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Structuring Commercial Finance Term Sheets, Proposals, and Commitment Letters: Key Terms for Lenders and Borrowers

Avoiding Unintended Consequences, Limiting Drafting Ambiguity

THURSDAY, MARCH 3, 2022

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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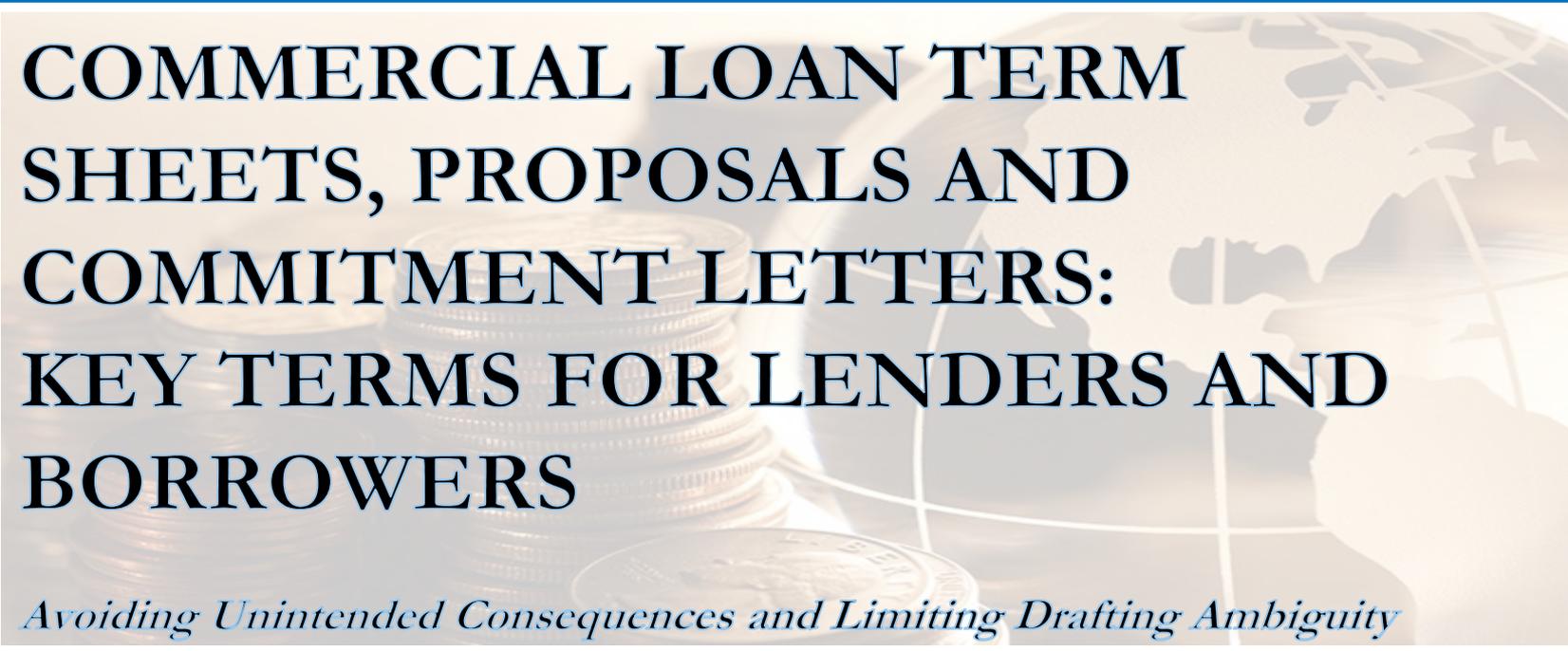
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COMMERCIAL LOAN TERM SHEETS, PROPOSALS AND COMMITMENT LETTERS: KEY TERMS FOR LENDERS AND BORROWERS

Avoiding Unintended Consequences and Limiting Drafting Ambiguity

March 3, 2022

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INTRODUCTION

I. Introduction: Focus

A. Commercial loan term sheets and proposal and commitment letters are used when parties to a potential financing transaction wish to establish baseline terms. These documents are integral to many transactions but can introduce significant risk, especially to lenders, by obligating them to fund the transaction if not drafted carefully and precisely.

B. This CLE will examine term sheets, proposal and commitment letters, the appropriate situations of use, terms to use and terms to avoid, and potential risks from both a lender and borrower perspective.

I. Introduction: Topics Covered

A. Market Developments

B. Proposal and Commitment Letters

C. Term Sheets

1. Structure

- a. Binding or nonbinding
- b. Conditions

2. Negotiating Key Terms

- a. General Scope of Terms
- b. Loan Amount
- c. Collateral
- d. Interest Rate
- e. Prepayments and Prepayment Fees
- f. Guaranties
- g. Representations and Warranties

I. Introduction: Topics Covered (Continued)

2. Negotiating Key Terms (continued)

- h. Affirmative and Negative Covenants Generally
- i. Financial Covenants
- j. Casualty and Condemnation Proceeds
- k. Default Provisions
- l. Voting
- m. Assignments and Participations
- n. Expenses and Indemnification
- o. Other Considerations (Cost and Yield Protection, Governing Law, Jurisdiction and Other Miscellaneous Provisions)

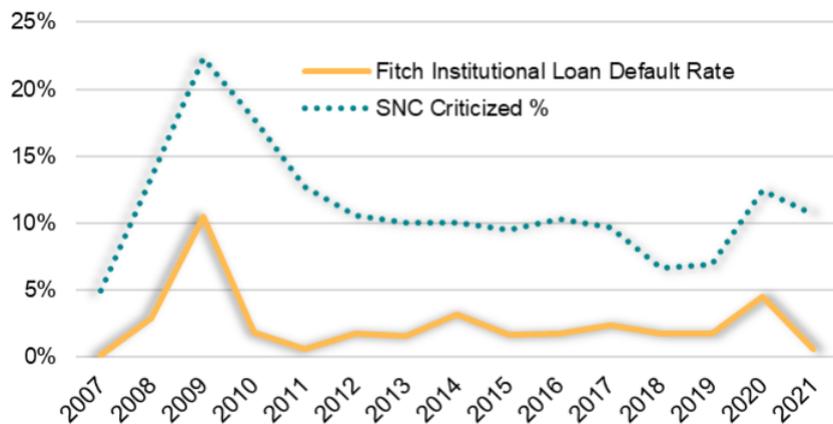
D. Key Takeaways



MARKET DEVELOPMENTS

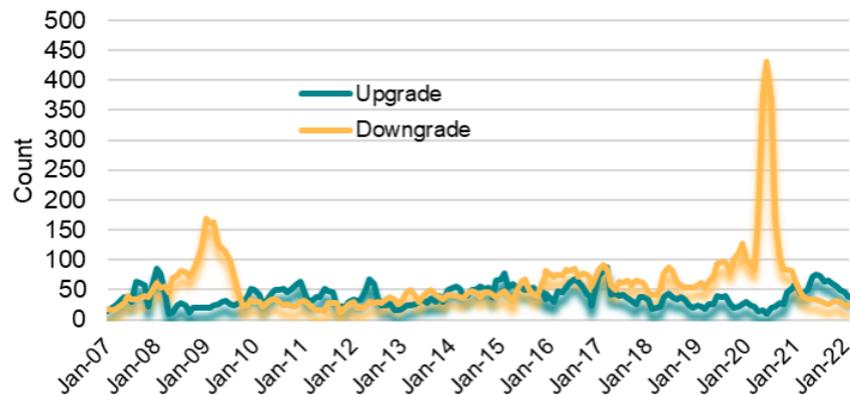
II. Impact of Current Market Conditions: Borrowers Generally Fared Better During COVID than in Financial Crisis

