§ 7.04 Terms Included in Commitment Papers

After a prospective lender has evaluated the legal and commercial implications of a proposed financing, a prospective lender is ready to prepare commitment papers for presentation to the buyer and the seller. In addition to the economic terms of the proposed financing, commitment letters set forth the conditions precedent that must be satisfied before the committing lender will provide the proposed financing. An informed seller will want to understand and, to the extent feasible, influence the conditionality that must be satisfied before a committing lender will provide the contemplated financing. An informed seller will want to understand and, to the extent feasible, influence the conditionality that must be satisfied before a committing lender will provide the contemplated financing. Sellers should view the conditions to the proposed financing with as much concern as the conditions to the buyer’s obligation to close the acquisition in the acquisition agreement itself. Furthermore, commitment letters also will specify actions required to be taken by the seller and its representatives to facilitate syndication of the proposed financing.

There are no unconditional commitments to provide acquisition financing. From a seller's perspective, the conditions in a commitment letter should mimic the conditions to consummation of the acquisition that are set forth in the acquisition agreement, with only such changes as are necessary to give effect to the fact that the lender is a financing source rather than the buyer, and therefore has unique concerns that must be addressed. The following is a discussion of the material conditions set forth in a typical commitment letter for acquisition financing:

[1] Acquisition Shall Have Closed on the

Terms in the Acquisition Agreement

Understandably, a prospective lender must be given the opportunity to review and provide comments to the definitive acquisition agreement. From the seller's perspective, this opportunity must be presented before the acquisition agreement is executed by the seller; otherwise the utility of the financing commitment is undermined if the lender can simply object to some term in a signed definitive acquisition agreement. Even if an acquisition agreement is approved by the lender prior to the delivery of its financing commitment, the lender will reserve the right to review and approve any amendments to the definitive acquisition agreement. Often such approval right is limited to amendments that adversely affect the lender.

Strategic Point:
A seller should avoid formulations of this condition that give a lender discretion to alter the terms on which the acquisition must be completed, such as a condition that "the subject acquisition be consummated on terms acceptable to the lender."

As discussed in Chapter 10, "Acquisition Agreement: Representations & Warranties" and Chapter 12, "Acquisition Agreement: Closing Conditions," a typical closing condition in an acquisition agreement is a requirement that the representations and warranties in the acquisition agreement be true and correct as of the closing of the acquisition. A similar closing condition will appear in the definitive documentation for the financing. Subject to prevailing market conditions, a prospective lender may consent to limiting the representations and warranties that must be true and correct as of the closing of the acquisition (but not on any other date) to (i) those representations and warranties made by the target company in the acquisition agreement as are material to the interests of the lender, and then only to the extent that the buyer has the right to terminate its obligations under the acquisition agreement as a result of a breach of such representations and warranties in the acquisition agreement and (ii) those representations and warranties in the definitive financing documentation for the financing relating to the debtor's corporate power and authority to undertake the financing, the due authorization, execution, delivery and
enforceability of the definitive financing documentation, absence of conflicts between the definitive financing documentation and the debtor's charter documents, law or material contracts, compliance with the Federal Reserve margin regulations, the validity, priority and perfection of security interests (but only to those security interests that can be perfected by the filing of UCC1 financing statements and the delivery to the lender of any possessory collateral), the status of the financing as unsubordinated debt (if applicable), and compliance with the USA Patriot Act, as amended, and the Investment Company Act of 1940, as amended. These provisions are generally referred to as the "Sunguard" provisions, named after the first acquisition where such provisions were included in the commitment papers. These provisions are very buyer friendly, however, and thus will be resisted by a prospective lender unless market exigencies require the lender to consent to these terms.

