External Legal Counsel as Transaction Cost Engineer and its Influence on Loan Contract Design and Performance

Peter Pope
Bocconi University
peter.pope@unibocconi.it

Peeyush Taori
University of Hong Kong
peeyusht@hku.hk

Roberto Vincenzi
Bocconi University
roberto.vincenzi@unibocconi.it

We investigate whether external legal counsels (ELCs) affect the design and performance of syndicated loan contracts. Using a dataset of ELCs representing both borrowers and lenders in the U.S. syndicated loan market and fixed effect models, we find that ELCs explain significant variation in loan contract characteristics, including loan spreads, covenants intensity, and covenants strictness. To understand one of the potential channels through which ELCs exert their influence, we explore the role of ELCs acting as *transaction cost engineers*. We find that connected ELCs, i.e., ELCs advising the lender (borrower) and with a recent working relationship with the borrower (lender), reduce information asymmetries between the two sides of the transaction, thus lowering interest spreads as well as the intensity and the strictness and of loan covenants. Furthermore, we document that ELCs affect future loan performance—loan contracts with connected ELCs are less likely to be downgraded or experience default.

Keywords: Syndicated Loans, Debt Contracts, Debt Covenants, Banks, Law Firms, Information Asymmetry

We thank David Reeb and Regina Wittenberg-Moerman for helpful discussions.

1. Introduction

Syndicated loans vary in features such as maturity, interest spread, and covenant intensity. Syndicated loan contractual features are tailored during the negotiation process by the borrowing and lending firms and are significantly affected by market factors (Ball, Bushman, and Vasvari 2008; Murfin 2012; Ivashina and Sun 2011; Murfin and Pratt 2019). In addition to the lender and the borrower, external legal counsels (ELCs) that consult the parties involved in the deal are frequently present in the syndicated lending process. A widely assumed view is that ELCs primarily review the legal documents for the loan and, therefore, do not provide any material and independent inputs to contract design (Semkow, 1984; Ryan, 2008). Additionally, ex-ante, the scope of an ELC affecting contract design seems limited because of the highly competitive nature of the syndicated loan market and one would expect that the contractual features are driven by the characteristics of contracting parties and the market factors. However, ELCs are sophisticated entities that are hired by firms in complex strategic and financing events such as M&A and IPO for their specialized services (Krishnan and Masulis, 2013; Moran and Pandes, 2019). In the syndicated lending market, ELCs specifically work with several banks and borrowing firms and assist them by bringing their network as well as their prior industry and business experience. During the negotiation process, ELCs also interface with the managers of borrowers and lenders, the internal legal counsels (ILCs) of both contracting parties, and the ELC of the counterpart, thus potentially gathering soft information that is not available otherwise to the borrower and the lender. Finally, ELCs have a fiduciary duty toward safeguarding clients' interests and face significant reputational and legal concerns for the activities in which they are engaged. Failure to do so can result in significant financial penalties and reputational damage for the ELC (Stradley 2015). As a result, because of their unique knowledge, interactions, fiduciary duty, as well as significant reputational and legal exposure, ELCs can play an important role in the design of syndicated loan contracts.

In this paper, we empirically investigate the role of ELCs in the syndicated loan market. Using a large sample of data on the identities of ELCs, we explore several novel research questions around the influence of law firms on loan contracting choices and on the economic mechanisms that shape such lending outcomes. Specifically, we seek to address the following questions: *i*) Do ELCs have an impact on loan contract design that is incremental to the influence of market factors, borrower, and lender characteristics? *ii*) If ELCs do have an impact, then what is the potential mechanism of this effect, and which are the consequences of their involvement?

We provide evidence that ELCs significantly shape the design of syndicated loan contracts incrementally to the influence of borrowers and lenders documented by extant research (e.g., Christensen and Nikolaev 2012; Demerjian and Owens 2016; Li, Vasvari, and Wittenberg-Moerman 2016). In order to understand one of the potential mechanisms through which this effect manifests, we hypothesize and find that ELCs play an important role as *transaction cost engineers*. Specifically, under the transaction cost engineer role, ELCs reduce information asymmetry between contracting parties by providing soft information that might not be available through traditional channels. We additionally find that the role of ELC is more crucial when information asymmetry is high. Finally, if ELCs reduce information asymmetry at the outset, then this should result in better loan performance in the future. We show that loans in which ELCs have more scope to reduce information asymmetries have a better performance in the long-term—i.e., they experience fewer defaults and are less likely to be downgraded.

We begin our analysis by addressing whether ELC matters for syndicated loan design. Our primary specifications rely on a large sample of deals for which the ELCs advising the bank syndicate and the borrower are identifiable. Given the decision to involve an ELC in the structuring of a deal may not be exogenous to the lending outcomes, we mitigate this concern by limiting our empirical analyses to loans in which both ELCs are observable. Following Bertrand and Scholar (2003), we then exploit the involvement of ELCs in multiple deals to estimate how much variation in contracting

outcomes is due to individual ELCs. With this in mind, we restrict our sample to ELCs interfacing with multiple borrowers and lending banks, borrowers involved in multiple syndicated loans, and banks originating multiple deals. This empirical choice allows us to include multiple sets of fixed effects that absorb various sources of unobserved heterogeneity potentially leading to a non-random assignment between ELCs and syndicated loans. The merit of this approach is that if individual ELCs explain some of the variations in lending outcome over and above borrower and lender fixed effects, then one can infer that individual differences across ELCs are important to syndicated loan contracting. To develop our fixed effects model, we look at multiple dimensions of loan contract features including their pricing and covenant design. We find that borrower and lender ELC fixed effects jointly explain more than 5 percent of the variation in the number and the strictness of loan covenants, after controlling for borrower, lender, and loan time-variant and invariant characteristics. Importantly, to contextualize the relative economic importance of our findings, we show that ELC fixed effects explain at least twice as much of the within-borrower variation in covenant design choices as explained by lender fixed effects. We also find that ELCs have some, although more limited, effects on loan pricing. We test the significance of these results using a simulation approach (Fracassi, Petry, and Tate 2016; Bushman, Gao, Martin, and Pacelli 2021) that randomly allocates ELCs to the loans in the sample and generates a distribution of adjusted R-squared and F-statistics values. Results from this placebo analysis corroborate the statistical significance of our estimates and indicate that the incremental explanatory power of ELC fixed effects is not due to a mechanical over-fitting of the baseline model but to the underlying time-invariant influence exerted by law firms participating in the syndicated loan market. Additionally, in order to ensure that the marginal contribution of ELC fixed effects is not driven by the order in which predictor variables enter the regression, we conduct a Shapley (1953) value analysis by computing the average contribution of each predictor variable to the total adjusted R-squared in the regression. We continue to find similar results. Overall, we provide robust evidence that ELCs have a significant role in affecting loan contract design.

