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Improving Covenant Protections in the Investment Grade Bond Market

December 17, 2007
(updated as of July 2, 2008)

The Credit Roundtable is an association of fixed income investors seeking to improve the protective covenants in investment grade bond indentures. These investors, assembled under the auspices of the Fixed Income Forum, have come together to prepare and publish this covenant white paper. The purpose of this document is to identify those features of the investment grade covenant packages in use today that are most objectionable to bondholders and to suggest a set of model covenants for investment grade bond deals. The members of the Credit Roundtable appreciate that not every one of the suggested model covenants will be appropriate for every issuer for every deal. It is our hope, however, that the model covenants can and will be used to facilitate covenant negotiations in every deal. Some issuers will elect to include all of the model provisions in order to improve their market access or the rate on their bonds. Issuers that are more concerned with flexibility than rate may elect not to utilize some or all of the model provisions. This document will still be useful in the context of offerings by those issuers in that it will help investors to properly value the covenant protections that are missing in those deals.

The proposed model covenants attempt to fairly balance the desire of issuers to retain flexibility to run their businesses in the normal course without restriction and the expectation of bond investors that their covenants will protect them against substantial credit deterioration through voluntary actions by issuers. However, additional tailoring to adjust these model provisions to the circumstances of particular issuers and particular market conditions is appropriate and to be expected. The model provisions do not attempt to provide alternative “baskets” and “carve-outs” for every possible circumstance. The model provisions are attached as Annex A in the form of riders that can be used to add one or more of the proposed model covenants to an offering document. These riders cover the following topics:

- ***Change of Control***
- ***Step-Up Coupons***
- ***Limitation on Liens and Priority Debt***
- ***Reporting Obligations***
- ***Voting by Series***

The Credit Roundtable is calling for verbatim disclosure of indenture provisions in offering documents since the exact wording of these provisions can be material to investors. Some "plain English" descriptions of covenants in recent transactions have made it difficult for investors to fully understand the exact nature of the covenant protections being offered. We believe a verbatim approach makes more sense for issuers and underwriters as it reduces the possibility that an offering document will contain a material misstatement or omission.

We hope that these materials will help to identify the most common limitations in the protections provided by currently used investment grade covenants and improve the dialogue in the marketplace between issuers and bond investors about these important provisions. Recent changes to the offering process have accelerated the speed at which bond offerings are completed and have made dialogue about covenants during an offering more difficult. Members of the Credit Roundtable are hopeful that publication of these sample covenants will facilitate discussions of covenant terms before offerings are launched as well as during the new issue marketing process. Ideally, issuers will either adopt these model provisions in full or will note to prospective purchasers the ways in which a proposed set of covenants differs from the model provisions. The model provisions included in Annex A and the text below are designed to help to focus market participants on the key issues that arise in preparing the covenants for a particular transaction. Included in Annex B are the "Top 10 Questions" that every bond investor should ask before investing in any new investment grade offering. We hope that this document will help issuers and bondholders communicate more effectively and complete transactions more efficiently with a reduced risk of misunderstanding.

Change of Control

The Limitations in the Precedent. The purpose of a change of control covenant is to provide each bondholder with an opportunity to rethink her original investment decision if the issuer is acquired by new owners. The high yield market version of the change of control covenant permits each bondholder to "put" her bond back to the issuer at 101% of principal amount (plus accrued interest) in the event of a "Change of Control" (as defined). Many of the investment grade covenants have a two-part trip wire for this "put" right, requiring *both* a "change of control" and a "below investment grade rating event" in order to trigger the bondholder "put" right. Many issuers feel that a double-trigger approach is more appropriate for investment grade bonds. However, the double-trigger approach has produced a number of unexpected outcomes, as ratings agencies have not always behaved in the way the draftsmen of some of these covenants imagined. In fact, a surprising number of the existing Change of Control covenants suffer from one or more of the following shortcomings:

- some existing precedent does not apply to an acquisition of the issuer by another public company in a merger transaction, because the resultant surviving corporation is not more than 50% owned by any single "person" or "group";

- some "Change of Control" definitions do not include a sale of all or substantially all of the issuer's consolidated assets;

- some of the double-trigger provisions have failed to properly capture the timing of a ratings downgrading and have, therefore, overlooked change of control transactions that have had severely negative credit implications;

- still other double-trigger mechanisms have called for rating agencies to publicly state that their downgrade was caused by the change of control transaction and the rating agencies have not always been willing or able to do so; and

- some existing precedent does not properly respond to the implications of a cessation in ratings by multiple rating agencies, either following a going-private transaction where the issuer is no longer required to make financial information available to the agencies on a timely basis or due to a decision by an issuer not to maintain a rating for any other reason.

