

# Corporate Borrowers Should Make New Year's Resolutions, Too

January and February are months for action. We are all (at least for a little while) eating healthier and going to the gym. Companies can take action, too, and proactively address issues related to their loan documents.

## Address LIBOR's Imminent Demise

Most commercial loans have interest rates that reference the London Interbank Offered Rate (LIBOR). LIBOR is intended to measure the rate at which large global banks will lend to each other in the London financial markets. However, LIBOR is scheduled to be discontinued in 2021. Borrowers should review their loan documents to see how—if at all—the disappearance of LIBOR is addressed: Does the referenced index switch to the prime rate, which is historically higher than LIBOR? Does the lender have the option to unilaterally impose a new index? Neither option would be palatable to many borrowers.

Borrowers should try to ensure they have a voice in determining the new benchmark rate and any adjustments to the spread, along with what events trigger the new rate and spread. In 2014, the Federal Reserve Board and the New York Fed convened the Alternative Reference Rates Committee to help ensure a successful transition away from LIBOR. Throughout 2019, this committee released model "LIBOR fallback language" to be used as a starting point for lenders and borrowers when negotiating LIBOR related amendments.

Note that lenders and borrowers usually address the LIBOR fallback issue when making other changes to the documents—they do not enter into amendments specifically for LIBOR fallback provisions.

## Examine Lease Accounting Treatment

After years of discussion, a new accounting treatment for operating leases has been announced, although the effective date for some companies has been delayed. Under Accounting Standards Update No. 2016-02, Leases (Topic 842), operating leases will be required to be placed onto the lessee's balance sheet. An operating lease on the balance sheet might constitute "Debt" under the loan documents, thereby negatively impacting the calculation of financial covenants, such as a leverage ratio. Borrowers should know that this "mere accounting change" could trigger a violation of a loan document covenant even though the

## POSTED:

Jan 24, 2020

## RELATED PRACTICES:

### [Banking and Finance](#)

<https://www.reinhartlaw.com/practices/banking-and-finance>

### [Corporate Law](#)

<https://www.reinhartlaw.com/practices/corporate-law>

## RELATED SERVICES:

### [Accounting and Financial Professionals](#)

<https://www.reinhartlaw.com/services/accounting-and-financial-professionals>

### [Commercial Lending](#)

<https://www.reinhartlaw.com/services/commercial-lending>

### [Financial Institutions](#)

<https://www.reinhartlaw.com/services/financial-institutions>

### [Mergers and Acquisitions](#)

<https://www.reinhartlaw.com/services/mergers-and-acquisitions>

### [Private Equity](#)

<https://www.reinhartlaw.com/services/private-equity>

### [Food and Beverage](#)

<https://www.reinhartlaw.com/services/food-and-beverage>

## RELATED PEOPLE:

### [Robert J. Heinrich](#)

<https://www.reinhartlaw.com/people/robert-heinrich>



company's financial condition has not changed.

For public companies, this accounting change is already in effect. For privately held companies, this change was originally scheduled to take effect for fiscal years beginning after December 15, 2019; however, the FASB extended this deadline to December 15, 2020. Privately held companies should use this extra time to discuss this issue with their bankers. One common approach is to ["freeze" GAAP for lease accounting purposes](#), wherein the company's operating leases continue to be governed by GAAP prior to the change. Thus, the negotiated financial covenants are not impacted. Most lenders are aware of and understand the borrower's point of view, and we usually do not receive much pushback on requests to deal with this change in GAAP.

### **Plan for Maturity or a New Facility?**

If your facility is scheduled to mature this year, consider your options. If you are happy with your current lender (and if your current lender is happy with you), great. Still, consider using this opportunity to request loan document changes that would provide you additional operational flexibility and looser covenant packages. Of course, have specific reasons to justify your requests, as your banker might need such information to obtain internal approval.

Perhaps you are considering changing lenders. And even if you are not, it is always good to have connections and backup plans. Potential lenders might be courting you. Ask your advisors for referrals. When considering your options, remember: Pricing is important, but having a banker that understands you, your business and your industry is vital. Your lender is one of your key relationships; a good lender relationship is worth its weight in gold.

If you decide to change lenders, review your existing loan documents regarding the payoff process. What kind of notice is needed for a payoff? Is there a prepayment penalty? You don't want any surprises.

### **Get Ready for any Anticipated Acquisition or Other Fundamental Transaction**

Your credit facility no doubt places limits on your ability to enter into fundamental transactions such as mergers and acquisitions. What does your company anticipate in the near future? If you envision an acquisition, review your loan documents regarding the required notice provisions and consents. If you are only allowed to make "permitted acquisitions" that satisfy certain criteria, verify the acquisition is structured such that it will satisfy these criteria.



### **Do the Little Things Right**

On the opposite end of the spectrum, your credit facility requires you to do (and not do) a host of smaller things. For example, you will need to stay in good standing in your home state and possibly other states in which you conduct business. Under some loan documents, a simple failure to make the appropriate filings triggers a default, even if such an oversight results in no material adverse effect on the company. (Hopefully, however, your lawyer sufficiently negotiated your loan documents to include materiality thresholds that avoid such "technical" defaults.) Institute a system that ensures all required annual filings are taken care of in a timely manner.

More generally, it is prudent to assemble a compliance checklist that summarizes notice periods and the dates by which deliverables (for example, financial statements) must be provided to your lender. If you don't want to wade through the loan documents to create such a checklist, your lawyer can do so.

By using the traditionally slower months at the start of the year to connect with your banker and plan ahead, the stage will then be set for a smooth and efficient amendment process should it be needed later in the year.

*These materials provide general information which does not constitute legal or tax advice and should not be relied upon as such. Particular facts or future developments in the law may affect the topic(s) addressed within these materials. Always consult with a lawyer about your particular circumstances before acting on any information presented in these materials because it may not be applicable to you or your situation. Providing these materials to you does not create an attorney/client relationship. You should not provide confidential information to us until Reinhart agrees to represent you.*