set either very close to or even above the opening leverage, giving the Issuer either very near-term or even immediate Restricted Payments capacity under the Leverage-Based Permitted Payments Basket.

- dividends, loans, advances or distributions to any holding company in amounts equal to the amounts required for any such holding company to pay certain defined holding company expenses and related taxes; and

> *Practice Note:* This very limited (standard) exemption is not normally controversial, as it is merely intended to permit (typically relatively modest) Restricted Payments to fund certain ongoing and likely unavoidable expenses incurred by one or more holding companies of the Issuer. Arguably, avoiding related liquidity issues at holding company level also benefits the Issuer itself.
>
> However, there are also many examples of transactions that feature separate special baskets for servicing upstream debt (i.e. holdco debt incurred at a level above the Restricted Group. These transactions typically involve private equity-owned Issuers, sometimes with complex ownership and overall financing structures that may involve very significant amounts of holdco debt, often incurred concurrently with the senior (secured) high yield notes at the Restricted Group level, as a junior component of the overall financing package put in place to fund an LBO of the Issuer. The senior (secured) bond holders may be wary of such flexibility as it may provide significant capacity for cash leakage out of the Restricted Group and thereby limit a potential deleveraging of the Restricted Group, only to make potentially very significant interest (and principal?) payments on debt that is supposed to rank junior to the senior bond holders (and therefore typically carries a higher rate of interest), with no corresponding benefit to the Restricted Group.

- so long as no default has occurred and is continuing (or would result therefrom), any Restricted Payment, subject to a hard cap or soft cap (so-called "**General Basket**").

> *Practice Note:* In a more recent development, a relatively small number of transactions contain a new Permitted Restricted Payment exemption which allows the Issuer to repurchase, redeem, acquire or retire subordinated Indebtedness, certain "disqualified stock" or preferred stock of Restricted Subsidiaries (and sometimes generally to make any Restricted Payments) (i) with the net proceeds from Asset Dispositions, provided the Issuer has complied with the Limitation on Asset Sales covenant and purchased all notes tendered pursuant to any related Asset Disposition Offer, (ii) to the extent required by the underlying documentation governing such subordinated Indebtedness, disqualified stock or preferred stock following a Change of Control or Asset Disposition, provided the Issuer has complied with the Change of Control covenant or Limitation on Asset Sales covenant, as applicable, and has purchased all notes tendered pursuant to any related Change of Control Offer or Asset Disposition Offer, as applicable, or (iii) consisting of Acquired Indebtedness, other than Indebtedness incurred in connection with, or in contemplation of the relevant acquisition.

As with the exemptions and baskets in other covenants, while many Permitted Restricted Payment exemptions and baskets may be "standard" in the European market, the exact scope and size of the various exemptions and baskets can vary considerably and must always be tailored to fit the Issuer's business, strategic plans and other circumstances.

As a rule of thumb, most Permitted Restricted Payments should (and normally will) count against (i.e. reduce capacity under) the Build Up Basket, except for certain Restricted Payments which:

- are made pursuant to a basket or exemption which expressly provides that any cash or assets used for making the relevant Permitted Restricted Payments do not also increase capacity under the Build Up Basket;
- are credit-neutral; or
- are of a *de minimis* or "ordinary course" nature, making it impractical or disproportionately burdensome for the Issuer to track them.

In practice, however, the drafting of the Build Up Basket in many transactions, for various reasons or no reason at all, omits or carves out certain additional Permitted Restricted Payment exemptions or baskets that do not clearly fit into one of those three categories, but will still not reduce capacity under the Build Up Basket. All parties involved in drafting the Limitation on Restricted Payments covenant will therefore have to pay special attention that the drafting properly reflects the intention of the parties, especially if an unfamiliar precedent has been used and/or the numbering of the various Permitted Restricted Payments exemptions and baskets has changed during the course of the negotiations.

To give a more balanced example with a clear rationale for giving special treatment to a particular type of Permitted Restricted Payments, the author of this guide has advised on transactions for a particular Issuer where (a relatively modest principal amount of) PIK toggle notes had been issued by the immediate parent company in connection with a past refinancing. To encourage the early redemption of such legacy holdco PIK toggle notes in the interest of a cleaner and more stable overall capital structure, certain Restricted Payments made for the purpose of funding any such redemption in reliance on a special Permitted Restricted Payment Basket would only reduce capacity under the Build Up Basket subject to a zero floor.

Other Covenants that Might be Relevant

Not necessarily obvious to even experienced finance professionals that may not be intimately familiar with the workings of a typical high yield covenant package, guarantees of Indebtedness of third parties constitute both "Indebtedness" and "Investments". Therefore, prior to providing any guarantees of third party Indebtedness, the Issuer must make sure that sufficient capacity exists under both the Limitation on Restricted Payments covenant and the Limitation on Indebtedness covenant.

LIMITATION ON LIENS

The Limitation on Liens covenant limits (i) the Issuer's ability to effectively subordinate the bonds through liens on property or assets that do not constitute collateral for the bonds and (ii) in the case of secured bonds, the Issuer's ability to incur incremental senior secured Indebtedness that ranks *pari passu* with the Issuer's existing senior secured Indebtedness (including the senior secured bonds), benefits from liens over the same collateral and is therefore "collateral dilutive" to the Issuer's existing senior secured Indebtedness (including the senior secured bonds). See also "*Effective/Lien Subordination*" on page 7 above and "*Senior Secured Notes, Secured Leverage Ratio Test and Collateral Dilution*" starting on page 55 above.

Practice Note: Historically, the label "senior secured note" used to imply at least a somewhat comprehensive collateral package and possibly even a minimum expected recovery ratio with regard to the relevant bond in a potential default / insolvency scenario.

In recent years, however, there has been an increasing number of high yield bonds in Europe that are still marketed as "senior secured" notes, but feature collateral packages that are anything but comprehensive. Even "strong" collateral packages for senior secured notes issued by corporate issuers now typically do not include working capital items / current assets anymore, such as bank accounts, accounts receivable, inventory, raw materials or insurance proceeds. Especially in senior secured notes offerings by portfolio companies of financial sponsors, the collateral package may not even include any fixed assets anymore and even exclude (up-stream) guarantees of some or all subsidiaries of the Issuer. Instead, the relevant collateral packages may consist solely of certain (very) limited financial collateral, such as certain share pledges.

Liens on Non-Collateral Assets / "Permitted Liens"

With regard to any assets of the Restricted Group that do not constitute collateral for the bonds, the Limitation on Liens covenant prohibits any liens or other security interests on such assets to secure any Indebtedness unless either (i) the bonds are equally and ratably secured for as long as the relevant Indebtedness is so secured or (ii) the relevant lien is permitted by one or more available exemptions / baskets (so-called "**Permitted Liens**"). In this respect, the Limitation on Liens covenant is similar to (but in certain respects more robust than) "negative pledges" that are also a common feature of investment-grade bonds.

The definition of "**Permitted Liens**" typically includes a fairly extensive list of different types of liens that generally fall into the following broad categories:

- *Ordinary Course Liens.* Liens of a *de minimis* and/or technical nature that are typically incurred in the ordinary course of the Issuer's business, may be outside the control of the Issuer and may there for be impossible or impractical for the Issuer to track, for example, liens imposed by law, such as workmen's compensation laws, unemployment insurance laws or social security laws; tax liens, judgment liens, liens created under bank's standard business terms and conditions; retention of title arrangements or similar arrangements entered into in the ordinary course of business or minor survey exceptions, minor encumbrances, easements or reservations of, or rights of others for, licenses, rights-of ways, sewers, electric lines, telephone lines and other similar purposes and which do not materially adversely affect the value of the affected properties; or liens granted in connection with customary cash management, cash pooling or netting or setting-off arrangements.

- *Existing Liens.* Liens existing on the issue date of the bonds (including liens created for the benefit of the bonds and any related guarantees); subject to certain limitations, liens existing on property at the time the Issuer or a Restricted Subsidiary acquired the property (other than liens incurred in contemplation of such acquisition); and liens securing Indebtedness incurred to refinance Indebtedness that was previously secured (but limited to the collateral that secured the Indebtedness that is being refinanced).
- *Liens securing Indebtedness incurred under specific Permitted Debt baskets.* The definition of "Permitted Liens" typically includes specific baskets intended to ensure that Indebtedness under certain Permitted Debt baskets under the Limitation on Indebtedness covenant can, at least partly, be incurred on a secured basis.

Practice Note: For example, the definition of Permitted Liens typically includes specific baskets that permit certain liens securing Indebtedness represented by "Capitalized Lease Obligations" and "Purchase Money Obligations" or incurred in connection with "Qualified Securitization Financings". Typically, the relevant Permitted Liens basket expressly cross-refers to the corresponding Permitted Debt basket, such as the Capitalized Lease Obligations/Purchase Money Obligations basket.

Invariably, the definition of "Permitted Liens" will also contain a "**General Permitted Liens Basket**" that will be subject to either a hard cap or to a soft cap which would typically be expressed as the greater of a fixed amount and a percentage of Total Assets. Although baskets with grower elements in the definition of "Permitted Liens" are still less common than in the Limitation on Indebtedness covenant, for example, the number of transactions with soft capped Permitted Liens baskets, in particular General Permitted Liens Baskets, has certainly been on the rise in recent years. See also "*How do baskets work?*" starting on page 29 above for how soft caps / grower baskets have been becoming the norm.