Fig. 2: Companies Fared Better in Covid than in Financial Crisis



Source: Fitch Ratings, Shared National Credit Review

Fig. 3: Rolling 3M Leveraged Loan Upgrades vs Downgrades



Source: S&P/LCD

During the financial crisis, the Shared National Credit (“SNC”) Review noted that criticized loans (substandard, write-offs) exceeded 20% of the SNC portfolio while Fitch’s Institutional Default Rate climbed to 10%. By contrast, in the pandemic, SNC criticized loans increased to 12% and Fitch’s default rate was 4.5%.*

*Source: Loan Syndications and Trading Association

II. Impact of Current Market Conditions: Adoption of SOFR

SOFR Futures Record Activity

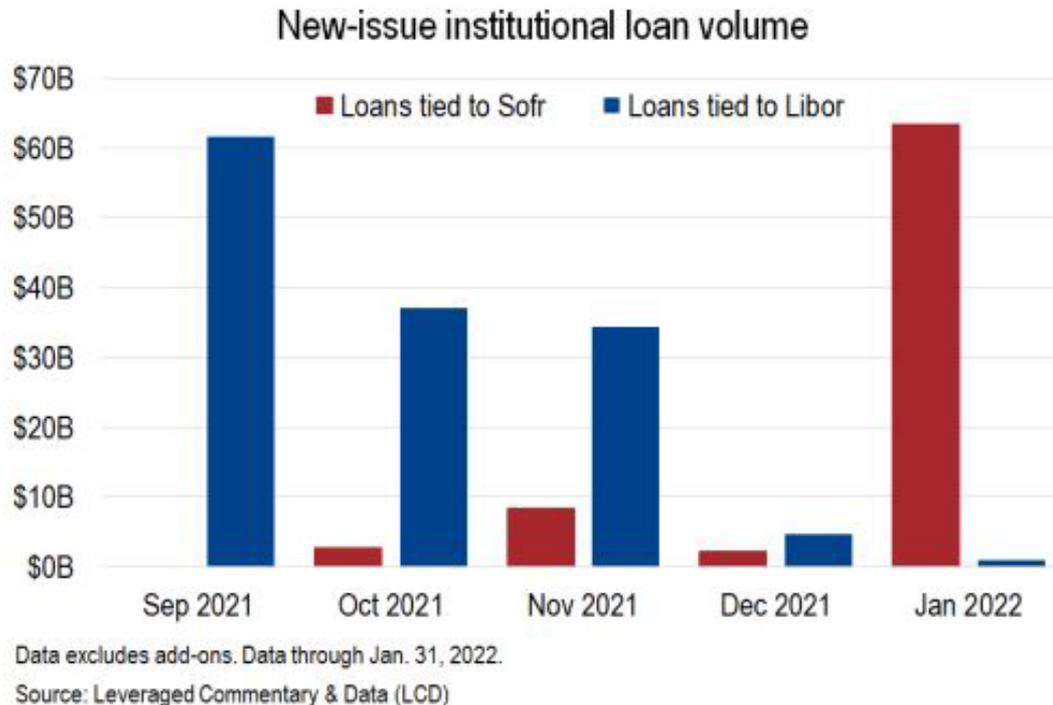
In the most recent 6-month period ADV is up 6x at over 700k and OI is up 4x at over 3.0m

SOFR Volume and Open Interest



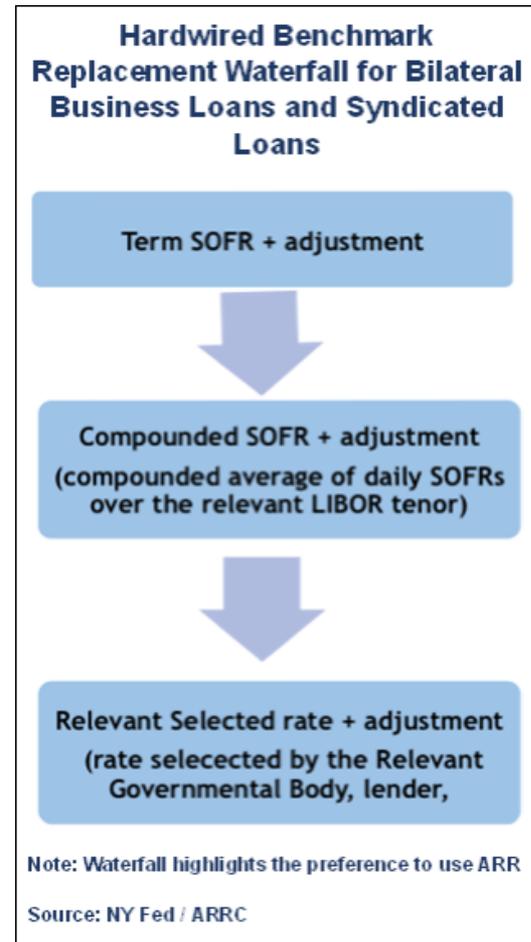
II. Impact of Current Market Conditions: Credit Spread Adjustments

According to S&P Global, 98% of the loans launched in January 2022 were priced using SOFR, accounting for \$63.4 billion in financings, an increase from 15% (\$13.3 billion) in the fourth quarter of 2021, excluding add-on and repricing transactions, according to Leveraged Commentary & Data.



Most new loans priced with SOFR include a credit spread adjustment as an additional element. Since SOFR is a risk-free rate (and lower than LIBOR) an adjustment may be required.

II. Impact of Current Market Conditions: Mechanics of Credit Spread Adjustments & Economics



II. Impact of Current Market Conditions: SPACs

A. **SPACs** - Special Purpose Acquisition Companies

1. SPACs are prevalent in the market.
2. Borrowers may request SPAC provisions in credit agreement to avoid having to obtain additional lender consents before the borrower is taken public via a merger with a SPAC.
3. There are numerous provisions of a credit agreement that should be considered, including:
 - a) **Change in Control** – any provision permitting a change in control without triggering an Event of Default must be analyzed carefully.
 - b) **Fundamental changes** – merger with a SPAC would need to be permitted. Also consider whether there are other reorganization transactions that need to be permitted.
 - c) **Restricted Payments** – The borrower may need to make restricted payments to its current equity holders as part of the SPAC consummation or may need to enter into certain tax agreements related to the SPAC.
 - d) **Financial Reporting** - Address any financial reporting changes as a result of the consummation of the merger with the SPAC.
 - e) **Collateral and Guaranty package** – Ensure that the loan parties are in compliance with collateral and guarantee requirements after giving effect to the merger with the SPAC to confirm that the lenders' collateral and guaranty position is not weakened.

II. Impact of Current Market Conditions: Liability Management Transactions

A. Drop-Down Financings: Structural Subordination (*J. Crew and Chewy*)

Formation of a NewCo	<ul style="list-style-type: none"> • Definition of Unrestricted Subsidiary and Subsidiary designation provisions • Collateral and guarantee requirements/excluded subsidiary provisions
Transfer of assets to NewCo (often accompanied by a license of transferred asset back to the borrower)	<ul style="list-style-type: none"> • Investments, Asset sales, Sale leaseback covenants • Collateral release provision • Limitations on release of all or substantially all of the collateral
Incurrence of new structurally senior debt by NewCo	<ul style="list-style-type: none"> • If applicable, restrictions on unrestricted subsidiaries guaranteeing, or being guaranteed by, credit parties • If incurred at or guaranteed by an excluded restricted subsidiary, debt and lien capacity (subject to any non-guarantor caps or sublimits)
Exchange or roll up of all or a portion of any existing loans for the new structurally senior debt	<ul style="list-style-type: none"> • Pro rata sharing provisions • Borrower buybacks or Dutch auction provisions • Limitations on prepayments of “junior debt” (if applicable)