Next, we aim to understand one of the potential mechanisms through which ELCs can influence loan contracting. Legal and economics literature suggests that a legal counsel plays three primary roles when performing her duties—client advocate, gatekeeper, and transaction cost engineer (Gilson 1984; Gordon 1990; Haskell 1998; Coffee 2003; Davis 2003). Under the client advocacy role, a legal counsel undertakes actions that best serve their client's interests. In their second role as gatekeepers, ELCs would be more likely to serve the public interest. Finally, ELCs acting as transaction cost engineers bring soft information that is not available otherwise, thus reducing transaction costs between uninformed contracting parties and increasing the value of a deal. While the gatekeeper and advocacy roles of legal counsels are more relevant in situations of corporate disclosure and financial reporting (Bozanic, Choudhary, and Merkley 2019), the transaction cost engineer role primarily relates to the dimension of value addition that ELCs can bring to complex financing transactions. Hence, we study whether ELCs act as transaction costs engineers in the context of syndicated lending. To empirically capture ELCs' ability to facilitate the exchange of soft information between lenders and borrowers, we define a measure of law firm connectedness that identifies those ELCs serving one entity in a loan while also having a recent advising relationship with the entity's counterpart.[1] Consistent with the transaction cost engineer channel, we find that when a connected ELC is involved in a deal—either on the borrowing or the lending side—loans are issued at a lower interest rate and with a more flexible covenant schedule, thus reflecting a smoother information flow between contracting parties. The economic magnitude of our results is material since we show that the involvement of a connected ELC is associated with an 8% average decrease in loan spreads and covenant intensity and with an 18% average reduction in covenant strictness, relative to the sample mean.

[1] For example, a *connected* ELC advising a borrower currently would have served as an ELC for the lender previously, and vice versa.

We then perform cross-sectional analyses to identify situations under which the role of connected ELCs is more important. If a connected ELC reduces information frictions between borrowers and lenders, then connected ELCs would be more important for loan design when information asymmetry is high. Following related literature (e.g., Hollander and Verriest 2016; Bushman, Williams, and Wittenberg-Moerman 2017), we proxy for information asymmetry using the geographical distance between a lead arranger and a borrower and the relationship status of the lead arranger (relationship vs. non-relationship lender). We find that connected ELCs play a more prominent role in setting loan contract terms when information frictions between contracting parties are high. Specifically, we show that the involvement of a connected ELC more significantly reduces loan spreads and relaxes covenant schedules when loans are syndicated by a non-relationship bank. We find similar results for covenants and strictness when the loan is initiated by a remote lead arranger. In additional cross-sectional analysis, we observe that the influence of connected ELCs is more prominent when lenders have a reduced ability to screen and monitor borrowers directly and, thus, when lenders are more likely to rely on the information transferred by the ELCs involved in the deal. Specifically, we document that the presence of a connected ELC more substantially reduces loan spreads and relaxes covenants strictness when the lead arranger of a syndicate has less experience in the loan market. We finally provide some, albeit less strong, evidence that ELCs more significantly affect lending terms when borrowers' in-house legal counsels (ILCs) have a less prominent role thereby arguably being less influential in their advisory role to executives and directors.

Having shown that time-invariant ELC characteristics impact loan contracting outcomes and an economic channel that may explain the influence of law firms on loan terms—i.e., ELCs acting as transaction cost engineers—we finally turn our attention to the potential consequences that ELCs have on ex post loan performance. By reducing information asymmetry, ELCs can help screen better-quality loans. Ceteris paribus, one would expect that loans with lower information asymmetry at contract initiation will perform better in the future. We document that loans issued with the involvement of connected ELCs are less likely to be downgraded or experience a default. This finding

suggests that lenders benefit from superior screening and monitoring potential through the information transferred by connected ELCs. Overall, by investigating ex post loan performance, we provide additional evidence corroborating the notion that ELCs facilitate the transfer of soft information between the parties negotiating a syndicated loan.

In additional robustness analysis, we test whether the influence of ELCs on lending terms becomes more prominent when borrowers experience a shock to their information environment. Specifically, if financial accounting information becomes less informative to creditors we should expect the transaction cost engineer role of ELCs to become more significant as the ELC would be able to bridge the increasing wedge in information asymmetry. Following Amiraslani (2017), we look at the impact of 2006 judicial decisions that reduced directors' duties to creditors for borrowers incorporated in Delaware, thereby diminishing creditors' rights and the credit relevance of borrowers' financial information. Based on this arguably exogenous change, we find that ELCs are significantly more important in affecting the loan contract terms when information frictions between contracting parties become more severe.

Our study contributes to multiple streams of literature. First, we add to the literature on loan contract design and performance. The syndicated loan market is highly competitive and contract design is a very specialized activity. Features of syndicated loan contracts are primarily driven by borrower characteristics and characteristics of the syndicate underwriting the loan (e.g., Costello and Wittenberg-Moerman 2011; Ma, Owens, Stice, and Wang 2021). Bushman et al. (2021) document that loan officers have an incremental impact on loan contract design and performance that is independent of borrower and lender characteristics. Similarly, Herpfer (2021) shows that personal relationships have an important impact on the syndicated loan market. We extend this literature by showing that ELCs also play an important role in the design and performance of loan contracts. While borrower, lender, and individual loan officer characteristics are directly associated with either of the

transacting parties, the influence of ELCs on contract design is interesting because ELCs provide their services to multiple borrowers and lenders and are not exclusively associated with a single entity.

Our second contribution is to the growing stream of literature on the role of legal experts in financial markets. De Franco, Vasvari, Vyas, and Wittenberg-Moerman (2020) study covenants similarity in the bond market and find that bonds issued by firms advised by the same legal counsel have similar restrictiveness. Earlier studies have also looked at the influence of internal legal counsels (ILCs) on financial reporting (Kwak, Ro, and Suk 2012; Bird, Borochin, and Knopf 2014; Maydew and Venkatachalam 2015). These studies primarily find that more prominent ILCs lead to better financial reporting quality and improved firm transparency. Recently, researchers have also looked at the role of ELCs. Bozanic et al. (2019), for instance, study the effect of external securities lawyers on companies' disclosure decisions by investigating SEC comment letter inquiries. They find that securities lawyers play both a client advocate role as well as a gatekeeper role in this context. By studying stock option backdating amongst firms, Dechow and Tan (2021) document that connections between law firms contribute to the spread of accounting practices. We add to this literature by examining an additional and previously unexplored role of ELCs—that of transaction cost engineers. While the gatekeeper and advocacy roles of legal counsels are more relevant in standard situations of disclosure and financial reporting, the transaction cost engineer role relates to the dimension of value addition that an ELC can bring to complex transactions, such as syndicated loans. Specifically, where information asymmetry between borrowers and lenders is high and deal structuring is complex, ELCs can bring in their soft knowledge and network to reduce information frictions and improve the loan contract characteristics.

The rest of the paper is structured as follows. Section 2 discusses the institutional background related to syndicated lending and the role of legal experts in financial markets. We develop hypotheses in Section 3 and empirical design in Section 4. Section 5 discusses the results of empirical analysis and Section 6 concludes.

2. Institutional Background

2.1 The Syndicate Lending Market

The corporate syndicated loan market in the U.S. is worth more than $4 trillion and is characterized by significant competition and involvement of institutions such as banks, rating agencies, and corporate borrowers (Sufi, 2007; Ivashina, 2009).

