

The Commitment Letter: Roadmap to a Successful Transaction

For as long as lenders have been extending credit to borrowers, commitment letters have marked the first formal step of the lending process between the parties. These initial contracts can take many forms—from a brief outline of key terms to a detailed, multi-page tome, complete with exhibits and addenda. What all properly drafted commitments share, however, is that they provide written evidence of a “meeting of the minds” between and among the parties as to the specific points of the transaction. In whatever form it takes, the ideal commitment letter should serve as a blue print for the lender and borrower to complete the deal with a minimum of uncertainty and misunderstanding.

Start with a term sheet as a cost-effective initial step

Often, lenders will utilize a “term sheet” or pre-commitment to outline the circumstances under which the lender would commit to making the loan. This approach is most frequently used in larger or more complex transactions and serves a number of purposes: (i) it is cost-effective, as it allows the lender to set forth a general framework of the deal for the borrower’s consideration prior to making a more substantial commitment of time and money in preparing (or hiring a third party to prepare) a more formal contract to lend; (ii) it can generally be completed more quickly than a formal commitment, which may provide a market advantage to securing the business; and (iii) it serves to bring to the surface any fundamental issues between the parties that may be deal breakers—better to learn earlier than later.

Once the parties have reached an agreement as to the parameters of the transaction, whether through the use of a countersigned term sheet or simply through verbal negotiation, the formal commitment letter is prepared. The document, which should be countersigned by all obligors to the transaction, will contain the basic terms of the deal:

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In 2011 Shapiro Sher Guinot & Sandler was named the top medium-size law firm in Maryland for “Business & Transactions” by Super Lawyers, a division of Thomson Reuters. The firm represents clients in numerous practice areas, including banking, bankruptcy, corporate, real estate, tax, and commercial litigation.

The firm’s banking lawyers provide experienced counsel in connection with all aspects of commercial loans. Co-chaired by **K. Lee Riley, Jr.** and **Scott W. Foley**, the firm’s **Banking & Financial Services Group** represents regional and community banks, credit unions, finance companies, pension funds, and other financial institutions in Maryland and throughout the Mid Atlantic.

Mr. Riley advises financial institutions in commercial lending transactions; Mr. Foley advocates for financial institutions in commercial loan workouts, restructurings, and bankruptcy proceedings. Because the group has extensive experience in the origination of loans and in workout situations, it is prepared to provide efficient representation at every stage in the commercial lending process. With over thirty years of experience in the banking industry between them, Mr. Riley and Mr. Foley appreciate the potential hazards facing clients in the commercial loan process, and strive to protect lenders’ interests throughout the lifecycle of the loan.

For more information about the Banking & Financial Services Group, contact Mr. Riley at LRiley@ShapiroSher.com or Mr. Foley at SWF@ShapiroSher.com.

loan amount, interest rate, term, amortization of loan, repayment and prepayment provisions, collateral description, unconditional/limited guarantors, purpose of the loan, title and other insurance requirements, financial disclosures, covenants, etc. If the loan involves construction, the letter may also contain provisions regarding disbursement procedures and other construction-related documentation, such as contracts, plans and specs, draw schedules, and the like. Depending on the lender, the commitment may also contain a section that includes certain general conditions that will be incorporated into the final loan documents.

Create a comprehensive checklist that includes all due diligence

One critical document that is strongly recommended to be included with the commitment letter, for the benefit of all parties, is a comprehensive checklist of all documentation and due diligence materials required prior to closing. In addition to ultimately serving as a table of contents for the closing binder, this checklist will serve as a roadmap for the parties to ensure a smoother transaction, particularly if it contains sufficient detail and assigns a responsible party for each item.

For example, "Insurance" is a common checklist item; however, including the types and amounts of coverage, the parties to be named on the various policies, and any notice requirements, will facilitate obtaining the appropriate certificate in a much more cost-effective way. "Lien and Judgment Searches" is another common example of an item that, with a little more attention to detail (e.g., clear descriptions of the jurisdictions to be searched and the full names of the parties to be searched), can provide greater guidance to the party responsible for ordering the information.

In short, a carefully drafted commitment letter, complete with a comprehensive and detailed list of closing documents, will greatly reduce the time, cost and angst associated with completing any commercial loan transaction.

¹ In some instances, courts have determined that loan commitment letters do not constitute binding contracts. Although the test for making this determination differs from state to state, the general rule is that a commitment letter for which a fee is paid is not binding on the lender unless it contains all material terms of loan and either (a) the lender's obligation is unconditional, or (b) all stated conditions have been satisfied. See, e.g., Peterson Dev. Co., Inc. v. Torrey Pines Bank, 233 Cal.App.3d 103 (Cal. App. 4 Dist. 1991). Courts are generally in agreement that the most important factor in distinguishing an enforceable commitment letter from a non-binding "agreement to agree" is the intention of the parties at the time of their entry into the understanding. Loan commitment letters frequently contain language stipulating that the lender's obligation to proceed with making the loan remains subject to, among other things, the approval of its internal credit committee. Under such circumstances, the commitment letter would typically be held to be unenforceable absent evidence that the lender's internal credit committee actually approved the loan. On the other hand, the lender's credit committee will generally be charged with an obligation to use good faith in making its decision.

For more information about the commitment letters and other banking and financial services questions, contact Scott W. Foley at swf@shapirosher.com or K. Lee Riley at lriley@shapirosher.com.