[2] Business and Legal Due Diligence

Most buyers in an acquisition conduct extensive due diligence on the assets to be acquired. See Chapter 6, "Due Diligence." Just as a prospective buyer will conduct due diligence, a prospective lender will conduct its own due diligence on the buyer and the assets and liabilities to be acquired or assumed. While a due diligence condition will often appear in the first draft of a commitment letter, such due diligence condition should be removed or materially circumscribed in the commitment letter before a buyer executes an acquisition agreement, at least to the extent the lender has had a reasonable opportunity to conduct its own due diligence. In order to facilitate a lender's due diligence review and to ease the removal of the due diligence condition from the commitment letter before a buyer executes an acquisition agreement, at least to the extent the lender has had a reasonable opportunity to conduct its own due diligence. In order to facilitate a lender's due diligence review and to ease the removal of the due diligence condition from the commitment letter, lenders will often request copies of the due diligence memoranda prepared by the buyer's legal and other advisors. Attorney client privilege and work-product issues notwithstanding, a buyer will often consent to the disclosure of its due diligence materials subject to the receipt of a so-called "non-reliance" letter or email, whereby the lender and its counsel agree that the materials are provided solely for information purposes and no party may make a claim against the buyer or its counsel in reliance upon the disclosures set forth in the due diligence materials provided.

In addition to conditions that expressly refer to the satisfactory completion of the lender's due diligence, other conditions can act as disguised due diligence conditions.

⚠️ Warning!
"Satisfactory" review of historical financial statements and the absence of any new material information effectively are disguised due diligence conditions and should be avoided.

[3] Absence of a Material Adverse Change in the Business of the Target Company

This condition requires that there has been no material adverse change in the target's business operations or financial condition. Typically, the buyer and seller will insist that the lender's material adverse change closing condition in the commitment letter mirror the negotiated material adverse change condition in the acquisition agreement. This will eliminate (or at least mitigate) the risk that a change in circumstance that would not serve to exonerate the buyer's obligation to consummate the acquisition in accordance with the terms of the acquisition agreement could be interpreted to exonerate the lender's financing commitment.

Any material adverse change evaluation is, however, essentially a qualitative, fact specific evaluation subject to considerable disagreement, whether simply between the buyer and seller in relationship to the acquisition agreement or between the buyer and the lender in relationship to the commitment letter. Disagreements as to what constitutes a material adverse change under the acquisition agreement versus the commitment papers can be compounded when, as is typically the case, the governing law and forum selection clauses of the acquisition agreement and commitment papers differ and the parties elect to litigate the resolution of a dispute involving the occurrence of a material adverse change in different jurisdictions.

⚠️ Judicial Perspective:
The inherent uncertainties, disagreements and essentially fact specific determinations of any evaluation of whether a material adverse change in the business of the target company has occurred are apparent when reading, for example, IBP, Inc. v Tyson Foods, Inc., 789 A.2d 14 (De. Ch. 2001), Genesco v. Finish Line,
07-2137, Chancery Court for the State of Tennessee (Nashville), BT Triple Crown Merger Co., Inc., et al. v. Citigroup Global Markets, Inc. Index No. 08-600899 (N.Y. Sup. Ct. N.Y. County 2008), and Clear Channel Commun's, Inc. et al. v. Citigroup Global Markets, Inc., Cause No. 2008CI04864 (Bexar County, TX). In the Genesco matter, for example, proceedings were engaged in the State of New York with the relevant banks over the terms of the commitment papers and the State of Tennessee over the terms of the acquisition document. Interestingly, the New York proceedings focused on the pro forma solvency of the combined enterprise, while the Tennessee proceeding focused on whether the material adverse change condition had been satisfied. Similarly, the Clear Channel litigation in Texas and New York is another cautionary example of scope of the disputes that can erupt when the choice of law and forum provisions of the commitment letter and acquisition agreement do not correspond.


Commitment letters often include a condition that there has been no material adverse change in the financial markets that would affect the syndication of the loans or the sale of any notes to be issued to finance an acquisition (a so-called "Market Mac"). Such provisions used to be prevalent in acquisition financing commitment papers, but became much less common in 2006 and 2007, only to reemerge in late 2007 and 2008 as lenders started to adopt more conservative lending practices. In a competitive bidding situation, a buyer should ask the lender to remove this condition. A lender will often be willing to do so, subject however to prevailing market conditions and any perceived market dislocations.