II. Impact of Current Market Conditions: Liability Management Transactions (Continued)

B. Uptiering Transactions: Contractual Subordination (*Serta*)

<p>Incurrence of new debt by the borrower that is senior to existing loans.</p>	<ul style="list-style-type: none"> • Debt and lien covenants • Limits on subordination of existing debt
<p>Exchange/roll up of all or a portion of any existing loans into senior debt that is pari with or junior to the new money loans (the “New Superpriority Debt”) but senior to the existing loans (the “Rolled Up Superpriority Debt”)</p>	<ul style="list-style-type: none"> • Pro rata sharing provisions • Borrower buybacks or Dutch auction provisions • Limitations on prepayments of “junior debt” (if applicable)
<p>The New Superpriority Debt and the Rolled Up Superpriority Debt may take the form of:</p> <ul style="list-style-type: none"> • a new tranche of loans within the loan document, with priority governed by a payment “waterfall”; or • new loans under a separate credit facility, with priority governed by an intercreditor agreement. 	<ul style="list-style-type: none"> • Pro rata sharing/waterfall provisions (including related amendment requirements) • Subordination/release of all or substantially all collateral • Intercreditor restrictions

II. Impact of Current Market Conditions: Liability Management Transactions (Continued)

A. Possible Documentation “Fixes” for Liability Management Transactions

Drop-downs:

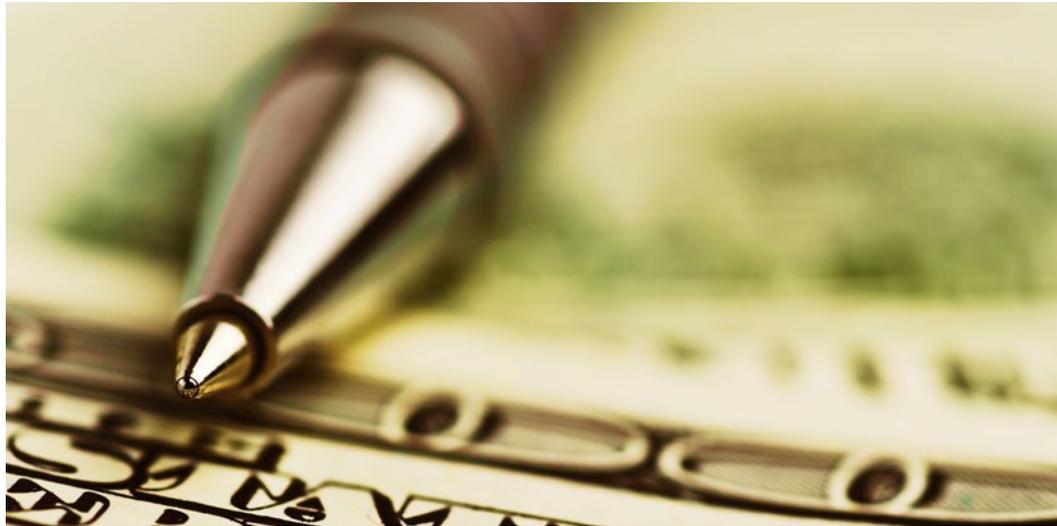
1. Chewy: “Wholly Owned Subsidiary” means, as to any Person, any corporation, partnership, limited liability company, association or other similar non-corporate entity in which such Person any/or one or more Wholly Owned Subsidiaries owns 100% of the capital stock of other equity interests at such time; provided that no such Subsidiary shall cease to be a Wholly Owned Subsidiary to the extent any such capital stock or other equity interests are sold, disposed of or otherwise transferred to an Affiliate of such Person.
2. JCrew: “Notwithstanding anything herein to the contrary, in no event shall (i) any Loan Party contribute, or otherwise invest, any [Material Asset] in, or Dispose of any [Material Asset] to, any Subsidiary that is not a Loan Party, (ii) any Restricted Subsidiary contribute, or otherwise invest, any [Material Asset] in, or Dispose of any [Material Asset] to, any Unrestricted Subsidiary or (iii) any Subsidiary be designated as an Unrestricted Subsidiary if such subsidiary owns any [Material Asset] or the [Equity Interests] of any Subsidiary that owns any [Material Asset].”
 - a) “Material Asset” means any [asset] owned by any Loan Party that is, [in the reasonable determination of the Borrower], material to the operation of the business of the Borrower and its Restricted Subsidiaries, taken as a whole.”

II. Impact of Current Market Conditions: Liability Management Transactions (Continued)

A. Possible Documentation “Fixes” for Liability Management Transactions (continued)

Up-Tiering:

1. Serta: “[No amendment, waiver or consent shall] without the prior written consent of each Lender directly affected thereby, (i) **subordinate**, or have the effect of subordinating, the **Obligations** hereunder to any other Indebtedness, (ii) **subordinate**, or have the effect of subordinating, the **Liens securing the Obligations** to Liens securing any other Indebtedness ...”



PROPOSALS AND COMMITMENT LETTERS

III. Proposals and Commitment Letters

A. Overview of Commitment Letters

1. **A commitment letter** is a letter from a lender to a borrower in which the lender sets out its commitment to lend money or arrange the financing for the borrower through other lenders and specifies the terms on which it is willing to make this commitment.
2. Critical document because once it is executed by lender, it is a **binding agreement** by the lender to lend money or arrange financing for the borrower to the extent specified in the commitment letter.
3. **Specific conditions** to lending and obligations of the borrower set out in the commitment letter are crucial if adverse circumstances arise in which the lender no longer wants to lend money to the borrower.

III. Proposals and Commitment Letters (Continued)

A. Overview of Commitment Letters (Continued)

4. Heavy Scrutiny of Commitment Letters During 2008 Financial Crisis. During 2008 financial crisis, major banks were distressed because they had signed commitment letters agreeing to lend billions of dollars to various borrowers and they were not able to find other lenders that were willing to share in those commitments to lend.

- Commitment letters were scrutinized to determine if the banks had any flexibility in their commitments or the ultimate terms of the loans that they were going to have to make and hold. Most of these banks ended up with significant losses after attempting to renegotiate the terms of their loans with borrowers.
- Banks generally have more liquidity as a result of the reforms passed after the 2008 credit crisis and have weathered the COVID-19 pandemic. While there was initially noted scrutiny of MAE clauses in commitment papers for acquisition financings, there has been less concern about withdrawn commitments and Defaulting Lenders thus far during the pandemic.

5. Other Important Considerations in Commitment Letters

- a. The syndication process and the borrower's obligation to assist in the process (in the case of syndicated loans).
- b. Expense reimbursement for legal fees (which can be substantial even if the deal does not close).

III. Proposals and Commitment Letters (Continued)

A. Overview of Commitment Letters (Continued)

6. Different Perspectives

- a. **Borrowers** – Reliance on funding is key. Borrowers will advocate for fewer obligations and conditions to lending to minimize the risk that the lender will not fund the loan. Particularly in acquisition financings, where a buyer may be one of several parties bidding to acquire a target company, surety of funding is paramount. The seller will favor a bidder with financing that is certain to be funded.
- b. **Lenders** – Aim is for flexible funding conditions to avoid lending into deteriorating credit situation. Nuances with Material Adverse Change clauses and other qualifiers are heavily negotiated.

III. Proposals and Commitment Letters (Continued)

B. Types of Commitments

1. Fully Underwritten

- a. Initial lenders agree to loan 100% of the funds.
- b. Usually accompanied by right of initial lenders to act as lead arrangers and syndicate all or part of the loan to other lenders. Initial lenders usually retain a portion of the loan and the lead bank acts as the administrative agent.

