**Loan Agreement provisions – Purpose, Facility, Conditions Precedent and Fees**

This element starts exploring the provisions in a loan agreement, focussing on the purpose, facility, condition precedent and fees clauses.

Note: Any clause references throughout this element refer to the LMA Agreement. Unless specifically indicated, you are only required to familiarise yourself with the structure of the LMA Agreement. You are **not** required to read the clauses in the LMA Agreement in full.

**Introduction**

Once the terms have been agreed, attention can turn to drafting and negotiating the loan agreement and security documentation (if loan is to be secured).

Although every deal is different and the loan agreement needs to be tailored to the requirements of the transaction, these slides seek to highlight common clauses found in a loan agreement, as a starting point.

If the loan agreement is based on an LMA standard form (which will be the case for most corporate loans) the guarantee(s) (if given) will be incorporated into the loan agreement, so you will not expect to see a separate document for the guarantee(s).

The key clauses of a loan agreement are set out below and will be considered in the next few elements.

Finally, as a more general point, where you have a group of companies and there are separate loans at different levels of the group, this gives rise to the risk of subordination, which will be also be considered at the end of the discussion of clauses in a loan agreement.

**Loan Agreements – overview of key clauses**

**[Flowchart – with “Contents of a Loan Agreement” at the centre with arrows pointing towards the following terms clockwise in order]**

- Facility

- Purpose

- Conditions Precedent

- Governing Law and Enforcement

- Interest and Interest Periods

- Fees

- Withholding tax and tax gross up

- Increased Costs provision

- Representations

- Undertakings

- Financial Covenants

- Events of Default

**Purpose clause (clause 3)**

The purpose behind the loan shapes the transaction. It needs to be consistent with each lending bank’s policy. It also focuses the lender’s mind as to what the documentation must contain in order to protect its position. This clause also restricts the borrower to ensure the funds are used for agreed purposes only.

If there is an obvious violation of the purpose clause, the borrower will be in default and may hold the monies subject to a resulting trust in favour of the lender. This gives the lender an advantage in the event that insolvency follows default, because the money may be deemed to be held on trust for the lender and not to form part of the assets of the borrower on a winding-up *(Barclays Bank Ltd. v. Quistclose Investments Ltd* [1970] AC 567, HL*).*

In practice it is usual for the purpose clause to include a general statement relating to the purpose, for example that the funds must be used ‘towards the borrower’s working capital requirements’ or ‘towards general corporate purposes’.

**Purpose clause**

If the lender knows a facility is for an unlawful purpose, e.g. it will breach government imposed sanctions, then English law will treat the facility as void and unenforceable and will disallow any action to recover the funds advanced. Subsequent illegality of an initially lawful agreement, however, is treated differently and the lender can recover the funds by calling a **mandatory prepayment event** for **illegality** in the loan agreement (see clause 12.1 of the LMA Agreement).

**Facility clause (clause 2)**

Generally, a term loan can be drawn down during a relatively short period of time after the loan agreement is signed (called the ‘commitment’ or ‘availability’ period ). If the borrower does not draw down the funds in that period, the lender’s obligation to lend ceases. Compare this to the position with an overdraft or a revolving credit facility (‘**RCF**’) that can generally be drawn on at any time during the term of the loan, up to the specified loan amount.

In some transactions, the lender will agree to make the money available in a number of separate facilities or tranches (i.e. portions) all in the same loan agreement. Each facility and/or tranche may have different characteristics relating to maturity dates, availability, interest periods and repayment terms.

The existence of more than one facility and/or tranche in the loan agreement will be reflected in the mechanical provisions of the agreement such as the drawdown, repayment and interest provisions. The remaining terms of the agreement, such as representations, undertakings and the events of default, will apply to the agreement as a whole, irrespective of the different facilities and/or tranches.

**Facility clause**

The clauses mentioned below are only found in syndicated facilities:

• **Several obligations (clause 2.4(a)).** Each lender’s obligation to lend under a syndicated loan is several and not joint. As a result, syndicate members are responsible for their commitment only. This means syndicate members do not guarantee that the other lenders will provide their share of the loan. Conversely, the failure of one syndicate member to satisfy its obligations does not allow the others to back out.

• Each lender has a separate right of enforcement (clause 2.4(c)). However, in practice this right is subject to the decision of the Majority Lenders to accelerate the loan (clauses 29.20 ) and to the syndicate members’ obligation to share any amounts received under the pro rata sharing clause (clause 35).

• **Separate loans (clause 2.4(b)).** Legally, each lender agrees to make a separate loan to the borrower up to the maximum amount it has agreed to lend (its **commitment**).

• You might also hear about a lender’s ‘proportion’ or ‘participation’. This is simply the ratio of its commitment against total syndicate commitments. Lenders’ contributions to loan advances and payments of principal and interest made by a borrower are divided amongst the lenders in this proportion.

• For example, a syndicate of banks is put together to provide a borrower with a term loan of £25,000,000. There are 5 banks in the syndicate, each of whom has agreed to lend up to £5,000,000 (their individual commitment). If the borrower decides to drawdown £20,000,000 then each syndicate lender will have a participation of £4,000,000.