Syndicated loan contracts are generally tailored to meet the borrower's needs. Amongst the factors that affect the design of such contracts, borrower characteristics are documented to be the primary determinants of loan contracts. A large body of the literature indicates that loans are characterized by a larger number of covenants, stricter covenants, and higher levels of collateral when borrowers have more credit risk and lower accounting quality (e.g., Berlin and Mester, 1992; Sufi, 2007; Bharath, Sunder, and Sunder 2008; Ball et al., 2008). In addition to borrower characteristics, studies have also shown that features of the loan syndicate as a whole affect loan contract characteristics. For instance, borrowers pay a higher loan spread when information asymmetry is high between the lead bank and other syndicate participants (Ivashina, 2009). Additionally, market forces such as general interest rate spreads also play a role in contract outcomes (Ivashina and Sun, 2011; Murfin and Pratt, 2019; Carvalho, Gao, and Ma 2020). More recently, research has focused on the supply-side determinants of loan contracting features. Ma et al. (2021) indicate that lead arrangers have a style in debt covenant design that persists over time. Bushman et al. (2021) and Herpfer (2021) add to this finding by showing that the loan officers involved in the private debt market exert their personal influence when designing the characteristics of a loan.

In a syndicated lending transaction, the legal counsel is hired by the contracting parties to prepare credit documents, advise in the negotiation process, conduct a legal review of the transaction, and coordinate with other legal counsel such as the counterparty legal counsel, the in-house legal counsel (ILCs) and the counsel hired by individual members of the syndicate. Both borrower and lender can appoint their individual ELCs. From the perspective of a lending syndicate, the ELC hired

by the lending syndicate represents the interests of the entire syndicate although the ELC will primarily report to the lead arranger. During the drafting of credit documents, it would be the responsibility of the ELC to review and address concerns and comments raised by individual members of the syndicate. While the services of an ELC are generally solicited at the start of the negotiation process, they continue to engage with the lender and the borrower even after the closing process—i.e. when the legal contract is agreed upon and signed upon by both parties (Reade, 2009).

2.2 The Role of Legal Experts in Financial Markets

There is growing literature on the role of legal counsel in financial markets. While initial studies focused on the presence of in-house legal counsels (ILCs), recent studies have also looked at the ELCs a firm hires for a specific activity such as acquisitions and securities offerings. In general, firms will have both ILCs and ELCs to address different requirements. Firms will more likely develop in-house legal counsel capability if they face a certain requirement regularly and will choose to hire ELCs when such requirements are sporadic in nature (Morse 2004). While general counsel will help the firm in a number of generic matters such as intellectual property, employment-related contracts, and litigation, external counsel is often hired when a firm seeks the opinion of lawyers with specific technical expertise.

Researchers have looked at the roles legal counsel play in settings such as compensation, audit, and disclosure decisions. Most of the studies have examined whether legal counsel—either internal or external—provides client advocate or gatekeeper roles. In general, studies have found evidence consistent with legal counsel providing a gatekeeper's role where they help improve the financial reporting quality of firms (e.g., Kwak et al. 2012; Bird et al. 2014; Hopkins, Maydew, and Venkatachalam 2015). An exception to this is Hopkins et al. (2015) who find the opposite results. Brooks, Hairston, Njoroge, and Ryou (2020) study the impact of general counsel on audit outcome activities and find that presence of a general counsel in top management is positively associated with

audit effort. Firms typically do not provide information about legal counsel in their filings so it is challenging to identify legal counsel directly. To address these limitations, prior research has used proxies such as board members who have law degrees (Krishnan, Wen, and Zhao 2011) or whether a general counsel is among the top-paid executives in the firm (Kwak et al. 2012; Bird et al. 2014).

While earlier studies focused on the role of ILCs, there is relatively less evidence on the role of ELCs (Hanley and Hoberg, 2010; Hanley and Hoberg, 2012; Dechow and Tan, 2017; Bozanic et al., 2019; Drake et al., 2020). Hanley and Hoberg (2010) document that legal fees charged by lawyers are significantly associated with the information content of S-1 filings filed by firms going public. Bozanic et al. (2019) focus on the setting of SEC comment letter inquiries to address whether external securities lawyers act as client advocates or gatekeepers in guiding disclosure decisions of firms. Although the paper largely provides evidence of the advocacy role—through disclosure resistance and issuance of fewer amendments—authors also suggest that ELCs play a gatekeeper's role in case of complex inquiries. Dechow and Tan (2020) study the effect of law firms on executive compensation decisions and find that law firm connections play a role in defining spreading accounting practices among firms.

Overall, studies have documented that legal experts provide both client advocate and gatekeeper roles for firms. The net effect is in guiding the financial reporting and disclosure practices of firms. In addition to the two roles mentioned above, legal experts also play the role of transaction cost engineer (Coffee 2003). This role is most pertinent in situations where legal experts guide firms in structuring complex deals such as acquisition and securities offerings (Gilson, 1984; Bernstein, 1995). In syndicated loan transactions, where information asymmetry between borrowers and lenders can be high and deal structuring can be complex—especially when the borrower and lender enter into a new relationship—ELCs can bring in their soft knowledge to reduce information asymmetry and improve the loan contract characteristics

Within this literature, the paper closest to our study is De Franco et al. (2020) who find that the covenants on bonds issued by firms advised by the same legal counsel have similar restrictiveness.

Our paper differs from De Franco et al. (2021) in several dimensions. First, while De Franco et al. (2020) focus on a specific feature of bond securities (i.e., the similarity of covenant restrictiveness), we study the influence of ELCs on a diverse set of contractual outcomes (e.g., pricing, covenant strictness and numerosity, and loan performance). Second, we study the role of ELCs in the loan market rather than in the bond market. The syndicated loan market presents a very different setting compared to the bond market. Since syndicate loans and loan issuers are characterized by higher information opaqueness than bonds and bond issuers, it is not clear ex ante if the role of an ELC is important in the syndicated loan market. Third, and most importantly, we document a novel economic mechanism though which law firms exert their influence. In particular, we show that connected ELCs can transfer soft information between the lending and the borrowing side of a deal thus reducing contracting friction and ultimately affecting contractual outcomes.

3. Hypothesis Development and Cross-Sectional Predictions

3.1 Do ELCs Matter in the Design of Syndicated Loan Contracts?

We first seek to understand whether ELCs play any role in the design of syndicated loan contracts. The syndicated loan market is highly competitive and loan contract terms are primarily dictated by the characteristics of borrowers and lenders. Ex ante, it is not apparent whether an ELC would have any role to play in the design of loan contract terms. On one hand, ELCs have significant responsibilities in safeguarding and protecting the interests of their clients including, but not limited to, steps to ensure that contracts are drafted in a manner such that they will protect bank's collateral in event of defaults and shield borrower's independence from creditor control rights. Additionally, legal counsels also advise clients about bargaining power, strengths, and credit weaknesses. Through their experience, law firms would also be likely aware of the common practices prevalent in the industry and can advise the lender and the borrower accordingly when they are drafting the contract terms. Anecdotal evidence suggests that failure to do their job properly can result in loss of clientele

or lawsuits by firms engaging services of ELCs (Stradley 2015). Considering the significant responsibilities, reputational and financial risks, and close interactions that ELCs would have with lenders and borrowers when drafting contracts, it can be expected that legal counsels will bring in expertise and knowledge that can significantly affect the terms of a loan.