The Proposed Model Provision. Members of the Credit Roundtable believe that a fully functioning change of control covenant should apply to all corporate takeovers, regardless of the structure and regardless of the impact on rating. However, in cases where a double-trigger approach is agreed, the shortcomings described above should be remedied. In the model provision included in Annex A, we are proposing standard language for both a single-trigger and a double-trigger change of control covenant. The model version addresses the shortcomings identified above as follows:

- a public company stock-for-stock merger is treated as a change of control unless the bond issuer's stockholders end up with more than 50% of the voting stock of the surviving company;

- a sale of "all or substantially all" of the issuer's assets is treated as a change of control (in addition to being subject to the "Merger, Sale of Assets" provisions of the indenture), although internal reorganizations are specifically excluded;

- the double-trigger provisions only require that there be a temporal link between the change of control and the rating decline and do not require any rating agency testimony as to the cause of the downgrade. If the bonds cease to be rated investment grade at any time during a test period that straddles the change of control event, the second trigger is deemed to be satisfied; and

- the bonds are treated as ceasing to be "investment grade" unless at least two of the three identified rating agencies continue to rate the bonds at the investment grade level during the trigger period that straddles the change of control event. Thus, a single withdrawn rating is disregarded but multiple withdrawn rating situations can amount to a loss of investment grade status that will satisfy the requirements of the second trigger.

Step-Up Coupons

The Limitations in the Precedent. The senior bank market has employed various "grid pricing" arrangements for many years, with the most common formulations tying the applicable spread over LIBOR to the borrower's leverage ratio or debt ratings. A similar philosophy

underlies ratings-based pricing in the investment grade bond market: if the credit deteriorates, the interest rate should increase. These step-up coupon provisions are arguably distinguishable from other investor protections in that they are not necessarily triggered exclusively by voluntary issuer actions. Ratings can decline for any number of reasons, including as a result of both voluntary and involuntary events. Arguably, with a proper "Limitation on Liens and Priority Debt" covenant (discussed below) and a proper "restricted payments" covenant,[*] ratings-based pricing adjustments should not be necessary. However, some issuers and bond investors may feel that a ratings-based pricing mechanism is a reasonable alternative to a meaningful covenant package that addresses all of the voluntary actions that can cause abrupt credit deterioration. The Credit Roundtable's members recognize that step-up coupon provisions will not be appropriate in every deal. The model provisions include a step-up mechanism because it is likely to continue to be employed by issuers to address bondholder credit concerns in some deals and having standardized language for those situations will be a benefit to all market participants.

There are a number of shortcomings in the ratings-based interest rate adjustment mechanisms currently in use in the market, including:

- most ratings-based pricing mechanisms are capped at a level that does not begin to compensate bondholders for the loss in value associated with a precipitous ratings decline;

- some of these mechanisms do not properly address the issues that arise if one or more of the originally designated ratings agencies ceases to rate the notes; and

- some of the precedent includes a "fall-away" provision whereby the step-up mechanism is forever eliminated if the bonds are upgraded beyond a specified level.

The Proposed Model Provision. Members of the Credit Roundtable believe that a fully functioning ratings-based interest adjustment mechanism should not require the investors to bear the risk that the rating agencies cease to rate the bonds — that risk properly belongs with the issuer, since the issuer is best positioned to manage the risk. The model provision addresses the short-comings described above as follows:

- if only one agency drops its rating, the dropped rating is disregarded for purpose of the interest rate adjustment provision. If more than one of the three identified rating agencies ceases to rate the bonds, however, that is taken into account and can result in an interest rate adjustment;

- issuers are not allowed to manipulate ratings by replacing Rating Agencies; and

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[*] *A typical "restricted payments" covenant would limit an issuer's ability to spin off major divisions, engage in credit-destructive leveraged recapitalizations or consummate a leveraged buyout. All of these are voluntary actions and could be limited within a set of agreed upon parameters through a "restricted payments" covenant that properly balanced issuer needs and bondholder concerns.*

- the “fall-away” provision has been eliminated.

Limitation on Liens and Priority Debt

The Limitations in the Precedent. The traditional “Liens” covenant in an investment grade indenture is intended to limit the amount of additional debt that the issuer is permitted to incur that is effectively senior to the bonds issued under that indenture. Surprisingly, many of the examples of this covenant found in indentures in use today do no such thing. These ineffective examples suffer from one or more of the following shortcomings:

