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Commitment Letters in Commercial Loans

Borrower and Lender Approaches to Negotiate and Enforce Binding Loan Commitments

THURSDAY, MARCH 15, 2012

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

Today's faculty features:

Aric T. Stienessen, Partner, **Hinshaw & Culbertson**, Minneapolis

Pauline M. Stevens, Partner, **Allen Matkins**, Los Angeles

Eric Goodison, Partner, **Paul Weiss Rifkind Wharton & Garrison**, New York

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Commitment Letters in Commercial Loans

*Borrower and Lender Strategies to Negotiate
and Enforce Binding Loan Commitments*

March 15, 2012

1:00 PM – 2:30 PM Eastern Standard Time

Aric T. Stienessen

HINSHAW
& CULBERTSON LLP

Pauline M. Stevens

Allen Matkins
CHALLENGE. OPPORTUNITY. SUCCESS.

Eric Goodison

Paul | Weiss

Presenters

Pauline M. Stevens, Partner

Allen Matkins Leck Gamble Mallory & Natsis, Los Angeles

She represents financial institutions in connection with syndicated and bilateral leveraged and multicurrency financings, interest rate swap and other derivatives, workouts, and restructurings. She has worked with agricultural businesses, chemical manufacturers, energy companies, entertainment companies, governmental entities, healthcare companies and many others.

pstevens@mofo.com

213.955.5606

Presenters

Eric Goodison, Partner

Paul Weiss Rifkind Wharton & Garrison LLP, New York

He has over 20 years of experience as a financing lawyer. He represents domestic and international clients in their borrowing and lending and other financing transactions, including acquisitions, divestitures, and restructurings. He has significant expertise in structuring, negotiating and consummating all types of leveraged financings.

egoodison@paulweiss.com

212.373.3292

Presenters

Aric T. Stienessen, Partner

Hinshaw & Culbertson LLP, Minneapolis

He represents lenders, investment banks and borrowers in commercial finance transactions. He also represents businesses and real property developers in sales and purchase transactions involving commercial real property, and handles transactions involving mergers, acquisitions, divestitures and corporate organization and governance.

astienessen@hinshawlaw.com

612.334.2504

Outline

- I. Legal developments
 - A. 55 Eckford Realty, LLC
 - B. First National Mortgage Co.
 - C. Teachers Insurance
 - D. Amcan Holdings
- II. Structure
 - A. Binding or nonbinding
 - B. Conditions
- III. Negotiating key terms
 - A. General scope of terms
 - B. Loan amount
 - C. Collateral
 - D. Interest rate
 - E. Prepayment penalty
 - F. Guaranties
 - G. Financial covenants
 - H. Casualty and condemnation proceeds
 - I. Default provisions
 - J. Affirmative and negative covenants
 - K. Other considerations

I. Legal Developments

- A.** 55 Eckford Realty LLC, Judity Septimus and Aaron Gertz v. The Bank of East Asia (U.S.A.) N.A. (Supreme Court State of New York May 2011) (available at <http://www.nycourts.gov>)
1. “Due diligence” permitted exercise of discretion.
 2. “Implicit in all contracts is a covenant of good faith and fair dealing.”
 3. See also Copeland v. Baskin Robbins U.S.A., 117 Cal. Rptr. 875 (Cal.Ct.App. 2002).
- B.** First National Mortgage Co v. Federal Investment Realty Trust, 631 F. 3d 1058 (9th Cir. 2011)
1. “Final Proposal.”
 2. “The above terms are hereby accepted by the parties subject only to approval of the terms and conditions of a formal agreement.”

I. Legal Developments Cont.

C. Teachers Insurance and Annuity Association Of America v. Tribune Company, 670 F. Supp. 491 (SD NY 1987).

1. **Two types of preliminary contracts:** fully negotiated and those still to be negotiated.
2. First type includes contract where there is an agreement to negotiate in good faith additional and customary terms. Second type does not carry duty to continue to negotiate.

I. Legal Developments Cont.

D. Amcan Holdings, Inc. v. Canadian Imperial Bank of Commerce, 894 NYS 2d 47 (N.Y. App. Div. 1st Dep't Feb. 4, 2010)

1. Two term sheets provided that the credit facilities: “will only be established upon completion of definitive documentation” containing terms and conditions in term sheet and other terms “reasonably” required by CBIC.
2. Conditions precedent were “usual and customary for transactions of this type.”
3. Not an enforceable contract because:
 - Intent of the parties was not to form a contract (subject to terms required by the lender, definitive documents).
 - No explicit statement intending to be bound.
 - Term sheets contemplated later agreements.

II. Structure

- A. Binding or Nonbinding
 - 1. Lender's Perspective
 - a. Lender's fees and expenses, including attorneys' fees, paid regardless of whether loan closes
 - 2. Borrower's Perspective
 - a. Trade off – underwriting fees and grant of exclusivity vs “certainty” of funds
 - b. Certain transactions require a fully underwritten commitment (acquisitions), while others may not (dividends, refinancing)
 - c. Expenses paid only at close
- B. Conditions
 - 1. Lender's Perspective
 - a. No material adverse change
 - b. Approval from participants or syndicates
 - c. Be mindful of tying arrangements
 - 2. Borrower's Perspective
 - a. Depends on fully underwritten vs best efforts, general rule the fewer the better -- need to understand “Flex” terms to see if commitment is really a disguised best efforts

II. Structure Cont.

- b. Sometimes borrower wants lender to have an “out” so they have a transaction out – very dangerous strategy
- c. Best Efforts deal – subject to lenders coming in on market clearing terms so limiting conditions is potentially less important
- d. Underwritten deal – want an exhaustive list (avoid wording such as “to include” or “including”) and as narrow and as objective as possible with any lender determinations made by commitment party and not syndicate (both a cosmetic issue for seller in an acquisition and an economic issue if reverse break fee on financing)

