Legal Business Solutions Academy:

How a Credit Facility Impacts Your Business

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How a credit facility impacts your business

The session will focus on the key points for borrowers of credit facilities to consider when carrying out an internal group reorganisation or a third-party disposal or acquisition.

PwC's Legal Banking and Finance team

Our team advises clients on both domestic and cross border acquisition finance, real estate finance and general corporate finance transactions, as well as refinancing transactions and amendments. We also advise on financial restructurings, non-performing loan sales and purchases (as well as single credit sales and purchases). We also work with corporate treasury teams on cross border cash management and cash pooling arrangements (including payments on behalf and collections on behalf).

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Agenda

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Introduction

Introduction - Types of credit facilities

Types

- Term loans
- Revolving credit facilities
- Overdraft facilities

Term loans

- Lender commits to providing the borrower with a specified amount of money for a specified amount of time (known as the 'term')
- Money must usually be drawn in a short period of time after the signing of the facility agreement (known as the 'availability period')
- Prepayment usually permitted (but may be subject to a prepayment fee)

Revolving credit facilities

- Also a committed facility
- However, unlike a standard term loan, the availability period covers the entire term of the loan
- The borrower is free to drawdown tranches up to the specified maximum amount and as often as it likes
- The borrower is able to repay the tranche at the end of an interest payment or roll over into the next interest period

Overdraft facilities

- Generally uncommitted, so the facility can be withdrawn by the lender at any time
- Tend to be based on the lender's standard form document (unless built into a wider term facility agreement)
- Usually repayable on demand by the lender
- Interest payable on the amount overdrawn

Introduction - Ancillary facilities

Types

- Bank guarantee
- Letters of credit
- Corporate credit cards

Bank guarantees

An undertaking given by a bank under which it will guarantee to cover the indebtedness of a borrower under a transaction.

In exchange for the bank guarantee, the bank receives a counter-indemnity or fee from the borrower or security granted in its favour by the borrower.

Letters of credit

Commonly used in international trade transactions, letters of credit are contracts under which a lender agrees to pay the seller the value of the relevant goods once the lender is presented with specific documents relating to the goods (which include an invoice) by the seller.

The lender then delivers the documents to the buyer in return for reimbursement of the purchase price by the buyer. The buyer is then able to present the documents to the carrier in exchange for the goods.

Corporate credit card

- A corporate credit card is similar to a personal credit card but is issued to a business instead of an individual. Any purchasers made by the borrower are guaranteed by the lender and the borrower is given a set time to pay down the balance spent on the card.
- Suitable for short-term borrowing and usually quick and easy to apply for.

Introduction - The lender and the borrower

Lender's perspective

The lender wishes to control the corporate actions of the borrower and the obligors (eg. guarantors, subordinated creditors) as closely as possible in order to:

- Trap value in the obligor's group
- Ensure that the lender has visibility over the borrower's business and asset
- Protect the availability of the assets secured in favour of the lender

Borrower's perspective

The borrower wishes to retain as much control over its business as possible by carving out permissible acts from the restrictions imposed by the lender.

A well negotiated facility agreement will, from the borrower's perspective, ensure operational flexibility for existing and future anticipated business operations (including expansion) within the safeguards understandably required by a lender in order to preserve value.

Introduction - General

Documents to consider

- Facility agreement
- Security agreement
- Intercreditor agreement
- Standalone guarantee

Clauses to consider

- Representations
- General covenants
- Information covenants
- Financial covenants
- Events of default
- Mandatory prepayment triggers