On the other hand, if the primary responsibility of an ELC is to conduct a legal review of the transaction, then we would expect that ELCs do not materially affect the terms of loan contracts. A widely assumed view is that ELCs primarily draft and review the legal documents for the loan and, therefore, do not provide any material and independent inputs to contract design (Semkow, 1984; Reade, 2009). Given the highly competitive nature of the syndicated loan market, lenders and borrowers might not necessarily utilise the expertise of ELCs in affecting loan outcomes. While firms hire ELCs for their expertise, such expertise might primarily emanate from the viewpoint of legal due diligence and might not have any impact on loan terms. Thus, it is not clear ex ante whether ELCs have any role to play in the design of loans. In the absence of a clear prediction, we state our first hypothesis in the null form:

H1: ELCs do not have any effect on syndicated loan contract design.

3.2 How Do ELCs Matter? The Transaction Cost Engineer Role

Empirical evidence on the first hypothesis can help us understand if ELCs have a significant impact on the design of loan contract terms. We next aim to improve our understanding of how ELCs can have an influence. Arranging a syndicated loan is an economic activity that is driven by significant information asymmetry that leads to transaction costs. Such transaction costs can manifest —to both parties—in the form of loan spreads and covenants that are less than optimal but are nevertheless introduced because of information asymmetry. Legal and economics literature suggests that a legal counsel plays three primary roles when performing her duties—client advocate, gatekeeper, and transaction cost engineer (Gilson 1984; Gordon 1990; Haskell 1998; Coffee 2003;

Davis 2003). While prior studies have explored the client advocacy and gatekeeper roles of ELCs, the transaction cost engineer role of an ELC is largely unexplored. Under a transaction cost engineer role, ELCs are viewed as adding value to complex transactions by reducing information asymmetries between counterparties, designing optimal contract structures, and by providing specialized skills and soft information that is otherwise either not available or unverifiable or too costly to acquire (Bernstein 1995). By playing this role, ELCs can help design efficient loan structures that can bridge the gap between an optimal contract and an actual one. Due to the nature of their function, ELCs work closely with multiple clients over time and would be privy to soft information that is otherwise not captured by alternative souces. Based on this argument, we posit that ELCs can help reduce frictions between transacting parties by facilitating the flow of soft information through their inter-company network. Specifically, we expect that if an ELC has served a lender (borrower) before and is now advising the borrower (lender), then the ELC can help reduce information frictions by facilitating the flow of soft information between the two sides of the deal. Based on this discussion and on the well-known argument that reduction in agency problems can lead to better contractual outcomes (e.g., Jensen and Meckling 1976), we state the second hypothesis:

H2: A connected ELC helps reduce information asymmetry between a borrower and a lender and leads to better loan contract terms. In other words, as a result of decreased information asymmetry through connected ELC, lenders can charge lower interest rates and loosen covenant restrictions to signal lower screening and monitoring costs and increased confidence in the borrower.

3.3 Severity of Information Asymmetry and the Relative Importance of ELC

Information asymmetry plays an important role in affecting contract terms. When information asymmetry is high, it is optimal for lenders to set tighter covenant restrictions and higher interest rates since such a form of restrictiveness helps lenders prevent wealth transfers to shareholders and maintain stronger decision rights (Garleanu and Zwiebel 2009). Under the transaction cost engineer

role, an ELC can reduce the information asymmetry between borrowers and lenders by providing soft information that is incremental to the information available to contracting parties. Thus, in the cross-section, we would expect ELCs to have wider scope in affecting loan contracting terms in situations characterized by higher information frictions**.** Specifically, we would expect the results to be stronger when information asymmetry between borrowers and lenders is high.

3.4 Lender Experience and the Relative Importance of ELC

In a syndicate lending relationship, the lead arranger plays an important role of screening (Diamond 1984; Diamond 1991). Studies have shown that more experienced and reputed lead arrangers are better at reducing adverse selection problems. On the other hand, inexperienced lead arrangers might not have the in-house resources and capabilities to screen borrowers (Ma et al. 2021; Bozanic et al. 2021). If ELCs add value to a deal beyond the duties of legal compliance, then this expertise would be more valued by clients who have relatively less experience in the syndicated loan market. In other words, ELCs are more likely to complement the capabilities of inexperienced than experienced lenders by providing specialized knowledge and additional soft information that helps lenders in drafting contracts. Based on this argument, in the cross-section, we would expect that the ELCs' role of transaction cost engineer is valued more by lead arrangers that are less experienced and have fewer resources compared to more experienced banks.

3.5 Do ELCs Affect Future Loan Performance?

As long as the soft information provided by connected ELCs decreases information frictions between contracting parties, lower information asymmetry should affect not only loan contract design but also future loan outcomes (Bolton, Freixas, Gambacorta, and Mistrulli 2016; Gopalan, Nanda, and Yerramilli 2011). Following lower adverse selection problems through the presence of connected ELCs, lenders should be able to more efficiently assess borrowers' credit risk thus granting loans to

firms characterized by a stronger expected economic performance. Hence, we expect that loans involving a connected ELC should, on average, experience lower downgrades and default rates. Based on these arguments, we present our final hypothesis:

H3: Information asymmetry reduction by connected ELCs affects future loan performance outcomes.

4. Empirical Approach

4.1 Data and Sample Construction

We obtain ELC data from DealScan. Our initial sample comprises 126,989 facilities issued in the U.S. over the years from 1995 to 2021. We require key loan contractual variables to be available from the same database and borrower characteristics to be provided in Compustat. The Dealscan-Compustat link is performed using the linking table from Chava and Roberts (2008). This results in 25,634 observations. We also require the primary ELCs advising the lead arranger (*Law Firm Lender Primary*) and the borrower (*Law Firm Borrower Primary*) to be jointly observable.[2] Information on ELCs is occasionally missing from the DealScan database accessible via WRDS while is provided when accessing DealScan directly from the Refinitiv platform. We manually check observations with missing ELC information in WRDS and supplement it with data from Refinitv when possible. Finally, we restrict our analysis to borrowers that issued at least two loans and to ELCs serving at least two borrowers or at least two lead arrangers to accommodate our baseline fixed effect structure.[3] This process results in a sample comprising 5,217 facilities (Table 1, Panel A). Since there are instances in which we observe more than one ELC acting as the primary legal counsel of the borrower or the

[2] The results of our primary analyses are robust to an alternative approach which requires that *either* the ELC of the lender *or* the ELC of the borrower is observable. Please see the Appendix.

