HOTELY NEGOTIATED TERMS IN CREDIT FACILITIES: WHO AGREED TO THAT?

As lenders continue to face fierce competition to deploy capital, an increasing number of topics are being hotly negotiated in proposal letters, commitment letters and credit documents. In this credit environment, certain Borrowers are empowered to make more aggressive requests for what many may argue are well-established “market” provisions, while also requesting additional creative requests that debt providers may have never seen before. For example, time periods for providing notice of certain events, cure periods, reinvestment periods, post-closing delivery time periods (and what items are permitted to be delivered post-closing) and realization of synergy benefits for purposes of EBITDA add-backs are continually being requested to be lengthened and stretched. EBITDA add-backs requested are pages long with the Lender relying on a general cap to add-backs to provide some comfort. Lenders are also facing resistance to obtaining security for foreign collateral, even in light of the change in tax laws, and with respect to any perfection steps that require additional time or expense on the part of the Borrower (for example, complying with federal assignment of claims or providing applicable documentation in connection with lending on in-transit inventory). Borrowers are also requesting additional flexibility with respect to making restricted payments and/or permitted investments to grow and expand their business through permitted acquisitions and joint ventures and other opportunities. Lender are tasked at providing that flexibility while also protecting the value of their collateral and the rating of the underlying credit structure. In addition to requesting additional flexibility on the actions the Borrower is permitted and/or prohibited from taking, Borrowers are also making more aggressive demands with respect to having control over the Lender’s ability to assign the loans and voting rights among the Lenders. There are various formulations with respect to consent rights granted to the Borrowers and when and which entities may never take a portion of the loan by assignment.

This program is going to discuss how some of what appeared to be settled issues are moving to favor the Borrowers and how Lenders are (or are not) comfortable with making those accommodations and evaluating some of the reasons for, and risks related to, some of the newer requests that the panelists have come across.
(1) Non-recurring recruitment and severance costs not to exceed [$ cap] in the aggregate during the term of the Credit Agreement;

(2) Non-recurring consulting expenses related to operations, information technology systems and accounting systems not to exceed [$ cap] in the aggregate during the term of the Credit Agreement;

(3) With respect to each new store that has been opened and/or acquired in any a Permitted Acquisition, solely with respect to stores opened within the prior 24 months, a 24-month post-opening annualized run-rate credit capped at [$ cap] per new store;

(4) All fees and expenses related to identifying and opening a new store location; and

(5) Transition services related to Permitted Acquisitions (less any expected incremental recurring expenses anticipated upon the termination of such transition services) not to exceed in the aggregate [$ cap] per fiscal year.
The aggregate amounts added back to EBITDA in reliance on clauses (1), (2), (3), (4) and (5) for any period of four consecutive fiscal quarters shall not exceed [percent cap]% of EBITDA for such period (calculated [before] [after] giving effect to any such adjustments).

Discussion Points:

• Industry – Business of the Borrower.

• Caps as a percentage of EBITDA.

• Whether the percentage caps are calculate before or after giving effect to such addbacks.
Borrowers and Lenders are particularly focused on covenants relating to restricted payments and investments because they, along with restricted debt payments, are ways that assets, including cash, can leave the debt structure and devalue the credit.

Borrowers and Sponsors are consistently looking for new and creative ways to transfer value out of the Company while Lenders are worried about leakage of value, in particular relating to their collateral.
Hot Button Restricted Payment and Investment Provisions

- Sublimits for non-guarantor or assets that do not constitute collateral
  - Permitted Acquisitions
  - Investments
- “Available Amount” basket
  - Usage
  - Conditions
- Ratio and General baskets
  - “No worse than”
  - Conditions
- Management fees and expenses
  - Grower component
  - When payable
  - What is payable
- Usage of general dividend basket for debt incurrence
Restrictions on Assignments
Borrowers and Lenders have conflicting interests regarding restrictions on assignments.

Borrowers and Sponsors are consistently demanding comprehensive restrictions on assignments in order to control who holds their debt.

In contrast, Lenders would like as few restrictions on assignments as possible so that their loans are as liquid as possible.

In general, the vast majority of deals grant Borrowers consent rights on assignments and permit Borrowers to submit a “disqualified lender” of ineligible assignees.

• The issues arise on when those consent rights go away and the particulars of how the DQ List works
Hot Button Provisions in Assignments

- Borrower consent rights
  - When do they go away?
  - Deemed consent?

