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COMMERCIAL LOAN DOCUMENTATION

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Doing it Right

New York

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STRUCTURING THE COMMERCIAL LOAN:

ISSUES AND OPTIONS

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Documenting the Commercial Loan 1989
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INTRODUCTION

The structure of a commercial loan must at its outset necessarily be determined by two central considerations, _viz._, the nature of the borrower and the required nature of the facility. From these considerations flow a broad spectrum of operational requirements ranging from required closing conditions to due diligence to controlling covenants to events of default. Given the broad implications of these threshold considerations, lenders and their counsel should appreciate how the differences between various aspects of the form of business organization of a borrower affect the interests of the lender: lending to a partnership, for example, raises issues that differ from those raised by lending to a corporation or a trust. Then, after lenders have informed themselves of the concerns raised by the nature of the particular type of borrower, they can factor in ingredients dictated by the nature of the credit facility to be provided.

The first portion of this presentation will provide an overview of the issues which lenders must address in deciding how to structure loans to:

- Corporations
- Holding companies vs. operating companies
- Trusts
- Partnerships
- Not-for-profit corporations
- Regulated industry borrowers
- Employee Stock Ownership Plans

The second portion will outline the salient characteristics of the following types of facilities, so that lenders will be better able to determine what facility or combination of facilities would satisfy the requirements of a particular transaction:

- Revolving credits
- Term credits
- Discretionary facilities
- Committed facilities

THE NATURE OF THE BORROWER

Corporations

A lender making a loan to a corporation must know that the corporation is empowered to undertake the transaction requiring the loan and to assume the particular obligation embodied in the loan and that the person acting for the corporation has the proper authority to obligate the borrower pursuant to the loan documents. As evidence of power and authority to undertake the transaction in question and to borrow, the lender should receive (a) copies of the articles of incorporation and by-laws of the borrower in order to ascertain that these instruments permit the transaction contemplated and confer on the officers involved the authority to authorize the transaction and the borrowing involved; (b) proof of a vote of the board of directors authorizing the transaction or the loan; and (c) a certificate from the secretary of the corporation which verifies that the person who signs the loan documents on behalf of the corporation is a currently serving officer of the corporation duly authorized to enter into such a loan. If the transaction or borrowing contemplated is not within the powers of the corporation as expressed by the articles of incorporation or if the board of directors has not approved the underlying transaction or the loan or if the officer acting on behalf of the corporation lacks the requisite position and authority (absent apparent authority), the loan documents may be unenforceable. Of course, the objective evidence of the necessary power and authority should be reinforced by an opinion of counsel to the borrower addressing these questions. The specific content of the foregoing evidentiary requirements will be handled in detail by a later speaker.

<u>Holding Companies vs. Operating Companies</u>

As corporations, holding and operating companies are affected by all of the issues of power, authority and incumbency discussed relative to corporations generally. Beyond these basic principles, however, the concerns of a lender lending to holding companies will be different from its concerns in lending to operating companies based on the characteristic asset composition of the two different entities.

- An <u>operating</u> company is a corporation having substantial assets, such as real estate, manufacturing equipment, inventory, or accounts receivable. It has direct creditors, such as trade, payroll or tax creditors, and may take out loans for uses such as working capital, independent of its holding company.
- A <u>holding</u> company is generally a corporation (although it may be a partnership or other kind of business organization) the primary or sole asset of which is shares of stock of one or more subsidiary companies, each of which in turn holds the actual operating assets, constitutes the operating company and generates the revenue for the corporate family.

Assuming the loans are secured by liens on the assets available at each level, the direct creditors of any subsidiary of a holding company will have rights to payment senior to those of a lender lending directly to the holding company. That is, in a troubled loan, the obligation of the holding company to the lender cannot be satisfied by monies derived from the operating subsidiary until the subsidiary has satisfied the claims of its own direct creditors. Consequently, to the extent it has a lien on the assets of the holding company, _i_._e_., the shares of the subsidiary, a lender to a holding company is essentially in the position of a shareholder of the subsidiary in that the laws of bankruptcy, insolvency and fraudulent conveyances will curtail its ability to receive payment on the loan before direct creditors of the subsidiary -- even unsecured creditors of the subsidiary.