2. Partially Underwritten Commitments

- a. Lender may agree to underwrite **part of the loan** amount, with other lenders agreeing to loan the rest of the funds.
- b. If no additional lenders signing the commitment letter for the balance of the loan, commitment letter state that the **initial lender will only lend its committed portion if lenders are found for the balance of the loan.**
- c. Rationale is that the initial lender will not want to be left with a loan that is too small to syndicate to other lenders or that is too small to achieve the goals of the borrower.

III. Proposals and Commitment Letters (Continued)

B. Types of Commitments (Continued)

3. Best Efforts Commitments

- a. Agent bank may agree to use its best efforts (or commercially reasonable efforts) to arrange a syndicate of lenders that will make the loan.
- b. In a best efforts deal, the agent bank has **no obligation** to make the loans itself (although it often commits to fund a small portion if the loan is fully syndicated).
- c. If the loan is not fully syndicated, either the terms are renegotiated or the loan does not close.
- d. **Best Efforts Versus Commercially Reasonable Efforts**
 - i. Banks often prefer to use “commercially reasonable efforts” because it is believed to be a more flexible standard than “best efforts.”
 - ii. However, many US courts have found no real distinction between the various “efforts” standards unless the contract specifies otherwise or both terms are used in the same agreement.
 - iii. “New York courts use the term ‘**reasonable efforts**’ interchangeably with ‘**best efforts**’” *Scott-Macon Securities, Inc., v. Zoltek Companies*, No. 04-Civ.-2124,2005, WL 1138476 (S.D.N.Y. May 12, 2005).

III. Proposals and Commitment Letters (Continued)

B. Types of Commitments (Continued)

d. Best Efforts versus Commercially Reasonable Efforts (Continued)

- iv. If a contract contains both terms, a court has stated that by using “reasonable efforts,” the parties meant to impose a lesser obligation than would have been required had they chosen to use the term “best efforts” as they did elsewhere in the agreement (see also *LTV Aerospace and Defense Co. v. Thomson (In re Chateaugay)*, 198 B.R. 848, 854 (Bankr. S.D.N.Y. 1996).
- v. **Financial considerations** do not necessarily excuse nonperformance.
 - 1. “Difficulty of performance occasioned only by financial difficulties, **even to the extent of insolvency**, does not excuse performance of the contract” *Showtime Networks Inc. v. Comstat Video Enters. Inc.* (Index No. 600848/95, 6/29/98 (Crozier, J.) (Emphasis added.)
 - 2. However, the Second Circuit has held that a party need not bankrupt itself to meet its best efforts obligation and stated that “the requirement that a party use its best efforts necessarily does not prevent the party from giving reasonable consideration to its own interests.” *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609, 614 (2d Cir. 1979).

III. Proposals and Commitment Letters (Continued)

C. Types of Lenders Issuing Commitments

1. Bilateral Financings

- a. **Initial lender** that holds the loan or sells portions of the loan to other lenders in a syndication.
 - i. The loan may be syndicated to other lenders before or after the closing date.
 - ii. Any lenders who become part of the deal pre-closing date will sign a **one-page commitment advice** with the initial lender (but not the original commitment letter) agreeing to buy a portion of the commitment and lend their portion of the funds on the closing date.

- b. The initial lender's commitment will be reduced by the amount of the commitment that it syndicates to other lenders.
 - i. Lenders that come in to the deal after the closing date come in **via assignment**.
 - ii. Assignees buy a portion of the commitment and outstanding loans from the initial lender.

III. Proposals and Commitment Letters (Continued)

C. Types of Lenders Issuing Commitments (Continued)

2. Syndicated Deals

- a. **Joint Lead Arrangers** agree to underwrite loans and act as initial lenders and joint lead arrangers.
- b. **Lead Bank** will usually have main responsibility for negotiating the commitment letter and the other terms of the transaction.
- c. Commitments are then syndicated to other lenders before or after the closing date and the commitments of the initial lenders are reduced proportionately by the amount of the commitments that are syndicated to others.
- d. Commitments of initial lenders **are several (not joint)** and if one initial lender does not provide funds, the other initial lenders are not obligated to fund the missing portion.
- e. Certain institutional investors (Term B Lenders), are not permitted by their governing documents to lend money, so they cannot be a party to the loan agreement on the closing date. They invest in the loan via assignment post-closing.

III. Proposals and Commitment Letters (Continued)

C. Types of Lenders Issuing Commitments (Continued)

3. Club Deals

- a. Typically smaller middle market loans (usually \$25 million to \$150 million) that are marketed in advance to a small group of relationship lenders with which the borrower has a long-term relationship.

- b. Each lender typically receives a full share of the fees.

III. Proposals and Commitment Letters (Continued)

D. Syndication Issues in Commitment Letters

1. Syndication

- a. Commitment letters usually reserve the right of the agent banks to syndicate the loans and commitments.
- b. Commitment letters usually require the **assistance of the borrower and, as applicable, the sponsor and the target company**, as follows:
 - i. Preparing an **information memorandum** (the bank book) and other marketing materials for presentation to potential lenders.
 - ii. Providing agent banks a set period of time before the closing date to syndicate the loans, excluding certain holidays.
 - iii. Ensuring that the syndication efforts benefit from existing lending relationships of the borrower, the target company and the sponsor (if applicable).
 - iv. Providing direct contact their senior management.
 - v. Preparing financial projections for each year through the term of the loans.
 - vi. If applicable, obtaining credit ratings for the loan facilities.
 - vii. Hosting meetings with prospective lenders.

III. Proposals and Commitment Letters (Continued)

D. Syndication Issues in Commitment Letters (Continued)

2. Leverage of Parties

- a. Agent banks retain the right to manage all aspects of the syndication process, select the lenders, determine the allocations of commitments between the lenders, determine the timing of each aspect of the syndication process and allocate titles and compensation among the lenders.
- b. Depending on its bargaining power, the borrower will typically have some say in these decisions and may negotiate limitations on its obligations in the syndication process

III. Proposals and Commitment Letters (Continued)

E. Preliminary Issues Addressed in Commitment Letters

1. Parties

- a. The commitment letter should be addressed to and signed by a party that has sufficient assets to pay the fee and indemnity obligations under the commitment letter and fee letter.
- b. This party may not always be the borrower. If the borrower is a shell company at the time the commitment letter is signed, consider addressing letter to borrower's parent company.
- c. If there is more than one addressee, commitment letters should indicate that the addressee's obligations under the commitment letter are **“joint and several.”**

2. Commitments.

In addition to specifying type of commitment (fully underwritten, partially underwritten, best efforts, etc...), the commitment letter specifies the allocations among the lenders.

- a. The portion of the commitments to be lent by each “arranging” bank is often stated in **percentages** in case the final dollar amount of the loan changes.
- b. If there is **more than one arranging bank**, letter should specify that the commitments of the arranging banks are **several and not joint**.

III. Proposals and Commitment Letters (Continued)

E. Preliminary Issues Addressed in Commitment Letters (Continued)

3. Titles and Roles

- a. Important for league table purposes.
- b. The **left lead** is the lead bank and will have “left placement” on the commitment letter to indicate its primary status among the other agent banks and the commitment letter will provide for left placement in all marketing materials. The left lead is usually the administrative agent.
- c. Initial lenders can hold titles of joint lead arranger and joint bookrunner.
- d. Other titles include documentation agent or syndication agent, but these titles are granted often for marketing purposes only and do not have any meaningful roles or duties associated with them.