[3] Following deHaan (2021), we form our baseline sample by dropping obvious singleton observations. As shown in the following Tables, a varying number of additional singletons are dropped from the models depending on the specification and the fixed effect structure employed. Our results are qualitatively similar when we do not drop singleton observations.

lead arranger, our baseline regressions are estimated on a final sample of 6,102 loan facility-lender's ELC-borrower's ELC observations.[4]

Table 1, Panel B, reports the primary summary statistics describing our sample. The median loan amount equals $250 million and the median loan maturity is 60 months. The median loan in our sample carries an interest spread of 200 basis points above the LIBOR and contains 2 covenants. The median borrower in our sample has a leverage ratio of 31%, total assets of $1.7 billion, and a tangibility ratio of 24%. The median value of borrower loan experience is 5 thus suggesting that the median borrower in our sample has made use of syndicated loans 5 times. In general, summary statistics indicate that the borrowers and the loans that we include in our analysis are comparable to the ones in related recent studies (e.g., Lou and Otto 2020; Cohen, Li, and Lou 2022) that do not require the availability of information on ELCs. Consequently, our sample is not significantly skewed by this specific data requirement.

Table 1, Panel C reports correlations amongst the variables. Borrower loan experience is positively correlated (0.369) with firm age and is negatively associated with covenants count (-0.144) and covenants mix (-0.069). The presence of a connected ELC in a deal (*ELC Connected*) is positively correlated with loan size (0.190) and the size of the borrowers (0.179) while is negatively correlated with loan spread (-0.150), covenant numerosity (-0.167) and covenant strictness (-0.182).

4.2 Research Design and Variable Measurement

Our investigation of the role of ELCs on loan contract design choices starts with the following set of regressions:

$$Loan\ Term_{ijltab} = \alpha + \beta_1 X_{it} + \beta_2 X_j + \sum \gamma_k + \epsilon_{ijbtab} \quad (1)$$

$$Loan\ Term_{ijltab} = \alpha + \beta_1 X_{it} + \beta_2 X_j + \sum \gamma_k + \theta_a + \theta_b + \epsilon_{ijbtab} \quad (2)$$

[4] As in Bushman et al. (2021), we conduct our analysis at the facility level since several of the lending terms that we investigate vary across facilities within the same loan package.

where *i* indicates the borrower, *j* indicates the loan facility, *l* indicates the lead arranger, *t* indicates the time, *a* indicates the primary ELC advising the borrower, and *b* indicates the primary ELC advising the lender. X_{it} denotes a range of controls capturing the characteristics of the borrower at the time when the facility is issued (*Size*, *Age*, *Profitability*, *Tangibility*, *Market-to-Book*, and *Leverage*). X_j captures specific characteristics of the facility (*Spread*, *Loan Size*, *Maturity*, *Covenants*, and *Collateral*). γ_k are borrower, year, loan type, rating, and lead arranger fixed effects capturing time-invariant characteristics that may be associated with specific lending terms. θ_a and θ_b respectively denote fixed effects for the borrower's and the lead arranger's primary ELC. Since ELCs are identified in DealScan only by their commercial name, we inspect the list of law firms involved in the syndicated market and adjust for naming differences relying on multiple online sources, such as ELCs' company websites, loan contract filings available in EDGAR, and financial news.[5] *Loan Term* represents multiple lending contractual choices including loan spread (*Spread*), number of covenants (*Covenants*), covenant strictness (*Strictness*), and the proportion of performance covenants relative to capital covenants included in a contract (*Covenant Mix*). All variables are described in detail in the Appendix.

Following Bushman et al. (2021), our baseline analysis on the role of ELCs primarily focuses on the incremental adjusted R-squared generated in Equation 2 from the addition of ELC fixed effects to Equation 1. In other words, we infer the influence of ELCs on loan terms by measuring the ability of ELC fixed effects to account for residual variation in lending outcomes that is not explained by the set of time-varying and time-invariant characteristics included in Equation 1.

In order to understand one of the potential channels through which ELCs may manifest their influence—i.e., their role as transaction cost engineers—we rely on the following regression:

$$Loan\ Term_{ijltab} = \alpha + \beta_1 Connected_{a,b\ t} + \beta_2 X_{it} + \beta_3 X_j + \sum \gamma + \sum \theta + \epsilon_{ijbtab} \quad (3)$$

[5] For instance, the international law firm Allen & Overy is sometimes referred to as *Allen & Overy* while as *Allen & Overy LLP* in other instances.

where *Connected* is defined following related research studying alternative types of links between firms, such as political ties and director networks (e.g., Chaney et al. 2011; Renneboog and Zhao 2014). Specifically, *Connected* may take one of the following specifications. First, *ELC Connected with Borrower*, is a dummy variable that equals one if the ELC representing the lead arranger in the current deal has advised the borrower in a loan market deal over the three years leading to the issuance of the current loan, and zero otherwise. Second, *ELC Connected with Lender*, is a dummy variable that equals one if the ELC representing the borrower in the current deal has advised the lead arranger in a loan market deal over the three years leading to the issuance of the current loan, and zero otherwise. Third, *ELC Connected,* is a dummy variable that equals one if either *ELC Connected with Borrower* or *ELC Connected with Lender* equals one, and zero otherwise. In other words, the *Connected* proxy captures those cases in which an ELC serving one side of the transaction has a recent advising relationship with the loan counterpart, thus potentially facilitating the flow of soft information between contracting parties.

5. Results

5.1 Main Results

Table 2 presents the results of the regression in Equation 1 estimated with time, loan type, and rating fixed effects. We observe that more profitable firms carry lower interest spreads on their loans and are bound by less tight covenants. This baseline analysis also indicates that increasing firm leverage leads to a higher cost of debt, more numerous and stricter covenants. Furthermore, we find that larger firms receive loans with lower spreads and fewer covenants. Overall, our analysis supports the findings of related research (e.g. Dennis et al. 2000) addressing the relationship between borrower time-varying characteristics and lending outcomes, thus corroborating the idea that the facility in our final sample provides an unbiased representation of the population of loans received by U.S. borrowers during recent decades.

To investigate our baseline hypothesis—i.e., whether and to what extent ELCs matter for syndicated loan design—we augment Equation 1 with progressively denser fixed effect structures (Bushman et al. 2021). Specifically, we report in Column 2 of Table 3 the adjusted R-squared of multiple regressions of loan design outcomes on borrower and loan level characteristics as well as borrower, time, loan type, and rating fixed effects. We then estimate and report adjusted R-squared values from regressions of loan design outcomes that also include *i*) lead arranger fixed effects (Column 3), *ii*) lead arranger's ELC fixed effects (Column 4), and *iii*) borrower's ELC fixed effects (Column 5). By doing so, the results in Table 3 indicate how much variation in loan contracting outcomes is due to time-invariant lead arranger and ELC characteristics, respectively.

Several results are worth discussing. First, ELC fixed effects account for a significant proportion of the unexplained variation in loan covenant characteristics both when we evaluate lead arranger's ELC and borrower's ELC fixed effects independently (Columns 4 and 5) and when we consider them together (Column 6). Importantly, ELC fixed effects jointly increase the explanatory power of the *Covenants* model by 5.1 percent, of the *Strictness* model by 6.1 percent, and of the *Covenant Mix* model by 2.2 percent. To contextualize the relative economic importance of our findings, lead arranger fixed effects respectively add 0.7 percent, 1.4 percent, and 1.6 percent to the adjusted R-squareds of our models. Second, we find that ELCs have some, despite more limited, effect on loan pricing. In particular, ELC fixed effects explain about 1.2 percent of the variation in loan spreads. Interestingly, we observe that lead arranger fixed effects have a more material role in explaining loan design outcomes than ELC fixed effects only with respect to the pricing of facilities. For covenants related outcomes, ELC fixed effects play a more prominent role.