Hot button issues:

- 1) Due diligence
- 2) Maximum closing leverage
- 3) Solvency – certificate or opinion; objective vs subjective standard
- 4) Outside date and marketing or syndication period
- 5) Approval of financial statements
- 6) Limiting closing representations to “Specified Representations” matching acquisition agreement
- 7) Acquisition Agreement amendments and approval

III. Negotiating Key Terms

A. General Scope of Terms

1. Need further negotiations, ordinary & customary definitive documentation
2. Identify key parties (Lender/group, servicer, borrower, guarantors)
3. Terms unique or controversial to particular loan

B. Loan Amount

1. Lender's Perspective
 - a. "Not to exceed"
 - b. All advanced and accruing interest, though possibly subject to control and disbursement
 - c. Basis for fees
2. Borrower's Perspective
 - a. Commitment to cover full amount necessary – watch terms like "up to"
 - b. ABL potential uncertainty over ultimate amount at time of close due to:
 - i. Fluctuations in borrowing base assets
 - ii. Field Audits to be done
 - iii. Eligibility criteria to be negotiated
 - iv. Reserves
 - v. Minimum Availability or Liquidity at close

III. Negotiating Key Terms Cont.

- c. Ability for Incremental Facilities

C. Collateral

1. Lender's Perspective

- a. Cross-collateralize
- b. Releases and substitutions
- c. Priority and intercreditor and subordination agreements
- d. Access agreements

2. Borrower's Perspective

- a. Negotiate exceptions or identify categories – leaseholds, immaterial collateral
- b. Timing of perfection – “Sungard” post closing language for non stock/ucc collateral
- c. Intercreditor – if multiple secured commitments (1st/2nd lien structure or ABL/Term crossing lien structure), outline key intercreditor terms (priority, standstill, etc.)

III. Negotiating Key Terms Cont.

D. Interest Rate

1. Lender's Perspective

- a.** 360 day convention
- b.** Default interest upon default occurrence (vs. continuing/uncured default)

2. Borrower's Perspective

- a.** 365 day for Base Rate
- b.** Default Rate – only on overdue, only if required, other mitigation
- c.** Payment periods – quarterly vs monthly for non Libor loans

III. Negotiating Key Terms Cont.

E. Prepayment Penalty

1. Lender's Perspective
 - a. Amount, frequency, timing, and notice
 - b. Due upon acceleration
2. Borrower's Perspective
 - a. Exceptions – “involuntary acts” such as excess cash, casualty events
 - b. Make Whole better than a “no call”
 - c. Soft Calls – designed to protect against downward repricing
 - i. Triggers – repayment with low cost debt
 - ii. Time – 1 year
 - iii. Premium – 101
 - iv. Flex vs. commitment term

III. Negotiating Key Terms Cont.

F. Guaranties

- 1. Lender's Perspective**
 - a. Payment and collection
 - b. Secured or Unsecured
 - c. Standstill
- 2. Borrower's Perspective**
 - a. Limit to domestic entities, avoid a 956 "material cost" analysis
 - b. Consider unrestricted concept
 - c. Stop chain at one level above borrower, so any super hold co is unrestricted

III. Negotiating Key Terms Cont.

G. Financial Covenants

1. Lender's Perspective
 - a. Compliance certificates
 - b. Understand metrics (EBIT vs. Gross Sales vs. Cash)
2. Borrower's Perspective
 - a. Agree cushion to plan and perhaps identify plan
 - b. Consider setting levels or annual levels with mid year stepdowns TBD
 - c. Consider asking for Equity Cure right

III. Negotiating Key Terms Cont.

H. Casualty and Condemnation Proceeds

- 1.** Lender's Perspective
 - a.** Percentage damage
 - b.** Reinvest or repay the loan
- 2.** Borrower's Perspective
 - a.** Definitely want a full reinvestment right
 - b.** Where to apply proceeds pending reinvestment – cash collateral or pay down line

III. Negotiating Key Terms Cont.

I. Default Provisions

1. Lender's Perspective

- a.** Cross-default
- b.** Grace periods and opportunities to cure

2. Borrower's Perspective

- a.** Generally negotiated in loan documentation phase
- b.** Identify the list of defaults, limit surprises later ("MAE")
- c.** Introduce concept of grace periods, cure rights and materiality thresholds

III. Negotiating Key Terms Cont.

J. Affirmative and Negative Covenants

1. Lender's Perspective

- a. Keep in mind expectations of participants/syndicates
- b. Recognize the common covenants and specifically address covenants unique to the particular loan

2. Borrower's Perspective

- a. Generally negotiated in loan documentation phase
- b. Identify the covenants and introduce concept of materiality threshold and grace periods
- c. Greater specificity on financial reporting (how long and how often) and hedging
- d. On negative covenants, consider addressing key exceptions such as material acquisitions or acquisition flexibility generally, debt incurrence, dividend expectations, know or planned major asset sales, sale lease back transactions or major planned cap ex

III. Negotiating Key Terms Cont.

K. Other Considerations

A. Lenders Perspective

1. Length of commitment and protection on being shopped
2. Ability to successfully syndicate – assistance, flex, assignment

B. Borrower's Perspective

1. Length of commitment, time to complete transaction
2. Other material terms: amortization, voting rights, mandatory prepayments (equity sweeps, excess cash flow, asset sales), borrower or affiliate right to acquire debt, and restrictions on transfers, including to competitors and blacklists