III. Proposals and Commitment Letters (Continued)

F. Conditions Precedent in Commitment Letters

1. General Conditions Precedent

- a. If conditions are not satisfied by the closing date, lenders are not obligated to fund.
 - i. Conditions precedent can be the most negotiated items in the commitment letter.
 - ii. PE sponsors attempt to minimize the number of conditions precedent in acquisition financings in order to satisfy sellers' implicit requirements for certainty of financing.
- b. Conditions precedent can show up in a number of places – the commitment letter itself, the term sheet or a separate exhibit attached to the commitment letter.
- c. Customary conditions precedent in commitment letters include:
 - i. **Due Diligence.** Completion of the business, accounting, legal, tax and regulatory due diligence review of the loan parties (including the target company in an acquisition financing) and satisfaction with the results. This condition precedent is often deleted from the commitment letter, particularly in acquisition financings.
 - ii. **No New Information.** Absence of any materially adverse information becoming known that is inconsistent with the results of the due diligence review or the other information provided by the borrower prior to the date of the commitment letter.

III. Proposals and Commitment Letters (Continued)

F. Conditions Precedent in Commitment Letters (Continued)

1. General Conditions Precedent (Continued)

c. Customary conditions precedent in commitment letters include (continued):

iii. **Business MAC.** Absence of a material adverse change (MAC) in the business, assets, liabilities, operations, condition (financial or otherwise) or prospects of the loan parties (including the target company in an acquisition financing) since the date of the last audited financial statements.

iv. **Company MAC.**

1. In an acquisition financing, sponsors typically request that the MAC condition precedent to the financing be substantively identical to (or incorporate by reference) the definition in the acquisition agreement, where it **only pertains to the target company and contains the same exceptions customarily found in acquisition agreements.**
2. Arranging banks aim to ensure that exceptions to the MAC clause for changes to the economy, financial markets, political conditions, the **borrower's industry**, laws, or accounting standards, or acts of war or terrorism apply only if they do not have a **disproportionate impact on the borrower as compared to its peers in the industry.**

III. Proposals and Commitment Letters (Continued)

F. Conditions Precedent in Commitment Letters (Continued)

1. General Conditions Precedent (Continued)

c. Customary conditions precedent in commitment letters include (continued):

iv. Company MAC (Continued)

1. Where the buyer is an operating company (rather than a shell company of a sponsor), lenders often seek to apply the MAC condition to the buyer and the target taken as a whole, rather than just the target on its own. This continues to be a contentious point with buyers who need funding certainty.
2. To support the idea that the MAC condition precedent is the same as the MAC condition precedent in the acquisition agreement, sponsor commitment letters often provide that the interpretation of the MAC definition (and the Specified Acquisition Agreement Representations) is governed by the laws of the jurisdiction that apply to the acquisition agreement (often Delaware law), **even though the rest of the commitment letter is governed by New York law**. This makes the sponsor's bid more attractive to sellers because it minimizes uncertainty in litigation by increasing the likelihood that any determination as to the occurrence of a MAC pursuant to the acquisition agreement and the commitment letter will align.

III. Proposals and Commitment Letters (Continued)

F. Conditions Precedent in Commitment Letters (Continued)

1. General Conditions Precedent (Continued)

c. Customary conditions precedent in commitment letters include (continued):

- v. **Clear Market Provision:** absence of any loan party issuing or syndicating any other debt or equity offering that would compete with the syndication of the loans.
- vi. **Market MAC:** Absence of any change or disruption in the loan syndication, banking or capital markets that could have a material adverse effect on the syndication of the loans. Before the financial crisis, this condition was frequently deleted, especially in private equity sponsor financings. Although it was expected to return as a result of the financial crisis, the condition is still not included in most commitment letters and lenders **typically require greater flex rights** instead as protection against adverse market conditions. *(See below for lists of CPs usually not found in sponsor commitment letters.)*
- vii. **Compliance with Letters.** Compliance by borrower with the terms of the commitment letter and fee letter.
- viii. **Loan Documentation.** Negotiation, execution and delivery of satisfactory loan documentation consistent with term sheet and, often, agreed documentation principles.
- ix. **Term Sheet Condition Precedent.** Satisfactory completion of additional conditions precedent specified in the term sheet.

III. Proposals and Commitment Letters (Continued)

F. Conditions Precedent in Commitment Letters (Continued)

2. Conditions Precedent in Sponsor Deals

- a. Following conditions precedent are **typically not found** in sponsor commitment letters:
 - i. **Market MAC.**
 - ii. **Due Diligence.** Often included in initial drafts of the commitment letter with the general expectation is that due diligence review of the target company will be completed and condition removed before signing the commitment letter and submitting to the seller.
 - iii. **No new information condition.** Agent banks generally no longer require as a condition to funding that there be an absence of any materially adverse information becoming known that is inconsistent with the results of the due diligence review or other information provided pre-signing.
 - iv. **Financial covenant tests.** Sponsor commitment letters typically do not require the target company to meet financial tests (such as having a maximum leverage ratio or a minimum amount of EBITDA) as a condition precedent to funding on the closing date.

III. Proposals and Commitment Letters (Continued)

F. Conditions Precedent in Commitment Letters (Continued)

2. Conditions Precedent in Sponsor Deals (Continued)

- b. Customary conditions precedent in sponsor commitment letters include:
- i. **Loan documentation condition.**
 - ii. **Accuracy of representations.** All representations and warranties in the definitive loan documents are traditionally required to be true and correct in all material respects on the date of borrowing. Due to **SunGard language**, the only representations and warranties that are required to be true in acquisition financings are the “**specified representations**” and the “**specified acquisition agreement representations**”. *(See below for further discussion of SunGard language.)*
 - iii. **Acquisition agreement condition.** Commitment letters for acquisition financings include a condition precedent that there are no modifications, amendments, consents, or waivers of the terms of the acquisition agreement that **are material and adverse to the agent banks** and that the acquisition of the target company is consummated under the acquisition agreement. Most deals also limit the amount the acquisition price may be modified, with specific attention paid to purchase price reductions and allocation of such reductions to the sponsor’s equity contribution and closing date term loans.

III. Proposals and Commitment Letters (Continued)

F. Conditions Precedent in Commitment Letters (Continued)

2. Conditions Precedent in Sponsor Deals (Continued)

b. Customary conditions precedent in sponsor commitment letters include (continued):

iv. **Company MAC**

v. **Xerox Protections**

1. Agent banks generally agree to approve a specific draft of the acquisition agreement (and preferably, also the related disclosure schedules) on the date that the commitment letter specifies.
2. However, agent banks cannot be amended, modified or consented to in any also include a condition that the acquisition agreement way that is materially adverse to the agent banks without their consent.
3. For the acquisition agreement to be satisfactory, the agent banks are likely to require a series of lender protective provisions called “Xerox language” and satisfactorily review other provisions in the acquisition agreement relevant to a financing source (e.g., requirements on the target to cooperate with syndication).

III. Proposals and Commitment Letters (Continued)

F. Conditions Precedent in Commitment Letters (Continued)

2. Conditions Precedent in Sponsor Deals (Continued)

b. Customary conditions precedent in sponsor commitment letters include (continued):

v. **Xerox protections** typically include:

1. The seller's sole and exclusive remedy against the lenders (and the buyer) is the payment of the reverse termination fee.
2. Any suits against the lenders are to be brought only in New York.
3. The seller waives its right to a jury trial in litigation involving the financing.
4. The seller has no recourse against the lenders.
5. The lenders are express third-party beneficiaries of these provisions in the acquisition agreement.
6. These provisions in the acquisition agreement cannot be amended in a manner adverse to the lenders without the lenders' consent.