- the restrictions only apply to new debt that is secured and ignore the fact that new debt can be structurally senior to the indenture’s bonds if it is incurred at a subsidiary level or is guaranteed by subsidiaries of the issuer;
- some examples only apply to the issuer and its “Restricted Subsidiaries” and have no meaningful limitation on the issuer’s ability to declare current or future subsidiaries to be “unrestricted” (and thereby outside of the reach of the covenant);
- some examples only restrict liens on items of property, plant and equipment that constitute “Principal Property,” thereby overlooking liens on accounts receivable, inventory, intellectual property and other valuable corporate assets;
- in other cases, the term “Principal Property” is defined with such a high threshold of materiality that most (or even all) of the issuer’s assets are excluded from the definition;
- in still other cases, “Principal Property” is defined to exclude stock (or intercompany payables) of the subsidiaries that own the issuer’s property, plant and equipment, thereby permitting indirect security interests in those same assets through liens on stock (or intercompany payables) of subsidiaries; and
- finally, most existing “Liens” covenants allow the issuer to incur unlimited secured debt (including secured debt with a much shorter maturity than the indenture’s bonds) so long as the indenture’s bonds are secured “equally and ratably” with the new debt for so long as the new debt is so secured. In the context of a leveraged buyout or leveraged recapitalization, this “equal and ratable” clause can yield the unexpected result that the investment grade bonds are suddenly sharing collateral with a massive amount of new debt incurred in a voluntary transaction that has a material adverse impact on creditworthiness.

The Proposed Model Provision. A proper limitation on liens covenant needs to limit the amount of debt that can be incurred by the issuer or any of its subsidiaries that is effectively senior to the bonds. In the model provision included in Annex A, we are proposing a new approach to the traditional “Liens” covenant entitled “Limitation on Liens and Priority Debt.” The model version addresses the shortcomings identified above as follows:

- debt of non-guarantor subsidiaries is considered to be “Priority Debt” and is, therefore, subject to the covenant’s limitations;

- the covenant's limitations apply to the issuer and each of its subsidiaries and there is no ability to remove subsidiaries from the purview of the covenant by declaring them to be "Unrestricted";

- there is no "Principal Property" definition. Instead, the covenant applies to all assets, but is subject to a list of negotiated exceptions that will be tailored to fit the facts of each deal; and

- the "equal and ratable" clause has been eliminated (with the effect that the permission to incur unlimited secured debt has also been eliminated).

The model "Limitations on Liens and Priority Debt" covenant obviates the need for a separate sale and leaseback covenant because "Attributable Debt" arising out of sale and leaseback transactions is treated as "Priority Debt" for purposes of the model provision.

Reporting Obligations

The Limitations in the Precedent. On more than a few occasions in recent years, issuers of investment grade bonds have withdrawn from the periodic reporting requirements of the Securities Exchange Act of 1934. The resulting absence of information about these issuers has made it difficult for bond investors to properly evaluate the creditworthiness of these issuers and has had a detrimental impact on the trading markets for their bonds. Members of the Credit Roundtable believe that bondholders are entitled to reasonable access to financial information about an issuer for as long as it has bonds outstanding.

The Proposed Model Provision. The model reporting covenant draws on the experience of the "144A-for-life" market and calls for public disclosure that will satisfy the needs of bondholders without requiring issuers to bear the substantial costs of compliance with all of the Securities and Exchange Commission's regulations. The model provision would require an issuer that is no longer required to make SEC filings to continue to produce unaudited quarterly and audited annual financial statements, together with a management report on results of operations and financial condition, and make them available to current and prospective bondholders on a public-access website. This compromise allows issuers to avoid unnecessary expense while continuing to provide sufficient information to the public to support a healthy level of after-market trading.

Voting by Series

The Limitations in the Precedent. Many existing investment grade indentures permit amendments or waivers to be approved by the holders of a majority in aggregate principal amount of the notes then outstanding under that indenture, regardless of how many series of notes may at the time be outstanding under the indenture and regardless of the differences between the economic interests of the holders of each series of bonds. The members of the Credit Roundtable believe that this seemingly harmless administrative provision can produce

inappropriate outcomes. The holder of a note with a remaining maturity of 30 days may have a very different credit perspective than a holder of a note with a remaining maturity of 30 years. For example, in a consent solicitation under an indenture that does not provide for voting by series, the holders of the short-term notes under the indenture may be in a position to bargain away the rights of the long-term noteholders.

The Proposed Model Provision. The model provision would require voting by series (rather than by indenture) where an individual series is of a sufficient size to justify this right. The Credit Roundtable's members recognize that it may make sense to group multiple smaller series together for voting purposes (for example, in a Medium Term Note program) or to combine two or more series with near identical terms. The model provision seeks to balance the issuers' need for administrative convenience with the investors' concern that one series of notes could approve an amendment or waiver that would adversely affect a different series of notes.

Conclusions

Investment grade bonds bear a lower interest rate than bonds issued by lesser credits because they are thought by investors to be less risky investments. Purchasers of these bonds are prepared to accept the risk of loss associated with a general decline in the issuer's industry, or even its business in particular. However, many investment grade bond investors are not prepared to accept the risk of loss associated with the credit deterioration that results from voluntary acts taken by management. Many of the investment grade covenant packages in use today do not properly restrict voluntary issuer actions that erode bondholder value, such as leveraged recapitalization or leveraged buyouts. The members of the Credit Roundtable believe it is time to revisit these important indenture provisions and modify them to suit modern market circumstances.

