

Permitted Discretion

BACKGROUND

Committed ABL/RF facility agreements typically contain detailed eligibility criteria and reserves that regulate the available funding that can be achieved in respect of the assets being funded.

Although the eligibility criteria and reserves are usually drafted as extensively as possible (to provide the customer with clarity and confidence as to what assets will be eligible and what level of reserves will be applied), a financier will invariably require discretion to amend or include additional eligibility criteria or reserves should an unforeseen future event or circumstance affect the value of the assets, the financier's ability to enforce its security or its rights over the assets, or the credit profile of the debtors, etc.

This discretion to amend or include additional eligibility criteria or reserves leads some customers to question whether the facility being provided is fully committed.

WHAT IS PERMITTED DISCRETION?

Permitted Discretion is a concept uniquely found in ABL/RF facility agreements, particularly those provided to higher rated customers.

Due to the conflict between the financier's requirement to have discretion to amend or include additional eligibility criteria or reserves and the customer's concern as to the level of commitment being provided by the financier, a compromise is to qualify the financier's discretion by a requirement to act in good faith and reasonably.

However, to ensure the customer cannot hold the financier to a standard that is not representative of the ABL/RF market (or its unique related risks), a financier will want to ensure that those qualifications are viewed from the perspective of an asset-based lender and not from the perspective of the customer or that of participants in a different market.

This type of qualified discretion is known as a "Permitted Discretion" and a common formulation is "*a determination made in good faith and in the exercise of reasonable business judgment (from the perspective of an asset-based lender)*".

WHEN IS PERMITTED DISCRETION USED?

As discussed above, Permitted Discretion is commonly used to qualify a financier's discretion to amend or include additional eligibility criteria or reserves.

However, it is also possible to apply it to other decisions of a financier such as its discretion to amend advance rates, serve notices on debtors or to undertake additional audits.