Overall, our main results suggest that ELCs have an independent and incremental effect on loan contract features. While this effect is more substantial on the design of covenant packages—a deal outcome on which ELCs can have a direct influence when drafting contracts or performing legal due diligence—ELCs also partially affect other dimensions of loans more directly related to market factors and the structure of the loan syndicate, such as loan pricing.

Following extant research (e.g., Fracassi et al. 2016; Bushman et al. 2021), we develop additional simulation analysis to test the statistical significance of the fixed effect models presented in Table 3. Specifically, we are interested in understating whether the ability of ELC fixed effects to explain a sizable portion of the variation in lending outcomes is due to the specific role played by the ELCs in the loan market or is merely driven by statistical overfitting of the regression model in Equation 1. We test the significance of our findings by randomly assigning lender ELC and borrower ELC to the facilities in our sample and by estimating 1000 regressions based on this random assignment. Following this approach, we generate a random distribution of adjusted R-squared values that allows us to compare the actual incremental adjusted R-squared reported in Table 3 with the percentiles of the simulated distribution. Results in Table 4 support the statistical significance of our fixed effect analysis. In particular, we observe that the incremental explanatory power of actual ELCs (Column 4) exceeds the 99th percentile of the simulated adjusted R-squared distribution (Column 3) for all loan contracting variables. Corroborating the findings in Table 3, we also observe that the relative difference between the actual and the 99th percentile of the simulated distribution of the adjusted R-squared is particularly sizable for the *Covenants*, *Strictness*, and *Covenant Mix* loan terms. For instance, based on the 99th percentile of the distribution of adjusted R-squareds, randomly allocated ELCs fixed effects increase the explanatory power of the *Strictness* and *Covenants* models by 1% only. As reported in the Appendix, we derive similar inferences supporting the significance of our fixed effects models when we rely on simulated F-stats rather than on incremental adjusted R-squared values.

While the stepwise decompositions presented above look at the marginal contribution of ELCs' fixed effects, results may be biased by the order in which the predictor variables enter the regressions and by the possible correlation between the contribution of a particular predictor variable and that of the other variables (Israeli 2007). Therefore, to further assess the relative importance of ELCs fixed effects and other measures to the total explanatory power of the regressions, we employ the Shapley

(1953) value analysis. Specifically, Shapley values compute the average contribution of each predictor variable to the total adjusted R-squared in a regression model accounting for the correlation between the predictors. Larger Shapley values indicate a higher marginal contribution of the predictor in explaining variations in the dependent variable (e.g., Wells 2020; Abdalla and Carabias 2022). We find in Table 5 that the amount of the explanatory power contributed by lender ELC and borrower ELC fixed effects is significant—and larger than the contribution of lender fixed effects—across all the specifications. Corroborating the evidence from the previous analysis, ELC fixed effects are estimated to account for a particularly relevant portion of the total adjusted R-squared in the *Covenants* (18.2%) and the *Strictness* (16.0%) regressions.

5.2 Channel Analysis—Transaction Cost Engineer

Once we have provided evidence that ELCs have a role in shaping loan contract design, we then attempt to shed light on the economic channel behind the documented effects. A growing literature in accounting and finance suggests that informal information networks, such as connections among board members and common auditors (e.g., Houston, Lee, and Suntheim 2018; Francis and Wang 2021), affect the characteristics of loan syndicates and loan contracts. The legal literature indicates that legal counsels can play a transaction cost engineer role in complex transactions by bringing soft information and reducing information frictions between contracting parties (Gilson 1990; Gordon 1990; Haskell 1998; Coffee 2003; Davis 2003). As reduced information frictions lessen the agency problems between borrowers and lenders (Jensen and Meckling 1976; Asquith, Beatty, and Weber 2005), loan deals characterized by the presence of ELCs that specialize in various aspects of the contracting process and have previously worked with the counterparty to present deal may exhibit less stringent pricing and covenant protection mechanisms. Motivated by this argument, we define empirical proxies designed to capture ELCs' connectedness with loan transacting parties: *i*)

ELC Connected with Borrower; *ii*) *ELC Connected with Lender;* and *iii) ELC Connected*.[6] In general, these indicator variables identify those ELCs that serve one party in the current deal (either the borrower or the lender) while having advised the party's counterpart in the short span (3 years) before the current deal is closed.

We investigate the impact of connected ELCs on the loan *Spread*, the number of *Covenants*, and the covenant *Strictness* relying on Equation 3 and report estimation results in Table 6. In addition to including borrower fixed effects to control for unobserved borrower quality, we augment the regressions reported in Table 6 by adding a control for borrower loan experience. *Borrower Loan Experience* counts the number of loans taken by a borrower before the current loan and is designed to address the possibility that the results could be driven by stronger borrowers—those that borrow more frequently in the syndicated loan market—being more likely to share ELCs with lead arrangers. Panel A indicates that borrowers carry lower interest spreads when a connected ELC is involved in a deal. The influence of connected ELCs on loan pricing is particularly sizable when the law firm counselling the lender has a recent advising relationship with the borrower. In particular, the negative coefficient on the *ELC Connected with Borrower* dummy suggests that loan spreads are reduced by as many as 69 basis points in these deals. Coefficients are smaller but remain negative and highly statistically significant when we focus on the remaining columns of Panel A. Specifically, in Column 2, we observe that loan spreads are about 18 basis points lower when the legal counsel of the borrower is connected to the lead arranger. The negative and statistically significant coefficient on the *ELC Connected* variable (Column 3) indicates that, on average, loan spreads decrease by 18 basis points when at least one of the ELCs involved in the deal can facilitate the flow of soft information between the lender and the borrower. This reduction is economically significant since it accounts for approximately 8% (=18/235) of the average interest spread in the sample.

[6] These variables are defined in Section 4.2 and the Appendix.

We obtain comparable results when we analyse the covenant packages of the loans characterized by the presence of a connected ELC. The coefficients on *ELC Connected* are statistically significant and equal to, respectively, -0.145 in the *Covenants* model (Panel B) and -0.062 in the *Strictness* model (Panel C). In economic terms, this indicates that the involvement of a connected ELC corresponds to an 8% (=-0.145/1.735) reduction in the number of covenants and an 18% (=-0.062/0.348) decrease in covenant strictness for a given loan.

Overall, the analysis in Table 6 provides support that ELCs act as transaction cost engineers in the syndicated lending market. Connected ELCs can facilitate the flow of soft information between borrowers and lenders, thus reducing the need for ex ante price protection and the likelihood of an ex post transfer in control rights. By looking at the individual effects of ELCs connected with borrowers and lenders separately, results suggest that if an ELC is connected with a borrower then the impact is more important. These results are in line with the reasoning that a significant component of information asymmetry in a syndicated loan emanates from the borrower.

