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Key Developments in Secured Transactions

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Agenda

- Impacts of the COVID-19 Pandemic on Secured Financings
  - Deal Flows
  - Electronic Closings: duly executed and delivered opinions
- Updates to the PPSA
  - Proposed Amendments to Purchase Money Security Interests
  - Electronic Chattel Paper
- LIBOR/CDOR Benchmark Replacement:
  - LIBOR
  - CDOR
- Launch of the Ontario Business Registry and ONCA now in force
- Questions & Answers

Impacts of the COVID-19 Pandemic on Secured Financings

- Deal Flow
- Impact on Loan Documents
  - Anti-Hoarding Provisions
  - Material Adverse Change
- Other new developments
  - Revlon – Erroneous Payments - *In re Citibank Aug. 11, 2020 Wire Transfers*, No. 20-CV-6539 (JMF), 2021 WL 606167, at *1 (S.D.N.Y. Feb. 16, 2021).
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The “Revlon” Clause: Background

- Citibank was the administrative agent for Revlon's syndicated loan transaction.
- Revlon's loan had become increasingly risky as a result of decreasing sales during the (COVID-19) pandemic.
- On August 11, 2020, Citibank received an interest payment of approximately US$7.8 million from Revlon.
- Instead of wiring the lenders their respective shares of the interest payment, Citibank made a (colossal!) administrative error and wired the lenders the full balance owing on the Revlon loans - almost $900 million of its own funds.
- Citibank sent notice to the lenders saying the payment was made in error and requested that the lenders remit the payments back to Citibank.
- While Citibank did receive approximately US$385 million back, lenders holding the balance (approximately $500 million) refused to repay Citibank. Citibank sued to recover these funds.

The “Revlon” Clause: Decision

Decision of the New York District Court

On February 16, 2021, the United States District Court for the Southern District of New York released its decision, finding that:

- In general, erroneous payments are a form of unjust enrichment and must be repaid, unless all of the following are true (known as a "**discharge for value**" defence):
  - the payment discharges a valid debt;
  - the recipient made no misrepresentations to induce the erroneous payment; and
  - the recipient did not have notice of the mistake.
- On the facts of this case, the lenders had made out all of the elements of discharge for value and were therefore entitled to keep the erroneous payments, leaving Citibank out of pocket $500 million.

The “Revlon” Clause: Immediate Impact

- Within weeks of the decision, various forms of a "Revlon" clawback clause began appearing in US and Canadian syndicated loan agreements.
- The goal of these clauses is to have lenders waive their right to assert the defence of "discharge for value" or any other similar defence (such as “good consideration”) to reimbursing an agent who has mistakenly overpaid them.
- The "discharge-for-value" defence has not been recognized in Canada.
- Canadian law does recognize a defence of "good consideration”: money mistakenly paid to a beneficiary does not need to be repaid if it discharges a valid debt (*B.M.P. Global Distribution Inc. v. Bank of Nova Scotia, 2009 CarswellBC 809 (S.C.C.)*).
- It is quite possible that a Canadian court would reach the same result as the court in Revlon did.

Impacts of the COVID-19 Pandemic on Secured Financings

- Electronic Closings: Duly executed and delivered opinions
  - When did you last do an in person closing?
  - *Electronic Commerce Act, 2002* enables most documents to be done electronically where the parties agree and enables electronic signatures
  - the exclusion for real estate documents was repealed in 2013 and the PPSA amended in 2019 for ECP

Impacts of the COVID-19 Pandemic on Secured Financings

- Opinions
  - the Toronto Opinion Group (“TOROG”), a group of law firm volunteers creating uniform opinion language and practices, is working on best practices for remote, electronic closings; due to COVID there is a gap in the TOROG work on this issue
  - TOROG’s settled language is posted at: https://www.slaw.ca/torogmemos/

Impacts of the COVID-19 Pandemic on Secured Financings

- Opinions (continued)
  - your third party transaction opinion letter for your client likely contains an opinion as follows:
    - The execution, delivery and performance by the Corporation of the Transaction Documents to which it is a party has been authorized by all necessary corporate action on the part of the Corporation and the Transaction Documents to which it is a party have been executed and delivered by the Corporation.

Impacts of the COVID-19 Pandemic on Secured Financings

- Opinions (continued)
  - for authorization and execution, most law firms exercise sufficient due diligence to know that their clients have signed the documents, in wet ink or PDF or an electric system like DocuSign, and have passed resolutions authorizing the signatory and have done certificates of incumbency to identify the signatory
  - for remote closings with cut off signatures pages your client signed some days prior, how to you know that your client is delivering the documents into closing intending to be bound?

