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Cash Domion

In the ABL market, where a financier is providing a borrowing base loan secured against its receivables, it is common to have provisions relating to "cash dominion".

WHAT IS MEANT BY CASH DOMINION?

Cash dominion is the term used to describe the mechanism where the proceeds of receivables collected into a borrower's collection accounts are swept to the financier and applied to repay the loan, as opposed to being transferred to the borrower's general trading accounts for its own use.

Cash dominion provides obvious benefits for a financier because the financier will usually have taken control over the proceeds of the receivables when activating cash dominion and, by virtue of the loan being repaid using the proceeds, its exposure at any time is more closely aligned with the value of unpaid receivables.

In turn, the borrower should not be significantly inconvenienced by the application of the proceeds to the loan, as this will free up availability to allow the borrower to draw down further amounts if there is sufficient borrowing base availability.

Cash dominion may be in place from day one or may be triggered on a springing basis (see later), depending on the commercial agreement between the financier and the borrower.

HOW DOES CASH DOMINION WORK OPERATIONALLY?

If cash dominion is in effect, there will be a requirement in the documentation (ideally reinforced by provisions in the agreement with the account bank) for the proceeds of receivables to be swept from the collection accounts to an account of the financier (or agent in a syndicated deal). This is done on a frequent basis; often daily.

The proceeds are then applied by the financier down a payment waterfall. This will usually require the repayment of outstanding fees, costs and expenses, before the proceeds are applied against outstanding revolving loans. If there are other types of advances (e.g. term loans or letters of credit), in circumstances where there is no default, proceeds are generally not applied against these amounts.

One frequent issue in multicurrency deals is the question of what happens if there is a mismatch between the currency in which the proceeds are denominated and the currency of the outstanding obligations. In these circumstances, there can often be a requirement to convert the proceeds at an agreed rate of exchange so as to better meet outstanding revolving obligations.

WHAT IS MEANT BY SPRINGING CASH DOMINION?

Where it has been commercially agreed between the financier and the borrower that cash dominion will occur only on a "springing" basis, cash dominion does not apply from the start of the loan and instead the proceeds of receivables collected into the collection accounts are transferred to the borrower's general trading accounts for use by the borrower, subject to any control restrictions imposed for fixed security purposes in England & Wales (see below), until a pre-agreed trigger event. Following the trigger event, cash dominion springs into place and the collected proceeds are swept to pay down the loan.

Typically a borrower will prefer its loan to operate on a springing cash dominion basis because it flattens its borrowing profile and provides it with access to increased working capital between drawdowns.

A financier may also prefer this because it can earn increased interest on the loan (which would be reduced if the collected proceeds were used to repay the loan between drawdowns).

The route taken on any particular transaction, however, will depend on the commercial circumstances and the borrowing profile.

WHAT ARE COMMON TRIGGER EVENTS FOR SPRINGING CASH DOMINION?

In our experience the most common trigger event for springing cash dominion is the earlier to occur of a breach of a headroom or availability threshold (which typically indicates that the borrower's cash flow is being squeezed and, potentially, the onset of some form of distress) and an "event of default". Relying solely on the occurrence of an "event of default" is not as common because, by that time, there could be a serious issue with the borrower.

CAN FIXED SECURITY OVER RECEIVABLES BE ACHIEVED WHEN OPERATING ON A SPRINGING CASH DOMINION BASIS?

This is a common question. How do you reconcile the requirement for the financier to control the proceeds of receivables for the purposes of achieving fixed security over such receivables (see Security over Receivables) versus the borrower's access to and use of the proceeds while cash dominion has not been triggered?

In short, yes it is possible to achieve fixed security over receivables where the facility is operating on a springing cash dominion basis, but care must be taken.

The proceeds of receivables being released back to the borrower for its own use is not, in and of itself, inconsistent with fixed security over receivables. What is determinative for achieving fixed rather than floating security is whether the financier actively controls the release of the proceeds back to the borrower (i.e. the release of the proceeds is at the financier's discretion), as opposed to the borrower being able to unilaterally withdraw the proceeds from the collection account without the consent of the financier or such proceeds automatically being transferred to the borrower's general trading accounts. What does and doesn't constitute active control is a matter of some debate and should be carefully considered based on the relevant facts at hand.

It is worth noting that in the US there is no similar requirement to control the borrower's access to proceeds in order to achieve first ranking security over receivables, and, therefore, the concept of springing cash dominion in the US is usually conflated with the concept of springing control of collection accounts. Springing control of collection accounts does not work if trying to achieve English fixed security over receivables because the necessary control required to achieve fixed security (see above) must be demonstrated from the date that the security is granted. As such, English lawyers draw much more of a distinction than US lawyers between springing cash dominion and springing control of collection accounts.

In order to sufficiently control proceeds paid into a collection account, the financier will typically require that the borrower and account bank enter into an agreement with the financier regulating access to the bank account (e.g. a bank account control agreement).

If you have any questions or require specific legal advice in respect of any of the English law matters discussed in this publication, please click here and get in touch with any of the Key Contacts.