5.3 Cross-Sectional Tests

We explore cross-sectional heterogeneity of the connected ELC effect to better understand underlying mechanisms. Since ELCs can enhance the flow of soft information between contracting parties, we predict that connected ELCs can have a more material influence on the design of contract terms in loans characterized by higher information frictions between the borrower and the lender. Based on extant research, we develop two measures of information asymmetry. First, we exploit the different information sets to which relationship and non-relationship lead arrangers have access. In this regard, studies (Greenbaum and Thakor 1995; Boot 2000; Bharath et al. 2009) indicate that outside lenders are at an information disadvantage relative to inside lenders and that, therefore, information frictions with the borrower are higher when a loan syndicate is managed by a non-relationship lead arranger. We classify a lead arranger as a relationship (non-relationship) lender if it

has syndicated more (less) than 50% of a borrower's loan deals by volume over the three-year period preceding the loan issuance date (Schenone 2010; Bushman et al. 2017). Second, we rely on banking research suggesting that geographical distance limits the ability of lenders to acquire borrower-specific information (e.g. Hauswald and Marquez 2006) thus enhancing information frictions between contracting parties. Following Hollander and Verriest (2018), we proxy for the distance between a borrower and a lender by measuring the length of the shortest path between two firms' corporate headquarters. To develop our cross-sectional analysis, we partition our sample separately *i*) into relationships and non-relationship lead arrangers and *ii*) at the median of the geographical distance between the borrower and the lead arranger. We then estimate Equation 3 for each partition and report results in Panels A and B of Table 7.

Consistent with our conjecture, we find that the influence of connected ELCs on loan contract terms is mostly concentrated among deals arranged by non-relationship lenders. In the non-relationship lender partition, the coefficient on *ELC Connected* is -41.168 for the *Spread* model, -0.278 for the *Covenant* model, and -0.208 for the *Strictness* model. The absolute values of these coefficients are, respectively, 51% (-19.573), 61% (-0.110), and 81% smaller (-0.038) in the relationship lender partition. The differences between estimated coefficients are also statistically significant for all three dependent variables – *Spread*, *Covenants*, and *Strictness*. We find similar directional evidence when we analyse our second proxy of information frictions, i.e. the geographical distance between the headquarters of the borrower and the lender. While the coefficients on *ELC Connected* are very close across the two partitions in the *Spread* model, we observe that the effect of connected ELCs on *Covenants* and *Strictness* is mostly concentrated among the facilities issued by remote lenders.

We perform additional cross-sectional tests to better understand how ELCs affect loan contracting outcomes. Specifically, we posit that connected ELCs are more likely to complement the capabilities of inexperienced than experienced lenders by providing specialized knowledge and additional soft information that helps lenders in drafting contracts. Therefore, we expect that

connected ELCs more materially affect loan terms when the lender arranging a deal is less experienced and has fewer resources relative to more experienced banks. Based on this argument, we compute the overall dollar amount of the loans syndicated by a lead arranger in the three years leading to the issuance of the current loan and partition our sample on the median of this variable. We also hypothesize that the influence of connected ELCs on loan contracting outcomes is more likely to materialize when borrowers have less prominent in-house legal counsels (ILC) and, therefore, a less structured internal legal practice advising executives and directors on important contracts (Ham and Koharki, 2016). To proxy for the strength of a borrower's internal legal expertise, we follow Kwak at al. (2012) and collect information from *ExecuComp* on the top five highest paid executives at the borrower-year level. We denote a borrower as having a *Strong ILC* if its General Counsel/Chief Legal Officer is included within this group of executives, and as having a *Weak ILC* otherwise.

We present the results of these cross-sectional analyses in Table 8. As predicted, in Panel A, we find that the effect of connected ELC is mostly driven by loans arranged by relatively less experienced lenders. In particular, we do find a significantly larger decrease in *Spread* and *Strictness* through connected ELCs for facilities in the *Inexperienced Lender* partition compared to that for other loans (*ELC Connected* coefficient respectively equal to -39.758 and -0.110 compared to *ELC Connected* coefficient respectively equal to -22.229 and -0.021). In Panel B, we document some explorative evidence that connected ELCs have more influence on loan pricing when borrowers employ weaker (coefficient=-24.259, *t-stat*=-3.294) rather than stronger (coefficient=-3.430, *t-stat*=-0.167) ILCs. We do not observe significant differences in the effect of connected ELCs across the *Strong* and *Weak ILC* subsamples with respect to the *Covenants* and the *Strictness* variables.

Overall, the results of our cross-sectional tests suggest that ELCs' connectedness matters most when information asymmetry between contracting parties is high and when lenders and borrowers have less market or legal internal expertise. It is in these contexts that soft information flowing through connected ELCs is more likely to affect lending outcomes.

5.4 Additional Robustness Analysis

To further assess the influence of connected ELCs on loan contracting outcomes and provide explorative causal evidence supporting our main arguments, we develop additional analysis exploiting arguably exogenous variations in the level of agency conflicts and information asymmetry between lenders and borrowers and, therefore, in the relevance of the transaction engineering role of connected ELCs. Our identification strategy relies on relevant court rulings that significantly affected creditor rights. Specifically, two 2006 Delaware court cases (*Trenwick America Litigation Trust v. E&Y LLP* and *North American Educational Programming Foundation Inc. v. Gheewalla*) reversed the notorious Delaware judicial ruling from the 1991 case between *Credit Lyonnais N.V. v. Pathe Communication Corporation*, thus constraining the scope of directors' fiduciary duties to creditors and, as documented by extant research (Amiraslani 2017), the debt contracting relevance of financial information produced by borrowers. We postulate that connected ELCs would have a more critical role in shaping loan contracting outcomes through the transfer of the soft information between borrowers and lenders in a setting characterized by diminished duties to creditors and less contracting relevant disclosure from borrowers' financial statements.

We develop a triple differences-in-differences analysis to test this conjecture. Specifically, we define the indicator variable *Post Ruling* denoting loans issued after the Delaware court ruling (i.e., from the year 2007) and a variable *Delaware* that is equal to one if a firm's state of incorporation is Delaware, and zero otherwise.[7] We then interact the *ELC Connected* indicator with *Post Ruling* and *Delaware*. Results in Table 9 show that the coefficients on the triple interaction are significantly negative in the *Covenants* (coefficient=-0.358, *t-stat*=-1.774) and the *Strictness* (coefficient=-0.209, *t-stat*=-2.480) models. The coefficient on the triple interaction is statistically insignificant in the *Spread* model. Taken together, these results suggest that the influence of connected ELCs on loan contracting terms—through the transfer of soft information—is particularly important in a setting

[7] To avoid the backfill bias in the Compustat state of incorporation data field, we collect dynamic borrowers' state of incorporation from DealScan as available from the Refinitiv platform.

characterized by reduced creditors rights and heightened information asymmetry between contracting parties, thus providing explorative causal evidence on the nature of our findings.