- Whitelists for Revolving Lender

- Disqualified Lenders
  - Who can be on the list?
    - Competitors
    - Blacklisted Entities
    - Certain Affiliates of Competitors and/or Blacklisted Entities
  - Can the list be updated?
    - If so, who has consent rights?
  - Should list be posted?
  - Should a Net Short Lender be considered a Disqualified Lender?
  - Are assignments to Disqualified Lenders (1) always prohibited or (2) prohibited only so long as certain specified Events of Default have not occurred?
ABL Related Provisions

• Deemed Borrowing Base Concept
• In-Transit Inventory
Deemed Borrowing Base

In the event the Administrative Agent has not completed more recent field examinations and/or appraisals prior to the Closing Date than those completed prior to the date of the Commitment Letter, Borrower shall ensure that the Administrative Agent and its advisors and consultants shall have sufficient access and relevant information relating to the Loan Parties and their assets to complete such field examinations and/or appraisals on or before the 60th day after the Closing Date and during the period from the Closing Date and until the later of (x) Administrative Agent’s receipt and reasonable opportunity to review such field examinations and/or appraisals and (y) the 60th day after the Closing Date, Availability shall be based on an alternative borrowing base (the “Alternative Borrowing Base”) equal to the greater of (a) $100 million and (b) an amount equal to the borrowing base then calculated pursuant to the field examinations and appraisals prior to the date of the Commitment Letter. On and after the Administrative Agent’s receipt and reasonable opportunity to review such field examinations and/or appraisals, Availability shall no longer be based on the Alternative Borrowing Base but shall be based on the Borrowing Base as provided above.
Types of In-Transit Inventory

• Domestic In-Transit Inventory – In-Transit within the continental United States

• Foreign In-Transit Inventory – goods “on the water or in the air” – moving from outside the US to the US

• Focus of negotiation tends to be on Foreign In-Transit Inventory – Inventory “on the water”
Industry Practices

• Current Trends vs. Historical Practice
  • Today, negotiable documents are rarely used
  • Typically we see non-negotiable documents
  • Industry seems to prefer non-negotiable documents for ease of use – variations of bills of lading:
    • Seaway bill
    • Ocean bill
    • Express release
    • Telex release

• Issues Posed:
  • Perfection methods vary based on type of document
  • Seller’s rights in the Goods vary based on type of document
Typical eligibility requirements for in-transit inventory:

- Inventory is excluded if it is not located in the U.S. or is in transit with a common carrier from vendors and suppliers, provided that, up to $___________ of Inventory in transit from vendors and suppliers may be included as Eligible Inventory despite the foregoing provision of this clause so long as

  (i) the Administrative Agent shall have received (1) a true and correct copy of the bill of lading and other shipping documents for such Inventory and (2) evidence of satisfactory casualty insurance naming the Administrative Agent as lender loss payee and otherwise covering such risks as the Administrative Agent may reasonably request,

  (ii) if the bill of lading is non-negotiable, the inventory must be in transit within the U.S., and the Administrative Agent shall have received, if requested, a duly executed Collateral Access Agreement, in form and substance satisfactory to the Administrative Agent, from the applicable customs broker, freight forwarder or carrier for such Inventory,

  (iii) if the bill of lading is negotiable, the inventory must be in transit from outside the U.S., and the Administrative Agent shall have received (1) confirmation that the bill is issued in the name of such Borrower and consigned to the order of the Administrative Agent, and an acceptable agreement has been executed with such Borrower’s customs broker, in which the customs broker agrees that it holds the negotiable bill as agent for the Administrative Agent and has granted the Administrative Agent access to the Inventory, (2) confirmation that such Borrower has paid for the goods, and (3) an estimate from such Borrower of the customs duties and customs fees associated with the Inventory in order to establish an appropriate Reserve,

  (iv) the common carrier is not an Affiliate of the applicable vendor or supplier, and

  (v) the customs broker is not an Affiliate of [such][any] Borrower;
What is a Bill of Lading?

• Under the UCC a “Bill of lading” means a document of title evidencing the receipt of goods for shipment issued by a person engaged in the business of directly or indirectly transporting or forwarding goods

• Types:
  – Negotiable
  – Non-Negotiable

• Typically serves three functions:
  – Gives the terms and conditions of the carriage of the goods
  – It is the shipper’s receipt for the goods delivered to the carrier
  – It is the document of title to the goods so that the holder of the original bill of lading is the only one who has the right to claim the goods from the carrier (for negotiable bills of lading only)
Negotiable vs. Non-Negotiable Bills of Lading

• Under Section 7-104(a) of the UCC a bill of lading is negotiable if by its terms the goods are to be delivered “to bearer or to the order of a named person.” A consignee is the person named in the bill of lading to which or to whose order the bill promises delivery. If Borrower is named should be stamped on reverse with “endorsed to PNC Bank.” That is “negotiation” (i.e., similar to endorsement of your personal checks).