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Covenants

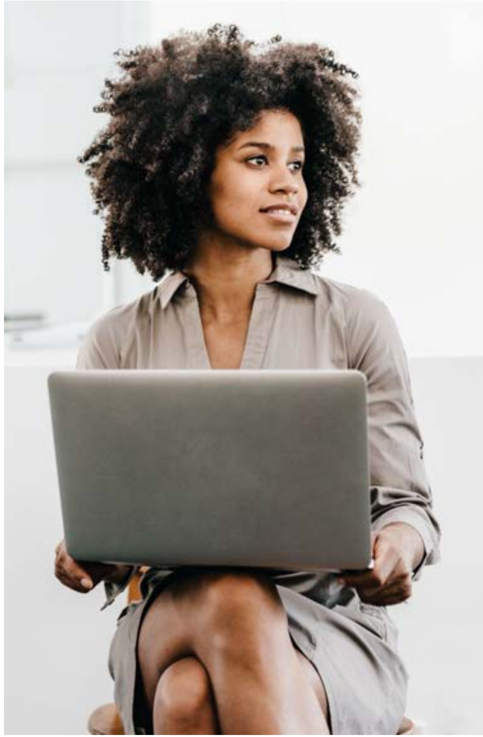
Covenants - Common covenants

- No disposals
- No acquisitions
- No share issues
- No distributions
- No buybacks, redemptions or capital reductions
- PSC – compliance with notices and requirements
- Arm's length transactions
- No making/receiving loans and other financial indebtedness
- No giving of guarantees
- No mergers - amalgamation, demerger, merger, consolidation or corporate reconstruction
- No substantial change of business
- No subsidiaries
- Keyman
- CoMI / re-domiciliation
- No change to VAT group
- No employees or occupational pension schemes
- Negative pledge

Covenants - Common carve-outs

Pre-negotiated carve-outs

- “Permitteds” for pre-consented transactions
  - ❖ Permitted Acquisition
  - ❖ Permitted Disposal
  - ❖ Permitted Distribution
  - ❖ Permitted Financial Indebtedness/Loan
  - ❖ Permitted Guarantee
  - ❖ Permitted Payment
  - ❖ Permitted Share Issue
  - ❖ Permitted Transaction
- Often subject to de minimis baskets/thresholds
- Even if a proposed reorganisation is pre-consented under the facility agreement or the lender provides consent, the borrower should consider the impact on the financial covenants



Covenants - Impact of carve-outs on financial covenants

Financial covenants

- Consideration should be given to the impact of the proposed transaction on the financial covenants, breach of which would lead to an event of default.
- Financial covenants are set of specified parameters (usually ratios or limits) which the borrower has to operative within.
- They are used by the lender as a health check on the borrower acting as an early warning system of a potential borrower default.

Typical financial covenants

- **Group/entity net worth** - borrower required to maintain a set net worth.
- **Leverage ratios** - a comparison of the borrowings to operating cash flows or EBITDA. Used to show the extent to which the borrower's profits cover the debt.
- **Gearing ratios** - a comparison of the debt of the borrower with its net worth. Used to show how well saleable assets would cover the borrower's debt.
- **Loan to value ratio** - common in real estate finance, compares the value of the loan with the market value of the borrower's properties.
- **Interest cover ratio** - compares the profit to the interest cost of a loan.
- **Debt service / cash flow cover ratio** - measures surplus cash generated by the borrower's business which can then be used to service the debt.

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Security

Security - Introduction (Part 1 of 2)

Purpose

Security creates an interest in an asset so that on the insolvency of a buyer, the lender can sell the asset(s) and use the proceeds to repay the borrower's indebtedness.

Types of security

Generally, a lender will take security over assets by way of a mortgage, a charge or a pledge.

A mortgage transfers the title of an asset to the lender on the understanding that the title will be transferred back to the borrower on the repayment of the loan.

A charge does not transfer title to the lender but represents an agreement that the asset will be appropriated until the loan is repaid.

A pledge delivers the possession (but not ownership) of an asset as security until the loan is repaid.

Security - Introduction (Part 2 of 2)

Security over shares

It is possible to take a legal mortgage over shares, however, despite the advantages of a legal mortgage when compared with a charge, a lender will often take a charge over shares rather than a mortgage.

Disadvantages of a legal mortgage over shares:

- The lender acquires voting rights which it may not want.
- Tax issues if borrower becomes a subsidiary.

Other jurisdictions

- The choice of governing law of the security agreement is driven by the location of the asset, particularly where the asset is a property.
- **NB:** some jurisdictions, such as Guernsey, do not recognise floating charges. Generally, separate security over the shares in the entity holding the asset(s) will be taken.

Security - Things to consider when carrying out a reorganisation or an arm's length acquisition/disposal (Part 1 of 2)

1 Are charged assets affected by the reorganisation?

Check whether assets affected by the reorganisation have been charged in favour of a lender.

For example, does the reorganisation include a share transfer or business transfer of charged assets?