In any case, it is important to note that the size of a particular Permitted Liens basket may not necessarily exactly match the size of the corresponding Permitted Debt basket and that it may also be used to secure Indebtedness incurred pursuant to other exemptions. For example, the size of Permitted Liens basket permitting liens securing Indebtedness represented by Capitalized Lease Obligations and Purchase Money Obligations may be higher than the size of the corresponding Permitted Debt Basket. In practice, this means that it may also be possible for the Issuer to rely on this basket for liens that secure Indebtedness represented by Capitalized Lease Obligations or Purchase Money Obligations that was incurred, for example, as Ratio Debt or in reliance on the General Debt Basket, rather than under the Capitalized Lease Obligations/Purchase Money Obligations basket.

Since the Limitation on Liens covenant will be similar to the relevant covenants contained in a typical senior credit facility, it is also important to cross-check / match the definition of "Permitted Liens" with the corresponding definitions in the Issuer's senior credit facility or facilities, i.e. any liens permitted by the Issuer's senior credit facilities should also be "Permitted Liens" under terms of bonds, although the terms of the bonds may contain additional "Permitted Liens".

"Permitted Collateral Liens"

With regard to property or assets that already constitute collateral for any senior secured bonds, the Limitation on Liens covenant will only permit so-called "**Permitted Collateral Liens**". Any additional / incremental Indebtedness secured by any such Permitted Collateral Liens will typically rank (at least) *pari passu* with the Issuer's existing senior secured indebtedness (including the senior secured bonds) and, because it benefits from liens over the same collateral, will be "collateral dilutive" to the Issuer's existing senior secured Indebtedness (including the senior secured bonds).

Super Priority Debt

A very significant majority of European senior secured bond transactions also involves at least some element of so-called "**Super Priority Debt**" or "**Super Senior Debt**", which is secured on a *pari passu* basis on the same collateral as the senior secured bonds, but is repayable ahead of the senior secured bonds in an enforcement scenario under the terms of the relevant Intercreditor Agreement.

This Super Priority Debt frequently includes (i) all Indebtedness incurred under the (often soft-capped) Credit Facilities Basket, (ii) certain priority hedging obligations, possibly including obligations under commodity hedges, in addition to interest rate and/or foreign exchange hedges, frequently without any cap and (iii) certain cash management liabilities. One particularly popular capital structure involves the issuance of senior secured bonds and the concurrent entry into a super senior secured revolving credit facility that is afforded super priority status under the terms of the relevant Intercreditor Agreement. However, the relevant super priority status (on terms not materially less favorable to bond holders than that accorded to the super senior revolving credit facility existing on the issue date pursuant to the Intercreditor Agreement as in effect on the issue date) is typically afforded to any Indebtedness incurred under the Credit Facilities Basket (including potential term loan facilities or any debt securities issued in reliance on the Credit Facilities Basket), rather than just Indebtedness incurred under the super senior revolving credit facility existing on the issue date.

Because the definition of "Permitted Collateral Liens" typically expressly permits the creation of (first-ranking) liens over the collateral to secure certain additional / incremental items of Indebtedness that may have super priority, rather than just certain items of Indebtedness that exist as of the issue date of the bonds, certain Permitted Collateral Liens may not only be merely (significantly) collateral dilutive to the senior secured bonds, but may even result in the senior secured bonds to become effectively and/or contractually subordinated to potentially very significant amounts of incremental Super Priority Debt under the terms of the Intercreditor Agreement.

The definition of "**Permitted Collateral Liens**" for a senior secured bond can vary significantly, depending on how much flexibility for the Issuer to incur further collateral dilutive *pari passu* and/or super senior Indebtedness is envisaged, but it will generally include the following:

- liens on the collateral to secure the bonds issued on the issue date or the related guarantees and any refinancing Indebtedness in respect thereof on a *pari passu* basis, *provided* that all property and assets securing such Indebtedness also secures the bonds and related guarantees on a senior or *pari passu* basis and that the relevant parties have entered into the Intercreditor Agreement or an additional intercreditor agreement;
- liens on the collateral to secure Indebtedness incurred pursuant to the Credit Facilities Basket, which may have super priority not materially less favorable to bond holders than that accorded to the super senior revolving credit facility existing on the issue date pursuant to the Intercreditor Agreement as in effect on the issue date, *provided* that all property and assets securing such Indebtedness also secures the bonds and related guarantees on a senior or *pari passu* basis and that the relevant parties have entered into the Intercreditor Agreement or an additional intercreditor agreement;
- liens on the collateral to secure Indebtedness incurred pursuant to the Hedging Obligations Basket, *provided* that liens in favor of (a most often capped amount of) "priority hedging obligations" may have super priority not materially less favorable to bond holders than that accorded to the super senior revolving credit facility existing on the issue date pursuant to the Intercreditor Agreement as in effect on the issue date, and *provided further* that all property and assets securing such Indebtedness also secures the bonds and related guarantees and that the relevant parties have entered into the Intercreditor Agreement or an additional intercreditor agreement;
- liens on the collateral to secure any Ratio Debt, *provided* that all property and assets securing such Indebtedness also secures the bonds and related guarantees on a senior or *pari passu* basis and that the relevant parties have entered into the Intercreditor Agreement or an additional intercreditor agreement; and

Practice Note: As described in more detail under "*Senior Secured Notes, Secured Leverage Ratio Test and Collateral Dilution*" starting on page 55 above, the majority of senior secured high yield bonds in Europe feature a secured leverage ratio test to determine the ability to incur incremental, collateral dilutive, secured Ratio Debt. However, collateral dilution pursuant to any of the other prongs under the definition of Permitted Collateral Liens is typically not similarly limited by reference to any such secured leverage test. While the incurrence of incremental (collateral dilutive) Indebtedness under the Credit Facilities Basket is capped by the size of the Credit Facilities Basket and there will certainly be practical limits with regard to Indebtedness that could be properly incurred under the Hedging Obligations Basket, the potential for very significant and potentially unchecked (i.e. not subject to the relevant secured leverage test) collateral dilution becomes much more of a concern (from an investor's perspective) in transactions with more expansive / aggressive definitions of Permitted Collateral Liens. Increasingly common examples include

> transactions that also allow the creation of Permitted Collateral Liens to secure, on a *pari passu* basis with the bonds (i) uncapped amounts of Contribution Debt, (ii) certain Indebtedness incurred pursuant to specific Permitted Debt baskets or (iii) any Indebtedness in the form of "Additional Notes" (i.e. additional bonds that are fungible with and form a single series with the senior secured bonds), including any Additional Notes issued pursuant to a Permitted Debt basket (rather than as Ratio Debt), in each case without any condition that either the Fixed Charge Coverage Ratio Test or any secured leverage ratio test must be satisfied for the incurrence of the relevant Indebtedness.

- most of the different categories of "Ordinary Course Liens" that are also included in the definition of "Permitted Liens" as described starting on page 74 above.

While there may be "standard" elements in the definitions of Permitted Liens and Permitted Collateral Liens, it is again important to stress that there is almost invariably a need to make adjustments to these definitions so they fit the Issuer's business, strategic plans and other circumstances. For example, the author of this guide has advised on a transaction where the Issuer's business model / key strategy involved either (i) encouraging key customers to establish production sites in immediate proximity to the Issuer's own production site (frequently on land owned by the Issuer that constituted part of the collateral for the bonds) or (ii) the Issuer itself establishing production sites in immediate proximity to production sites of its key customers. Either type of project could potentially involve bespoke financing arrangements by the Issuer or the relevant customers, including Indebtedness represented by Capitalized Lease Obligations and Purchase Money Obligations, potentially secured with bespoke Permitted Collateral Liens such as hereditary building rights, rights to purchase and certain easements and rights of way.

Other Covenants that Might be Relevant

It is important to review the Limitation on Liens covenant in the context of the Limitation on Indebtedness covenant because it limits the ability to incur Indebtedness on a secured basis. See also "*Senior Secured Notes, Secured Leverage Ratio Test and Collateral Dilution*" and "*Other Covenants that Might be Relevant*" on pages 55 and 62 above.

LIMITATION ON RESTRICTIONS ON DISTRIBUTIONS FROM RESTRICTED SUBSIDIARIES

The purpose of this covenant (sometimes also referred to as "Limitation on Dividend Stoppers" covenant) is to prevent funds needed to service Indebtedness of the Issuer from being trapped at a subsidiary level and to ensure that all cash generated by Restricted Subsidiaries can, subject to relevant exemptions, always be up-streamed to the Issuer so that it may be used to satisfy its obligations under the bonds. To this end, the covenant contains a general prohibition on the existence of any restriction on Restricted Subsidiaries (or sometimes only on Guarantors):

- to pay dividends, repay Indebtedness or other obligations owed to the Issuer or any Restricted Subsidiary;
- to make loans or advances to the Issuer or any Restricted Subsidiary; or
- to otherwise sell, lease or transfer any of its property or assets to the Issuer or any Restricted Subsidiary.

The covenant is important to investors because they look to the credit quality and financial condition of the Issuer and its Restricted Subsidiaries as a whole for the repayment of (and the payment of interest under) the bonds, not just the Issuer itself.