III. Proposals and Commitment Letters (Continued)

F. Conditions Precedent in Commitment Letters (Continued)

2. Conditions Precedent in Sponsor Deals (Continued)

- b. Customary conditions precedent in sponsor commitment letters include (continued):
- iv. **Equity Contribution.** Included if sponsor is required to make a minimum equity contribution on the closing date.
 - v. **Refinancing Condition.** If the target company has existing debt, lenders may require the concurrent repayment of existing debt and the termination of all associated liens and security interests is a condition precedent.
3. **Amcan Provision.** Following the decision in *Amcan Holdings, Inc. v. Canadian Imperial Bank of Commerce* (894 N.Y.S.2d 47 (N.Y. App. Div. 2010)), many commitment letters for large corporate loans began to incorporate “Amcan” provisions. An Amcan provision typically states that the commitment letter is a **binding and enforceable agreement** requiring the parties to proceed with negotiating the loan documents in good faith. The borrower can then obtain the funds, **as long as it satisfies the conditions precedent.**

III. Proposals and Commitment Letters (Continued)

G. Representations and Warranties in Commitment Letters

1. Information Representation and Covenant

- a. The commitment letter includes a representation from the borrower as to the accuracy of the information provided to the agent banks and a covenant to update the information as necessary to maintain its accuracy through the closing date.

- b. It is also a **disclosure mechanism** that requires the borrower to continually inform the lenders of adverse information as it becomes known and it provides a means for the lenders to avoid making the loan if material adverse information exists that was not disclosed. The representation typically mirrors the language of the **SEC Rule 10b-5** (17 C.F.R. § 240.10b-5) and states that all information (other than future financial projections) furnished by or on behalf of the borrower is “complete and correct in all material respects and does not contain any untrue statements of a material fact or omit to state a material fact necessary in order to make the statements contained therein not misleading.”

III. Proposals and Commitment Letters (Continued)

G. Representations and Warranties in Commitment Letters (Continued)

2. SunGard

- a. The conditions precedent also typically contain “SunGard language” (also called “**certain funds**” or “**limited condition**” provisions), first seen in the \$11.3 billion acquisition financing for SunGard Data Systems, Inc. by seven financial sponsors lead by Silver Lake Partners. The SunGard language has three components:
 - i. A description of the representations that are a condition to funding.
 - ii. A requirement that the terms of the loan documentation cannot prevent funding on the closing date if all conditions precedent have been satisfied.
 - iii. A description of the collateral that is required on the closing date and post-closing.
- b. The only representations made on the closing date that are conditions precedent to funding are:
 - i. **Specified Acquisition Agreement Representations.** Representations contained in the acquisition agreement pertaining to the target company that are as material to the interests of the agent banks that, if they cannot be satisfied on the acquisition closing date, permit the buyer to terminate its obligations under or decline to consummate the acquisition agreement.

III. Proposals and Commitment Letters (Continued)

G. Representations and Warranties in Commitment Letters (Continued)

2. SunGard (Continued)

b. The only representations made on the closing date that are conditions precedent to funding are (continued):

ii. **Specified Representations** are an enumerated list of representations of the borrower and guarantors, covering topics relevant to the agent banks that are not in the acquisition agreement and typically include:

1. Corporate existence
2. Power and authority to enter into the loan documents
3. Due authorization, execution, delivery, and enforceability of the loan documents
4. Federal Reserve margin regulations
5. Investment Company Act of 1940
6. Execution and delivery of loan documents not conflicting with charter documents
7. Status of the loans and guaranties as senior debt (if subordinated debt will be outstanding after the closing date)
8. Effectiveness, validity, and perfection of liens (subject to closing date limitations)

III. Proposals and Commitment Letters (Continued)

G. Representations and Warranties in Commitment Letters (Continued)

2. SunGard (Continued)

b. The only representations made on the closing date that are conditions precedent to funding are (continued):

ii. Specified Representations (continued):

9. Solvency of the target and its subsidiaries or, in some cases, of the consolidated company and its subsidiaries after giving effect to the transaction
10. OFAC, USA PATRIOT Act, FCPA, and other anti-terrorism laws

iii. Specified Representations in Middle Market Deals

1. Execution and delivery of loan documents not conflicting with laws or other debt agreements of the borrower and guarantors
2. Priority of liens
3. Accuracy of financial statements
4. Absence of litigation
5. Use of proceeds
6. Governmental and third-party approvals

III. Proposals and Commitment Letters (Continued)

H. Fees, Expenses and Indemnification

1. Fees.

- a. Commitment letters typically include the obligation of the borrower to accept the terms of the fee letter and pay the fees described in the fee letter.
- b. Provision also documents the agent banks' consideration for their commitments and agreement to arrange the loans.

2. Expenses and Indemnification:

- a. Commitment letters include provisions for reimbursement of fees and expenses, including legal fees, and indemnification for all liabilities that the agent banks, lenders and their respective officers, directors, employees, affiliates, agents, advisors and representatives (“**Indemnified Parties**”) incur in connection with the transaction.
- b. Typically, the borrower is obligated to pay all of the Indemnified Party's fees and expenses and indemnify the Indemnified Parties for all liabilities (absent gross negligence, willful misconduct or a material breach of its obligations under the commitment letter on the part of the indemnified party).
- c. Commitment letters typically provide that in no event are Indemnified Parties liable for any **special, indirect, consequential or punitive damages**.

III. Proposals and Commitment Letters (Continued)

H. Fees, Expenses and Indemnification (Continued)

2. Expenses and Indemnification (Continued):

- d. Borrowers with leverage may be able to negotiate some limitations on these obligations depending on their bargaining power such as capping the legal fees or paying for only one legal counsel for all lenders.
- e. Typically, the borrower is obligated to pay all of the Indemnified Party's fees and expenses and indemnify the Indemnified Parties for all liabilities (absent gross negligence, willful misconduct or a material breach of its obligations under the commitment letter on the part of the indemnified party).
- f. Commitment letters typically provide that in no event are Indemnified Parties liable for any **special, indirect, consequential or punitive damages**.
- g. After the financial crisis, lenders are careful to ensure, in acquisition financings, that the borrower, sponsor, seller, target company and any of their affiliates that have standing to sue the lenders are expressly bound by specific remedy waivers and damage caps with respect to the lenders and that suits against the lenders will be litigated in New York or another lender-friendly jurisdiction.

III. Proposals and Commitment Letters (Continued)

H. Fees, Expenses and Indemnification (Continued)

2. Expenses and Indemnification (Continued):

- h. If the sponsor is not a party to the commitment letter, lenders may require it to sign a side letter acknowledging it is bound by the same indemnification provisions, remedies and damage caps and jurisdiction provisions as specified in the commitment letter with respect to the borrower and confirming that the lenders are third party beneficiaries of all remedy waivers, damage caps and reverse termination fees specified in the acquisition agreement.
- i. Finally, it is worth noting that the New York State Court of Appeals has held that indemnification provisions will only cover legal costs incurred by the indemnified party (such as the agent banks) in a suit brought by the indemnitor (such as the borrower) if the **indemnification provision expressly provides for such coverage** (*Hooper Associates v. AGS Computers*, 74 N.Y.2d 487 (N.Y. 1989)).
- j. Agent banks' counsel should be sure that the indemnification provision states that the borrower must indemnify the indemnified parties for any losses arising from any claim, investigation, litigation or proceeding related to the transaction **“whether or not any such claim, investigation, litigation or proceeding is brought by the borrower, its affiliates, or any other person.”**

III. Proposals and Commitment Letters (Continued)

I. Confidentiality

1. **Proprietary Nature.** Lenders are very proprietary about the terms of their deals, especially the fees, and require that the commitment letter, term sheet and fee letter be kept confidential by the borrower.
2. **Exceptions.** Borrowers are typically allowed to disclose one or more of the commitment letter, fee letter or term sheet:
 - a. To its officers, directors, employees, attorneys, accountants and agents on a need-to-know basis.
 - b. As required by law or compulsory legal process (including required SEC filings).
 - c. To rating agencies (generally only the term sheets can be disclosed).
 - d. In the case of an acquisition financing, to the seller, the target and their professional advisors on a need-to-know basis (but not including the fee letter).