While it is occasionally possible successfully to persuade a bankruptcy or other court to set aside these limits, if the holding company structure and the transactions involved have been competently arranged, this is not a practical possibility. The lender should, therefore, employ defensive measures in negotiating the loan by requiring adoption of covenants which require full financial information about the holding company and all subsidiaries and which regulate the activities of the holding company and the subsidiary so as to preserve and protect assets which the lender can reach and other interests of the lender. Such financial information should, at the minimum, include full financials through to all levels of the corporate structure, including all transactions between the holding company and its subsidiaries. Covenants imposed could require management of the subsidiaries from the holding company level so as to leave a certain minimum amount of assets unencumbered.

In addition, loan documentation customarily will include covenants that control distributions to shareholders and additional debt or grants of security interests.

Lenders to holding companies should also include, in addition to the foregoing provisions, special covenants designed further to protect the interests of the lender. Possible special covenants include:

(a) a requirement that the holding company maintain a specific percentage of ownership of the stock of its subsidiary (in order to assure the full exercise of managerial prerogatives from the parental level);

(b) a provision proscribing the subordinating or compromising of claims between the holding company and its subsidiaries (in order to protect any revenue stream from the subsidiaries to the holding company);

(c) a requirement that the holding company enter into contracts with subsidiaries only on an arm's length, fair-dealing basis (thus protecting the continuing viability of the operating subsidiary as the principal source of revenue); and

(d) a requirement that the holding company restrict the amount of money used to finance offshore operations of foreign subsidiaries in the event that legal or other limitations on the repatriation of profits exist or come into being (to prevent the excessive movement of assets offshore).

Another goal of the lender to a holding company is to forestall the creation of direct debt by a subsidiary where such debt would have priority over the claims of the lender. Lenders should also seek to assure the greatest possible flow of cash from the subsidiaries to the holding company consistent with the continuing viability of the subsidiaries. These goals may be accomplished through inclusion in the loan documentation of covenants which prohibit subsidiaries from incurring long-term debt, granting liens or making guarantees other than within carefully negotiated boundaries.

In contrast, if the loan is being made to the operating subsidiary, complementary steps should be taken to insulate the subsidiary from the parent. Possible special covenants or structural requirements might include:

(a) limitations on dividends and other distributions to the parent (in order to retain assets at the subsidiary level);

(b) limitations on transactions with affiliates, including arm's length, fair dealing constraints (in order to ensure market driven management);

(c) grants of liens on operating assets or covenants not to encumber these assets for the benefit of other creditors (in order to ensure priority in interest of the lender -- at least relative to the holding company); and

(d) guaranties by the holding company (in order to preserve the opportunity to reach all assets of the corporate group).

The entire objective in lending at the subsidiary level is to preserve for the term of the loan the operational and financial characteristics which justified the loan in the first instance. This is done through a system of covenants which prevent the subsidiary or the holding company from disturbing those characteristics.

Partnerships

For the same reasons that arise in connection with corporations, lenders to partnerships must be sure that the underlying transaction and associated loan are authorized. The partnership agreement is analogous to the articles of incorporation and by-laws of a corporation and should delineate the powers of the partnership, the authority of partners to enter into such transactions and associated loans, the procedures which must be followed and which partners will be liable for partnership debts (limited partners are usually not liable beyond the amount of their investment, while each general partner is individually liable for all partnership debts and obligations). Careful lenders should obtain an authenticated copy of the partnership agreement and assurances that proper procedures have been followed. Where a partnership agreement is not specific, lenders should obtain proof of a written vote signed by all general partners approving the transaction and loan. Beyond these matters of power, authority and incumbency, covenants directly analogous to those imposed on corporations should be put in place.

Trusts

A trust is a voluntarily created arrangement in which a trustee holds legal title to property, while the beneficial interest is held by a separate person or persons, called the beneficiary/ies. For purposes of this presentation it is important to understand the difference between a "true" trust and a "nominee" trust. In a "true" trust, beneficiaries enjoy beneficial interests only and are not personally liable for claims against the trust. Rather, the sole remedy of a claimant would be to pursue the subject matter of the trust itself (the property comprising the corpus or "body" of the trust). In contrast, under a "nominee" trust, beneficiaries are liable for claims against or debts of the trust.

Like the articles of incorporation (in the case of a corporation), or the partnership agreement (in the case of a partnership) the instrument creating the trust, whether true or "nominee", dictates whether the trustee is empowered to undertake the transactions contemplated and authorized to execute loan documents. Thus, careful lenders should obtain an authenticated copy of the instrument before lending to a trust. In addition, when the trust is of the "nominee" variety, and the instrument merely empowers the trustee to commit to the loan, in order to evidence the personal liability of the beneficiaries, the lender should obtain signatures on the loan documents from each beneficiary.