Common exemptions to the covenant include, but are not limited to:

- any encumbrance or restriction in any agreements governing Indebtedness in effect or entered into on the issue date of the bonds;
- any encumbrance or restriction with respect to a Restricted Subsidiary pursuant to an agreement relating to any capital stock or Indebtedness incurred by such subsidiary prior to the date such subsidiary was acquired, other than any capital stock issued or Indebtedness incurred in connection with or contemplation of the relevant acquisition;
- any encumbrances or restrictions pursuant to an agreement or instrument effecting a refinancing of Indebtedness incurred pursuant to, or that otherwise refinances, an agreement or instrument referred to in the preceding two bullets or contained in any amendment, supplement or other modification to an agreement in the preceding two bullets, provided that any such encumbrances and restrictions are no less favorable in any material respect to the bond holders taken as a whole than the existing encumbrances and restrictions;
- customary provisions in leases, licenses, joint venture agreements and other similar agreements and instruments entered into in the ordinary course of business;
- any encumbrances or restrictions arising or existing by reason of applicable law or any applicable rule, regulation or order, or required by any regulatory authority;
- any encumbrance or restriction pursuant to certain hedging agreements;
- any encumbrance or restriction existing by reason of any lien permitted under the Limitation on Liens covenant; and
- any encumbrance or restriction arising pursuant to an agreement or instrument relating to any Indebtedness permitted to be incurred under the Limitation on Indebtedness covenant if the encumbrances and restrictions contained in any such agreement or instrument taken as a whole are not materially less favorable to the holders of the bonds than those contained in any existing credit facility, the related security documents and the Intercreditor Agreement, in each case, as in effect on the issue date.

Joint ventures entered into (and majority-owned / controlled) by the Issuer or its Restricted Subsidiaries may create issues under the Limitation on Restrictions on Distributions from Restricted Subsidiaries covenant, because the partner in such joint venture will typically insist, for example, on certain veto rights over dividend payments and certain related party transactions (e.g. up-stream loans). To the extent it is not possible to negotiate for relevant exemptions, an alternative solution may be the formation of joint ventures that are not controlled by the Issuer, as such a joint venture would not be a "Subsidiary" or to designate any joint venture subsidiary as an "Unrestricted Subsidiary", so the joint venture would not be subject to the bond covenants. However, any investment in such a joint venture would then constitute a Restricted Payment (unless it qualifies as a Permitted Investment) and be subject to the limitations imposed by the Limitation on Restricted Payments covenant.

Other Covenants that Might be Relevant

The covenant should be reviewed in conjunction with the Limitation on Indebtedness covenant and the Limitation on liens covenant since Indebtedness and/or Liens that otherwise may be incurred may be limited by this covenant if the terms of the additional Indebtedness or liens contain any provisions that restrict the free movement of cash or assets within the Restricted Group.

LIMITATION ON ASSET SALES

Sales of assets (including subsidiary stock) are potentially of concern to investors, because they may result in income-producing assets being transferred outside the Restricted Group. The purpose of the Limitation on Asset Sales covenant is to ensure that certain procedural requirements are met in connection with sales of assets and subsidiary stock. The covenant is not intended to prohibit sales of assets by the Issuer or its Restricted Subsidiaries per se, but it (i) restricts the types of proceeds the Issuer and its Restricted Subsidiaries may receive as consideration in connection with any "Asset Disposition" as well as (ii) prescribes how and within which time frame the Issuer and its Restricted Subsidiaries must use such proceeds.

"**Asset Disposition**" is typically defined broadly and will generally include traditional asset disposals as well as any direct and indirect sales of interests in the Restricted Subsidiaries, including any issue of new shares of a Restricted Subsidiary or any disposition by means of a merger, consolidation or similar transaction. At the same time, the definition will list numerous categories of asset disposals that do not need to satisfy the Asset Sale Test described below, including various types of ordinary course transactions and a carve-out / basket for dispositions of assets with a fair market value below a specified *de minimis* threshold.

Practice Note: Consistent with the overall trends with regard to relevant thresholds and baskets in other covenants, *de minimis* thresholds in the definition of "Asset Disposition" have been steadily increasing in recent years, and in a minority of transactions, the traditionally fixed *de minimis* threshold amounts have even been supplemented with a grower element. See also "*How do baskets work?*" starting on page 29 above. In addition, there appears to be no limit when it comes to creative new carve-outs from the definition of "Asset Disposition", and special carve-outs introduced in one transaction, possibly for a very specific purpose, frequently get copied by other Issuers and thereby quickly become "market". Analyzing the definition of "Asset Disposition" is therefore often a key threshold item in determining whether a particular Limitation on Asset Sales covenant may be considered "tight" or "loose". See also "*Other Covenants that Might be Relevant*" on page 84 below.

Those dispositions of assets that do meet the definition of an "Asset Disposition" must typically meet the following conditions (together, the "**Asset Sale Test**") under the Limitation on Asset Sales covenant:

- the Issuer or its Restricted Subsidiaries receive consideration at least equal to the fair market value of the assets sold (as determined in good faith by the Issuer's board of directors);
- a minimum percentage (typically 75%) of the consideration the Issuer or Restricted Subsidiary receives in respect of the Asset Disposition is in the form of cash or cash equivalents or a combination thereof; and

Practice Note: In addition to cash and "Cash Equivalents" (which is a separate defined term), the Limitation on Assets Sales covenant will also frequently contain a negotiated list of "**Deemed Cash**" items.

These "**Deemed Cash**" items typically include, but may not be limited to:

- the assumption by the purchaser of (i) any liabilities recorded on the Issuer's or Restricted Subsidiary's balance sheet or, if incurred since the date of the latest balance sheet, that would be recorded on the next balance sheet (other than contingent liabilities, disqualified stock or subordinated debt), as a result of which neither the Issuer nor any of the Restricted Subsidiaries remains obligated in respect of such liabilities or (ii) Indebtedness of a Restricted Subsidiary that is no longer a Restricted Subsidiary as a result of such Asset Disposition, if the Issuer and each other Restricted Subsidiary is released from any guarantee of such Indebtedness as a result of such Asset Disposition;
- consideration consisting of (at least *pari passu*) Indebtedness of the Issuer or any Restricted Subsidiary received from persons who are not the Issuer or any Restricted Subsidiary; and
- any securities, notes or other obligations received by the Issuer or a Restricted Subsidiary from the transferee that are converted by the Issuer or the relevant Restricted Subsidiary into cash or Cash Equivalents within a set number of days (typically 180 days) following the closing of the Asset Disposition, to the extent of the cash or Cash Equivalents received in that conversion.

In many transaction, the Limitation on Asset Sales covenant further permits consideration directly in the form of "**Additional Assets**" as defined below (i.e. certain asset swaps) and/or includes a separate basket for "**Designated Non-Cash Consideration**" (i.e. non-cash consideration with a maximum fair market value that is designated as such pursuant to an officer's certificate). In addition, Issuers may be able to negotiate certain carve-outs from the general requirement that 75% of the consideration be in the form of cash or Cash Equivalents. These carve-outs may cover (i) certain "**Permitted Asset Swaps**", i.e. the concurrent purchase and sale or exchange of assets used or useful in a "Related Business" or a combination of such assets and cash or Cash Equivalents) and/or (ii) certain "**Non-Core Assets**", with

> may either be specifically identified at issuance or, more and more frequently, designated as such in good faith by the Issuer at a later point in time. Some transaction further feature separate thresholds or (annual) baskets (possibly with grower elements) as additional carve-outs from the requirement that consideration for an Asset Disposition must be predominantly in the form of cash or Cash Equivalents.

- the net available cash proceeds from the Asset Disposition are applied by the Issuer or relevant Restricted Subsidiary within a specified period of time (historically within 365 days, but frequently 395 days or even longer):
  - to (permanently) repay, prepay, purchase or redeem certain types of qualifying (*pari passu*) Indebtedness;

> *Practice Note:* Traditionally, the permitted types of Indebtedness would be limited to Indebtedness that ranks *pari passu* with or senior to the high yield notes. Some Limitation on Asset Sales covenants, however, may also allow the Issuer to repay, prepay, purchase or redeem other (senior, but possibly unsecured) Indebtedness of the Issuer ahead of the notes.
>
> In addition, to the extent proceeds from an Asset Disposition were used to repay borrowings under a (revolving) credit facility, the covenant historically required that the relevant commitments under the credit facility were permanently cancelled. This requirement seems to have disappeared in most recent transactions.

  - to invest in any "Additional Assets" (or "Replacement Assets");

> *Practice Note:* "**Additional Assets**" is typically defined to include (i) any property or assets (other than Indebtedness and capital stock) used or to be used by the Issuer, a Restricted Subsidiary or otherwise useful in a "Related Business" (it being understood that capital expenditures on property or assets already used in a Related Business or to replace any property or assets that are the subject of such Asset Disposition shall be deemed an investment in Additional Assets), (ii) the capital stock of a Person that is engaged in a Related Business and becomes a Restricted Subsidiary as a result of the acquisition of such capital stock by the Issuer or a Restricted Subsidiary, and (iii) capital stock constituting a minority interest in any person that at such time is a Restricted Subsidiary. Traditionally, prong (i) of the preceding definition of "Additional Assets" contains an express carve-out for working capital items and other current assets, but this (arguably) important carve-out has been removed in a growing number of recent transaction, which effectively allows the relevant Issuers to use the net proceeds from the sale of income-producing fixed assets (such as property, plant & equipment, or even entire businesses) to fund working capital items (such as raw materials or other inventories).