• A non-negotiable bill of lading is any other bill of lading that does not say “To Bearer or To the order of...” in the consignee box.
Lender Protections – Best Practices

• Perfection of lien of Negotiable Bill of Lading in the US
  • Enables secured lender to take priority over certain seller claims
  • Gives secured lender priority over competing security interests perfected by filing

• If using Non-Negotiable Bills of Lading, consider risks from unpaid sellers and other creditors

• Supplemental protection from sellers’ claims to goods:
  • obtain waiver letters from Sellers and/or Shippers
  • Secured party named as consignee

• Freight Forwarder Agreements – including waiver of carrier’s liens
Foreign Subsidiaries as Loan Parties
On May 23, 2019, the Department of the Treasury and the IRS published final regulations (the final regulations) under Section 956 of the Internal Revenue Code of 1986, as amended (the Code).

The final regulations in most circumstances eliminate the adverse U.S. tax consequences to a U.S. corporate borrower when it pledges two-thirds or more of the voting stock of a controlled foreign corporation (CFC) or causes a CFC to guarantee the debt or to pledge its assets to secure the debt.

Section 956 was originally enacted to ensure that a CFC’s earnings that were not subject to immediate tax when earned would be taxed when effectively repatriated to the United States. An investment by a CFC of its earnings in U.S. property — such as through direct or indirect credit support provided by a CFC in respect of its U.S. corporate parent’s debt — equated to a taxable dividend distribution by such CFC to its U.S. shareholder(s) and thus should be taxed in a similar manner.
Foreign Subsidiaries as Loan Parties

• The Tax Cuts and Jobs Act included a new Section 245A which generally allows a deduction equal to the foreign source portion of such dividend. However, the Tax Cuts and Jobs Act failed to extend relief similar to that afforded actual dividends to corporate U.S. shareholders under Section 245A to deemed dividends to such shareholders arising under Section 956. The regulations provide that the amount of the Section 956 deemed dividend is offset to the extent the corporate U.S. shareholder would have been allowed a deduction under Section 245A if the amount deemed received from the CFC under Section 956 had been an actual dividend.

• The Section 245A deduction is not allowed if, among other things, the stock of the CFC is held by the corporate U.S. shareholder for 365 days or less during the 731-day period beginning on the date that is 365 days before the date on which such share becomes ex-dividend with respect to such dividend. As a result, corporate U.S. shareholders of recently acquired or newly formed CFCs may be ineligible for the Section 245A deduction.
Foreign Subsidiaries as Loan Parties

- In general, neither the receipt of an actual dividend by a corporate U.S. shareholder of a CFC nor such a shareholder’s tentative Section 956 amount will result in the imposition of additional U.S. federal income tax with respect to such shareholder under Section 245A.

- Thus, in usual circumstances, a CFC’s provision of a guarantee or pledge of its assets in support of its U.S. corporate parent’s indebtedness or a pledge by such parent of two-thirds or more of the stock of such CFC in support of its borrowing generally will no longer result in a deemed dividend includible in the income of the U.S. corporate parent under Section 956.

- The regulations have no impact on the applicability of Section 956 to other U.S. shareholders such as S corporations, regulated investment companies, real estate investment trusts and individuals. However, the final regulations do apply to certain domestic partnerships having one or more corporate U.S. shareholders by providing that the tentative Section 956 amount with respect to a domestic partnership is reduced to the extent that one or more domestic corporate partners of such partnership would be eligible for a Section 245A deduction if the partnership had received such amount as an actual distribution.
Summary - CFC subsidiaries of U.S. borrowers may guaranty and grant liens on their assets to support the debt obligations of its U.S. parent and the U.S. parent may pledge 100% of the equity of its CFC subsidiaries without any concern of additional taxes from deemed dividends.

Caveats:
• The CFC must be owned for more than 1 year.
• The parent must be a U.S. corporation or a partnership (or LLC) with one or more U.S. corporate partners.
• U.S. corporate borrowers with CFC subsidiaries may wish to review their existing loan documents, as some agreements contain provisions requiring such borrowers to augment credit support from their CFCs in the event of a change in law or if doing so would not result in the imposition of additional tax.