[5] Equity Sale Proceeds Have Been Received

The consideration paid in connection with an acquisition routinely involves a combination of debt and equity issuance proceeds. As a result, all commitment letters will require, as a condition to the receipt of the debt issuance proceeds, the contemporaneous receipt of all other funds required to finance the acquisition. In practical terms, commitment letters often require (1) the receipt of a minimum dollar amount of proceeds from the contemplated equity issuance (although it is generally preferable to define the condition as a percentage of the pro forma capitalization of the combined enterprise in order to avoid renegotiations of the commitment letter in the event of a change in the purchase price associated with the acquisition) and (2) at least in connection with the issuance of any preferred equity (which can have attributes that could characterize the preferred equity interest as a debt instrument), that the issuance of the equity be on terms reasonably acceptable to the lender. The terms of the preferred equity often are not fully developed at the time when the acquisition agreement and the commitment papers are executed and, therefore, it is not practically possible to remove the lender's discretion from the commitment letter as it relates to any concurrent preferred equity financing. From the seller's perspective, however, any concerns relating to the availability of any equity proceeds are usually mitigated by the receipt by the seller of a commitment letter from the buyer to provide the equity financing required to consummate an acquisition.

[6] Maximum Leverage Ratio or Other Financial Metric

Lenders providing acquisition financing will condition their financing on evidence that the buyer can satisfy one or more financial metrics, giving pro forma effect to all indebtedness to be repaid or incurred, as the case may be, and any other financial results impacted by the consummation of the acquisition. A pro forma leverage ratio (the ratio of funded debt to EBITDA) is the typical financial metric condition in a commitment letter. When considering whether a pro forma leverage ratio condition is satisfied, the parties often consider whether the calculation of EBITDA should be amended to reflect an add-back to net income for itemized one-time expenses that the parties do not expect to re-occur. An often contentious discussion point is whether the buyer can add back restructuring costs or anticipated cost-savings associated with the acquisition. In the public acquisition context or where the loans and notes to be issued as part of the acquisition are expected to be sold into the public capital markets, the lender will often require that all such adjustments comply with Regulation S-X promulgated by the Securities and Exchange Commission (17 C.F. R. § 210). Regulation S-X provides in relevant part that pro forma adjustments related to the pro forma income
statement of a registrant shall be computed assuming the transaction was consummated at the beginning of the fiscal year presented, and shall include adjustments which give effect to events that are (1) directly attributable to the transaction, (2) expected to have a continuing impact on the registrant; and (3) factually supportable. Further, material nonrecurring charges or credits and related tax effects which result directly from the transaction and which will be included in the income of the registrant within the 12 months succeeding the transaction shall be disclosed separately. 17 C.F.R. § 210. Alternatively, in other circumstances, reference is made to pro forma adjustments reflected in the accounting diligence report that a buyer may have commissioned as part of its diligence of the target.

[7] Receipt of any Required Contractual Consents

The scope of any required contractual consents that will be required to consummate the acquisition is regularly the subject of extensive discussions between the buyer and seller, the results of which are set forth in the acquisition agreement itself. Ideally, there should not be a separate determination by the lender of the contractual consents that would be required to be delivered as a condition to the lender's financing commitment. If given the opportunity to review the definitive acquisition agreement and the related disclosure schedules, the buyer and seller often will take the position that the lender has been given adequate opportunity to investigate and request any incremental contractual consents before it delivers its financing commitment and therefore any incremental discretion given to the lender to require contractual consents not otherwise required by the definitive acquisition agreement is a potential avenue for the lender to exonerate its financing commitment—a result not in the interests of either the buyer or the seller.

[8] Receipt of Any Required Governmental Approvals

All commitment papers will require evidence of the receipt of any necessary governmental approvals that are required to consummate the subject acquisition as well as any governmental approvals required to consummate the contemplated financing.