- in an increasing number of cases, more broadly to make any capital expenditures; or
- to enter into a binding arrangement to apply the net available cash proceeds pursuant to one or more of the preceding bullets that will be consummated within 180 days of the end of the relevant (i.e. typically 365-day) period.

To the extent the net available cash proceeds from an Asset Disposition are not applied in accordance with the Asset Sale Test as described above and exceed a specified minimum threshold amount, the Issuer must use such "**Excess Proceeds**" to make an offer to repurchase (a portion of) the bonds at their face value plus accrued interest and other *pari passu* Indebtedness with similar provisions (so-called "**Asset Disposition Offer**").

Practice Note: To avoid any uncertainty regarding a potential need to segregate the proceeds from any Asset Dispositions, the Issuers will want to ensure that the covenant directs the use of "an amount equal to" (or similar wording) the net available cash proceeds from any Asset Disposition, rather than the actual cash proceeds. The covenant may also include express wording to the effect that the Issuer and its Restricted Subsidiaries may temporarily reduce Indebtedness or otherwise use the relevant net available cash proceeds in any manner not prohibited by the bond covenants.

Because cash is fungible, as long as the Issuer or the relevant Restricted Subsidiary makes qualifying capital expenditures within the relevant time frame following an Asset Disposition, compliance with the covenant should normally not be difficult without the Issuer actually having to conduct an Asset Disposition Offer.

In addition, there have been a number of innovations in recent years with regard to the Excess Proceeds that must be used to make an Asset Disposition Offer. First, in a growing number of transactions, the traditionally fixed minimum threshold amount used for determining the "Excess Proceeds" is being supplemented by a grower element. Second, a growing number of (sponsor) transactions contain leverage-based carve-outs whereby a certain percentage (e.g. 50%) of the net available cash proceeds from an Asset Disposition is deemed not to constitute Excess Proceeds (and may then be used for any other purpose permitted under the relevant bond covenants, including potential Restricted Payments), as long as the Issuer satisfies a specific consolidated senior (secured) net leverage test. Third, while the net available cash proceeds from separate Asset Dispositions are typically aggregated to calculate any Excess Proceeds above the relevant threshold amount, some transactions calculate "Excess Proceeds" solely by reference to individual transactions. Fourth, a number of recent transactions contain broad carve-outs whereby any net available cash proceeds from an Asset Disposition need not be applied in accordance with the Limitation on Asset Sales covenant if doing so is prohibited or delayed by applicable local law or could result in material adverse tax consequences, as determined by the Issuer in its sole discretion.

Two other increasingly popular innovations finally call into question the traditionally purely voluntary nature of an Asset Disposition Offer. First, in a (still) relatively small but growing number of transactions, the Limitation on Asset Sales covenant and the Limitation on Restricted Payments covenant provide that to the extent bond holders or other eligible creditors decide not to tender their qualifying Indebtedness pursuant to an Asset Disposition Offer, the relevant amounts not tendered will be deemed not to increase the amount of Excess Proceeds, and the Issuer may instead use those amounts to make Restricted Investments or possibly any Restricted Payments (including dividend payments) pursuant to a specific Permitted Restricted Payments basket. See also the related "*Practice Note*" on page 72 above. Second, as already mentioned under "*Optional Redemption upon Certain Tender Offers; Drag-Along Right* " on page 42 above, most European high yield bonds now contain a "drag-along" right in connection with any tender offer (including any Asset Disposition Offer) in which holders of not less than 90% of the aggregate principal amount of the then outstanding notes of any particular series have validly tendered their notes.

Other Covenants that Might be Relevant

In the event that a proposed Asset Disposition involves the transfer of all or substantially all of the assets of the Issuer and its Restricted Subsidiaries, the permissibility of the relevant transaction or transactions will likely be determined by the Change of Control covenant and the Limitation on Merger, Consolidation Sale of Substantially All Assets covenant, rather than the Limitation on Asset Sales covenant. This is because transactions permitted under the Limitation on Merger, Consolidation Sale of Substantially All Assets covenant and transactions that constitute a Change of Control are typically excluded from the definition of "Asset Disposition".

In addition, certain types of Asset Dispositions may also meet the definition of "Investment" and/or "Restricted Payment", and could therefore potentially be restricted under the Limitation on Restricted Payments covenant. The definition of "Asset Disposition" therefore also typically contains a carve-out for dispositions that constitute a Restricted Payment permitted under the Limitation on Restricted Payments covenant or a Permitted Investment. In recent years, this carve-out has been expanded in some transactions to also cover dispositions the proceeds of which are used within a specified period to make such Restricted Payments or Permitted Investments. Finally, in some transactions, the definition of "Asset Disposition" provides that in the event that a transaction (or any portion thereof) meets the criteria of a permitted Asset Disposition and would also be a Permitted Investment or an Investment permitted under the Limitation on Restricted Payments covenant, the Issuer, in its sole discretion, will be entitled to divide and classify such transaction (or a portion thereof) as an Asset Disposition and/or one or more of the types of Permitted Investments or Investments permitted under the Limitation on Restricted Payments covenant.

LIMITATION ON AFFILIATE TRANSACTIONS

The purpose of the Limitation on Affiliate Transactions covenant is to avoid leakage from the Restricted Group to controlling shareholders and other affiliates. An "**Affiliate**" is typically defined to include any person which controls, or is under common control with, the Issuer.

The covenant prohibits the Issuer and its Restricted Subsidiaries from entering into transactions with any Affiliate, subject to a *de minimis* threshold, unless:

- the transaction is on an arm's-length basis, i.e. on terms no less favorable to the Issuer or the relevant Restricted Subsidiary than those that could have been obtained from a third party;
- if the transaction value exceeds a negotiated threshold amount, the transaction is approved by a majority of the Issuer's board of directors, including a majority of disinterested directors (although sometimes this approval is required only from an officer); and
- at least traditionally, if the transaction value exceeds a higher specified threshold amount, the Issuer obtains a fairness opinion from an independent investment bank, accounting or appraisal firm (although often this approval is required only from the Issuer's board of directors).

> *Practice Note:* The traditional requirement that the Issuer must obtain a fairness opinion for affiliate transactions with a value in excess of a particular threshold amount has been rapidly disappearing in recent years, even from otherwise relatively balanced / conservative covenant packages. Instead of a requirement to obtain fairness opinions for at least very large / highly material affiliate transactions, the relevant covenant packages now typically include an additional safe-harbor exemption / carve-out for transactions for which the Issuer has (voluntarily) obtained a fairness opinion. In addition, the *de minimis* thresholds and threshold amounts for affiliate transactions that require at least the approval of disinterested directors have been steadily increasing in recent years. In (still) a minority of transactions, the traditionally fixed threshold amounts have even been supplemented with a grower element. See also "*How do baskets work?*" starting on page 29 above.

Typical exemptions / carve-outs from the application of the Limitation on Affiliate Transactions covenant include: (i) transactions between and among the Issuer and its Restricted Subsidiaries, (ii) payment of reasonable and customary fees to directors, (iii) Restricted Payments and Permitted Investments made in accordance with the Limitation on Restricted Payments covenant; (iv) transactions with the Issuer's parent company and its subsidiaries in the ordinary course of business, consistent with past practice and as otherwise permitted by the covenants; (v) arm's length transactions with customers, clients, suppliers, or purchasers or sellers of goods or services or providers of employees or other labor, in each case in the ordinary course of trading; (vi) arm's length transactions in the ordinary course of business between the Issuer or any of its Restricted Subsidiaries and any person that is an Affiliate of the Issuer solely because a director of such person is also a director of the Issuer or any direct or indirect parent of the Issuer; (vi) if applicable, payment of management fees to leveraged buyout sponsors; and (vii) as already described in the "Practice Note" above, transactions for which the Issuer has obtained a third party fairness opinion.

LIMITATION ON DESIGNATION OF RESTRICTED SUBSIDIARIES AND UNRESTRICTED SUBSIDIARIES

The Limitation on Designation of Restricted Subsidiaries and Unrestricted Subsidiaries covenant ensures that the various other covenants are not thwarted through the designation and re-designation of Restricted Subsidiaries and Unrestricted Subsidiaries. As a general rule, all subsidiaries of the Issuer are Restricted Subsidiaries unless either (i) a subsidiary is designated as an Unrestricted Subsidiary upon issuance of the bonds or (ii) the Issuer subsequently designates a Restricted Subsidiary as an Unrestricted Subsidiary in accordance with the requirements of the Indenture.

The Issuer may designate and re-designate its subsidiaries as either Restricted Subsidiaries or Unrestricted Subsidiaries at any time; provided, that in order to designate a Restricted Subsidiary as an Unrestricted Subsidiary, the following conditions must traditionally be met, although there has also been significant loosing of this covenant in some transactions in recent years:

- the Issuer must comply with the Limitation on Restricted Payments covenant, i.e. the fair market value of the Issuer's deemed Investment in the relevant subsidiary at the time of designation must be permitted under the Restricted Payments covenant or as a Permitted Investment;

> *Practice Note:* Such deemed Investment will be valued at the fair market value of the sum of the net assets of such subsidiary at the time of designation and the amount of any Indebtedness of such subsidiary owed to the Issuer and any Restricted Subsidiary.