2 Separate representations/covenants in the security documents

If so, consideration should be given to any separate representation/covenants in the security documents.

For example, the security agreement will most-likely contain a covenant under which the chargor promises to not dispose of any secured assets.

3 Location of share certificates / original deeds

If security over shares is to be re-granted in favour of the lender, then the lender will usually require the relevant share certificates to be deposited with the lender.

Share certificates are often misplaced so time needs to be allocated towards locating the relevant share certificates or issuing indemnities for lost share certificates.

4 Transfer of asset subject to existing security or release of security

Consider the tax implications of transferring an asset which is subject to existing security to another group company vs releasing the security over the relevant asset and then re-granting security following the transfer.

NB - Even if the transfer of an asset subject to existing security is transferred to a group company, the lender will usually require security over the asset to be re-granted

Security - Things to consider when carrying out a reorganisation or an arm's length acquisition/disposal (Part 2 of 2)

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Deeds of release

Deeds of release should be used to document the release of the security.

Full deed of release vs partial deed of release.

Lender's solicitors will usually prepare a first draft.

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Companies House registrations

Release of security

Need to notify Companies House that security has been released.

Registration of re-granted Security

If security is not registered it is void against a liquidator, administrator and any creditor of the company.

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Other registries - security over land and IP

Land registry

If the security to be released includes a legal mortgage over land, Land Registry Form DS1 (or DS3) will need to be completed and submitted at the Land Registry.

UK Intellectual Property Office

Similarly, an application to cancel the relevant registration will need to be made in respect of a charge released over registered intellectual property

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Entry into new security agreements by the borrower's entities

When taking new security, the lender may either require new entities in the borrower's group to accede to an existing security agreement or enter into a standalone security agreement

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Intercreditor agreements

Intercreditor agreements

What is an intercreditor agreement?	Implication for intra-group debt and any assignments or novations
A contract whereby two or more creditors agree among themselves the order of priority in which their respective rights in relation to the debts owed by them will rank and the ranking of their respective security from a common borrower. Typically include standstill periods and/or restrictions on enforcement or taking other insolvency related actions.	New junior lenders to the borrower’s group may need to become parties to the intercreditor agreement and provide security over their receivables in favour of the senior lender.

Typical subordination/priority agreement	Role in a restructure
A subordination agreement is used where an unsecured subordinated creditor agrees that it will be paid any amounts due by the common borrower until the senior creditor has been repaid in full. A deed of priority is used where both debt providers are secured and regulates the distribution of any proceeds on the enforcement of security.	In a group reorganisation involving the repayment of debt to the junior intra-group lender, to the extent that an intercreditor agreement is in place, this will need to be reviewed to see if any of the entities in question are listed as subordinated creditors. If so, the junior lender within the group will not be able to be repaid until the senior debt is repaid.

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Lender consent

Seeking lender consent - Considerations

01	Timing implications for transactions if there is a need for consent to be obtained
02	Ability of the lender to withhold consent and/or impose conditions on consent
03	Who needs to consent? ● Majority lender concept - typically defined as the lenders holding [66⅔]% of the loan amount ● “Snooze you lose” - a lender who does not respond to a consent request within as set time period is not included in determining whether majority lender consent has been obtained ● “Yank the bank” - gives the borrower the right to replace a lender of a lending syndicate with a new lender in certain circumstances
04	Conditions / common lender asks on giving consent - Repayment or prepayment - Replacement security - Fees - Opportunities for lenders to revising previous terms to improve their position?

Seeking lender consent - Failure to seek consent

Implications of the failure to seek/obtain lender consent when required

Events of default

- Allows lender to accelerate and immediately demand repayment/cancel undrawn commitments.
- Grace periods and remedy rights.
- Financial covenant cures.

Mandatory prepayment triggers

- Creates an immediate obligation on the borrower to repay the loan upon the occurrence of certain specified events.
- For example, on a change of control of the borrower or on the disposal of an asset by the borrower.

Possible prepayment fees

- Prepayment fees - there may be fees linked to the prepayment of a loan in certain circumstances.

Cross-default

- Cross-default provisions provide that an event of default will occur if an event of default has occurred under any other agreement to which is the borrower is party.

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Break-out session - Questions

Thank you

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