European Leveraged Finance Association

INSIGHTS

10 March 2022

Voting Cap in European Loan is an Inappropriate Curtailment of Lender Rights

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In December 2020, we released an Insights report which highlighted the first instance of a voting cap provision making its way into a US bond offering. We explained just how detrimental the inclusion of such a provision can be to creditors.

We have now encountered the first instance of an aggressive voting cap provision entering a European leveraged loan as part of a recent buyout financing.[1] This feature of the lending agreement limits individual creditors' voting rights to 15% of total commitments;[2] or if a vote relates to a specific facility or tranche, to 15% of the commitments under the relevant facility or tranche.[3]

Voting provisions like this one substantively disadvantage creditors while simultaneously benefitting the equity sponsor and its affiliates. ELFA believes that these covenant terms significantly harm credit investors' best interests and therefore objects to their inclusion within European leveraged credit deals.

The voting cap language applies to all decisions under the finance documents, whether requiring the approval of the majority lenders, super majority lenders, all lenders, or any other class of lender (unless the company dictates otherwise). While investor groups may be able to band together in theory to meet the requisite threshold, no single investor would be able to enforce contractual covenant protections, even in the event of a default.

Furthermore, this provision will curb the ability of a lender to accumulate a blocking stake in the context of a super-majority vote, as the super-majority threshold is usually around 662/3 – 80%. This divide-and-conquer treatment of creditors seems even more egregious when factoring in the presence of additional clauses that exclude "net short lenders" when calculating consent thresholds.[4]

Worse yet, these provisions also allow the issuer to adjust any individual holder's voting cap.[5] This aspect of the provision affords the borrower and its owners the discretion to prevent specific funds from taking action in selected situations where it would be unfavourable to their own interests. Similarly, the borrower also has the power to disapply the voting cap to their advantage, either across all lenders or with respect to an individual lender (and its affiliates). Finally, it is worth noting that the voting cap from the recent European loan deal in question does not apply to commitments held by the arranging banks or original lenders, thereby further exaggerating the disparity of treatment between different creditors and between classes of creditors.

Voting cap provisions severely undermine the notion of equal contractual rights and pro-rata principles for creditors. Such manoeuvres undermine the privileges ordinarily conferred to creditors by virtue of their superior position within a borrower's capital structure. It is ELFA's view that any increase in the prevalence of voting cap provisions will serve to lessen the appeal of investing in European leveraged credit markets while lowering the valuations of distressed credit in secondary markets. For these reasons, investors should be very vigilant about the potential proliferation of such language in lending agreements.

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[1] 9fin, our Platinum Partner for covenants, published an alert on the deal. Click here to read it.

[2] In the aforementioned US bond deal, the cap was set at 20%.

[3] In the restructuring context, the "voting cap" would apply to a creditors' vote under the finance documents but not to a vote under, for example, a court led restructuring process.

[4] A term that is increasingly common in leveraged loan documentation.

[5] There is some ambiguity as to whether or not the voting cap could be decreased as the wording requires the company to give notice of the level of the cap but omits to include a floor at the current level of 15%.

About ELFA:

The European Leveraged Finance Association (ELFA) is a professional trade association comprised of European leveraged finance investors from over 55 institutional fixed income managers, including investment advisors, insurance companies, and pension funds. ELFA seeks to support the growth and resilience of the leveraged finance market while acting as the voice of its investor community by promoting transparency and facilitating engagement among European leveraged finance market participants. For more information please visit the ELFA website: www.elfainvestors.com.

Our Mission Statement:

ELFA seeks to create a more transparent, efficient, and resilient leveraged finance market while acting as the voice of its investor community. To that end, our diverse forum of investors engages with other industry professionals in order to educate and to promote best practices and transparency.

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