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ACC CANADA
ONTARIO CHAPTER

BANKING BASICS FOR IN-HOUSE COUNSEL

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MERITAS LAW FIRMS WORLDWIDE

IMPACT OF ECONOMY ON LENDING RELATIONSHIP

A. LEGISLATIVE REACTION

1. Federal Taxes
   - Source Deductions
   - UIC/CPP
   - GST

2. Federal: Other
   - Suppliers
   - WEPPA Claims

IMPACT OF ECONOMY- Cont'd

3. Provincial Taxes
   - PST

Impact: All above priority claims (and others) affect operating loan margin requirements

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IMPACT OF ECONOMY- Cont'd

B. PRICING AND AVAILABILITY

1. Cost of funds more expensive/tighter margins
2. Availability is Industry Specific

   Examples: Real Estate / Manufacturing

   - tight

   Auto Dealerships

   – more availability
3. Closer analysis at inception and renewal stage

IMPACT OF ECONOMY- Cont'd

Result:

- Syndication trends = lender negotiating on own behalf and on behalf of others = more requirements, pre-closing condition
- Increased activity in secondary markets:
  - asset based
  - lease
  - factoring
  - BDC and similar institutions

MANAGING THE PROCESS AND CONTROLLING COSTS

A. KNOW YOUR LENDER

1. Be Mindful of:
   - Movement from "sales" to "hunkering" down mentality
   - What motivates the account manager
   - Dynamics of internal decision making structure
   - Desire of many banks to work with/rehabilitate borrowers experiencing financial difficulty

MANAGING THE PROCESS - cont'd

B. EXPENSE SAVING TIPS

1. Allocate Resources Wisely:
   - Business to Business
   - Legal to Legal
   - In house to External Counsel
   - Establish your team
   - Determine roles/responsibilities

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MANAGING THE PROCESS - cont'd

2. Identify Key Issues Early in Process/Term Sheet Phase:
   - Closing Pre-Conditions
   - Lender Due Diligence
   - Legal Opinions
   - Third Party Consents

3. Pick your battles wisely (particularly those you are paying external counsel to negotiate).

MANAGING THE PROCESS - cont'd

4. Unlikely to win/not worth extensive investment of time:
   - "Standard" language in loan agreements (general covenants, evidence of debt clauses, set off clauses, expense recovery clauses)
   - Standard bank forms (security agreements, guarantees)
   - Legal opinions

MANAGING THE PROCESS - cont'd

5. Focus on:
   - Financial Covenants
   - Reporting requirements
   - Definition of financial terms/test/ratios (Tangible Net Worth, Debt to Equity)
   - Legal opinions

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NEGOTIATING THE LOAN AGREEMENT

A. OBJECTIVES

1. To identify the key provisions that are the most significant for corporate counsel in a typical loan agreement.
2. To highlight the provisions / issues that should be dealt with early in the process.
3. To anticipate frequently encountered problem areas/points of contention.

NEGOTIATING THE LOAN AGREEMENT cont'd

B. ESSENTIAL BUSINESS TERMS

1. The facilities:
   - quantum – principal amount – subject to margining or otherwise limited?
   - purpose
   - pricing – fixed or floating? if floating – base rate and risk premium
   - payment terms
   - prepayment terms
   - fees

NEGOTIATING THE LOAN AGREEMENT cont'd

2. Nature of recourse/liability
   - full vs. limited recourse
   - secondary (guarantor) liability
3. Security
4. Covenant structure

NEGOTIATING THE LOAN AGREEMENT cont'd

C. THREE USEFUL GENERAL DISTINCTIONS

1. Committed vs. uncommitted loans
2. Term vs. demand loans
3. Asset based vs. non-asset based loans

NEGOTIATING THE LOAN AGREEMENT cont'd

D. REPRESENTATIONS AND WARRANTIES

4 broad categories:

(a) Status representations – usually not contentious

(b) Enterprise-wide representations – for an uncommitted facility, should be more limited

(c) Project or property specific representations

(d) Other deal specific representations

NEGOTIATING THE LOAN AGREEMENT cont'd

Simplify the process by obtaining agreement at an early stage on certain general principles, such as:

- general scope
- thresholds/exceptions, e.g., de minimus threshold for litigation, etc.
- consider developing standardized drafting tools such as:
  - definition of materiality
  - definition of scope of inquiry, e.g., "best knowledge and information"

NEGOTIATING THE LOAN AGREEMENT cont'd

E. CONDITIONS PRECEDENT

Early in the process, identify the significant conditions precedent, and especially those that will involve third party matters, e.g., reports of experts, certificates of public officials, consents from landlords or other third parties.

NEGOTIATING THE LOAN AGREEMENT cont'd

Allocate responsibility for coordinating conditions precedent: internal vs. external; among external disciplines.

Where conditions precedent recur for successive draws, attempt to establish agreed-upon protocols, standard pre-approved formats.

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NEGOTIATING THE LOAN AGREEMENT cont'd

Legal opinions – strategies for avoiding unproductive use of time – consider in advance:

- responsibility for registrations and priority opinions
- responsibility for title opinions, if any
- strategy for coordinating multiple opinions
- scope of opinions - enforceability

NEGOTIATING THE LOAN AGREEMENT cont'd

F. COVENANTS

As a general rule, the covenants required for uncommitted facilities should be more limited and less heavily negotiated than for committed facilities.

The borrower should approach the loan document as a "live" document – covenants should be tailored so that compliance will conform with ongoing operations and will not be unduly burdensome, disruptive or costly.

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NEGOTIATING THE LOAN AGREEMENT cont'd

Some categories of covenants can and should be anticipated and settled in principle early in the process:

- reporting covenants
- financial covenants
- control/transfer restrictions
- project or asset specific covenants

NEGOTIATING THE LOAN AGREEMENT cont'd

G. EVENTS OF DEFAULT

Functional approach - consider the manner in which events of default function under the loan agreement. For example, where all loans and credit facilities are payable on demand, events of default may not be necessary at all.

To the extent possible, settle on a definitive list of Events of Default and use consistently in all loan documents.

NEGOTIATING THE LOAN AGREEMENT cont'd

Streamline the negotiating process by obtaining agreement in advance on certain general principles:

- thresholds/exceptions – should mesh with corresponding representations and warranties and covenants
- agree on a consistent approach to cure periods
- anticipate and resolve cross-default issues:
  - as between different transactions/loan documents
  - as between entities

CONCLUSIONS

A. KNOW YOUR LENDER

B. ALLOCATE RESOURCES WISELY

1. People
2. Financial

C. IDENTIFY KEY ISSUES EARLY IN PROCESS

D. NEGOTIATE SMARTLY

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