Impacts of the COVID-19 Pandemic on Secured Financings

- Opinions (continued)
  - suggestions:
    - a call with the client and your confirming email after the call, on the matters in the agreements that were negotiated and changed (likely at the last minute) and whether your client accepted the changes
    - a closing call with all counsel on the call, with each counsel confirming that the documents held in escrow pre-closing, are now released from escrow and delivered into closing

Impacts of the COVID-19 Pandemic on Secured Financings

- Opinions (continued)
  - **Some electronic deal resources:**
    - William M. Estey, Legal Opinions in Commercial Transactions, 3rd Edition, at pages pp. 143 – 157
    - *UK Resources*
    - The Law Society (UK) - Execution of Documents by Virtual Means - https://www.lawsociety.org.uk/support-services/advice/practice-notes/execution-of-documents-by-virtual-means/
    - The Law Commission (UK) Electronic Execution of Documents - https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2019/09/Electronic-Execution-Report.pdf

Proposed PPSA Amendments re PMSI

- December 8, 2020, OBA Personal Property Security Law Committee issued advisory to Ministry of Government and Consumer Services entitled *Modernizing the Purchase-Money Security Interest*
- Advisory proposed several PPSA amendments to address:
  - Cross-collateralization by inventory financers
  - PMSI status in connection with renewed, refinanced, consolidated, restructured or mixed PMSIs
  - Allocation of payments

PMSI Amendments – Cross-Collateralization

- Under current wording of PPSA, concept of PMSI is inherently collateral specific and often requires repayment to creditor on sale of such inventor
- Requires detailed bookkeeping and if payment applied to wrong item of inventory, could lead to situation where creditor loses PMSI over other item of inventory

PMSI Amendments – Cross-Collateralization

- Proposal to amend definition of PMSI to add following:
  - secures any obligation arising out of **a related transaction creating an interest** referred to in clauses (a) or (b) of the definition of "purchase-money security interest";
  - extends to other inventory in which the secured party holds or held a security interest **under a related transaction** that secures or secured an obligation referred to in clauses (a) or (b) of the definition of "purchase-money security interest"
  - a transaction is **related to another transaction when** the **possibility of both transactions** is **provided for in the first transaction** or an agreement between the parties entered into before the first transaction

PMSI Amendments – Refinancing

- Under current PPSA there is no mechanism to allow a new creditor to obtain PMSI status in prior financed inventory or equipment
- Proposal to add, among other things, following subsections to s. 33
  - (4) When refinancing of certain PMSI obligations occurs pursuant to a refinancing agreement between debtor and secured party other than the secured party who provided the credit or value referred to in those clauses, and
    - (a) the original registration relating to the purchase-money security interest securing the obligation is amended to identify the secured party named in the refinancing agreement as a secured party; or
    - (b) before expiry or discharge of the original registration relating to the security interest, a registration relating to the purchase-money security interest is effected disclosing the secured party named in the refinancing agreement as the secured party, or the security interest is otherwise perfected,
  - the purchase-money security interest is deemed for priority purposes to have been assigned to the secured party who provided value to the debtor pursuant to the refinancing agreement.

PMSI Amendments – Allocation of Payments

- PPSA currently silent on question of the manner in which payments are allocated
- Proposal to amend PPSA to reflect that allocation will be:
- (i) First, as debtor and creditor agree
- (ii) Failing agreement in (i), as debtor asserts on making payment
- Failing (i) and (ii), fist to unsecured, second to secured non-PMSI and third to PMSI

Vexatious PPSA Registrations

"**vexatious registration**" means the registration of a document that,

a) the registrar considers to have been tendered,
   - for the purpose of annoying or harassing the person named as the debtor in the document, or
   - for any other improper purpose, **and**

b) has been tendered by or on behalf of a person who,
   - (i) does not hold the security interest referred to in the document, or
   - (ii) is claiming an interest that is not registrable under this Act.

Section 66.1(1), PPSA

Vexatious Registrations

- Amendments to the PPSA came into force on December 8, 2020.
- A new Part V.1 was added to the PPSA that deals exclusively with vexatious registrations.
- The amendments give the registrar the power to discharge a vexatious registration or to reject a document if the result would be a vexatious registration.
- Previously, the process for discharging vexatious registrations required a court order. This was a time-consuming and expensive process.

Vexatious Registrations – New Filings

Section 66.3, PPSA

(1) The registrar may reject a document that, if registered, would result in a vexatious registration.