III. Proposals and Commitment Letters (Continued)

J. Agent Activities, Sharing Information and Affiliate Activities

- 1. Agent Activities.** Commitment letters include several provisions to protect the agent banks in connection with other activities that they may perform in the normal course of their business. These are primarily legal disclosure provisions.
- 2. Sharing Information.** Agent banks may be doing business with competitors or other parties that have conflicting interests with the borrower. Commitment letters disclose these potential arrangements and ask the borrower to acknowledge this fact. The agent banks agree not to share any information about the borrower with those other parties and confirm that they have no obligation to (and they will not) share any information about the other parties with the borrower.
- 3. Affiliate Activities.** Agent banks may also disclose that they are full service securities firms and may provide investment banking and other financial services to, and buy or hold securities or debt obligations (including the loans) of, the borrower or its affiliates in the ordinary course of the firm's business. In such capacity, agent banks may have conflicting economic interests with the borrower and its affiliates. The borrower is asked to acknowledge these arrangements and agree that the transactions contemplated by the commitment letter are arm's-length transactions.

III. Proposals and Commitment Letters (Continued)

K. No Fiduciary Duties (“eToys Provision”)

1. Since June 2005, commitment letters have included a provision clarifying that the agent banks do not have any fiduciary, advisory or agency relationship with the borrower and are not advising the borrower as to any legal, accounting, regulatory or tax matters as a result of the transactions contemplated by the commitment letter. This language is a result of an unfavorable ruling in the *eToys* case by the New York State Court of Appeals that noted that the lead underwriter of an initial public offering could have a fiduciary duty to clients for which it also serves as expert advisor, which creates a duty to reveal any conflicts of interest (*EBC I Inc. v. Goldman, Sachs & Co.*, 799 N.Y.S. 2d 170 (N.Y. 2005)). This led to concern among banks that if they act as an underwriter of the loans and also render advice to the borrower on other matters, they may be held to have a fiduciary duty to the borrower which would expose them to additional liability.
2. In December 2011, the New York Supreme Court, Appellate Division, affirmed a November 2010 decision by a lower New York court granting Goldman Sachs’ motion for summary judgment to dismiss the complaint brought by the eToys plaintiff for breach of fiduciary duty (*EBC I, Inc. v. Goldman Sachs & Co.*, 936 N.Y.S.2d 92 (1st Dep’t 2011)). Despite this ruling, *eToy’s* provisions continue to be included in commitment letters.

III. Proposals and Commitment Letters (Continued)

L. Surviving Provisions (Survive Termination of the Commitment Letter if Deal Does Not Close)

- 
1. Compensation
 2. Reimbursement
 3. Indemnification
 4. Confidentiality
 5. Agent activities
 6. Jurisdiction
 7. Governing law
 8. Jury trial waiver

III. Proposals and Commitment Letters (Continued)

M. Acceptance and Termination

1. Commitment letters have two key dates: one for signing the commitment letter and one for closing the transaction.
2. The commitment to lend expires if either of these dates is not met.
3. Borrowers are usually given **one to two weeks** to negotiate and sign the commitment letter to avoid negotiating indefinitely.
4. For the second “drop dead” date, the later the date, the greater the risk that conditions will change adversely in the future before the transaction closes. Therefore, agent banks do not want to keep their commitments **open for more than a few months**.

III. Proposals and Commitment Letters (Continued)

N. Miscellaneous

1. **Assignments.** Commitment letters **cannot be assigned** by the borrower. The commitments can be assigned by the agent banks to prospective eligible lenders.
2. **Amendments.** The commitment letter cannot be amended or modified without the written consent of all parties to the letter.
3. **Governing Law, Jurisdiction and Waiver of Jury Trial.** The governing law and jurisdiction provisions govern which law will apply and which courts will be used if matters concerning the commitment letter are litigated. In some acquisition financings the governing law clause is split between two jurisdictions in cases where the acquisition documents are governed by the laws of another state. This provides greater certainty to the seller that the lenders will fund the acquisition since there will be no disagreement as to the interpretation of certain commitment letter provisions that could otherwise result from the application of two different laws.
4. **Patriot Act.** Provision requests certain information to properly identify the borrower and guarantors in an effort to prevent money laundering and aid the US government in its fight against terrorism



TERM SHEETS

IV. Term Sheets: Structure

A. Binding or Non-binding

1. **Term sheets attached to a commitment letter - binding**
 - a. Important to clearly identify conditions to closing and areas that aren't fully agreed or subject to further negotiation (e.g., baskets or thresholds "to be mutually agreed)
 - b. Market pressure to use SunGard limited conditionality concepts even in transactions that aren't acquisition financing and wouldn't necessarily require certainty of funding.

2. **Stand alone Term Sheets or those attached to a proposal letter - assumed to be non-binding, but lenders should be cautious.**

IV. Term Sheets: Structure (Continued)

A. Binding or Non-binding (Continued)

a. Clear disclaimers should be added:

“This Indicative Term Sheet has been provided solely for discussion purposes and does not represent an offer, agreement or commitment to enter into the financing arrangements described herein (the “Proposed Financing”) and the Lender has not made any such offer, agreement or commitment. Any such offer, agreement or commitment would be made only in writing and on such terms and conditions as determined by the Lender in its sole and absolute discretion. The terms of this Indicative Term Sheet are not all-inclusive and should not be construed to reflect all of the provisions to be included in the Proposed Financing, may be varied as the parties may determine in their sole and absolute discretion, and may be materially changed by the Lender in its sole and absolute discretion at any time prior to any final execution and delivery of a commitment, if any, to provide such Proposed Financing.”

b. Important to illustrate the requirement for definitive documentation and that negotiation and execution of that documentation is a condition to closing any transaction.

IV. Term Sheets: Structure (Continued)

B. Drafting Approach

1. **“Usual & Customary”, “Including but not limited to”**
 - a. Ambiguous, defers negotiation of specific terms
 - b. As noted above, borrower driven market trend to increase certainty

2. **Limited to Specified Items: “limited to the following”**
 - a. More certainty, advances negotiation of terms early in process
 - b. Limits flexibility if new issues are learned in documentation (if binding)

3. **Documentation Principles**
 - a. Use of precedent agreement to set baseline
 - b. Defines scope of negotiation

4. **Level of Specificity**
 - a. Laundry list of subjects
 - b. Leave specific exceptions for documentation but understand “customary”

IV. Term Sheets: Structure (Continued)

B. Drafting Approach (Continued)

i. Deferring specific negotiation:

“Usual and customary for transactions of this type, to include without limitation: (i) corporate existence and status; (ii) corporate power and authority, enforceability; (iii) no violation of law or organizational documents; (iv) no material litigation; (v) accuracy and completeness of specified financial statements and no material adverse effect..”

ii. Detailing applicable exceptions / baskets specifically:

“The negative covenant relating to liens will permit liens arising from escrow or deposit of cash in an aggregate amount not to exceed \$[___] to satisfy “funds certain” or good faith deposit requirements in connection with Permitted Acquisitions; provided that the applicable liens shall terminate upon the earliest to occur of (i) the consummation of the applicable Permitted Acquisition and (ii) the date of the termination or abandonment of such Permitted Acquisition”

IV. Term Sheets: Structure (Continued)

C. Key Terms of Term Sheets:

Outline of Credit Agreement and Collateral

- i. **Borrower and Guarantors** (identify all obligors; rules for identifying future obligors)
- ii. **Amount / Types of Facilities**
 1. **Revolving Credit Facility**
 - a) Letters of Credit (standby and/or commercial LCs)
 - b) Swing Line (discretionary or committed)
 2. **Term Loan Facilities** (draw at close/ delayed draw)
 3. **Increase Options:** variability in terms of accordion options
 - a) Uncommitted but pre-approved increase to commitment level of revolving credit facility—same terms or MFN likely
 - b) Option for other *pari passu* revolving or term facilities, may be on same terms, and if not, there may be limited MFN protection, which may also sunset; current trends indicate lessening protection.