- the Issuer must comply with the Limitation on Indebtedness covenant, i.e. any guarantee by the Issuer or the remaining Restricted Subsidiaries of any Indebtedness of the Unrestricted Subsidiary will be deemed to be an incurrence of additional Indebtedness;

> *Practice Note:* Typically, the Unrestricted Subsidiary may only incur "non-recourse" Indebtedness, i.e. the Unrestricted Subsidiary must not incur any Indebtedness that is guaranteed or secured by the Issuer or any Restricted Subsidiary. In addition, the Issuer and its Restricted Subsidiaries are often prohibited from being the lenders of any Indebtedness to an Unrestricted Subsidiary.

- the newly Unrestricted Subsidiary must not hold capital stock or Indebtedness of, or hold any liens on the assets of, or have any investment in, the Issuer and its remaining Restricted Subsidiaries;
- the Issuer and its remaining Restricted Subsidiaries must not have any obligation to (i) subscribe for additional equity in the newly Unrestricted Subsidiary or (ii) maintain or preserve the financial condition of the newly Unrestricted Subsidiary (whether by guarantee or extension of credit); and
- the designation will not result in a Default or an Event of Default.

It goes without saying that, following the designation of a subsidiary as an Unrestricted Subsidiary, any agreement, transaction or arrangement between the Issuer and the Restricted Subsidiaries, on the one hand, and, the newly Unrestricted Subsidiary, on the other hand, must comply with the Limitation on Affiliate Transactions covenant. See also "*Restricted Subsidiaries vs. Unrestricted Subsidiaries*" on page 16 above.

In order to designate an Unrestricted Subsidiary as a Restricted Subsidiary, the following conditions must traditionally be met, again subject to significant loosing of the relevant requirements in many transactions in recent years:

- any Indebtedness of the newly Restricted Subsidiary must be permitted to be incurred in accordance with the Limitation on Indebtedness covenant; and
- the designation will not result in a Default or an Event of Default.

In addition, the Issuer must ensure that any Investment held by the newly Restricted Subsidiary must be able to be made in accordance with the Limitation on Restricted Payments covenant or as a Permitted Investment and that any liens on the newly Restricted Subsidiary's assets are permitted to exist under the Limitation on Liens covenant.

LIMITATION ON MERGER, CONSOLIDATION AND SALE OF SUBSTANTIALLY ALL ASSETS

The goal of this covenant is to prevent a business combination in which the surviving entity is not financially healthy, as measured by the "€1.00 of Additional Ratio Debt Test" (and sometimes a consolidated net worth test), or otherwise does not have the same basic characteristics of the Issuer. The covenant traditionally prohibits the Issuer from merging with or consolidating into another entity, or transferring all or substantially all its assets and the assets of its Restricted Subsidiaries, as a whole, to another entity, unless the following general conditions are satisfied:

- either the Issuer is the surviving entity or the surviving entity is an entity organized under the laws of a specified jurisdiction (e.g. the laws of the Issuer's jurisdiction of organization or the laws of a European Union member state or the United States);
- the surviving entity, if other than the Issuer, assumes all of the Issuer's obligations under the bonds;
- the Issuer or the surviving entity would be able to satisfy the €1.00 of Additional Ratio Debt Test (see also page 66 above); and

- no Default or Event of Default under the bonds exists either before or as a result of the transaction.

Sometimes, this covenant contains an additional condition that the consolidated net worth of Issuer or the surviving entity must be at least equal to the consolidated net worth of the Issuer prior to the relevant transaction.

As the covenant restricts certain transactions that may also constitute a Change of Control that would potentially give bondholders the option to put their bonds back to the Issuer, this covenant must be reviewed and negotiated together with the Change of Control covenant. See also "*Change of Control and Portability*" starting on page 46 above.

REPORTS

The purpose of the Reports covenant is to ensure the availability of current information on the Issuer's financial performance. While it may often appear to be a "boiler-plate" covenant, potential investors can be very sensitive about the content of this covenant and generally require the Issuer to provide full public disclosure for as long as the bonds are outstanding, whether or not the Issuer is subject to any other reporting requirements under applicable securities laws or stock exchange rules.

Public availability of current information on the Issuer's financial performance is not only a critical prerequisite for the potential development of a liquid market in the bonds, but it also protects bondholders that may wish to sell their bonds from potential liability under any applicable market abuse rules. In addition, the availability of certain current information about the Issuer is also necessary to permit U.S. investors to on-sell their bonds within the United States in reliance on Rule 144A . See "*U.S. Securities Law Considerations*" starting on page 18 above.

Practice Note: Some (privately-held) Issuers that are not otherwise subject to any significant public reporting obligations, do not regularly access the debt capital markets and also do not plan any equity offering (e.g. an IPO) in the near future, may struggle to get comfortable with the (common) requirement that the MD&A in future annual reports prepared pursuant to the Reports covenant must be prepared "with a level of detail that is substantially comparable to the offering memorandum".

Another potential point of contention may be whether the Issuer may meet its obligations under the Reports covenant by posting the required reports on a password-protected investor relations website that requires registration or whether the relevant reports must be posted on a freely accessible website. Even though many investors will likely have a strong preference for, and certain investor groups have long been advocating for, reports to be made available on freely accessible websites, it remains common practice, especially among privately-held Issuers, to maintain password-protected investor relations websites, as doing so at least partly addresses concerns by some Issuers about giving otherwise private and potentially competitively sensitive information to a broad audience, including competitors, customers, suppliers, employees or even just nosy neighbors or personal acquaintances. As long as all actual and (bona fide) prospective investors in the bonds are, in fact, able to obtain access, maintaining a password-protected investor relationship website will normally be acceptable.

Although the Reports covenant traditionally did not include any relevant requirements, it has always been common practice for Issuers to hold quarterly investors calls in connection with the publication of their quarterly and annual reports during which the relevant reports and result of operations during the relevant reporting periods are discussed and investors are given an opportunity to ask questions of management. Traditionally, Issuers would conduct these calls simply as a matter of generally accepted market practice and in the spirit of good investor relations, i.e. not because of some technical legal requirement, but as an opportunity to engage with and obtain feedback from investors with a view to securing their long-term support, including in connection with potential future (re)financings. However, because of the failure by what are likely just a few black sheep to hold "voluntary" investor calls, it has become increasingly common in recent years to see express wording in the Reports covenant requiring the relevant Issuer to at least exercise commercially reasonable efforts to conduct investor calls within a certain time period following publication of each quarterly and annual report. This is one of the rare examples of a recent investor-friendly (rather than issuer-friendly) covenant trend.

EVENTS OF DEFAULT & REMEDIES

Historically, the definitions of "**Event of Default**" and "**Default**" (i.e. any event which is, or after notice or passage of time or both would be, and Event of Default) and the related remedies / enforcement provisions were not normally the subject of extensive negotiations. Instead, the Issuer, the Initial Purchasers and their external lawyers would often just go through the fairly "standard" and non-controversial list of Events of Default with a view to ensuring at least high level alignment (to the extent appropriate) with the corresponding provisions in other financing arrangements of the Issuer and making certain "technical" adjustments, for example, to ensure that the wording of bankruptcy/insolvency-related Events of Default properly reflect local insolvency regimes in the jurisdictions of organization of the relevant Issuer and its Restricted Subsidiaries. The (normally) fairly limited commercial discussions would often focus primarily on agreeing appropriate *de minimis* thresholds in relation to, for example, cross-(payment) defaults and cross-acceleration events, failure to pay final judgments or invalidity of security interests granted to secure obligations under the bonds. Sometimes, discussions might also cover the appropriate duration of cure / grace periods for certain Events of Default, but even those have historically followed fairly consistent market standards. Because of this relative consistency of the relevant provisions across the market and the relative lack of (non-obvious) commercial points that require negotiation, the prior edition of this guide did not even contain a section on Events of Default and remedies.

However, it is important to note that this (historic) lack of "innovation" with regard to the definition of "Event of Default" and the related enforcement provisions must not be taken as an indication that the relevant provisions are not important. On the contrary, one of the possible reasons for the (historic) reluctance by Issuers, Initial Purchasers and their lawyers to deviate in any material way from the relevant market standard provisions may be that they are, in fact, of fundamental importance. From a marketing / investor relations perspective, it is also hard for issuers to argue in favor of any innovations that make it more difficult for investors to actually enforce the ever more issuer-friendly covenant packages we have seen in recent years. In a sense, the remedies and enforcement provisions of high yield bonds, in particular, had long been a sort of final frontier that remained largely untouched, even through long years of issuers successfully challenging traditional covenant protections and pushing for incremental flexibility in almost all other areas.

That said, we have identified a number of trends and developments in this area that are worth mentioning here. Some of these trends and developments seemed to have just started to gain momentum before the European high yield markets temporarily shut as a result of the Covid-19 pandemic, while others may have even accelerated because of the Covid-19 pandemic.

Higher Acceleration Thresholds?

