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Negotiating Loan Documents

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Agenda

- Types of Lending
- Term Sheets and Commitment Letters
- Overview of Loan Documents
- General Structure of a Loan Agreement
- Guaranty Agreements

Types of Lending, Types of Credit Facilities, and Bilateral vs. Syndicated

- Types of Lending
 - Secured Lending
 - Unsecured Lending
- Types of Credit Facilities
 - Term Loans: involves borrowing a fixed amount of money and repaying the sum, together with interest, over a specified period of time
 - Revolving Facilities: involves incremental borrowing up to a maximum amount, with the ability to repay and re-borrow funds
- Bilateral (single lender) vs. Syndicated (multiple lenders)

Initial Step – Term Sheets and Commitment Letters

- Nearly all loans begin with the parties negotiating a term sheet or commitment letter
- Term Sheets
 - Non-binding, with certain exceptions
 - Typically, Term Sheets are issued at the very beginning of the transaction before the Lender has completed its underwriting process
 - Terms are typically not considered final
- Commitment Letters
 - Lender's legally binding commitment to lend, and Borrower's legally binding commitment to borrow, subject to certain conditions
 - Typically, Commitment Letters are not issued until the Lender has completed its underwriting process
 - Terms contained in a Commitment Letter are usually close or identical to the terms in the Loan Documents

Overview of Loan Documents

- Loan Agreements
- Promissory Note(s)
- Collateral Documents
 - Security Agreement
 - Pledge Agreement
 - Collateral Assignment(s)
- Subordination Agreements
- Guaranty Agreements

General Structure of a Loan Agreement

- Credit Terms
- Conditions Precedent to Closing/Lending
- Representations and Warranties
- Covenants
- Events of Default
- Lender's Remedies upon the occurrence of an Event of Default

Representations and Warranties

- Representations and Warranties: A tool used by lenders to gather material information and allocate risk
- Common Representations and Warranties are:
 - Organization, power and authority
 - No pending or threatened litigation against the borrower
 - Borrower is in compliance with all applicable laws
 - Borrower has valid title, free and clear of liens, to its property
 - Accuracy of financial statements
 - Industry specific representations and warranties
- Knowledge and Materiality Qualifiers

Covenants Generally

- Covenants: Designed to protect a lender's investment during the life of loan by monitoring the borrower's business activities, limiting certain actions of the borrower, and requiring other actions to be taken
- Types of Covenants:
 - Affirmative Covenants
 - Negative Covenants
 - Financial Covenants

Affirmative Covenants

- Affirmative Covenants: Actions a borrower must take during the life of the loan, such as notifying the lender of certain events, maintaining insurance, and permitting the lender to inspect its books and records
- Generally, from a borrower's perspective, affirmative covenants should not require the borrower to do anything it is not already doing
- Materiality and reasonableness qualifiers

Negative Covenants

- Negative Covenants: Actions the borrower is not allowed to take without the lender's consent, such as incurring debt, selling material assets and paying dividends or distributions

Financial Covenants

- Financial Covenants: Specify different financial metrics that monitor the performance of the borrower and/or the collateral
- Financial tests based on the information contained in the borrower's financial statements
- Generally, stated as either a min/max dollar amount or as a ratio
- Maintenance vs. incurrence financial covenants
- Affirmative/negative covenants vs. financial covenants

Events of Default

- An “Event of Default” is the occurrence of an event that allows a lender to exercise remedies (such as non-payment of the loan, the breach of a covenant or bankruptcy)
- A “Default” is a violation of the loan terms that will become an Event of Default if corrective action is not taken within a specified period of time, or if required notice is given
- Payment vs. covenant Events of Default

Lender's Remedies Upon Events of Default

- Cancellation of subsequent loan advances (if any)
- Imposition of default interest
- Acceleration of unpaid loan obligations
- Commencement of foreclosure proceedings
- Set-off against funds on deposit in borrower accounts
- Any other remedies available to a lender under applicable law or equity

Guaranty Agreements

- Guaranty Agreement: A contract whereby one party stands behind the obligations of a borrower under the loan documents
- Guarantors agree to guarantee the payment and performance of the borrower's obligations under the loan agreement and other loan documents
- Guarantors provide additional collateral support for credit

Types of Guaranties

- Unlimited Guaranty
- Limited Guaranty
- Specific Performance Guaranty
- Burn-Off Guaranty
- Joint and Several Guaranty
- Carve-Out Guaranty (aka Bad Boy Guaranty)