The Following Firms Support this Document:

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ABN AMRO Asset Management
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California Public Employees' Retirement System
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Capital Research and Management Company
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The Vanguard Group, Inc.
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Western Asset Management Co.
White Mountains Advisors LLC
Xtract Research LLC

Annex A

Suggested Riders to Prospectus Supplement

Rider 1

Offer to Redeem Upon Change of Control [Triggering Event]. Upon the occurrence of a Change of Control [Triggering Event], unless the Company has exercised its right to redeem the Notes as described under "—Redemption at the Company's Option" or "—Redemption Upon Changes in Withholding Taxes," the Indenture provides that each Holder of Notes will have the right to require the Company to purchase all or a portion of such Holder's Notes pursuant to the offer described below (the "***Change of Control Offer***"), at a purchase price equal to 101% of the principal amount thereof plus accrued and unpaid interest, if any, to the date of purchase, subject to the rights of Holders of Notes on the relevant record date to receive interest due on the relevant interest payment date.

Within 30 days following the date upon which the Change of Control [Triggering Event] occurred, or at the Company's option, prior to any Change of Control but after the public announcement of the pending Change of Control, the Company will be required to send, by first class mail, a notice to each Holder of Notes, with a copy to the trustee, which notice will govern the terms of the Change of Control Offer. Such notice will state, among other things, the purchase date, which must be no earlier than 30 days nor later than 60 days from the date such notice is mailed, other than as may be required by law (the "***Change of Control Payment Date***"). The notice, if mailed prior to the date of consummation of the Change of Control, will state that the Change of Control Offer is conditioned on the Change of Control being consummated on or prior to the Change of Control Payment Date.

Holders of Notes electing to have Notes purchased pursuant to a Change of Control Offer will be required to surrender their Notes, with the form entitled "Option of Holder to Elect Purchase" on the reverse of the Note completed, to the paying agent at the address specified in the notice, or transfer their Notes to the paying agent by book-entry transfer pursuant to the applicable procedures of the paying agent, prior to the close of business on the third business day prior to the Change of Control Payment Date.

The Company will not be required to make a Change of Control Offer if a third party makes such an offer in the manner, at the times and otherwise in compliance with the requirements for such an offer made by the Company and such third party purchases all Notes properly tendered and not withdrawn under its offer.

"Change of Control" means the occurrence of any one of the following:

(1) the direct or indirect sale, lease, transfer, conveyance or other disposition (other than by way of merger or consolidation), in one or a series of related transactions, of all or substantially all of the assets of the Company and its Subsidiaries taken as a whole to any Person (including any "person" (as that term is used in Section 13(d)(3) of the Exchange Act)) other than to the Company or one of its Subsidiaries;

(2) the consummation of any transaction (including without limitation, any merger or consolidation) the result of which is that any Person (including any "person" (as that term is used in Section 13(d)(3) of the Exchange Act)) becomes the "beneficial owner" (as defined in Rules 13d-3 and 13d-5 under the Exchange Act), directly or indirectly, of more than 50% of the outstanding Voting Stock of the Company, measured by voting power rather than number of shares;

(3) the Company consolidates with, or merges with or into, any Person, or any Person consolidates with, or merges with or into, the Company, in any such event pursuant to a transaction in which any of the outstanding Voting Stock of the Company or such other Person is converted into or exchanged for cash, securities or other property, other than any such transaction where the shares of the Voting Stock of the Company outstanding immediately prior to such transaction constitute, or are converted into or exchanged for, a majority of the Voting Stock of the surviving Person immediately after giving effect to such transaction;

(4) the first day on which the majority of the members of the board of directors of the Company cease to be Continuing Directors; or

(5) the adoption of a plan relating to the liquidation or dissolution of the Company.

"Change of Control Triggering Event" means the Notes cease to be rated Investment Grade by at least two of the three Rating Agencies on any date during the period (the "***Trigger Period***") commencing 60 days prior to the first public announcement by the Company of any Change of Control (or pending Change of Control) and ending 60 days following consummation of such Change of Control (which Trigger Period will be extended following consummation of a Change of Control for so long as any of the Rating Agencies has publicly announced that it is considering a possible ratings change). Unless at least two of the three Rating Agencies are providing a rating for the Notes at the commencement of any Trigger Period, the Notes will be deemed to have ceased to be rated Investment Grade by at least two of the three Rating Agencies during that Trigger Period. Notwithstanding the foregoing, no Change of Control Triggering Event will be deemed to have occurred in connection with any particular Change

of Control unless and until such Change of Control has actually been consummated.

"Continuing Director" means, as of any date of determination, any member of the board of directors of the Company who:

(1) was a member of such board of directors on the date of the Indenture; or

(2) was nominated for election or elected to such board of directors with the approval of a majority of the Continuing Directors who were members of such board of directors at the time of such nomination or election.