(2) The registrar shall give each person who is named as a secured party on the document,

(a) written reasons for rejecting the document; and

(b) at the same time, notice of the right to appeal the decision to the Divisional Court.

Existing Registrations

- The registrar may discharge a vexatious registration both (i) on his/her own initiative, and (ii) in response to a request by an affected person (Section 66.4)
- Registrar must provide notice of his/her decision to affected parties, together with written reasons.
- Decision may be appealed to the Divisional Court. Right of appeal expires 14 days after receipt of notice.

Electronic Chattel Paper (ECP)

- **The Problem:** s. 28(3)
  - The PPSA gives priority to the buyer of chattel paper (eg a securitization) who takes physical possession of the tangible wet ink chattel paper

Electronic Chattel Paper (ECP)

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  - The PPSA gives priority to the buyer of chattel paper (eg a securitization) who takes physical possession of the tangible wet ink chattel paper
- Ontario's PPSA amended on May 29, 2019 to enable perfection by control of ECP
- SK made the same changes and AB is considering them

Electronic Chattel Paper (ECP)

- **ECP - s. 1 definition:** "electronic chattel paper" means chattel paper created, recorded, transmitted or stored in digital form or other intangible form by electronic, magnetic or optical means;
- leases and conditional sale contracts for vehicles and other goods done electronically during COVID and go forward can be used as collateral by the lessor or lender to raise funds

Electronic Chattel Paper (ECP)

- **ss. 1(3) and 22.2**
  set out the standards to create "control" over ECP and are akin to the 2006 changes for perfection by control of investment property in conjunction with the *Securities Transfer Act, 2006*

- ***s.* 1(4)**
  Despite subsection 8 (1) of the *Electronic Commerce Act, 2000*, control of an electronic document, other than electronic chattel paper, does not constitute possession or control of the original document for the purposes of this Act. s. 31 still prohibits electronic documents for wills, codicils, trusts, powers of attorney and negotiable

Electronic Chattel Paper (ECP)

- generally speaking, “control” is achieved via technology and other steps to give a secured party buyer of the ECP control over a vault holding the ECP
- to deal with the *Consumer Protection Act, 2002* requirements to give a consumer a copy of their agreement, ensure that copy is marked “COPY” and or is watermarked for “COPY”

Electronic Chattel Paper (ECP)

- s. 4(2) of the *Motor Vehicle Dealer Act 2002* is an impediment to online vehicle dealers
  Name and place of business
- (2) A motor vehicle dealer shall not,
- (a) carry on business in a name other than the name in which the motor vehicle dealer is registered; or
  (b) invite the public to deal in a place other than the place that is authorized in the registration of the motor vehicle dealer.

Electronic Chattel Paper (ECP)

- during COVID the Ontario Motor Vehicle Industry Council permits dealers to provide vehicles for a test drive from the consumer's home and deliver vehicles at that home. See:
- https://www.omvic.on.ca/portal/NewsPublications/DealerBulletins/2020/tabid/559/aid/457/Default.aspx
- Ontario held a consultation that closed Sept. 19, 2021 on the *Motor Vehicle Dealer Act, 2002* to consider enabling all electronic vehicle deals - as has been available in the USA for about a decade

Electronic Chattel Paper (ECP)

- For more technical details of the ECP amendments see:

  Putting the “E” in ECP: Saskatchewan’s PPSA Introduces Electronic Chattel Paper

- May 3, 2019 | Eric F.W. Johnson, and David G. Gerecke (now Justice Gerecke)

- https://www.millerthomson.com/en/publications/communiques-and-updates/financial-services-restructuring-communique/may-3-2019-financial-services/putting-the-e-in-ecp-saskatchewans-ppsa-introduces-electronic-chattel-paper/

Background: What is LIBOR?

LIBOR is:

- The London Interbank Offered Rate.
- An interest rate benchmark used as a reference rate for a wide range of financial transactions, including USD loans.
- Intended to reflect the rate at which banks can obtain funding in the London interbank market.
- Quoted daily for 5 currencies and 7 terms.
- Administered by ICE Benchmark Administration Limited (IBA).
- Also called the “Eurodollar Rate” in US loan documentation.

LIBOR Discontinuation Timeline

All 35 LIBOR settings will either cease to be provided by any administrator or will no longer be representative after the following dates:

- **December 31, 2021**:
  - Non-US dollar LIBOR publication ceases (GBP, JPY, Euro, CHF).
  - 1 week and 2-month USD LIBOR publication ceases.
- **June 30, 2023**:
  - Remaining USD LIBOR tenors: publication ceases.

