Financing Options During a Legal Dispute

When large public companies get into legal disputes, they have plenty of liquidity available to proceed with business as usual even if the dispute leads to a protracted defence. But for a majority of businesses, a legal dispute can pose great difficulty, particularly if the business has urgent financing needs. Traditional banks can find themselves restricted in providing financing when there are uncertainties. For both borrower and lender, a legal dispute can be a dark cloud that limits their ability to move forward. In some cases, it can be crippling and force the business to shut down.

Whether you are a banker, an accountant, or lawyer—it is critical to be aware of and be in a position to advise a business owner of a variety of financing options that can move them forward during a legal dispute.

A recent client situation provides a great example. A viable and respected not-for-profit academic institution needed to resolve a stakeholder dispute. The dispute loomed over the school’s operations, threatening the stability of the school, with parents and staff alike wondering about its long-term future.

On the advice of its lawyers, the best course of action was to source financing and pay into court the disputed amounts. By doing so, the disruption to school operations could be minimized, parents and staff calmed, and our client could rely on the legal system to resolve the disagreement.

The client owns a valuable real estate asset that was at the centre of the dispute and was available to the school to be pledged as collateral for a loan. Proceeds of financing the real estate could prospectively resolve the dispute, and provide working capital going forward.

On the surface, the conventional nature of the asset appeared to be something that a traditional lender could finance. However, given the litigation aspect, and a stringent 45-day funding timeframe imposed by the court, conventional financing was problematic.

Instead, non-traditional lenders could put bridge financing in place quickly. Once the court case was resolved, the client could then pursue a conventional mortgage, and pay out the non-traditional lender.

For an outside-of-the-box financing such as this, there were three different types of non-traditional lenders that could provide the prospective financing:

1. **real estate lender** – based on strong real estate collateral, these lenders can provide an interest only short-term term loan. Interest rates are higher than conventional bank rates, but usually under 12% for a first mortgage. These lenders focus on loan to value (LTV), and not the repayment ability of the business. In this situation, real estate lenders could not achieve a high enough LTV to meet the amounts required.
2. **asset-based lender** (ABL): ABLs focus on the value of the underlying asset, and the viability of the business. An ABL will lend into a variety of situations. They are often a great solution when a business has hit a “bump in the road” that places them outside of the traditional lender’s normal criteria. An ABL is comfortable margining assets to provide lines of credit for working capital, as well as interest-only term loans that are open for repayment. Often an ABL will structure their financing to include both types of facilities. Interest rates generally range from 12% to 20% depending on their perceived risk.
3. **debtor-in-possession lender** (DIP): a DIP lender is very familiar with the proceedings around payments into court, so these lenders made a natural choice for our client. Similar to ABLs, they focus on the viability of the business, along with the value of the underlying assets. Due to the potential level of risk when there is litigation, interest rates tend to be in the 15% to 20% (or higher) range. The term loans are interest only and short-term so that the borrower can refinance at better rates once the litigation is resolved.

Given the short timeframe, eight potential lenders were approached, and the client received five term sheets (i.e., expressions of interest) within a two-week span. To select the lender, a variety of criteria was evaluated: the ability to deliver under the timeframe, interest rates and fees, overall costs, and loan term. Ultimately, it was an asset-based lender that met all the criteria and was the optimal solution. Due diligence and documentation were completed quickly, and funds were successfully paid into court on schedule.

For the client, their objectives were met:

- it was strategically important to have the prescribed financing in place and before the court prior to the end of the school year. By doing so, they could reassure parents and staff that the school would continue normal operations the following September.
- the lender understood the not-for-profit nature of the school and was accommodating in terms of rates, minimized covenants and reporting, and provision of an interest only term loan and operating line.
- they had the option to re-finance with traditional financing, and without breakage costs, once the court case was settled.
- reduced stress on their over-worked board of directors and staff.

The key takeaway for professionals is to recognize early the degree to which a stakeholder dispute can impair their client’s financial standing, identify probable scenarios from a legal perspective, and the costs and timeframe involved, and engage in discussions with the lending community, including non-traditional lenders, to discover financing options or comfort level with these scenarios. Providing excellence in client service requires a holistic approach. Keeping a clear focus on the client's overall strategy and helping them to problem solve around the financial impact of a dispute sets up all parties for success.

Recommended for you:

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