Other than certain bankruptcy/insolvency-related Events of Default, which typically result in automatic termination of (and acceleration of all obligations to repay the principal and pay interest under) the bonds, termination and acceleration under an Indenture upon the occurrence of an Event of Default, that has occurred and is continuing, typically (i.e. almost universally) requires delivery of a relevant termination/acceleration notice from the Trustee for the bonds to the Issuer. And the Trustee will only be authorized to deliver such a notice upon the instruction of holders of a specified percentage of the outstanding principal amount of the relevant bonds. Other than under a traditional bank credit facility, which typically contemplates acceleration by lenders holding at least a majority (and possibly even a super majority) of the relevant commitments, it is normally sufficient for a specified minority of bondholders to give the required instruction to the Trustee. This is because bonds will typically be held by a much larger and much more diverse group of investors than even broadly syndicated, institutional term loans. This and the fact that bonds are typically listed and are freely tradeable by investors (which will not necessarily be know to each other) means that bond investors may have to overcome significant collective action problems (i.e. need to self-organize, retain and agree on compensation of legal and other third party advisers, …..) before being able to start considering potential enforcement of their rights in a potential default scenario. See also "*In good times and in bad times*" starting on page 24 above, with regard to the challenges facing Issuers in soliciting necessary or desired consents from the required (super) majority of bond holders.

As a result, it has long been market standard in both the European and US high yield market that the Trustee may deliver a termination/acceleration notice to the Issuer upon instruction of holders of at least 25% in principal amount of all outstanding bonds, which may subsequently be overruled / rescinded by simple majority vote of the holders. In a fairly recent development, however, the near universal acceptance of the 25% acceleration threshold has been slowing coming under pressure, with (still) a fairly small number of transaction providing for higher (e.g. 30%) acceleration thresholds. Especially in scenarios where speed may be of the essence, even such seemingly small changes could potentially make a significant difference in practice.

Special Cure Rights for Failure to provide Required Certificates and Breaches of Reports Covenant?

In a not so recent development, it has further become increasingly common for high yield bond indentures to provide that (i) if a Default for a failure to report or failure to deliver a required certificate in connection with another Default (the "**Initial Default**") occurs, then at the time such Initial Default is cured, such Default for a failure to report or failure to deliver a required certificate in connection with another Default that resulted solely because of that Initial Default will also be cured without any further action and (ii) any Default or Event of Default for the failure to comply with the time periods prescribed in the Reports covenant or otherwise to deliver any notice or certificate pursuant to any other provision of the Indenture shall be deemed to be cured upon the delivery of any such report required by such covenant or such notice or certificate, as applicable, even though such delivery is not within the prescribed period specified in the Indenture.

At first sight, the inclusion of this or similar features may seem fairly innocuous, as termination / acceleration of a bond may appear to be a draconian/disproportionate remedy anyway for what Issuers' may argue should be treated as mere "technical" (and possibly unintentional) breaches of mere notice or reporting obligations. However, as a practical matter, the inclusion of this feature may effectively deprive investors of any effective remedy for enforcing, for example, the market standard obligation of the Issuer to self-report any Defaults or even the most basic and critical, from their perspective, reporting obligations under the Reports covenant. Under the Reports covenant, for example, the Issuer typically already has 120 days after the end of its fiscal year to publish its annual report. Should the Issuer fail to so publish its annual report by the prescribed deadline, the related Default will typically only become an "Event of Default" once it has failed to cure such breach within 60 days after notice from the Trustee, which, in turn, will only act upon the instruction of holders of at least 25% in aggregate principal amount of the relevant notes outstanding. Only after the further fruitless expiration of this 60 day cure period would holders of at least 25% in aggregate principal amount of the relevant notes outstanding be entitled to instruct the Trustee to deliver a termination/acceleration notice to the Issuer. The effect of the feature described above would be that the relevant Issuer could then still subsequently (and retro-actively) cure the relevant reporting breach at any time by delivering a report, possibly months after the expiration of the original deadline and after investors may already have spent very significant time, money and other resources coordinating amongst each other, trying to engage with a potentially non-cooperative Issuer and pursuing remedies.

Anti-Net Short Investor Provisions

"Net short" activism and the emergence of a number of novel provisions to address (i.e. frustrate) it in both leveraged loan and high yield bond documentation became a hot topic in 2019 and early 2020 as a result of a prominent dispute between Windstream Holdings Inc., a US provider of telecom services, and US hedge fund Aurelius Capital Management LP. In September 2017, Aurelius Capital delivered a notice of default under a tranche of Windstream's bonds in which it held a controlling position. Aurelius Capital also sued Windstream, contending that a sale/leaseback transaction in March 2015 had been conducted in breach of Windstream's bond covenants. Not only did Aurelius Capital bring its claim more than two years after the 2015 sale/leaseback transaction was completed and had become public, but Aurelius Capital also appears to have been the only creditor of Windstream that claimed a Default, while other bond holders even worked with Windstream to try to retroactively cure any Default caused by the transaction. However, in February 2019, a trial judge ruled in favor of Aurelius Capital, which resulted in an Event of Default under Windstream's Indenture and therefore in Windstream's creditors becoming entitled to accelerate about $5.8 billion of Indebtedness, forcing Windstream to file for bankruptcy protection under Chapter 11 of the US Bankruptcy Code. Because Aurelius Capital was supposedly "net short" (i.e. had entered into credit default swaps (CDSs) with regard to an aggregate principal amount in excess of its bond holdings), Aurelius Capital is reported to have made a $310 million profit as a result of Windstream's bankruptcy filing, which triggered its right to collect payments under its CDSs.

This widely reported outcome did not only alarm issuers / borrowers that became concerned that they could also fall victim to similar net short activism, but also traditional (long) investors in high yield bonds and leveraged loans as they could also be harmed by even healthy companies being forced into bankruptcy to benefit net short positions by activist investors.

In direct response to the Windstream/Aurelius dispute, both borrowers and issuers therefore started to include a number of novel provisions in their leveraged loan and high yield bond documentation, including provisions that impose time limits on delivering notices of acceleration as well as provisions that extend or stay applicable cure periods with regard to (alleged) covenant breaches that are the subject of litigation. These two types of provisions are described in more detail under "*Time Limitation on Delivering Notices of Acceleration and/or Extension or Stay of Default Cure Periods?*" on page 93 below. Although their status as anti-net short investor provisions may not be obvious, they appear to have been introduced in direct response to facts and circumstances specific to the Windstream/ Aurelius dispute. The relevant provisions are fairly straightforward and seem to have generated much less controversy than a third category of anti-net short investor provisions designed to disenfranchise (i.e. disregard instructions by) certain net short investors.

Under this third category of anti-net short investor provisions, instructions by "net short" investors are to be disregarded for the purpose of determining whether applicable thresholds for triggering Events of Default and delivering valid notices of acceleration have been met. In some transactions, "net short" investors may also be precluded from participating in amendments and waivers. To allow Issuers to enforce the relevant provisions, bondholders may be required to make related "position representations" to the Trustee and the Company when delivering relevant instructions to the Trustee.

While some may argue that there is a compelling rationale for the inclusion of such provisions, attempting to draft appropriate net short investor disenfranchisement provisions involves numerous potential pitfalls and will require the relevant Issuers, Initial Purchasers, investors and their lawyers to consider a number of questions. Is it truly appropriate or even desirable to effectively require that investors only maintain a perfectly hedged or long position in credit derivatives, or could a proposed disenfranchisement provision potentially reduce the pool of potential investors for a proposed offering and thereby decrease both the liquidity and value of the relevant bonds? Will the Issuer potentially even be required to included a related risk factor in the offering memorandum should it decide to include relevant disenfranchisement wording? What if a particular investor's "net short position" is a *de minimis* amount? What if the investor's net hedged position fluctuates over time? How difficult / easy will it be for a particular investor to determine whether it is "net short"? Will a "reasonable inquiry" suffice and, if so, what must an investor undertake to satisfy such a requirement? What if a particular investor is long, for example, with regard to loans or just with regard to a particular series of the Issuer's bonds, but net short on the overall credit or vice versa? What if a "beneficial owner" is potentially deemed "net short", but the underlying positions are, in fact, held by separate (but affiliated) entities that may manage separate pools of assets and pursue different investment strategies, possibly on behalf of separate clients? Although it may be relatively straightforward to properly capture any "short" positions in a definition of "net short", capturing how to determine any corresponding "long" positions may be significantly less straightforward, in particular with regard to freely tradable bonds. Should any "long" positions be determined by reference to the principal amount of any bonds held by the relevant investor, the (average) price at which the relevant bonds where acquired, or possibly even at current trading prices at the date of determination? In addition to potential disenfranchisement of "net short" investors by simply disregarding their instruction for the purpose of determining whether applicable thresholds in the enforcement provisions of an Indenture have been met, should the Issuer also be entitled to force net short investors to sell their positions (as in some loan transactions) and, if so, at what price? Finally, what impact will the potential disenfranchisement of holders of potentially very significant positions in one or more series of bonds have on perfectly "legitimate" and good faith covenant enforcement efforts by other (i.e. "net long") groups of investors? Will it be more difficult (or even impossible) for those net long investors to achieve any applicable voting / instruction thresholds?

Because of these complex questions, the drafting of net short investor disenfranchisement provisions continues to evolve, and there is certainly not yet a "market standard". In any case, it is important to note that that the emergence and development of the various anti-net short investor provisions has been largely confined to a relatively small (but growing) minority of US leveraged loan and high yield bond transactions and that initial examples of these provisions had only just started to appear in European leveraged loans and high yield bonds at the beginning of 2020 before the relevant markets temporarily shut down in response to the Covid-19 pandemic. It therefore remains to be seen whether the inclusion and further evolutions of any of these provisions will continue to gain traction.