Corporations are normally perpetual in existence. Trusts, however, typically are not perpetual. Lenders to a trust must therefore consider the question of the expiration, termination or revocability of the trust, and the effect these events might have upon the proposed loan. The same problem can arise in connection with loans to partnerships.

<u>Not-For-Profit Corporations</u>

Not-for-Profit corporations, which in general pursue educational or charitable rather than commercial goals, exist on donations and income from investments and are governed by the same principles regarding power and authority as are for-profit corporations. Beyond these considerations, however, lies the fact that income to the not-for-profit corporation is not subject to federal or state income taxation provided that the corporation restricts its activities to those allowed by the Internal Revenue Code and the law of the applicable states. Thus, in addition to dealing with issues of power, authority and incumbency common to all corporations, steps must be taken to ensure that this privileged status is not lost due to improper activities or mismanagement. These steps would be taken through the imposition of specialized covenants controling the behavior of these corporations. Consequently, the art of structuring loan arrangements with not-for-profit corporations is highly specialized due to the labyrinthine provisions and effects of the tax laws governing them. Lenders should obtain advice from special counsel in this intricate area regarding substantive provisions and covenants which are appropriate to protect the interests of the lender. Such provisions and covenants are far beyond the scope of this presentation, but the flavor of the requirements can be gained from my later discussion of loans to ESOPs which exemplify the problems of regulating the behavior of specialized borrowers.

Regulated Industries

Loans to regulated industries are affected by the same issues that affect corporations generally, but in addition, knowledge of the unique characteristics of the regulated industry in question is the most important prerequisite to an appropriately structured loan. These considerations are analogous to those affecting not-for-profit corporations in the sense that the not-for-profit is heavily regulated from the perspective of the taxing authorities. The same is true of an ESOP. An overview of all regulated industries is beyond the scope of this presentation; however, the following examples should serve as illustrations of the types of issues lenders should consider in structuring loans to such borrowers:

(a) Public utility companies that are subject to regulation under the Public Utility Holding Company Act of 1935 must obtain SEC consent to borrow. Failure to obtain such consent may render a loan void;

(b) National banks generally are prohibited from pledging their deposits as loan collateral, and from guaranteeing the debts of another person or entity other than pursuant to their banking business, and an agreement to do any of these things may be unenforceable;

(c) Railroad companies are subject to the jurisdiction of the Interstate Commerce Commission which must approve certain borrowings. Consequently, the transaction should be structured to either fulfill or avoid this requirement; and

(d) Securities companies are heavily regulated and certain specialized requirements are imposed relative to certain types of loans. For example, the net capital rule permits certain asset based loans, but restricts the terms and conditions of these loans.

Employee Stock Ownership Plans ("ESOPs")

An ESOP is a tax-qualified employee benefit plan ("plan") created by an employer to benefit its employees by facilitating the acquisition of the securities of the employer. When an ESOP funds the acquisition of employer securities from the employer by means of a loan from a third party lender, both the employer and the lender become eligible for tax and regulatory benefits. The transaction involving a loan to an ESOP illustrates all of the issues affecting a lender in connection with power, authority, incumbency and regulation and for that reason more time will be spent on this type of borrower in order to convey a flavor of the full scope of structural issues which can appear.

In very simple terms, the issues of power, authority and incumbency which arise in connection with ESOP loans are directly analogous to those which arise in connection with loans to trusts. After all, a trust is the central vehicle in the operation of the ESOP. Consequently, the trust instrument must empower and authorize the trustee to borrow in order to fund the acquisition of the securities involved. The governing plan document must be in accord. In addition, federal tax law imposes many specialized regulations germane only to leveraged ESOPs. For example, the plan document, trust instrument and loan documentation must require the leveraged stock to be maintained in a suspense account; the employer must covenant to contribute funds sufficient to amortize the loan; and a formula must be specified for the release of the securities from the suspense account and distribution to the accounts of the participants. If the securities are not publicly traded or registered, participants must have the right to "put" the securities to the employer upon distribution. Conversion ratios, if preferred stock is used, must be specific. Many other requirements are imposed as well. Also, as a practical matter the employer will be expected to issue a guaranty of the loan in favor of the lender. Of course, the employer also should satisfy the usual formalities with regard to action on the part of the employer, including directions to the trustee to leverage and issuance of any guaranty.