**Conditions Precedent (‘CPs’) (clause 4 and schedule 2 Part 1B)**

**Conditions Precedent (or ‘CPs’)** are conditions that a borrower has to fulfil before a lender becomes obliged to lend. A borrower is therefore unable to draw down any funds from a loan until the CPs are either a) satisfied or b) waived by the lender / agent (if a syndicated loan). These are explained below:

**CPs to first utilisation:**

These are mainly documentary in nature and are intended to ensure all legal and certain other matters (such as commercial, regulatory and practical matters) are in order and that, for a secured loan, any security is in place before the lender is obliged to lend any money. For an acquisition finance transaction, the security package granted by the target group companies will be put in place after the acquisition has been funded and completed.

**Further conditions precedent:**

These are also known as 'drawstops'.

It will be a condition to each new advance that certain of the representations (i.e. statements of fact) made on the original signing date are true and correct. These are known as the 'Repeating Representations'.

It will also be a condition to each new advance that no **actual or potential** event of default is outstanding. This applies to all advances under any loan except a 'rollover' loan under an RCF

For a 'rollover' under an RCF, the condition to the further advance will be (less onerously) no **actual** event of default is outstanding.

**Conditions Precedent: Function**

A lender is not obliged to make loan advances immediately upon the signing of the loan agreement – any loan advances are subject to satisfaction of the CPs. The CPs are included in the loan agreement to ensure that all legal matters are in order and that a lender is not obliged to lend if the borrower has become a greater credit risk than when the financial terms were agreed. However, certain fees will accrue from the date of signing so it is not in a borrower’s interests to sign the loan agreement unless it is confident it will be in a position to meet all CPs at the point it requires the monies. Accordingly, the process of agreeing, collecting and approving CPs takes place before the completion date as far as possible.

Very often it is a trainee’s responsibility to organise, agree and check CPs in connection with any loan agreement. If there is an international element to the transaction, this can involve liaising with overseas companies and lawyers.

**Examples of Conditions Precedent**

CPs vary according to the circumstances of the borrower and should be altered for each transaction. The following are examples of common CPs:

- constitutional documents (e.g. the company’s articles);

- **legal opinion(s);**

- insurance policies;

- financial information and auditors’ reports;

- any licences/consents relevant to that borrower;

- board resolutions or other corporate authorisations;

- compliance with KYC (‘know your client’) requirements (although this is normally dealt with internally by the lender’s compliance team); and

- evidence that all fees have been paid.

- Depending on the circumstances of the particular deal there may also be deal-specific CPs, for example in a real estate finance deal (where a property purchase is being financed) there will be property related CPs such as valuation reports, reports on title and environmental reports.

**What is a legal opinion?**

Broadly, a legal opinion is a letter confirming the corporate capacity of the borrower (and, if relevant, any guarantor or security provider) and that the finance documents (i.e. the loan agreement and, where relevant, any security agreement or guarantee) are legally valid, binding and enforceable. It is another way for the bank to reduce the risk of non-payment.

It is usually the bank’s solicitors who will be asked to give the opinion but it may, on occasion, be the borrower’s solicitors. In a bilateral loan the opinion will be addressed to the bank whereas in a syndicated loan it will be addressed to the agent (where the agent is the agent of the syndicate) and may also be addressed to the original syndicate lenders.

The opinion will only apply to matters of law and not of fact. The statements of opinion will often reflect the kind of legal representations given by the borrower in the loan agreement, e.g. that the documents associated with the loan are legally valid and enforceable.

An opinion does not give the bank any assurance that the borrower will be able to service the loan (i.e. pay the interest payments) or repay the loan (capital). It merely offers another level of comfort for the bank by confirming the further legal due diligence carried out on the borrower. It also provides the bank with an alternative course of action if the opinion is incorrect (i.e. against its lawyers).

For the above reason, legal opinions will always contain qualifications limiting the scope of the legal opinions and assumptions as to certain facts by the lawyers providing them.

If the lender is lending to a borrower incorporated in a foreign jurisdiction or a foreign subsidiary of the borrower is granting security over its assets, the lender will require a legal opinion from local lawyers. This opinion will generally cover the corporate capacity of the company in that jurisdiction and the validity of its choice of English law to govern any English law documents it enters into and (to the extent any of the documents entered into by the company are governed by the local law of its country of incorporation) the enforceability of any documents governed by the relevant local law.

**Legal opinions**

**Two situations where legal opinions are invariably required:**

• **Secured lending:** Banks will usually want an opinion to confirm the enforceability of the security, and to outline any risks associated with the security.

• **Overseas jurisdictions:** If the bank is lending to a borrower incorporated in a foreign jurisdiction or is taking security over assets in a foreign jurisdiction (e.g. the assets of a foreign subsidiary of the borrower), the bank will require a legal opinion from local lawyers. This opinion will generally cover the corporate capacity of the company in that jurisdiction and the enforceability, legality and priority of the documents which that company is entering into.