IV. Term Sheets: Structure (Continued)

C. Key Terms of Term Sheets: Outline of Credit Agreement and Collateral (Continued)

iii. Collateral

1. **Scope of Collateral** (all assets / specified pool / types of collateral)
2. **Obligations Secured** (including hedging (subject to ECP) and cash management)
3. **Foreign Equity Interests** (65% pledge limitation in the case of voting stock of CFCs) – Changes to tax law and regulations have impacted the economic implications of many CFC guarantees of US parent debt and pledge of 100% of CFC equity, and those changes are starting to be reflected in the market. However, Borrowers continue to argue for the status quo to maintain flexibility and protect against potential changes in law, unless they perceive a benefit to a guaranteed structure.

IV. Term Sheets: Structure (Continued)

C. Key Terms of Term Sheets: Outline of Credit Agreement and Collateral (Continued)

iv. Interest Rates & Fees

1. Floating Rate Interest

- a) LIBOR/SOFR/SONIA plus margin
- b) ABR plus margin
- c) In light of impending LIBOR sunset, most existing credit facilities include provisions to address triggers for replacement of LIBOR and rules for how replacement benchmark(s) will be implemented. This could include reference to LSTA or ARRC approaches, if applicable. The term sheet should specify the new replacement benchmark and general approach to be taken for future replacement rates.

2. Fixed Rate Interest

- a) Typically includes make-whole or call premium

3. Fees

- a) Unused fees/facility fees for revolvers
- b) Letter of Credit Fees
- c) Upfront/arrangement/exit fees

IV. Term Sheets: Structure (Continued)

C. Key Terms of Term Sheets:

Outline of Credit Agreement and Collateral (Continued)

v. **Maturity, Amortization and Extensions**

1. **Types and amounts** of mandatory prepayments vary widely depending on industry/borrower credit profile, spell out to avoid misunderstanding
2. **Required Revolver** paydowns may (or may not) require accompanying permanent commitment reductions
3. **Maturity extensions /amend and extend provisions** (especially if less than 100% approval is required – leaving non-extenders with existing maturity and not benefiting by economics related to extension)

vi. **Representations and Warranties**

1. Scope and industry specific considerations
2. Address lenders' regulatory/diligence requirements
3. When are they made or “brought down” (type/purpose of facility is relevant)

IV. Term Sheets: Structure (Continued)

C. Key Terms of Term Sheets:

Outline of Credit Agreement and Collateral (Continued)

vii. Covenants (Affirmative and Negative)

1. **Scope** varies widely with credit profile of borrower
2. **“Grower” baskets** provide flexibility as borrower’s business improves
3. **Trend toward “incurrence” type tests** rather than strict limitations
4. **Materiality standards/thresholds** for compliance requirements

viii. Covenants (Financial) (if not cov-lite)

1. Typically outline the scope of financial covenant tests
2. Levels often set if financial model is available for review prior to signing, and at least short form definitions of components. Note that recent changes in GAAP and IFRS, especially in the context of leases and revenue recognition, should be address in the definitions.
3. Specifically address which debt contributes to the ratios and which cash, if any, is netted therefrom

IV. Term Sheets: Structure (Continued)

C. Key Terms of Term Sheets: Outline of Credit Agreement and Collateral (Continued)

ix. Conditions to Closing

1. While **inclusive scope** is obviously important in a committed deal, it remains important even in a stand-alone term sheet to outline conditions
2. **Execution and delivery of definitive documentation** should always be stated as a condition
3. **MAE**
4. **KYC and Beneficial Ownership Certifications** are an important focus for banks as diligence items, to comply with regulation, and a condition to closing
5. **Payment of fees and expenses** – circumstances under which fees are paid and setting expectation for financing costs

IV. Term Sheets: Structure (Continued)

C. Key Terms of Term Sheets:

Outline of Credit Agreement and Collateral (Continued)

x. **Default & Remedy Provisions**

1. Outline **types and scope** of defaults
2. Identify **thresholds and materiality** standards
3. Cross default vs. cross acceleration
4. **Equity cure** provisions

xi. **Voting**

1. **Required Lenders** (at least two unaffiliated lenders in club deals)
2. **Supermajority Lenders**
3. **All lenders and affected lenders** (“sacred rights”)
4. **Affiliated Lenders**

IV. Term Sheets: Structure (Continued)

C. Key Terms of Term Sheets: Outline of Credit Agreement and Collateral (Continued)

xii. Assignments & Participations

1. Consent requirements and exceptions
2. Deemed consent
3. **Disqualified Lenders**, balance between borrower desire to avoid assignment to certain lenders and competitors and lenders' need for certainty and liquidity

xiii. Expenses & Indemnification

1. Scope and exceptions

xiv. Governing Law; Jurisdiction

xiv. Miscellaneous



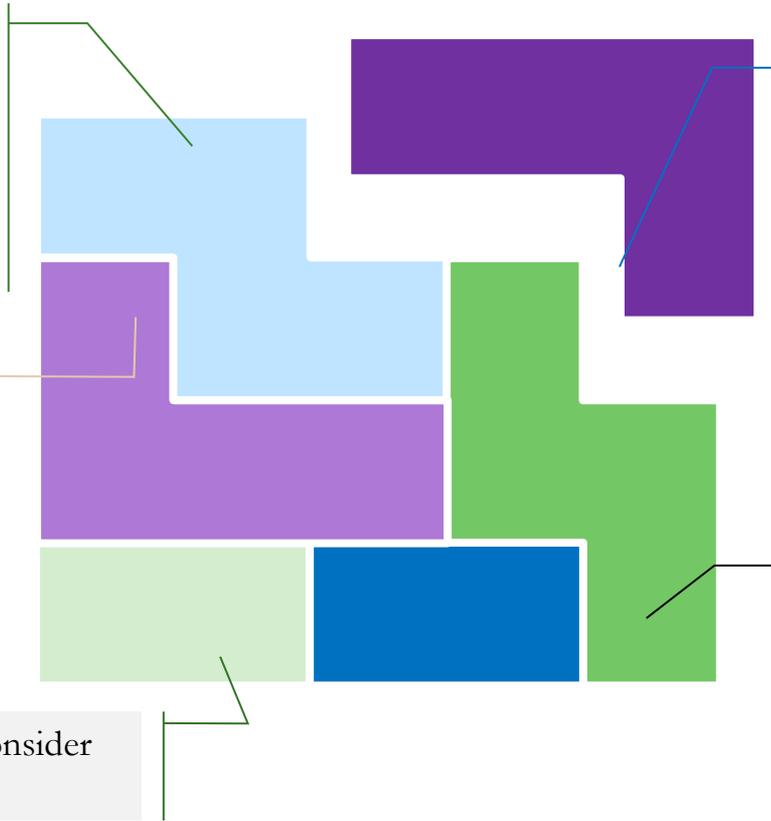
KEY TAKEAWAYS

V. Key Takeaways

Covenant-lite credit structures with no financial maintenance covenants (other than a springing covenant applicable to the revolving credit facility) have returned to the market.

Conditions precedent are of paramount importance when negotiating commitment papers. Consider implications of Amcan provisions.

In acquisition financings, carefully consider SunGard and Xerox provisions



Term Sheets can be an invaluable tool for flushing out issues that will otherwise arise in the documentation process, at a time when it may be more difficult to address them. Take advantage of the opportunity to work through issues to the extent possible.

However, be sure to identify the anticipation of definitive documentation, and the requirement for its negotiation, execution and delivery as a condition to any proposed financing.