In terms of covenants designed to regulate the behavior of the plan and the company, much depends on the structure of the loan and the requirements of federal tax law. Three different structures are common. The most basic structure exists when the lender makes a loan directly to the ESOP. The employer guarantees the loan and makes periodic and tax-deductible cash contributions to the plan. The plan uses the borrowed funds to buy a block of the stock of the employer to be allocated to plan participants' accounts during the term of the loan. The ESOP uses the employer contributions to repay the loan. Covenants should be imposed to compel the issuance of the guaranty, the contributions and so on.

A second way to structure an ESOP loan is for the lender to make the loan to the employer, which in turn lends the funds to the ESOP in a back-to-back fashion. The ESOP purchases employer stock with these funds and the employer makes tax-deductible cash contributions to the ESOP which the ESOP uses to pay off its debt to the employer. The employer then utilizes these funds to pay off its debt to the lender. This type of "back-to-back" loan structure is used when the lender prefers lending to an issuer over lending to an ESOP. Covenants should be introduced to ensure faithful execution of this structure.

In the third structure, an "immediate allocation" loan, the lender makes a loan to the employer for a term not to exceed seven years, and the employer then immediately gives to the ESOP a block of its securities equal in value to the amount of the loan. The ESOP must allocate these shares to the accounts of plan participants within one year of the date upon which the loan was made. The stringent nature of these requirements necessarily places limits upon the amount of immediate allocation loans.

The use of leveraged ESOPs has arisen in part because of tax advantages. Under the present law,1/ a bank, insurance company, corporation actively engaged in the business of lending money, or a regulated investment company, is entitled to exclude from its income 50% of the interest received on a loan to an ESOP or to an employer, the proceeds of which are used to acquire employer securities or to refinance a prior loan used to

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1. *See infra*, p.23, regarding pending proposed legislation.

acquire employer securities. Such a loan is called a "securities acquisition loan."

If the securities acquisition loan is structured as a direct loan or a back-to-back loan, the terms of the loan must satisfy the following requirements in order to qualify for the 50% interest exclusion:

(i) the loan must be assumed primarily for the benefit of the ESOP participants and their beneficiaries. Loans are subjected to special scrutiny by the IRS and the Department of Labor to determine whether this requirement is satisfied.

(ii) the terms of the ESOP loan must be as favorable to the ESOP as the terms of a loan negotiated at arm's length.

(iii) the interest rate must be reasonable giving due consideration to elements such as the term of the loan and its principal amount, the credit-worthiness of the ESOP, the securities, and the guarantees being provided.

(iv) the ESOP must use the loan proceeds to purchase employer stock, or to repay a previous ESOP loan within a reasonable time. With limited exceptions, securities acquired with the loan proceeds and held by the ESOP or distributed therefrom may not be subject to a call, option or any like arrangement. Convertible preferred stock may, however, be callable if the holder is accorded a reasonable period to convert after the call.

(v) only securities purchased with proceeds of the loan or used for collateral in connection with a previous ESOP loan which is being refinanced may be pledged as collateral for the loan. The only recourse of the lender must be (a) the collateral securing the loan; (b) contributions made by the employer pursuant to the ESOP to satisfy loan obligations; and (c) any earnings on the collateral or from investment of the contributions.

(vi) the securities purchased with the loan proceeds must initially be held in a suspense account. As contributions (loan payments) are made, stock must be released from the suspense account and allocated to accounts of participants pursuant to a specified allocation formula.

(vii) upon the occurrence of a default on an ESOP loan, a lender that is not a party-in-interest to the ESOP would be permitted to declare the debt due and payable in conformity with reasonable commercial practices. Back-to-back or direct loans from a party-in-interest must prohibit the employer from accelerating its loan.

(viii) the term of the loan must be fixed and, absent default, must not be payable prior to the end of the term provided.

(ix) at the time the loan is made, the ESOP must satisfy ESOP qualification conditions under ERISA and the Code.

All of the foregoing must be required and controlled by means of properly drafted documents.

