

**ACQUISITION INSIGHTS**

# Sellers Beware!

## Three Crucial Terms To Review In Your Buyer's Acquisition Financing

**BY EMILY STORK**

During the frenzied period before execution of an acquisition agreement, a seller will be overwhelmed with pressing tasks, so the terms of the buyer's financing may not be front of mind. There is good reason for this since it is not the seller's debt and many of the financing terms will apply only after the acquisition closes. But there are some terms of a buyer's financing that it is crucial for sellers to review in order to ensure that closing of the deal is as smooth as possible. This article will discuss in-depth three of those crucial terms.

**Conditionality**

Sellers should align the conditions to the financing with the conditions to the acquisition as closely as possible. This limits the chances of a situation in which the parties have completed all conditions to close the acquisition, but the transaction cannot close because the buyer's financing is unavailable due to extra conditionality. (The question of which party bears the risk of such a situation will be hashed out in the purchase agreement, but, regardless of whether there is a financing out, it is still a poor outcome for a seller to invest significant resources into an acquisition that never closes.) By way of example, consider the target material adverse effect condition (referred to as an MAE). The definition of an MAE in an acquisition agreement typically has more exceptions and a more limited scope and duration than in a loan agreement. But, in order to limit conditionality, the definition of target MAE for purposes of the MAE condition to initial funding should mirror the definition in the acquisition agreement.

More generally, it is important to keep financing conditionality as tight as possible within the bounds of reasonableness. Sellers should endeavor to strike or narrow conditions to the financing which are vague or broad or give lenders significant discretion. An example would be a condition to financing that there be no MAE in the lender's discretion. With this condition, there would be potential daylight between the MAE condition for the acquisition and the MAE condition for the financing, which would decrease funding certainty. Another example is when a term sheet provides that a financing is subject to "customary conditions". Sellers should push for lenders to instead specify these customary conditions. Also, the financing term sheet should state that there are no conditions other than those explicitly specified.

Sellers should seek to have a buyer's financing term sheet include "SunGard" provisions. Typically, a financing is conditioned on the accuracy in all material respects of all representations and

warranties on the closing date. But SunGard clauses provide that, with respect to representations and warranties as to the target, funding is conditioned on only the accuracy of a limited set of such representations and warranties, specifically those that, were they not accurate, would be material to the lender and would give the buyer a right to not close under the purchase agreement. These representations and warranties vary depending on the transaction, but typically they include corporate

existence, authority, enforceability, no conflicts, solvency, status of liens, anti-terrorism/anti-money laundering and, in some cases, financial covenant compliance. By limiting and specifying these representations and warranties, SunGard provisions enhance funding certainty. SunGard provisions also replace the condition that security interests on the loan parties' assets be perfected at closing with more limited collateral requirements, which again enhances funding certainty by decreasing conditionality.

**Collateral requirements**

Closing of a secured loan is typically conditioned on perfection of liens on the applicable assets. But completing all the actions necessary to create and perfect such liens by closing can be difficult, particularly in the case of an acquisition financing where the acquiror and target are separate until closing. Collateral tasks such as mortgages, control agreements, delivery of physical collateral, etc., can require a longer time period than that between signing and closing of the acquisition agreement, and certain collateral tasks may be impossible to complete during that period (e.g., delivery of physical collateral of a target that is in the possession of target's existing lender to secure the target's existing debt). Sellers should check the collateral requirements that are conditions to closing to determine whether they are reasonable in light of the desired closing timeline.

The decreased funding certainty caused by broad collateral perfection requirements inspired the SunGard collateral requirement clauses mentioned in the prior section that limit collateral perfection conditions to specified tasks. Those tasks vary depending on the transaction but often are limited to the filing of UCC financing statements, the recording of intellectual property security agreements and, in some cases, delivery of the certificate representing equity of the target. The borrower is still obligated to perform the remaining collateral perfection tasks but is given a specified period of time after closing during which to complete them.



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# Takeaways

- 1** There are certain terms of a buyer's acquisition financing to which sellers should pay attention.
- 2** The conditions to the financing should align with the conditions to the acquisition as closely as possible.
- 3** The collateral requirements that are conditions to the financing must be realistic in light of the desired closing timeline.
- 4** Sellers receiving deferred payments must review certain terms of the buyer's facility, including covenants, delayed draw loan conditions and prepayment terms.
- 5** Even if there is no financing out, no seller wants to put significant resources into a deal only for it to not close due to the financing not closing. Review of the terms of a buyer's financing can reduce the chances of that and make execution as smooth as possible.

By specifying the collateral perfection steps that must be taken, SunGard clauses improve funding certainty and execution of the acquisition.

## Deferred payments

The consideration for many acquisitions includes deferred payments. Sellers receiving deferred payments, particularly payments made from the proceeds of a delayed draw loan under the buyer's facility, must review certain substantive terms of the buyer's facility. The buyer's facility will be subject to covenants restricting the borrower's activities, e.g., a debt covenant (note that deferred payments are typically treated as debt under a loan agreement). Sellers must confirm that the deferred payments are carved out from any such covenants that would otherwise restrict making of the payment. Sellers can mark up the term sheet to include a sentence to the effect of 'Notwithstanding anything to the contrary in this term sheet, deferred payments in the aggregate amount of \$[ ] under [DESCRIBE ACQUISITION AGREEMENT] shall be permitted under this facility'.

If the deferred payments are to be made from the proceeds of delayed draw loans under the buyer's facility, sellers must also examine the conditions to such loans. Ideally there will be limited specific conditions, which will increase the likelihood of buyer being able to incur the loan. Sellers should be aware that lenders frequently condition the borrowing of delayed draw loans on compliance with a leverage ratio, so sellers may need to confirm that, based on pro forma projections, the borrower is expected to comfortably hit this ratio.

In addition, sellers also must confirm that mandatory prepayment provisions aren't triggered by any additional debt to make deferred payments. Also, because deferred payments are treated as debt, sellers should consider priority of payment (and, if such payments are secured, priority of liens) among the deferred payments and any other debt of the buyer and should ensure that such priority is properly spelled out in the term sheet. ▣

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*jurisdiction or circumstances. If you have specific questions as to the application of the law to your activities, you should seek the advice of your legal counsel.*

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