Regulatory Pressure to Cease LIBOR Lending

Pressure to Transition Away From LIBOR Now:

- **Canada**:
  - **June 22, 2021**: OSFI issued an industry letter to Federally Regulated Financial Institutions (FRFIs) which set out their expectation that:
    - **USD LIBOR: all FRFIs will cease new LIBOR-loan originations as soon as possible and by no later than December 31, 2021.**
    - Other LIBORs: all FRFIs should have already stopped entering into new transactions using any non-USD LIBOR as a reference rate
- **United States**:
  - The Alternative Reference Rates Committee (ARRC) recommended that all originations of new USD LIBOR-based loans cease by **June 30, 2021**.
  - US banking regulators have stated an expectation that all banks will cease LIBOR-loan originations as soon as possible and by **no later than December 31, 2021**.

USD LIBOR Replacement Rates: SOFR

Secured Overnight Funding Rate

- Reflects the pricing of short-term (overnight) loans that are secured by US government debt.
- The market for this debt exceeds US$700 billion daily and, as a result, SOFR will provide a reference rate that is based on a large pool of actual transactions.
- The Federal Reserve Bank of New York (FRBNY) has been publishing SOFR at 8 a.m. each morning since April, 2018.

Differences Between SOFR and LIBOR

LIBOR

- Based on few transactions and good faith estimates (less than $500 million of daily trading).
- Reflects unsecured overnight funding costs among banks.
- Reflects the cost of credit prospectively.
- Term rates (including overnight, two weeks and one, two, three, six and twelve months).
- Has historically tracked at higher rates than SOFR.
- Serves as a proxy for a bank's cost of funding a loan – increases in times of credit stress.
- Easily manipulated.

SOFR

- Based on a large and liquid market ($750 billion in daily trading).
- Based on secured overnight lending transactions.
- Reflects the cost of secured credit retrospectively for the prior overnight period.
- Not a term rate, but term rates can be derived from SOFR.
- SOFR has historically tracked at lower rates than LIBOR.
- Is determined independently of the interbank market and a bank's cost of funds – does not increase in times of credit stress.
- Difficult to manipulate.

LIBOR Replacement Clauses

- ARRC Recommended Standard Clauses
  - Bilateral Loans:
    - Amendment approach published: May 2019.
    - Hardwired (SOFR) clause first published: August 2020.
    - **Current Hardwired SOFR clause published: March 2021**.
  - Syndicated Loans:
    - Amendment approach published: April 2019.
    - Hardwired (SOFR) clause first published: June 2020.
    - **Current Hardwired SOFR clause published: March 2021**.
  - Hedged Loan, hardwired approach, published in August 2020.

LIBOR Replacement Clauses: Basic Elements

At a high level, these clauses provide that:

- On the first to occur of either:
  - **LIBOR cessation**: the date on which LIBOR will no longer be published or is no longer representative.
  - **Early opt-in**: the lender (or the agent in a syndicated transaction) determines that market practice has moved to a new benchmark in place of LIBOR and elects to amend the agreement prior to a formal cessation of LIBOR (an Early Opt-in Election);
- LIBOR will be replaced in the agreement by a successor rate (the Benchmark Replacement). Parties may elect to negotiate the Benchmark Replacement at the time that LIBOR is discontinued (the amendment approach) or to pre-select the replacement rate up front (the hardwired approach).
- The Lender/Agent has authority to unilaterally make "Conforming Changes" to the loan agreement.

Canadian Market Practice

- As of Spring 2021, based on publicly available loan agreements:
  - Clauses contemplating the end of LIBOR are seen in almost 100% of Canadian agreements with LIBOR loans.
  - Prior to February 2021, the amendment approach dominated and no publicly-filed agreements had hardwired SOFR as a replacement rate.
  - Now, the ARRC recommended language (hardwired approach) is dominant (over two-thirds of loan agreements since February, 2021).
  - Simpler variants of the amendment approach are seen in the remaining agreements.
  - New loans based solely on SOFR (or any other alternative benchmark) have not yet been seen in Canadian public deals.

Replacement Benchmark Waterfall

The ARRC recommended fallbacks have been adopted in almost all hardwired benchmark replacement clauses. The waterfall is:

1. Term SOFR + an Adjustment.
2. Simple Daily SOFR + an Adjustment.
3. An alternative selected by borrower and agent/lender jointly + an Adjustment.