Furthermore, for the interest exclusion to apply to a back-to-back loan, <u>either</u> (a) the terms of repayment of the loan made by the employer to the ESOP must be substantially similar to the repayment terms of the loan made by the third party lender to the employer; <u>or</u> (b) the loan made by the employer to the ESOP must require repayment of principal or interest at a faster rate than the repayment rate of the loan made by the third party lender to the employer, <u>and</u> allocation of stock to plan accounts for participants due to the difference in payment schedule may not favor highly compensated employees, <u>and</u> the loan commitment period of the loan by the third party to the employer may not exceed seven years.

Under both back-to-back and immediate allocation loans having a maturity of less than seven years, funds may be obtained from one or more other lenders as short term loans utilized to retire the main loan. In all cases appropriate covenants must be imposed to ensure compliance with these requirements of federal tax law.

The interest exclusion also is available for a refinanced ESOP loan if:

(i) the original loan satisfied the criteria for the interest exclusion; and

(ii) the proceeds of the original loan were used to purchase stock of the employer after May 23, 1984.

Even if these conditions are met, and the terms of the refinanced loan are substantially similar to those of the original loan, the exclusion will apply only during the longer of the first seven years of the commitment period of the refinanced loan, or the remainder of the commitment period of the original loan. If the refinanced loan differs substantially from the original, the interest exclusion will be available only for the first seven years of the loan.

The 50% interest exclusion usually induces lenders to offer lower interest rates. Consequently, ESOP loans should provide for a gross-up to indemnify lenders for lost interest income, and for the additional taxes, interest and penalties which may result in the event that the exclusion is lost. The lender should also require an opinion of counsel to the borrower to the effect that the exclusion is available.

Lenders should always bear in mind that, like a holding company, the only assets of an ESOP are employer stock, employer contributions and dividends on the stock. Lenders will want to structure their loans in a way that will obligate the employer to make ESOP contributions which are adequate to enable the ESOP to discharge the obligation created by acquisition of the employer stock.

Lenders must also be aware of the fact that the stock which the ESOP purchases with the loan will not all be available as collateral. Rather, under the provisions of the ESOP, when the stock is released from the suspense account and allocated to the accounts of the employees, such stock is no longer available as collateral for the loan. In addition, under certain conditions lenders are permitted to foreclose not on the entire obligation, but only on an amount of collateral sufficient to satisfy a presently payable installment.

Proposed legislation is now pending before Congress which would amend the tax advantages of leveraged ESOPs, as follows:

- A loan to an ESOP would not be treated as a "securities acquisition loan", 50% of the interest on which the lender may exclude from income, unless immediately after the acquisition or transfer of securities the ESOP owns at least 30% of (a) each class of outstanding stock of the corporation issuing the employer securities; or (b) the total value of all outstanding stock of the corporation.

- A loan to an ESOP would not be treated as a "securities acquisition loan" (a) if the loan was originated by an entity other than a bank, an insurance company, a corporation actively engaged in the business of lending money, or a regulated investment company; or (b) for any period after such loan is first held by such an entity.

The proposed legislation includes other amendments the discussion of which is beyond the scope of this presentation: lenders considering entering into an ESOP loan should obtain the advice of competent counsel in this regard. The proposed legislation, if adopted, would apply to loans made after July 10, 1989. This state of flux in the regulation of ESOPs also highlights the importance of a current understanding of the law by the lenders, competent advice of counsel and well developed opinions of counsel as conditions of funding.

Issues Lenders Should Address Regardless of the Nature of the Borrower

When considering any type of loan, lenders must confirm that the borrower is not a party to any contract or other agreement which prohibits the borrower from entering into the loan, such as a pre-existing bank loan. Lenders should also determine that no outstanding judicial or regulatory order prohibits the borrower from entering into the loan.

In order to be satisfied that authority to enter into the loan exists, the lender should obtain an opinion from counsel to the borrower stating that (a) all actions necessary to authorize the execution and delivery of loan documents have been taken by the borrower; and that (b) when executed, the loan documents will evidence legal, valid and binding obligations of the borrower.

Lenders may request that counsel to the borrower give opinions on additional matters, such as the non-existence of proscriptive pre-existing contracts or court orders or laws, regulations and other requirements.

THE NATURE OF THE FACILITY

In the very simplest terms, facilities can be revolving or term and discretionary or committed. In addition, they can be secured or unsecured. The characteristics of secured versus unsecured loans will be discussed later in the program by another speaker. I will limit myself to a discussion of the four, basic operational parameters -- revolving or term, discretionary or committed -- bearing in mind that a revolver or a term loan may, as a separate proposition, be discretionary or committed and that among the black and white of the six extremes, there are many hybrids. For example, a facility may be a revolving credit and term loan which may be either discretionary or committed.