**Conditions Precedent: Lender perspective**

Lender solicitors should suggest and draft appropriate CPs to achieve that lender’s **commercial objectives** based, in particular, on the outcome of its **due diligence process**. CPs are important to the lender as they protect it and reduce its risk by allowing it to withdraw from the loan commitment if something is wrong or if the documentation is not to its satisfaction.

Completed CPs are **evidence** that the borrower’s position is as the credit committee anticipated at the outset of the deal. Lenders commonly demand a letter from their solicitors confirming that each CP has been satisfied (‘CP Satisfaction Letter’).

Notwithstanding the above, the lender / its agent can nonetheless waive a requirement for a CP if it is not capable of being satisfied prior to initial utilisation. The waiver would usually be documented in a CP waiver letter and the lender / its agent may specify that the condition must be met within a certain time period of completion. This condition will then be known as a ‘**condition subsequent’.** It is therefore important that the **CPs are always specified as being in form and substance satisfactory to the lender (in a bilateral loan) or the agent (in a syndicated loan).**

**Conditions Precedent: Borrower perspective**

A borrower will need to **exercise caution** when agreeing to CPs. As the borrower will not be able to draw down funds until CPs are satisfied (or waived), this could be disastrous if the funds are needed on time for a specific project (e.g. to fund an acquisition). therefore, the borrower should seek to have as many CPs as possible satisfied **before the loan agreement is signed**.

The list of CPs should be as **clear and objective** as possible so that the borrower knows exactly what is needed in order to satisfy **each individual CP**. In some circumstances certain CPs cannot be satisfied before the loan agreement is signed, so a borrower would be advised to have as many of such CPs in agreed form before signing.

**Practicalities**

**When drafting or reviewing the CPs, remember to check:**

Timing- Although no contractual time limits, will it be possible to satisfy the relevant CP in the time available before the funds need to be drawn down?

Approval- Who will decide if a CP is met - and are they to act reasonably? This is usually at the lender’s or its agent’s discretion: for example, “in form and substance satisfactory to the agent, acting reasonably”.

Control If third parties are involved (e.g. report providers), what control can be exercised over such parties to get the required information/documents delivered on time?

It is often a trainee’s responsibility to create a list of the CPs on the deal (‘CP Checklist’), including:

· making a list of the CPs in the order as they are drafted in the loan agreement; and

· documenting the status of each individual CP for information.

**Fees (clause 18)**

The fees to be paid by the borrower are set out in a fee clause (and, for syndicated loans, separate fee letter(s)) and usually comprise:

Commitment fee: This fee reflects the cost to the lenders of having set aside money to lend (rather than actually having handed over the money) during the availability period of the loan.

Arrangement fee/participation fee: Only relevant for syndicated loans. The arranger will charge a one-off fee, sometimes referred to as a front end fee, for its role as arranger of the loan. Although the loan agreement specifies that the arranger is to receive a fee, the actual amount of the arrangement fee is set out in a separate fee letter addressed to the arranger so it is kept confidential from the syndicate members

The arranger will decide, as part of the syndication strategy, how much of this fee to share amongst the lenders and how much to keep for itself. The amount each of the other lenders receives, often known as a participation fee, will usually depend on the amount of money that lender has committed to lending. These amounts are set out in the invitation letter sent out by the arranger to solicit banks to join the syndicate.

**Fees**

**Agent’s fee**: Only relevant for syndicated loans. This is the fee paid to the agent for its administrative services. It is normally paid annually but may be paid quarterly in some cases. Similarly to the arranger’s fee, the loan agreement specifies that the agent is to receive a fee and that it is for its own account. The actual amount of the agency fee is not disclosed in the loan agreement, but is set out in a separate fee letter addressed to the agent for the purpose of confidentiality. Note that even though the agent is appointed on behalf of the syndicate lenders it is the borrower that is responsible for paying this fee.

**Underwriting fee:** Only relevant for syndicated loans. This fee is paid to the arranger (and co-arrangers, if any) if a loan is underwritten. As seen previously, underwriting a loan means that the arranger (and co-arrangers, if any) will guarantee to provide the total loan amount to the borrower if it is/they are unable to fully syndicate the loan. This will be paid in addition to the arrangement fee. Again, it will be set out in a separate fee letter between the arranger and the borrower

**Security Trustee fee:** This will be paid by the borrower to the security trustee (or security agent) on a secured deal. Like the agent’s fee, it will be set out in a separate fee letter.

**Summary**

• The Purpose clause sets out what the loan monies can be used for.

• The Facility set out the type of facility the lender is prepared to provide under the loan agreement.

• Conditions Precedent (or ‘CPs’) are conditions that a borrower must fulfil before a lender becomes obliged to lend.

• A borrower is therefore unable to draw down any funds from a loan until the CPs are either satisfied or waived by the lender / its agent.

• The Fees clause set out the fees the borrower will have to pay in connection with the facility, but the actual amount of the fees will be set out in a separate fee letter, to ensure confidentiality from other syndicate members.