

## insights

# FAQs: Anti-net short provisions and what they mean for credit agreements

Parties to syndicated credit agreements and high-yield bond indentures have recently introduced provisions to limit the effect of those transactions on lenders that hold overall net short positions with the borrower or its debt.

Here's a summary of the key parties and terms related to anti-net short provisions, also known as Windstream Provisions.

### What is a net short lender?

A net short lender is a lender or participant (or prospective lender or participant) that would stand to benefit economically from the loan default or bankruptcy of a borrower (by holding a short position created by purchasing a credit default swap (CDS) or a similar derivative instrument or insurance product). If a borrower defaults on its debt or enters bankruptcy, a net short lender could benefit financially from the adverse credit event (in contrast, a creditor's usual credit goal rests on debt repayment and value preservation). The credit priorities of net short lenders tend to sharply contrast with those of the borrower, the borrower's equity holders, sponsors and other lenders/creditors, which could lead to broad disagreements in work-out negotiations and bankruptcy voting.

### What is a net short position?

A net short position is the net positive position to the borrower or of its debt, if any, held by a lender after **deducting** the aggregate amount of its "long" exposure (where such lender is exposed to the credit risk of the borrower) **from** the aggregate amount of its "short" exposure (where such lender is protected from, or effectively insured against, the credit risk associated with its long position).

Please note that the calculation of a net short position does not include any derivative contracts entered into by a lender pursuant to **bona fide market-making transactions**. Also, any index that includes the borrower (or other member of the credit group) should be excluded from the calculation of a net short position as long as the lender (or other member of the credit group) is not involved in the formation or administration of the index and the obligations of the borrower and the other members of the credit group in the aggregate represent less than a certain percentage of such index.

### What are net short debt activists?

The risk to a borrower is that a lender holding a net short position will act as a net short debt activist, which occurs when a lender identifies and acts upon historical or technical defaults ("manufactured defaults") to cause distress and drive down the value of a borrower's loans or bonds, because the lender will benefit from a net short provision. As a result, the behavior of net short debt activists is likely to be out-of-sync with the objectives of borrowers, their equity holders, and other lenders and creditors.

### What are net short provisions (a/k/a Windstream Provisions)?

Net short provisions are recent credit agreement provisions, which first appeared earlier this year, following the [Windstream Holdings, Inc. bankruptcy](#), which was filed after Windstream lost a court battle with a bondholder over whether Windstream had defaulted under its bonds (hence, the name "Windstream Provisions"). Windstream Provisions are an attempt to insulate borrowers from unwanted conduct by net short debt activists.

Windstream Provisions often treat net short lenders like "Disqualified Lenders" and/or "Defaulting Lenders." As a result, net short lenders may have limited access to information regarding the borrower, voting restrictions and forced divestment, among other limitations. Disqualified Lender provisions that prohibit the assignment of loans and disclosure of confidential information to certain entities (e.g., financial institutions and competitors identified by the borrower (or financial sponsor) or on a disqualified lender list). Also, "yank-a-bank" provisions may be used to remove and/or replace net short lenders.

Windstream Provisions may strip net short lenders of their right to approve or disapprove any amendment, waiver or consent, and the votes of net short lenders are disregarded for purposes of any determination as to whether Required Lenders or all lenders (whichever applicable) approved a proposed amendment, waiver or consent.

#### What are Term Loan B tranches?

Windstream Provisions apply generally to all credit facilities in a credit agreement, but are primarily directed to a Term Loan B (TLB) tranche, where net short lenders are more common; net short provisions tend to carve out “Unrestricted Lenders”—regulated entities such as commercial banks which for various reasons tend not to enter the default swap market.

It is an open issue if lender affiliates should be subject to Windstream Provisions. In one approach, when a lender’s affiliates are subject to Windstream Provisions, “Screened Affiliates” (lender affiliates that (i) are managed separately from the lender itself, (ii) have ethical walls between themselves and the lender and (iii) whose investment policies and decisions are not influenced by the lender or its investment decisions) are excluded. In another approach that **excludes** affiliates from Windstream Provisions, each lender represents that it is not knowingly and intentionally acting in concert with any of its affiliates to create the same economic effect with respect to the credit group as if such lender was a net short lender.

#### What is Net Short Representation and when should it be made?

Windstream Provisions include a “Net Short Representation,” which is made (or deemed to be made) by each lender (**except** Unrestricted Lenders) and generally state that the lender is **not** a Net Short Lender. A Net Short Representation is generally not made (or deemed to be made) upon execution of the credit agreement but is made in connection with the following:

- **Assignments to new lenders:** Where the assignee is required to make a Net Short Representation in the assignment and assumption instrument.
- **Sales of participation interests:** Where the lender is obligated to require the participant to make a Net Short Representation in the participation agreement.
- **Amendments and waivers:** Where each voting lender is required to make a Net Short Representation at the time of its response to any proposed amendment, waiver or other modification to the credit documentation.
- **Notices of default:** Where the notifying lender is required to make a Net Short Representation at the time of delivery of such notice.
- **Lender instructions to the administrative agent to accelerate the debt and/or exercise remedies:** Where each instructing lender is required to make a Net Short Representation at the time of delivery of such instructions.

For now, in credit facilities that are attractive to Net Short Lenders, related credit agreements and indentures appear to be getting longer and more complicated. We will know more as Windstream Provisions develop and loan parties analyze whether such Windstream Provisions prove problematic.



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