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Negotiating Conditions Precedent – Material Adverse Change, Due Diligence and Other Conditions Precedent

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Recall that the definition of a commitment to lend is an agreement to provide financing on certain terms, subject to specified conditions precedent. If the conditions precedent to the financing are not satisfied or waived by the arranger and/or commitment party, the commitment party will not be required to fund. The absence of funding could have disastrous consequences for the borrower who is relying on the availability of financing to achieve its business goals. Conversely, if the borrower has failed to meet the conditions precedent, it probably means something has gone materially wrong in a way that could alter a lender's decision to provide financing to the borrower. Accordingly, both the borrower and the arranger will focus intensely on the conditions precedent section of the commitment letter.

The level of conditionality in commitment letters can vary drastically depending on a number of factors, including the financial and operational condition of the borrower and the condition of its industry, the nature of the financing, the negotiating strength of the parties, and the state of the financial markets generally.

Conditions precedent may include the following:

Company MAC

No event has occurred or condition resulted since a specified date (usually the date of the most recent audited financial statements), that could reasonably be expected to have a material adverse effect on the borrower's business, assets, liabilities, operations, condition (financial or otherwise), results of operations, or prospects.
As a practice tip, the borrower will often negotiate for a narrower Company MAC condition, such as excluding "prospects" from the condition and limiting "operations, condition (financial or otherwise), results of operations" to simply "financial condition and results of operations."

Market MAC
The absence of a disruption or adverse change in the financial or capital markets generally, or in the market for syndicated loans in particular, that could reasonably be expected to impair the syndication of the credit facilities.

The Market MAC condition is often strongly resisted by borrowers on the grounds that it significantly weakens the commitment by subjecting the borrower to the vagaries of the financial markets. Indeed, arrangers may not even include a Market MAC in the first draft of the commitment papers in anticipation of this reaction by the borrower, particularly in the case of acquisition financings or commitments to seasoned financial sponsors or companies with an established track record in the debt markets. However, Market MAC provisions may be appropriate in certain circumstances, and they periodically come into fashion in times of financial uncertainty, such as during the Asian debt crisis of 1998, after the tragic events of September 11, 2001, and in the aftermath of the real estate, securitization and financial market meltdown of 2008.

Even when a Market MAC provision is included in commitment letters, the efficacy of the provision is uncertain. For example, in 2008, a group of banks refused to fund their commitment to Solutia Inc. to finance its exit from bankruptcy.

Solutia filed a complaint against the banks in bankruptcy court. Ultimately, the litigation was settled and resulted in the funding of the banks' commitments. Although no court decision was reached, and putting aside any unique factual circumstances, the Solutia litigation illustrates that lenders should expect to face heavy challenges to any refusal to fund based on a Market MAC condition.

Due Diligence

Completion of satisfactory due diligence by the arranger, including business, legal, tax, and environmental diligence.
The "diligence out" is often resisted by borrowers on the grounds that it raises uncertainty by giving the arranger the ability to withdraw its commitment if some aspect of its due diligence investigation becomes a concern. Conversely, the arranger needs the opportunity to conduct due diligence to its satisfaction to obtain the necessary internal credit approvals for the commitment. In the absence of a due diligence condition, the arranger and its legal counsel and other advisors will need to complete their due diligence before the arranger signs the commitment letter.
As a practice tip, in acquisition financings, a diligence condition is unlikely to be acceptable to the borrower (or the seller), and although a diligence condition may be included in preliminary drafts of the commitment letter it is usually removed when the commitment letter is signed.

No New Information

The arranger has not become aware of any adverse information not previously disclosed by the borrower that is materially inconsistent with the information previously provided.
As a practice tip, borrowers often try to limit this condition on the grounds that it gives the arranger a back-door diligence condition in the event that new information becomes available.

Clear Market

No competing issuances of debt (or sometimes of equity) being offered or arranged by the borrower or its affiliates that could impair the syndication of the credit facilities.
As a practice tip, the arranger may agree to customary exceptions, such as a working capital facility at the subsidiary level, capital lease or purchase money financings, and other ordinary course financings (which, being a different type of financing, are unlikely to impair the syndication of the credit facilities in any event).

Definitive Documentation

The negotiation, execution and delivery of definitive documentation for the credit facilities, such as the credit agreement and any security and guarantee agreements.

Compliance with Commitment Papers

Compliance by the borrower with the material terms of the commitment letter and the fee letter.

Documentary Conditions

The delivery of ancillary documents referred to in the conditions section of the term sheet or in the conditions annex attached to the commitment letter, such as officer certificates, borrowing request, evidence of insurance, corporate organizational documents, good standing certificates, opinions of legal counsel, etc.

Consummation of Transactions

The completion of the underlying transaction, such as an acquisition, refinancing or recapitalization, prior to or contemporaneously with the closing of the financing, including the application of any other sources of capital used in the transaction (such as an equity contribution or the proceeds of other indebtedness).

Specified Financial Conditions

Specified financial conditions relating to the borrower's financial performance on a pro forma basis after giving effect to the financing and the underlying transaction, such as a maximum total leverage ratio or minimum amount of EBITDA.

Marketing Period

The arranger shall have been provided with an agreed time period before closing to market the credit facilities to potential lenders.

As a practice tip, the marketing period will vary on a deal by deal basis, but usually will be 10 to 20 business days. If the syndication is likely to occur during the summer or winter holidays, the marketing period may include blackout dates to avoid having to market the loans during a time when many investors are on holiday. For example, if the commitment letter is signed in July, the marketing period condition will provide that the entire marketing period must have elapsed either before or after the week leading up to and including Labor Day weekend.

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