Commitment Letters: Trends in Selected Provisions

Practical Law Finance

An Expert's View

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Janet examines current developments in commitment letter negotiations, including issues concerning disqualified lender lists and marketing periods:

What has been your experience with the way issues arising in connection with disqualified lender lists have been addressed in commitment letter negotiations?

Common market practice is for arrangers to allow borrowers and sponsors to designate a list of disqualified lenders and their affiliates at the time a commitment letter is signed. Nonetheless, competing interests remain among:

- The borrower's desire to limit its investor group to good partners and protect its confidential information from competitors.
- The arrangers' desire to maximize the population of potential investors and promote loan liquidity.
- The arrangers' and agents' desire to limit their own responsibility for implementing restrictions imposed by the disqualified lender list.

As a result, current issues of contention are:

- **Whether the borrower can update the list and, if so, how often.** Different approaches are seen in the market and one compromise is to allow competitors, but not institutional investors, to be added to the list.
- **Whether the list is distributed to all lenders or only to the arrangers and agents.** This issue bears directly on who has responsibility to uphold restrictions. Arrangers and agents negotiate to distribute the list widely so that each lender is responsible for its own trades, but borrowers resist this distribution because they do not want friction or retaliation resulting from broad identification of investors they view as unpalatable. Market practice varies, but borrowers are mostly winning this battle.
- **Which party bears responsibility for identifying affiliates of named disqualified lenders.** Some agents seek to avoid this determination and one alternative approach is to include only affiliates "reasonably identifiable by name," which is inexact but partially effective. Another approach is to put the task to the borrower.
- **Whether the affiliate restriction should also apply to bona fide debt funds with separate fiduciary duties to their investors.** Arrangers and investors are increasingly seeking exclusion of these debt funds from the affiliate restriction and the market is not yet settled on this point.

What are the common issues of negotiation between borrowers and arrangers with respect to marketing periods in commitment letters?

Marketing periods provide arrangers with an opportunity to reduce funding exposure by selling their underwritten debt to market investors prior to closing. The marketing period is a specified time period that must be completed before the financing provider is required to fund. Since sponsors want to protect available funds at closing, they aggressively limit the marketing period and match its triggers as closely as possible to purchase agreement conditions.

Marketing period negotiations revolve around the length of the period and the triggers to begin the period. The length of the period is usually an agreed number of calendar or business days, frequently extended by slower syndication periods, such as the end of August. The triggers are strategically critical. Sponsors propose clear and objective triggers within their control, for example, the signing of commitment papers or delivery of specific financial information required to be delivered by the seller in the purchase agreement (historical audit) or which sponsors know they can prepare (budgets or projections).

Arrangers seek as much information and flexibility as possible to shape and extend the marketing period, so they propose triggers, such as the dissemination of the bank book, hosting of a syndication bank meeting or delivery of information more broadly defined, all of which sponsors resist.

In addition to sponsor risk regarding certainty of funds at closing, auction sellers evaluate the speed and certainty of a potential buyer's ability to close, so a longer or less well-defined marketing period can be a competitive bidding disadvantage. For these reasons, sponsors have been largely successful in narrowly tailoring marketing periods and resisting gaps between purchase agreement and financing commitment provisions regarding marketing periods.

What are currently the main areas of concern for sponsors in commitment letter negotiations?

Sponsors are currently laser focused on detailed negotiations and specifications in the commitment phase. They correctly perceive that competitive tensions among prospective lead lenders prior to signing provide a window of enhanced sponsor negotiation strength which disappears once the lead has been selected.

This is especially evident for financial covenant levels, accounting definitions (especially EBITDA), acquisition flexibility and key basket amounts (including investment, restricted payment and debt baskets, with these baskets having growth features tied to performance metrics as opposed to absolute dollar caps). Until recently, most of these terms were often "to be determined" later rather than fully negotiated in commitment papers. Sponsors also want the deal they negotiate to be firmly underwritten, with as little room as possible post-signing for arrangers to "flex" away favorable borrower provisions to ease syndication, so agreed flex terms are narrower than in the past.

Sponsor concern regarding maximum certainty of funding remains strong and the tight and protective conditionality tied to purchase agreement conditions, which has become market standard for acquisition financings, is now frequently extended to incremental loans provided for add-on acquisitions. Tension is building due to increasing pressure from lender internal compliance policies for more robust closing conditions relating to anti-terrorism, anti-money laundering and anti-corruption laws, which are areas frequently not fully covered in purchase agreements. Sponsors are concerned about this risk and are resisting these demands with varying degrees of success.