

UPDATE

News of Developments in the Financial Sector and Related Areas

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Bank Failures

During the first nine months of this year there have been 95 bank failures. The FDIC expects bank failures to continue in the coming months. There were 416 institutions with total assets of \$299.8 billion on the Federal Deposit Insurance Corporation ("FDIC") trouble list at the end of the second quarter 2009 reflecting an increase of 111 problem institutions and an increase in assets of \$79.8 billion during the three month period. The FDIC's problem list represents 5% of all insured institutions. Problem institutions are characterized as those institutions having a risk of failing and being closed by the FDIC. This is the largest number of problem institutions since June 30, 1994 and is the largest amount of assets on the list since December 31, 1993. In lieu of assessing institutions as a result of bank failures, the FDIC may borrow money from the Treasury Department and repay the borrowed funds with fees collected from insured institutions.

Information on problem institutions is contained in the FDIC's *Quarterly Banking Profile* which is available on its website at www.fdic.gov.

Letters of Intent

Letters of intent, which are sometimes known as memorandums of understanding or letters of understanding, are generally utilized by parties to a business transaction to set forth the major terms of their understanding prior to the execution of a definitive agreement. Letters of intent may be either binding or non-binding, and it is important that the parties to a letter of intent state their understanding.

A typical provision in letters of intent is a statement that it is not a binding agreement. However, the parties may want to specifically provide that although the letter of intent is not binding on the parties until the execution of the definitive agreement, that certain portions of the letter of intent are binding and enforceable such as (i) the parties will deal exclusively with one another and will not utilize the letter of intent to shop the proposed transaction to third parties, (ii) a confidentiality provision requiring the parties to maintain in strict confidence all confidential information relating to the terms of the proposed transaction and the disclosed information by one party to another, (iii) access to information to determine if the proposed transaction should proceed, commonly referred to as "Due Diligence", and (iv) each party will be responsible for their own legal fees and expenses.

The main purpose of a letter of intent is to summarize the material terms of the proposed transaction and to prevent unnecessary expense in the preparation of

the definitive agreement. In those cases where the parties cannot agree upon the terms of a letter of intent, there is no need to proceed with the effort and expense of preparing a definitive agreement.

A non-binding letter of intent may include material terms such as, the purchase price, the assets involved in the transaction, closing conditions, date for closing, and other terms which may also be in the definitive agreement. Besides setting forth the key elements of a proposed transaction, a letter of intent provides a sense of assurance that each side is committed to moving forward with the proposed transaction. The letter of intent needs to be signed by the parties to the proposed transaction.

In connection with the execution of a letter of intent by the parties, courts have recognized the obligation of each party to act in good faith in attempting to negotiate a definitive agreement. Some years ago after signing a letter of intent to merge with Pennzoil, the Getty Oil board of directors backed out of the deal and merged with Texaco because Texaco had made a better offer. When litigation arose over the obligations of the parties to the letter of intent, the jury in the case awarded Pennzoil over \$10 billion in compensatory and punitive damages with the case being ultimately settled by the parties for approximately \$3 billion. As a result, even though certain terms and conditions of a letter of intent are not binding and enforceable, each party needs to deal in good faith when entering into a letter of intent.

Loan Commitments

There are substantial differences between binding loan commitments and letters of intent. A letter of intent is generally a non-binding letter or term sheet issued by the lender which states a general understanding of the terms of intent to negotiate and enter

into a loan transaction. These letters of intent issued by lenders are more likely to make a loan subject to various conditions such as (i) preparation of loan documentation, (ii) acceptable financial information of the borrower, (iii) security and collateral for the loan, (iv) appraisals, and (v) due diligence such as environmental inspections. Suggested language in a non-binding letter of intent would include (i) this is a non-binding loan commitment, (ii) this is not a commitment to lend, or (iii) this is a proposal for a loan only.

A binding loan commitment letter will generally include a commitment fee that is paid by the borrower when the lender issues the commitment letter. The lender receives the fee based on its commitment to set aside capital or allocate capital to make the loan. The commitment fee will in most cases be non-refundable regardless of whether the loan closes or not. A borrower will generally be required to accept the binding commitment letter within a specific period of time, or it will otherwise expire. Once the borrower has signed the commitment letter it will expire at a specified time. In those cases where a binding commitment letter has an expiration date, the borrower will want to be sure that it is extended if the loan transaction has not closed prior to the expiration date. Suggested language to include in a binding loan commitment is (i) this is a binding commitment from the lender to lend funds to the borrower, or (ii) this loan commitment is binding on the lender. A loan commitment must contain the essential terms such as (i) the loan amount, (ii) the interest rate, (iii) the repayment terms, (iv) collateral for the loan, (v) the closing conditions, and (vi) any other agreements between the borrower and the lender.

In negotiating a commitment letter, both the lender and the borrower should have a clear understanding whether it is binding or non-binding.