Time Limitation on Delivering Notices of Acceleration and/or Extension or Stay of Default Cure Periods?

As already mentioned on page 92 above, the Windstream/Aurelius dispute further led to an increase in the number of transactions that include provisions that (i) impose a shortened "statute of limitations" (of typically just two years) on the right of noteholders to take enforcement action based on certain Defaults / Events of Default and/or (ii) provide for the extension or stay of applicable cure periods with regard to (alleged) covenant breaches that are the subject of litigation, often as part of a broader package of provisions designed to frustrate "net short" activism. It is important to note, however, that these provisions typically apply to all investors, i.e. not just "net short" investors, however such term may be defined.

Under the former type of provision, a notice of default, notice of acceleration or instruction to the Trustee to provide a notice of default, notice of acceleration or take any other action with respect to an alleged Default or (certain types of) Event of Default may not be given with respect to any action taken, and reported publicly or to holders of the bonds, more than two years prior to such notice or instruction. Note that the relevant provisions do not normally require that bondholders must be aware of any Defaults (i.e. that the relevant action was taken in breach of relevant covenants) or that bondholders even have all information necessary to make the relevant determinations.

In addition, a small but increasing number of transactions also started to include express provisions pursuant to which any cure periods provided for in the Indenture with regard to any (alleged) Defaults / Events of Default that are the subject of pending litigation may either be extended or stayed by a court of competent jurisdiction or are even automatically stayed pending a final and non-appealable determination of the relevant court.

Prepayment Premium upon Covenant Breach or (Voluntary) Bankruptcy?

As already mentioned under "*Higher Acceleration Thresholds?*" on page 90 above, the occurrence of certain bankruptcy/insolvency-related Events of Default with regard to an Issuer almost always results in the automatic acceleration of all its bonds under the relevant provisions of the Indenture or other documentation governing such bonds, while other Events of Default merely give holders the right to accelerate the bonds, subject to certain procedural requirements. In addition, as discussed under "*Optional Redemption / Make-Whole Redemption*" starting on page 42 above, the terms of traditional high yield bonds typically give the Issuer the option to redeem all or a part of the bonds (i) if redeemed during the relevant non-call period, at a redemption price equal to 100% of the principal amount of the bonds that are being redeemed plus an "Applicable Premium" as well as accrued and unpaid interest and any "Additional Amounts" and (ii) if redeem after the expiration of the relevant non-call period, at different scheduled redemption prices that involve payment of different fixed premiums that apply during different time periods. However, whether bondholders are also entitled to any such premium in the event of an acceleration of the bonds, either as a result of a bankruptcy of the Issuer or otherwise, is often unclear and has been the subject of a number of US court decisions with different outcomes.

First, the relevant court must interpret the relevant provisions of the Indenture or other document governing the bonds to determine whether bondholders are entitled, as a matter of contract law, to any premium in case of an acceleration of the bonds during a period when a premium would have been payable if the Issuer had decided to optionally redeem the bonds. Historically, the terms of high yield bonds would rarely address this issue expressly, and the wording of the (generic) provisions describing acceleration following the occurrence of an Event of Default would often differ slightly. Some Indentures might provide that "all unpaid principal of, and accrued interest on, the notes then outstanding will become due and payable", while other Indentures might simply provide that "all outstanding Notes shall be due and payable". Yet other Indentures might expressly provide that "the principal of, premium, if any, and interest on, all the outstanding notes shall become immediately due and payable". The US bankruptcy courts, in particular, have also taken conflicting positions as to whether bondholders are entitled to a make-whole premium in a bankruptcy context. In a 2016 decision, the Third Circuit determined that "redemption" covered both pre- and post-maturity repayments of debt and that the "redemption" of notes by an Issuer as a result of an acceleration was "at its option" because the Issuer had voluntarily filed for Chapter 11 bankruptcy protection. As a result, the court held that the words "premium, if any" in the acceleration provisions of the Indenture were clearly meant as a reference to any premium contemplated by the relevant optional redemption provisions of the Indenture. Based on substantially identical provisions in the relevant Indenture, however, the Second Circuit determined in a 2015 decision that an acceleration of the maturity date of a series of bonds as a result of a bankruptcy filing meant that the relevant Issuer did not "redeem" the bonds and, even if it had "redeemed" the bonds, such redemption would not have been "at its option", because the Indenture provided for automatic acceleration of the relevant bonds upon a bankruptcy filing. As a result, the express reference to "premium, if any" in the acceleration provisions did not help bondholders as they were not entitled to any premium under the optional redemption provisions.

Other relevant cases were based on fact patterns that involved blatant covenant breaches by Issuers based on the theory that it would be cheaper for the relevant Issuer (or an acquirer) to refinance and repay the relevant bonds at par upon a threatened acceleration by bondholders, than to exercise the Issuer's contractual option to early redeem the bonds and pay the applicable (make-whole) premium or to solicit relevant consents from bondholders.

In response to the decision by the Second Circuit described above, very explicit provisions with regard to premium payments upon acceleration started to appear in Indentures for some US secured high yield bond transactions as early as the spring of 2015. These explicit provisions made it clear that any premium contemplated by the optional redemption provisions of the Indenture would also be payable upon the relevant bonds becoming due and payable upon an Event of Default, whether automatically or by declaration, i.e. not just in a bankruptcy context. Following the emergence of the Covid-19 pandemic, there have been reports of a significant increase in the frequency of such explicit provisions in the US market, possibly as a result of a large number of US issuers coming to market that have been severely adversely impacted by the pandemic. Often, the relevant Issuers have been issuing secured bonds for the first time, and had significant amounts of outstanding unsecured debt. Whether this trend will gain further momentum and whether similar provisions will start to appear in European transactions remains to be seen.

In any case, it is also important to note that a determination that the Indenture does provide for payment of a premium upon a particular acceleration event (either based on an explicit provision or as a matter of contract interpretation), will only be the first step. A claim for a make-whole premium or other premium may still be disallowed if the relevant (bankruptcy) court determines that the payment of the relevant premium, as contemplated by the Indenture, is unenforceable under applicable (local) insolvency regimes, which may take different approaches from the US approach on transactions involving Issuers and their subsidiaries in different European jurisdictions. Often, the explicit provisions described above also attempt to address and account for relevant (US) insolvency law considerations, for example, by qualifying any premium payable upon acceleration as (reasonable) liquidated damages and by including appropriate waiver and other wording.

AMENDMENTS & WAIVERS

As discussed under "*In good times and in bad times*" starting on page 24 above, soliciting consents from noteholders for any necessary or desired amendments of, or waivers under, the Indenture, the notes themselves or any guarantees, security documents or Intercreditor Agreement may pose a significant challenge for the Issuer. While many "ordinary" amendments or consents "only" require the consent of at least a majority in principal amount of the notes then outstanding, amendments or waivers that affect certain key commercial terms of the notes typically need to clear a higher consent threshold to pass. This typically includes amendments or waivers which would: (i) reduce the stated rate of or extend the stated time for payment of interest on any notes, (ii) reduce the principal of or extend the stated maturity of any notes, (iii) reduce any premium payable upon the redemption of any notes or change the time at which any notes may be redeemed, (iv) release any guarantees or security interests with regard to the notes, other than in accordance with the terms of the notes or the relevant security documents or guarantees, (v) change the currency in which notes are payable, or (vi) change the relevant consent thresholds.

Traditionally, any such key amendments or waivers require the consent of a supermajority of at least 90% in principal amount of the notes then outstanding. However, this almost universal market standard has been eroded in a minority of transactions in recent years which have successfully introduced lower consent thresholds (e.g. 75%) at least with regard to some (if not all) such key amendments and waivers.

It is also important to note that the terms of high yield bonds governed by a law other than New York law, in particular, may deviate significantly from the traditional high yield market standard with regard to amendments and waivers, as they may incorporate relevant local market practices and/or mandatory statutory provisions under applicable law. Under Section 5 of the German Act on Debt Securities of 2009 (*Gesetz über Schuldverschreibungen aus Gesamtemissionen*), for example, even amendments of certain key terms, including the types of amendments listed above, only require approval by a simple majority of the votes cast at a meeting of noteholders, i.e. not even approval by a majority of in principal amount of the notes outstanding.

As already mentioned under "*Anti-Net Short Investor Provisions*" starting on page 91 above, the terms of some transactions also preclude "net short" investors from participating in amendments and waivers.

Indicative Transaction Timetable

PRE-LAUNCH

Under ideal circumstances and with the full commitment of all parties involved in the offering, the preparations necessary for a "**Launch**" of a proposed high yield bond offering (i.e. the formal external announcement and distribution of the preliminary offering memorandum) by a first-time issuer can be completed in approximately eight to ten weeks from the initial kick-off meeting, although the actual lead time will always depend on a variety of factors that are specific to the individual Issuer and each offering. The lead time required for a high yield offering by a repeat issuer can be significantly shorter, in particular if the relevant issuer has recently completed another offering and preparations required for the proposed follow-on offering will focus primarily on updating the documentation for the prior offering.

