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Documentation Principles

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To provide for greater certainty and efficiency in documenting the credit agreement, borrowers and the commitment parties will often negotiate pre-determined guidelines regarding documentation, “documentation principles,” in the term sheet. The concept of documentation principles has been generally accepted by commitment parties, particularly in acquisition financings; however, there are meaningful variations in how the provisions may be drafted. Documentation principles are an important factor for the borrower or sponsor in determining which commitment provider should win the mandate for a transaction.

Identifying the appropriate precedent documentation is often the key element of documentation principles. In addition, the level of deference given to the precedent documentation is often a heavily negotiated point. Many sponsors and borrowers will request that the precedent documentation act as a “floor” or “baseline” such that the terms of the financing contemplated under the commitment letter will be “no less favorable to” or “no more restrictive on” the relevant borrower than those contained in the precedent documentation (except as expressly provided in the commitment letter), whereas commitment parties may negotiate for a more relaxed standard of adhering to the precedent such that the parties will give “due regard” to the precedent documentation or that the commitment parties can deviate from the precedent documentation to “reflect market conditions.” Market trend on this point has moved towards treating the precedent documentation as a “floor” with key deviations (if any) specified in the term sheet, such as changes to reflect administrative, agency and operational requirements of the relevant commitment party or specific changes to definitions or covenants, or changes in law. Some sponsors and borrowers have also successfully negotiated that the terms of the financing also take into account borrower-favorable flexibility provided to portfolio companies of other “first tier” private equity sponsors.

A sponsor or borrower may propose a precedent that was previously negotiated with one or more of the proposed commitment parties or in which one or more of the proposed commitment parties have participated. A generic standard of precedent financing transactions may also be requested, without identifying a particular transaction, such as referencing transactions consummated by the sponsor (or its portfolio companies) generally or financing transactions of “first tier” private equity sponsors; however, the commitment parties and sponsor will usually identify a specific transaction in the commitment letter. Often a proposed commitment party will not have been a participant in the requested precedent transaction but will nevertheless be asked to use it. In this scenario, the relevant commitment party (and its counsel) will usually be given an opportunity to review the precedent and make a determination as to whether the precedent is a satisfactory starting point from both a legal and business perspective. In evaluating a proposed precedent, the commitment party should consider whether the precedent transaction “cleared the market” and was successfully syndicated on its terms, in light of other prevailing factors at the time the precedent transaction was consummated, such as the condition of the precedent borrower and its industry and the state of the syndicated loan market and financial markets generally. In a competitive environment, potential commitment parties will be under pressure to agree to use the requested precedent in order to participate in the transaction if one or more competitors are amenable to this approach.

Whether counsel for the borrower-sponsor or the commitment parties will draft the initial credit agreement is also negotiated and provided for in the documentation principles.

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Commonly accepted concepts that are included in documentation principles (with minimal negotiation or controversy) provide that the terms of the financing will:

- be negotiated in good faith and give effect to any applicable SunGard or “certain funds” provisions;
- include modifications as are necessary to reflect the specific terms set forth in the commitment letter and reflect the operational and strategic requirements of the borrower and its subsidiaries in light of their size, industries, businesses and business practices, operations and, increasingly, the proposed business plan;
- only contain the representations and warranties, affirmative and negative covenants, financial covenants and events of default set forth in the term sheet; and
- include appropriate modifications to reflect changes in law or accounting standards since the date of the relevant precedent.

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