"Fitch" means Fitch Inc., a subsidiary of Fimalac, S.A., and its successors.

"Investment Grade" means a rating of Baa3 or better by Moody's (or its equivalent under any successor rating category of Moody's); a rating of BBB- or better by S&P (or its equivalent under any successor rating category of S&P); and a rating of BBB- or better by Fitch (or its equivalent under any successor rating category of Fitch).

"Moody's" means Moody's Investors Service, Inc., a subsidiary of Moody's Corporation, and its successors.

"Person" means any individual, corporation, partnership, joint venture, association, joint-stock company, trust, unincorporated organization, limited liability company or government or other entity.

"S&P" means Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., and its successors.

"Rating Agency" means each of Moody's, S&P and Fitch*; provided,* that if any of Moody's, S&P and Fitch ceases to provide rating services to issuers or investors, the Company may appoint a replacement for such Rating Agency that is reasonably acceptable to the trustee under the Indenture.

"Voting Stock" of any specified Person as of any date means the capital stock of such Person that is at the time entitled to vote generally in the election of the board of directors of such Person.

Rider 2

Interest Rate Adjustment Based on Rating Events. The Indenture provides that the interest rate payable on the Notes will be subject to adjustment from time to time if any of the three Rating Agencies downgrades (or subsequently upgrades) its rating assigned to the Notes, as set forth below.

If the rating of the Notes from any one or more of the three Rating Agencies is decreased to a rating set forth in any of the immediately following tables, the interest rate on the Notes will increase from the interest rate otherwise payable on the Notes by an amount equal to the sum of the percentages set forth in the following tables opposite those ratings; *provided*, that only the two lowest ratings assigned to the Notes (or deemed assigned, as provided in the rules of interpretation set forth below) will be taken into account for purposes of any interest rate adjustment:

Moody's Rating	Percentage
Baa1[*]	[____]%
Baa2	[____]%
Baa3	[____]%
Ba1	[____]%
Ba2	[____]%
Ba3	[____]%
B1 or below	[____]%

S&P Rating	Percentage
BBB+[*]	[____]%
BBB	[____]%
BBB-	[____]%
BB+	[____]%
BB	[____]%
BB-	[____]%
B+ or below	[____]%

Fitch Rating	Percentage
BBB+[*]	[____]%
BBB	[____]%
BBB-	[____]%
BB+	[____]%
BB	[____]%
BB-	[____]%
B+ or below	[____]%

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[*] *These rating levels will be adjusted up or down as appropriate under the circumstances and will be negotiated on a case by case basis. It is common for the first level in the table to be one or more notches below the original rating as of the date of issuance.*

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For purposes of making adjustments to the interest rate payable on the Notes, the following rules of interpretation will apply:

(1) if a Rating Agency has ceased to provide a rating of the Notes for any reason, that Rating Agency will be deemed to have rated the Notes at the lowest level contemplated by the table above;

(2) if only one of the three Rating Agencies ceases to provide a rating of the Notes for any reason, the deemed rating of that Rating Agency will be disregarded for purposes of all interest rate adjustments;

(3) if two of the three Rating Agencies cease to provide a rating of the Notes for any reason, the deemed rating of only one of such two Rating Agencies will be disregarded;

(4) if all three Rating Agencies cease to provide a rating of the Notes for any reason, the interest rate on the Notes will increase to, or remain at, as the case may be, [____]% *[the maximum increase]*[*] above the interest rate otherwise payable on the Notes prior to any adjustment;

(5) each interest rate adjustment required by any decrease or increase in a rating by any one Rating Agency will be made independently of (and in addition to) any and all other adjustments; and

(6) in no event will [(A)] the interest rate on the Notes be reduced to below the interest rate otherwise payable on the Notes prior to any adjustment [or (B) the total increase in the interest rate

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[*] *The appropriateness and size of any cap on the amount of rate increase will be negotiated on a case by case basis.*

on the Notes exceed [____]% above the interest rate otherwise payable on the Notes prior to any adjustment.][*]

If at any time the interest rate on the Notes has been adjusted upward and any of the Rating Agencies subsequently increases its rating of the Notes, the interest rate on the Notes will again be adjusted (and decreased, if appropriate) such that the interest rate on the Notes equals the interest rate otherwise payable on the Notes prior to any adjustment plus (if applicable) an amount equal to the sum of the percentages set forth opposite the ratings in the tables above with respect to the two lowest ratings assigned to the Notes (or deemed assigned) at that time, all calculated in accordance with the rules of interpretation set forth above.

Any interest rate increase or decrease described above will take effect from the first day of the interest period during which a rating change occurs requiring an adjustment in the interest rate. If any Rating Agency changes its rating of the Notes more than once during any particular interest period, the last such change to occur will control in the event of a conflict.

