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Understanding the Assignment

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Tucked into the back of every credit agreement there is a "Miscellaneous" section that often gets less attention than the more-heavily negotiated covenants and defaults. While much of this section is "boilerplate" language that is largely consistent from agreement to agreement, there are a few provisions that tend to draw more significant scrutiny. One such provision is the assignability, or lack thereof by one or more parties, to the contract.

While assignment provisions are not unique to the subscription finance space (in fact their existence is mostly universal in financing documents), there are some unique concerns that are raised in the context of subscription credit facilities. In this article, we set forth an explanation of the provisions generally and then address some aspects which are of particular interest to subscription lenders and fund borrowers.

Assignments Generally

Pursuant to New York law, contracts are freely assignable unless expressly stated otherwise. Both lenders and borrowers have their own reasons to resist the assignment of a loan to another party, which are discussed in more detail below. As a result, loan agreements set forth in some detail the conditions under which a loan may be, or not be, assigned. These provisions govern things such as (i) which party is permitted to or prohibited from assigning its interests, (ii) who and/or which types of entities are eligible to be an assignee, (iii) what consents must be obtained and under what circumstances, and (iv) other particulars such as minimum amounts, transfer fees, etc.

Most loan agreements include language stipulating that the contract is binding on successors and assigns. The latter arises when one party to the contract wishes to sell or *assign* all or a portion of its interests and obligations to a third party. If agreed to, the third party then *assumes* the obligations (typically documented via and Assignment and Assumption Agreement).

Distinguishing Assignments from Participations

An assignment establishes privity between a borrower and the assignee lender – meaning there are direct contractual rights and obligations. The assignee lender buys the obligation/debt and becomes the lender and this assumes voting rights, obligations to fund borrowing requests, rights to receive fees and other deliverables required by the loan agreement, etc. Following an assignment, the new lender can directly sue the borrower if the contract is breached and *vice versa*.

It is worth pausing to distinguish an assignment from its cousin, the participation. Participations do not establish any direct contractual rights between the participant and borrower but are instead derivative of the rights of the lender of record, who remains obligated to the borrower. The participant lender does not become party to the loan agreement and is not considered a "lender" thereunder.

Borrowers and participants *cannot* sue one another directly. Because participations convey no contractual privity and less rights than an assignment, participations give rise to no consent rights from borrowers. The lender of record and the participant can (and in practice often do) agree separately as to issues and how the lender will vote, but ultimately it will be the lender not the participant voting. In fact, in many cases a lender may grant a participation absent the borrower's knowledge.

Consent Rights, Eligible Assignees and Competitors

On the borrower side, as a general rule, borrowers cannot assign their interests and obligations under a loan agreement. This principle makes sense if one considers that a lender has underwritten a particular borrower in agreeing to make a loan. To illustrate, one might imagine a lender being comfortable making a loan on a given set of terms and pricing to a highly rated public entity.

However, if the borrower were able to assign such loan to a distressed entity, perhaps with a much lower rating, the lender would involuntarily become party to a credit facility it would have never originated in the first place. It is worth noting that this approach is consistent with the covenant that prevents a borrower from merging with another entity, unless, among many other requirements, the borrower is the surviving entity.

On the lender side, lenders may wish to assign a loan for a variety of reasons such as eliminating concentrated exposure to a particular sponsor, obtaining capital relief or even at the direction of a regulator. Assigning a loan allows a lender to accomplish such goals more quickly than waiting for the debt to mature.

When it comes to a lender's ability to assign its interests and obligation, there are a myriad of approaches to commonly contested issues. As one can imagine, such differences stem from a variety of distinct facts, including, but not limited to a particular lender's (i) internal policies, (ii) internal sensitivity to confidential information, (iii) relationship (or lack thereof) with a proposed new lender, (iv) comfort level with a sponsor's size and credit profile, (v) credit appetite related to the size and terms of the facility, and/or (vi) their view of general market conditions.

Some loan agreements contain little or no restrictions on assignments by lenders. For some lenders, free assignability is firmly held institutional policy. However, frequently borrowers obtain a right to consent to assignments (such consent customarily not be unreasonably withheld or delayed), at least under certain circumstances. However, such consent rights are typically forfeited if the borrower is in default.

For some borrowers, the identity of potential new lenders is a pressing concern, hence the effort to obtain additional control over future assignments. Many funds seek to avoid having a competitor purchase their debt and become their lender. One can imagine that there is a heightened sensitivity in the private debt and credit markets where funds are especially cautious about the prospect of their confidential information becoming available to a direct competitor or being beholden to a competitor in a borrower/lender relationship, especially if the "problem" were to occur under the credit facility. Funds are particularly cautious of the prospect of anything that might expose sensitive information about the fund's investors or capital commitments to an entity that a fund would least want to have such information.

One approach would be to simply include a definition of "Competitors." Such definitions may target a particular investment strategy or in some cases funds generally; the issue with such approaches is that they leave room for interpretation and generally can become overly inclusive. The more broadly the definition of a "Competitor" is constructed, the more likely the restrictions only apply prior to a default.

There is an interesting inflection point worth considering as parties seek to balance their interests. Following a default or borrower non-performance is the most-likely time in which a lender might want or need to offload the debt at issue. Meanwhile, the borrower, at a time of distress, is most vulnerable to and concerned about competitors being eligible assignees of their credit facility.

As a compromise – as opposed to agreeing to never assign to a "competitor" and the burden on the lender to determine who is or is not a "competitor" the borrower and lender will sometimes agree to a list of disqualified lenders (often called a DQ list or a blacklist). This list would be agreed to and scheduled at closing, and thereafter, amended solely by mutual agreement.

Another related issue on this path is whether or not the DQ list applies following an event of default. A lender's natural inclination is likely that such restrictions are removed when a facility is in default. In situations where a DQ list survives a default, it typically does so only for a specified period of time following the occurrence of the default. For example, if there is an ongoing default for 30 days, the protection of the DQ list is lost. We also note that maintaining a permanent DQ list, notwithstanding any continuing default, is rare.

Conclusion

Assignment restrictions are commonplace in loan documentation as a means of overriding the general law that contracts are freely assignable. However, in the context of subscription finance, there are unique concerns that frequently lead to significant negotiation around the terms governing assignments in order to determine what

restrictions and consents are appropriate for each facility, lender and borrower. Both lenders and borrowers (and their respective counsel) must weigh competing interests, needs and sensitivities in order to determine an agreeable path forward.