Key factors that can (very significantly) extend the required lead time for a particular offering include (i) the lack of existing, high-quality disclosure language (in English) regarding the Issuer and its business that can be tailored for purposes of the offering memorandum, (ii) the time needed by the Issuer's internal accounting team and external auditors to prepare the required financial information, in particular any *pro forma* information that may be required (iii) potential general resource constraints / availability of dedicated staff at the Issuer for the offering, (iv) complications and delays in any necessary negotiations with existing creditors of the Issuer, (v) complexities involved in releasing existing security interests (in favor of creditors that are to be repaid with the proceeds of the offering) and in creating new security interests (in favor of the bondholders), potentially in multiple jurisdictions, (vi) potential delays and complications in the rating process and (vii) general market conditions.

Time	Tasks
Week 1	• Issuer's counsel prepares initial outline of offering memorandum (**OM**) and discusses it with Issuer • Issuer, Initial Purchasers and their counsels agree offering structure • Issuer and Issuer's counsel discuss covenant package and flag key issues to Initial Purchasers and their counsel • Issuer commences preparation of data room based on due diligence request list provided by Issuer's counsel and Initial Purchasers' counsel • Initial Purchasers circulate management due diligence questionnaire • Issuer's counsel circulates publicity guidelines • Research guidelines (if any) circulated by Initial Purchasers' counsel
Week 2	• Issuer circulates / gives management presentation to working group • Issuer, Initial Purchasers and their counsel to agree approach with regard to existing lenders and security trustee • Working group provides initial feedback on approach to OM • Issuer and Issuer's counsel work on / revise draft offering memorandum • Initial Purchasers and counsel work on initial draft of description of the notes (**DoN**)

<table>
<tr><th>Time</th><th>Tasks</th></tr>
<tr><td>Week 3</td><td>
Select listing venue
Select Trustee and Trustee’s counsel
Issuer’s counsel circulates draft of preliminary OM
Initial Purchasers’ counsel to circulate draft DoN
Draft documentation for Trustee accession arrangements to existing security (if applicable)
Initial Purchasers and their counsel review draft preliminary OM and prepare by consolidated mark up
Issuer and Issuer’s counsel discuss DoN
Drafting session on OM / DoN
Auditors circulate draft engagement and comfort letters
Issuer and Initial Purchasers prepare draft rating agency presentation
Further discussions with regard to security trustee and potential lender consents and approach to existing lenders if required
</td></tr>
<tr><td>Week 4</td><td>
Issuer’s counsel and Initial Purchasers’ counsel commence documentary due diligence
Initial Purchasers and counsel circulate draft purchase agreement
Issuer’s counsel re-circulates draft OM to working group
Issuer’s counsel circulates mark up of DoN
Initial Purchasers and their counsel review revised draft OM and prepare by consolidated mark up
Drafting session on revised drafts of OM / DoN
Issuer and Issuer’s counsel to discuss and comment on purchase agreement, distribute mark up to Initial Purchasers and Initial Purchasers’ counsel
Issuer and Initial Purchasers continue to work on rating agency presentation
</td></tr>
<tr><td>Week 5</td><td>
Drafting sessions on OM, DoN, purchase agreement and/or security package, as necessary
Potential discussions with Trustee, fiscal agent and/or security agent, as necessary
Issuer and Initial Purchasers continue to work on rating agency presentation and commence work on road show presentation
</td></tr>
</table>

Time	Tasks
Week 6	• Issuer's counsel sends draft OM to stock exchange • Drafting sessions on OM, DoN, purchase agreement and/or security package, as necessary • Issuer and Initial Purchasers meet with rating agencies and receive feedback • Issuer and Initial Purchasers continue to work on work on road show presentation
Week 7	• Receive stock exchange comments and incorporate into OM, continue to fine-tune OM and resubmit OM to exchange • Finalize DoN • Issuer's counsel sends draft OM (including DoN) to financial printer for typesetting (if sufficiently advanced); "F-pages" with financial statements can be sent earlier, if available
Week 8	• Board meeting to approve issue of preliminary OM, appoint committee or individuals to approve pricing, approve contractual documentation when finalized • Finalize preliminary OM • Finalize purchase agreement • Finalize road show presentation and road show schedule • Security agent / trustee and any lender consents obtained • Give print order for preliminary OM, if hard copies are required • Announce and launch offering, subject to favorable market conditions

POST-LAUNCH

To market, and build momentum for, the inaugural offering of a first-time issuer, the Issuer and the Initial Purchasers will typically commence a physical roadshow after "**Launch**". The length of this roadshow can vary significantly from a few days to up to two weeks, depending on the nature of the Issuer, nature and size of the proposed offering and general market conditions. While senior management of the Issuer and certain representatives of the Initial Purchasers are out marketing the bonds to investors on the roadshow, other members of the working group, in particular the lawyers, will typically use the time to finalize the necessary contractual documentation, including Indenture, guarantees and security documents. Repeat Issuers with a strong existing investor base may only conduct an electronic roadshow or conduct the offering on a much accelerated basis, sometimes without conducting a proper roadshow at all.

Since many key European high yield investors are based in London, Paris or Frankfurt, European high yield roadshows frequently include visits to those three cities. Other common roadshow stops include Amsterdam and Edinburgh, and further stops may be included based on the home country or particular industry of the Issuer, the market environment and other factors.

Following completion of the roadshow, all parties participate in a final "bring-down due diligence call" with the Issuer's management, the Issuer's auditors deliver a comfort letter and the Issuer and the Initial Purchasers hold the "**Pricing**" meeting at which the exact offering terms are agreed, such as exact offering size, coupon and tenors. After the Pricing meeting, the Issuer, any Guarantors and the Initial Purchasers will execute the purchase agreement, at which point both the Issuer and the Initial Purchasers are bound to complete the offering, subject to certain closing conditions. Issuer's counsel and Initial Purchaser's counsel then prepare the final offering memorandum (by inserting the Pricing terms into the preliminary offering memorandum) and finalize and collect signatures for the various closing documents (including bring-down comfort letters, legal opinions and disclosure letters) in preparation for the "**Closing**" of the transaction. Upon Closing, the bonds are formally issued and delivered by the Issuer against payment therefore by the Initial Purchasers. Closing typically takes place three to five business days after Pricing (i.e., "T+3", "T+4", "T+5"), although a longer period (i.e. up to ten business days / "T+10") may be agreed, especially where transaction security must be put in place in multiple jurisdictions and/or existing security for the benefit of other creditors may need to be released. In case all or a part of the proceeds of an offering are intended to be used to redeem / refinance existing notes of the Issuer, agreeing a longer settlement period may also allow the Issuer to either (i) have the redemption of the existing notes (which typically requires at least 10 calendar days' notice) and Closing of the new offering fall on the same day or (ii) at least reduce the period between the issuance of the new notes and redemption of the existing notes, during which period the Issuer may otherwise have to pay interest with regard to both the new notes and the existing notes.

For more information about the marketing of high yield bond offerings, see also under "*Offering Memorandum*" on page 8 above.

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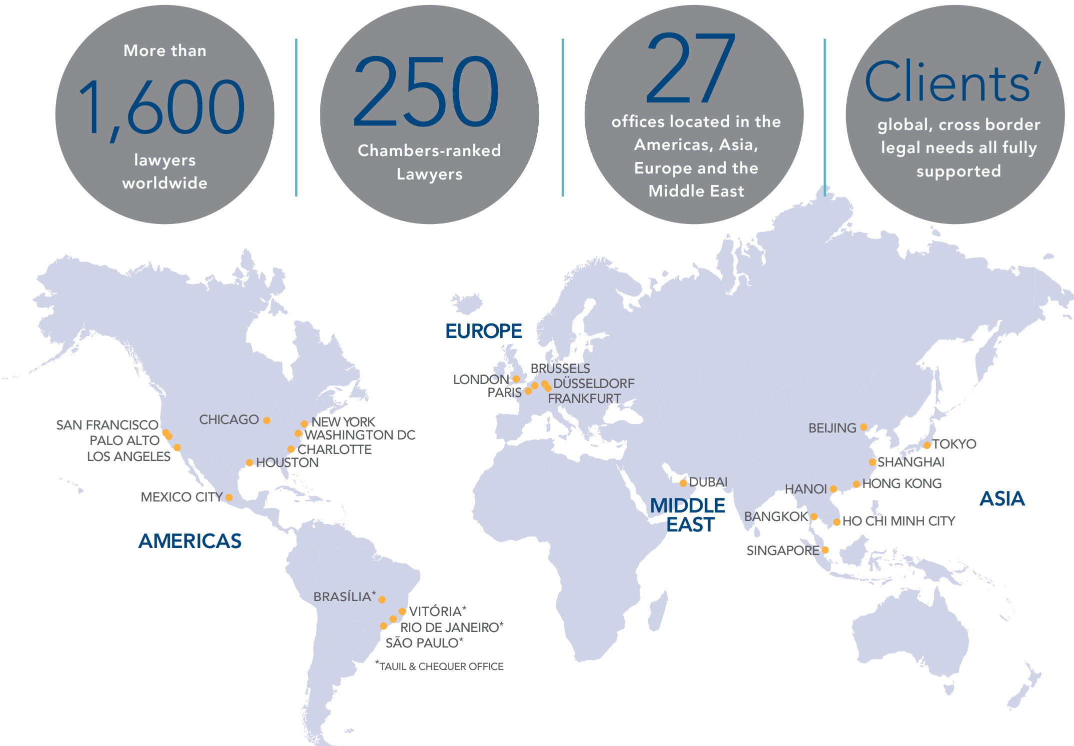

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