"Fitch" means Fitch Inc., a subsidiary of Fimalac, S.A., and its successors.

"Moody's" means Moody's Investors Service, Inc., a subsidiary of Moody's Corporation, and its successors.

"S&P" means Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., and its successors.

"Rating Agency" means each of Moody's, S&P and Fitch.

<u>Rider 3</u>

Limitation on Liens and Priority Debt. The Indenture provides that the Company will not, and will not permit any of its Subsidiaries to, create, assume, incur, guarantee or otherwise become liable for or suffer to exist any Priority Debt, other than Permitted Debt.

"***Priority Debt***" means:

(1) any Indebtedness of the Company or any of its Subsidiaries that is secured by a Lien on any asset of the Company or any of its Subsidiaries;

(2) Attributable Debt with respect to Sale and Leaseback Transactions; and

(3) any Indebtedness as to which a Subsidiary of the Company is the issuer, borrower, guarantor or in any other manner an obligor.

"Indebtedness" means, with respect to any Person, without duplication, any indebtedness of such Person, whether or not contingent:

(1) in respect of borrowed money;

(2) evidenced by bonds, notes, debentures, or similar instruments or letters of credit (or reimbursement agreements with respect thereto);

(3) in respect of banker's acceptances, bank guarantees, surety bonds or similar instruments;

(4) representing Capital Lease Obligations or Attributable Debt in respect of a sale and leaseback transaction; or

(5) representing the balance deferred and unpaid of the purchase price of any property or services due more than six months after such property is acquired or such services are completed;

if and to the extent any of the preceding items (other than letters of credit and Attributable Debt) would appear as a liability upon a balance sheet of the specified Person prepared in accordance with generally accepted accounting principles. In addition, the term "Indebtedness" includes all of the following items, whether or not any such items would appear as a liability on a balance sheet of the specified Person prepared is accordance with generally accepted accounting principles:

(1) all Indebtedness of others secured by a Lien on any asset of the specified Person (whether or not such Indebtedness is assumed by the specified Person);

(2) to the extent not otherwise included, any guarantee by the specified Person of Indebtedness of any other Person; and

(3) preferred stock or other equity interests providing for mandatory redemption or sinking fund or similar payments issued by any Subsidiary of the specified Person.

"Permitted Debt" means:

(1) Priority Debt having an aggregate principal amount (or deemed amount, in the case of Attributable Debt) not to exceed, as of any date of incurrence of Priority Debt pursuant to this clause

(1) and after giving effect to such incurrence and the application of the proceeds therefrom, taken together with the aggregate principal amount of Refinancing Indebtedness incurred to extend, renew, refinance or replace any Priority Debt incurred pursuant to this clause (1), [10-15]% of Consolidated Net Tangible Assets as of such date of incurrence;

[(2) Indebtedness of any Person that (A) is acquired by the Company or any of its Subsidiaries after the date of the Indenture, (B) is merged or amalgamated with or into the Company or any of its Subsidiaries after the date of the Indenture, or (C) becomes consolidated in the financial statements of the Company or any of its Subsidiaries after the date of the Indenture in accordance with generally accepted accounting principles; *provided, however,* that, in each case contemplated by this clause (2), such Indebtedness was not incurred in contemplation of such acquisition, merger, amalgamation or consolidation and is only an obligation of, and is only secured by Liens on the capital stock and assets of, the Person (and Subsidiaries of the Person) acquired by, or merged or amalgamated with or into, or consolidated in the financial statements of, the Company or any of its Subsidiaries;]

[(3) Indebtedness of the Company or any of its Subsidiaries incurred to finance (whether prior to or within 180 days after) the acquisition, construction or improvement of assets (whether through the direct purchase of assets or through the purchase of the capital stock of any Person owning such assets or through an acquisition of any such Person by merger); *provided, however,* that such Indebtedness is only secured by Liens on the capital stock and assets acquired, constructed or improved in such financing;]

(4) Indebtedness of the Company or any of its Subsidiaries existing on the date of the Indenture;

(5) any Indebtedness (“***Refinancing Indebtedness***”) incurred to extend, renew, refinance or replace, in whole or in part,

any Indebtedness ("***Refinanced Indebtedness***") referred to in clauses (1) through (4) above or this clause (5) if (A) the principal amount (or deemed amount, in the case of Attributable Debt) of the Refinancing Indebtedness does not exceed the principal amount (or deemed amount, in the case of Attributable Debt) of the Refinanced Indebtedness (plus all premiums and other costs incurred in connection with the extension, renewal, refinancing or replacement thereof) at the time of such extension, renewal, refinancing or replacement and (B) the Refinancing Indebtedness is only an obligation of some or all of the Person(s) who were obligors on the Refinanced Indebtedness and is only secured by Liens on some or all of the assets that secured the Refinanced Indebtedness;