Term SOFR Update

- The Alternative Reference Rates Committee (ARRC) issued its formal recommendation of CME Group's term SOFR rates on July 29, 2021.
- CME Group publishes term SOFR rates on a daily basis for three tenors (one, three and six months).
- Practical implications of ARRC's recommendation include:
  - **CME Term SOFR will (most likely) be the benchmark replacement in a majority of Canadian loan agreements**.
  - **For existing loan agreements, the transition will occur on July 1, 2023; or sooner**, if the Early Opt-In provisions of the agreement are triggered. June 30, 2023, has been announced as the last date on which LIBOR will be published.
  - **New loan agreements can now be booked using Term SOFR for USD loans**. It is expected that this will occur by the end of December 2021.

Alternatives to Term SOFR: CSRs

- CSRs are Credit Sensitive Rates
- More closely aligned with LIBOR in this respect.
- Leading examples include:
  - **Ameribor**. Endorsed by the Federal Reserve Chairman as an appropriate alternative benchmark for LIBOR for banks that fund themselves through the American Financial Exchange (AFE) or similar institutions for whom it may reflect their cost of funding. Membership of the AFE includes regional, midsize, and community banks. The CEO of the AFE noted that SOFR and Ameribor are complementary to each other and offer robust alternatives.
  - **BSBY**. Administered by Bloomberg Index Services Limited, BSBY incorporates bank credit spreads and define a forward term structure. The index is available for five tenors and is calculated each day and published at

CDOR Update

What you should know:

- There are two Canadian dollar benchmark rates of interest:
  - CDOR (Canadian Dollar Offered Rate) is the recognized benchmark for CAD banker's acceptances;
  - CORRA (Canadian Overnight Repo Rate Average) is used primarily for overnight indexed swaps.
- Benchmark replacement language has become standard in credit agreements with Bankers' Acceptances and CDOR-based loans.
- 6-month and 12-month CDOR are no longer published (effective May 17, 2021).
- There is currently no timeline for phasing out the remaining CDOR tenors, however, this possibility has not been ruled out.
- Canadian Alternative Reference Rate Group (CARR) is engaged with the following initiatives:
  - Developing robust fallback language for floating rate notes, securitizations and bank loans (ISDA is developing CDOR fallback language for the derivatives market).
  - Considering a transition framework for using CORRA as a reference rate in a wide range of Canadian dollar financial products.

Launch of the New Ontario Business Registry and ONCA

- Oct. 16 to 18: data for some 2.5 million entities in Ontario was moved into the OBR
- Oct. 19: launch of the OBR and the *Not-for-Profit Corporations Act, 2010* came into force and new regulations to many Acts using OBR were updated

Launch of the New Ontario Business Registry and ONCA

- documents submitted on the old forms by mail prior to Sept. 17 and not data entered into the old system by the Oct. 16 start of the data cut over, may be returned to sender to refile in the new electronic forms through the OBR
- For guides on using the OBR and the new forms both for electronic filing or fillable PDFs go to: https://www.ontario.ca/page/ontario-business-registry

Launch of the New Ontario Business Registry and ONCA

- The "company key" must be obtained from the OBR by your client entity by going online to apply. The OBR website provides:
- **Get a company key**
- In order to access the Ontario Business Registry, you must get a company key.
- **Get your company key**
- **2. Login into One-Key**
- Once you have a company key, select the button below and follow the prompts. For security reasons, you will be asked to create a ONe-key ID and a ServiceOntario account.
- **Login to ONe-Key**

Launch of the New Ontario Business Registry and ONCA

- The company key is mailed to the client at the registered office address about 3 business days
- **Tip:** check the corporate profile to ensure the registered office is up to date before seeking the key
- **Tip:** the OBR One-Key login will seek an email address. Be sure it is a safe and confidential recipient who get both the key and future emails

Launch of the New Ontario Business Registry and ONCA

- Government-authorized service providers - who don't need the key - are available to help you with your transactions on the new Ontario Business Registry:
- ecore by Dye & Durham Corporation
- ESC Corporate Services Ltd.

- an OBR software update is in the works to give lawyers, paralegals and accountants direct access without the key

Launch of the New Ontario Business Registry and ONCA

- The *Not-for-Profit Corporations Act, 2010* ("ONCA") came into effect on October 19, 2021
- non-share capital corporations formed under Part II the prior Ontario *Corporations Act* have a 3 year transition period and social clubs, such as golf clubs, created under Part II of the OCA have a 5 year transition period. See:
- https://www.millerthomson.com/fr/publications-fr/communiques-et-dernieres-nouvelles/impact-social-fr/14-octobre-2021-impact-social-fr/over-ten-years-in-the-making-proclamation-of-the-ontario-not-for-profit-corporations-act-2010/

Discussion and Questions