Revolving Line of Credit

Frequently referred to as a "revolver", this type of facility establishes a line of credit in which the borrower can cyclically borrow and repay for the duration of the commitment. Upon request of the borrower, the lender extends loans during the agreed upon period. The total amount of outstanding loans may not exceed the ceiling amount of the facility. Borrowers can borrow an amount equal to the difference between the maximum amount of the revolver and the entire amount of all loans outstanding. The primary characteristic of a revolver which distinguishes it from other credit facilities is the right of the borrower to repay a loan and then re-borrow the funds previously repaid.

The revolving line of credit is characteristically employed by a borrower to finance seasonal requirements of its business, because it affords it flexibility respecting the timing and amount of borrowing and repayment of the loans. Where a lender wishes to provide a revolver specifically for financing seasonal needs rather than more constant everyday requirements, it can include an "annual clean-up" clause, requiring that during a specific duration of time there will be no loan outstanding.

A good example of a revolver is the typical inventory financing. Frequently, the inventory is used as collateral for the loan. The lender will advance funds totalling a fixed percentage of the value of inventory which the lender deems "eligible" based upon its liquidation value. For example, stale goods or work in process are usually not "eligible" because such assets have no current liquidation value. To determine the amount of an advance, inventory may be valued at the lesser of cost or market value or some other formulation agreed upon by the parties. The borrower repays the lender from accounts receivable (the proceeds of the inventory) and pays interest at a fixed or floating rate per month determined by calculating the average daily balance outstanding during the month. A receivables financing, the complement of an inventory financing, is another example of a revolver as is the typical working capital loan.

Term Credits

Essentially, term credits represent the opposite end of the spectrum from revolvers. In a term facility the loan is funded in one or more advances, requested by the borrower, which remain outstanding for a specified time or term. The borrower can borrow up to the maximum agreed amount. At the expiration of this term the loan is repaid either in installments or in a single payment or bullet. The borrower usually can prepay the loan, but once a prepayment is made, the amount prepaid cannot be reborrowed. The term facility is typically employed by a borrower to finance capital goods since a series of one time fundings for payment for the capital good is required. A good example of a term facility would be one used to finance the construction of a hard asset such as a building or a power plant. Other examples would be capital leases and conditional sale agreements.

Committed And Discretionary Facilities

For a careful lender, all facilities are to some degree discretionary. In all cases, whether or not a commitment of the lender has been issued or embodied in the loan documents, there are conditions precedent which the borrower must satisfy. Properly drafted and where justified, these provisions are elaborate, extensive, broad and susceptible of differing interpretations. Clearly, a lender should only decline to honor a commitment in appropriate circumstances in order to avoid the liabilities to be discussed later in this program; however, when it is necessary, the loan agreement usually can be found to include a justification for the refusal to lend.

In a committed advance facility, lender is obligated to make an advance if the borrower satisfies the conditions precedent set forth in the loan agreement. An advance is pursuant to a commitment if the lender has bound himself to make it, whether or not a subsequent event of default or other event not within his control has relieved him from his obligation. A facility providing for advances pursuant to a commitment is advantageous to the lender because under U.C.C. §9-301(4) all secured advances made pursuant to a committed advance facility have priority over statutory liens obtained by other creditors, provided that the facility itself was entered into prior to the creation of the statutory lien or prior to the lender acquiring knowledge of it. The borrower obviously benefits from a committed facility to the extent he can depend on funding upon satisfaction of conditions precedent.

By contrast, under a discretionary credit facility, with regard to advances made after the statutory lien arose, lender has priority over lien creditors only where either (a) the advance was made within 45 days after the statutory lien arose; or (b) the lender made the advance without knowledge of the statutory lien. Thus, under a discretionary facility, where the lender becomes aware of a statutory lien on the assets of the borrower, it will be left with only two alternatives: to terminate the credit facility immediately, or to be relegated to the status of a second priority lien-holder as to future advances.

Another advantage to a secured lender of a committed over a discretionary facility is that if the borrower sells assets outside the ordinary course of business, advances under a committed facility will ordinarily continue to be secured by those transferred assets. A secured lender making advances under a discretionary facility will not have a security interest in such transferred assets respecting advances made either (a) 45 days after the sale of the assets; or (b) 45 days after the lender learns of the sale, whichever is sooner.

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