(6) intercompany Indebtedness of the Company or any of its Subsidiaries to the Company or any of its Subsidiaries;

(7) Indebtedness of any of the Company's Subsidiaries in the form of a guarantee of the Notes;

[(8) Indebtedness secured by Liens on accounts receivable and/or inventory and the products and proceeds thereof;] and

(9) [other specific carve-outs to be agreed].[*]

"Attributable Debt" in respect of a sale and leaseback transaction means, at any time of determination, the present value at that time of the obligation of the lessee for net rental payments during the remaining term of the lease included in such sale and leaseback transaction including any period for which such lease has been extended or may, at the option of the lessor, be

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[*] *The marketplace has produced a variety of carve-outs to the various flavors of liens covenants in existence today. Some of these carve-outs are suggested here. In any particular transaction, the carve-outs should be tailored to properly balance the business needs of the issuer with the concerns of bond investors. We recognize that this model form is only a starting place and that some degree of tailoring will be appropriate in most applications.*

extended. Such present value will be calculated using a discount rate equal to the rate of interest implicit in such transaction, determined in accordance with generally accepted accounting principles; *provided, however*, that if such sale and leaseback transaction results in a Capital Lease Obligation, the amount of Indebtedness represented thereby will be determined in accordance with the definition of "Capital Lease Obligation."

"Capital Lease Obligation" means, at any time of determination, the amount of the liability in respect of a capital lease that would at that time be required to be capitalized on a balance sheet prepared in accordance with generally accepted accounting principles.

"Consolidated Net Tangible Assets" of any Person as of any date means the total assets of such Person and its Subsidiaries as of the most recent fiscal quarter end for which a consolidated balance sheet of such Person and its Subsidiaries is available, *minus* all [current] liabilities of such Person and its Subsidiaries reflected on such balance sheet and *minus* total goodwill and other intangible assets of such Person and its Subsidiaries reflected on such balance sheet, all calculated on a consolidated basis in accordance with generally accepted accounting principles.

"Lien" means any mortgage, lien, pledge, charge, security interest or other encumbrance of any kind, whether or not filed, recorded or otherwise perfected under applicable law, including any conditional sale or other title retention agreement, any lease in the nature thereof, any option or other agreement to sell or give a security interest in and any filing of or agreement to give any financing statement under the Uniform Commercial Code (or equivalent statute) of any jurisdiction.

Rider 4

Reports. The Indenture provides that so long as any Notes are outstanding, if the Company is subject to the periodic reporting requirements of the Exchange Act, the Company will file with the SEC and furnish to the Holders of Notes (or cause the trustee to furnish to the Holders of Notes), within the time periods specified in the SEC's rules and regulations:

(1) all quarterly and annual reports on Forms 10-Q and 10-K required to be filed by companies that are subject to the periodic reporting requirements of the Exchange Act; and

(2) all current reports on Form 8-K required to be filed by companies that are subject to the periodic reporting requirements of the Exchange Act.

Each annual report on Form 10-K will include a report on the Company's consolidated financial statements by the Company's certified independent accountants. In addition, the Company will post a copy of each of the reports referred to in clauses (1) and (2) above on its website for public availability within the time periods specified for filing such reports with the SEC in the rules and regulations applicable to such reports.

If, at any time, the Company is no longer subject to the periodic reporting requirements of the Exchange Act for any reason, the Indenture requires that the Company will nevertheless continue to prepare the financial statements and a "Management's Discussion and Analysis of Financial Condition and Results of Operations" substantially similar to that which would have been required to be included in each of the reports specified in clause (1) of the preceding paragraph of this covenant had the Company been subject to such Exchange Act reporting requirements (with all such financial statements prepared in accordance with Regulation S-X promulgated by the SEC and all such annual financial statements including a report thereon from the Company's certified independent accountants) and post copies thereof to its website for

public availability within the time periods that would have been applicable to filing such reports with the SEC in the rules and regulations applicable to such reports if the Company had been required to file those reports with the SEC; *provided*, *however*, that if the Company is no longer subject to the periodic reporting requirements of the Exchange Act, the Company will not be required to comply with Section 302 or Section 404 of the Sarbanes-Oxley Act of 2002, or related Items 307 and 308 of Regulation S-K promulgated by the SEC, or Item 10(e) of Regulation S-K (with respect to any non-GAAP financial measures contained therein).[*]

In addition, the Company will furnish (or cause the trustee to furnish) to Holders of Notes, prospective investors, broker-dealers and securities analysts, upon their request, any information required to be delivered pursuant to Rule 144A(d)(4) under the Securities Act so long as the Notes are not freely transferable under the Securities Act.

<u>Rider 5</u>

Voting by Series. The Indenture provides that no amendment or waiver that requires a consent of Noteholders under the Indenture may be effected without the additional consent of the Holder(s) of a majority in aggregate principal amount of each series of Notes then outstanding having an aggregate principal amount of $100.0 million or more.[*]

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[*] *Other exceptions to the SEC's specific reporting obligations may be negotiated on a case by case basis.*

[*] *In some cases, it may be appropriate for more than one series to vote together as a single class — for example, in a Medium Term Note program involving numerous small issuances of notes having differing terms, or where two series of notes share maturities and other material terms.*

Annex B

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Top 10 Questions to Ask for Each New Investment Grade Offering

The initial question for every offering should be: Is the protective language the same as the language in the Covenant White Paper? If not, how is it different?

Change of Control

1. What events constitute a Change of Control?
The definition should pick up: (1) the acquisition of a majority of the issuer's voting stock, (2) a sale of substantially all the issuer's assets, (3) a merger with another company where the issuer's stockholders don't own a majority of the stock after the deal is closed, (4) continuing board directors, and (5) a plan of liquidation. Prospective purchasers should also make specific inquiry as to the existence of any carveouts/exceptions to the listed change of control triggers and if so, the business rationale/justification for including them.

2. Is rating agency testimony required to connect the ratings downgrade and the Change of Control?
Does the covenant require that the rating agencies state that the reason for the downgrade was the change of control? Rating agencies may not be willing to make this connection. The White Paper's model provision only requires that the downgrading occurs during a time period that straddles the Change of Control transaction.

3. What happens if a rating agency ceases to rate the bonds?
If the issuer has the right to replace a rating agency when coverage by the original agency is dropped, bondholders may be at risk because a new agency might not apply the same criteria as the original agency. The White Paper's model provision treats bonds as being "below investment grade" unless two out of the three specified agencies maintain an investment grade rating on the bonds.

Step-Up Coupon

4. Is the step-up provision subject to a cap? Is there a fall-away provision if the bonds are upgraded beyond a specified level?
The value of the step-up feature is diminished if it is subject to a cap on the amount of the rate increase or if the protection goes away once the issuer achieves a certain rating. Subsequent downgrades can always occur after an upgrade.

5. What happens if a rating agency ceases to rate the bonds?

The White Paper's model provision allows an issuer with ratings from three major rating agencies to lose coverage from one of the three agencies without consequence. Subsequent withdrawals of ratings are treated as a reduction in rating that triggers a coupon step-up.

<u>Limitation on Liens and Priority Debt</u>

6. Does the covenant only apply to "Restricted Subsidiaries" or "Principal Properties"?

To the extent the covenant only applies to Restricted Subsidiaries, Principal Properties or some other defined subset of entities or properties, you will want to know which entities/properties are actually covered by the covenant. Determining the scope of these definitions is important in order to determine what percentage of the issuer's EBITDA and valuable assets is protected from claims of holders of priority debt. The disclosure will not always give you the answers to these questions. Don't be afraid to ask for this important information.

7. Are there limitations on subsidiary debt or guarantees?

The White Paper's "Limitation on Liens and Priority Debt" restricts the incurrence of structurally senior debt by subsidiaries. If there are no such restrictions, the bonds are subject to being "primed" in a future financing. Many recent LBOs have used subsidiary guarantees of the LBO debt to "prime" the existing investment grade bonds.

8. Is there an "equal and ratable" clause that gives the issuer the ability to incur unlimited secured debt?

Most traditional "Liens" covenants permit the issuer to incur unlimited secured debt so long as the bonds are secured equally and ratably with the new debt. These "equal and ratable" provisions have been used to incur substantial additional debt in a transaction (for example, to finance an LBO) that can cause your bonds to lose value. The White Paper's model provision does not permit unlimited additional secured debt — it has no "equal and ratable" clause and is therefore more restrictive than the traditional approach.

<u>Reporting Obligations</u>

9. Is there an unconditional obligation to provide financials and MD&A, or is the obligation tied to '34 Act reporting obligations that could fall away in an LBO?

Some investment grade bond indentures do not contain an unconditional obligation to provide financial information. If the issuer eventually goes private, or the issuer becomes a subsidiary of another corporation, the obligation to file financial information with the SEC goes away. This means that bond buyers could lose access to issuer-level financial data in the future, which could adversely affect the trading price of your bonds.

<u>Voting</u>

10. Are indenture amendments subject to a bondholder vote on a series-by-series basis or do all series vote together to approve indenture amendments? If voting is by indenture, what other bonds are (or may in the future be) issued under this indenture?

Some investment grade indentures permit amendments or waivers to be approved by the holders of a majority in aggregate principal amount of the notes then outstanding under that indenture, regardless of how many series of notes may at the time be outstanding. More protection exists for bondholders if each series of bonds must separately approve all covenant changes applicable to that series, even if the covenants benefit multiple series of bonds. Different series with differing terms may have very different economic incentives when it comes to approving covenant changes.