5.5 Ex Post Loan Performance

Having shown that ELCs have a material effect on loan terms and, specifically, that the presence of connected ELCs leads to loans carrying lower spreads and fewer as well as less restrictive covenants, we finally analyse the relationship between connected ELCs and future loan performance. Since connected ELCs reduce ex ante adverse selection problems between contracting parties, we expect lenders to select borrowers with a strong ex post economic performance. Hence, lenders should be less likely to grant loans to borrowers which experience a credit rating downgrade or a credit default before a loan reaches maturity. To develop our empirical analysis, we define the *Downgrade variable as* an indicator that takes the value of one if a borrower is downgraded by S&P during the life of the loan, and zero otherwise. Similarly, we define the *Default* variable as an indicator that takes the value of one if a borrower experiences a default rating from S&P.

Our conjecture that the involvement of connected ELCs is related to future loan performance is supported by the results reported in Table 10. Precisely, we observe that the coefficient on the *ELC Connected* variable is negative and significant in the credit *Downgrades* (-0.126, *t-stat*=-2.226) and the *Default* models (-0.181, *t-stat*=-1.783).[8] Probit analysis suggests that when a connected ELC acts on a deal *Downgrades* are 4 percent less likely and *Defaults* are 2 percent less likely. In general, the results in Table 10 confirm that the influence of ELCs goes beyond lending terms and also relates to the future performance of loans.

[8] We develop regression models for *Downgrades* and *Default* following Herpfer (2021).

6. Conclusion

The corporate syndicated loan market in the U.S. is highly competitive and is characterized by the involvement of institutions such as banks, rating agencies, and corporate borrowers (Sufi, 2007; Ivashina, 2009). A large body of literature has documented that loan outcomes are primarily determined by borrower, syndicate, and market factors. However, ELCs are also commonly hired by contracting parties to provide their specialized services during the loan negotiation process. In this study, we ask whether ELCs have any impact on loan contract outcomes and performance that is incremental to previously documented factors. By using a large-scale dataset on the identities of ELCs, we find that ELCs play a significant role in the design of contract terms.

In order to understand one of the potential mechanisms through which ELCs influence loan design outcomes, we study a previously unexplored role of a transaction cost engineer that ELCs may play in complex financing transactions. Compared to the gatekeeper and client advocate roles previously documented in the literature (e.g., Bozanic et al. 2021), a transaction cost engineer works to increase the value of a transaction by providing information that is not available otherwise to the transacting parties and reducing information asymmetries in the negotiating process. Consistent with the transaction cost engineer hypothesis, we find that loans involving ELCs that can facilitate the flow of soft information between borrowers and lenders—i.e., connected ELCs—are characterized by lower spreads and more relaxed convent packages. Finally, we show that the reduction in information asymmetry through ELCs leads to better loan performance in the future.

REFERENCES

Asquith, P., Beatty, A., and Weber, J., 2005. Performance pricing in bank debt contracts. Journal of Accounting and Economics, 40(1-3), 101-128.

Ball, R., Bushman, R.M. and Vasvari, F.P., 2008. The debt-contracting value of accounting information and loan syndicate structure. *Journal of Accounting Research*, *46*(2), pp.247-287.

Berlin, M. and Mester, L.J., 1992. Debt covenants and renegotiation. *Journal of Financial Intermediation*, *2*(2), pp.95-133.

Bertrand, M. and Scholar, A., 2003. Managing with style: The effect of managers on firm policies. *The Quarterly Journal of Economics*, *118*(4), 1169-1208.

Bernstein, L., 1995. The Silicon Valley lawyer as transaction cost engineer. *Or. L. Rev.*, *74*, p.239.

Bharath, S.T. and Shumway, T., 2008. Forecasting default with the Merton distance to default model. *The Review of Financial Studies*, *21*(3), pp.1339-1369.

Bharath, S.T., Sunder, J. and Sunder, S.V., 2008. Accounting quality and debt contracting. *The Accounting Review*, *83*(1), pp.1-28.

Bird, R.C., Borochin, P.A. and Knopf, J.D., 2014. The value of the chief legal officer to the firm. *Journal of Corporate Finance*.

Bolton, P., Freixas, X., Gambacorta, L. and Mistrulli, P.E., 2016. Relationship and transaction lending in a crisis. *The Review of Financial Studies*, *29*(10), pp.2643-2676.

Bozanic, Z., Choudhary, P. and Merkley, K. J., 2019. Securities law expertise and corporate disclosure. *The Accounting Review*, *94*(4), 141-172.

Brooks, M.R., Hairston, S.A., Njoroge, P.K. and Ryou, J.W., 2020. Does the Presence of a General Counsel in Top Management Affect Audit Effort and Audit Outcomes? *Accounting Horizons*, *34*(3), pp.39-59.

Bushman, R., Gao, J., Martin, X. and Pacelli, J., 2021. The influence of loan officers on loan contract design and performance. *Journal of Accounting and Economics*, *71*(2-3), p.101384.

Bushman, R., Williams, C. D. and Wittenberg-Moerman, R., 2017. The informational role of the media in private lending. *Journal of Accounting Research*, *55*(1), 115-152.

Carvalho, D.R., Gao, J. and Ma, P., 2020. Loan spreads and credit cycles: The role of lenders' personal economic experiences. *Kelley School of Business Research Paper*, (19-30).

Christensen, H. B. and Nikolaev, V. V., 2012. Capital versus performance covenants in debt contracts. *Journal of Accounting Research*, *50*(1), 75-116.

Coffee Jr, J.C., 2003. Attorney as Gatekeeper: An Agenda for the SEC, The. *Colum. L. Rev.*, *103*, p.1293.

Cohen, D., Li, B., Li, N. and Lou, Y., 2022. Major government customers and loan contract terms. *Review of Accounting Studies*, *27*(1), pp.275-312.

Costello, A. M. and Wittenberg-Moerman, R., 2011. The impact of financial reporting quality on debt contracting: Evidence from internal control weakness reports. *Journal of Accounting Research*, *49*(1), 97-136.

Dechow, P.M. and Tan, S.T., 2021. How do accounting practices spread? An examination of law firm networks and stock option backdating. *The Accounting Review*, *96*(1), pp.431-464.

De Franco, G., Vasvari, F.P., Vyas, D. and Wittenberg-Moerman, R., 2020. Similarity in the restrictiveness of bond covenants. *European Accounting Review*, *29*(4), pp.665-691.

Demerjian, P. R. and Owens, E. L., 2016. Measuring the probability of financial covenant violation in private debt contracts. *Journal of Accounting and Economics*, *61*(2-3), 433-447.

Drake, M., Merkley, K., Potter, C. and Treu, J., 2020. Disclosure Crowdsourcing by Lawyers.

Fracassi, C., Petry, S. and Tate, G. (2016). Does rating analyst subjectivity affect corporate debt pricing? *Journal of Financial Economics*, *120*(3), 514-538.

Francis, J. R., and Wang, W., 2021. Common auditors and private bank loans. *Contemporary Accounting Research*, *38*(1), 793-832.

Gilson, R.J., 1984. Value creation by business lawyers: Legal skills and asset pricing. *The Yale Law Journal*, *94*(2), pp.239-313.

Gopalan, R., Nanda, V. and Yerramilli, V., 2011. Does poor performance damage the reputation of financial intermediaries? Evidence from the loan syndication market. *The Journal of Finance*, *66*(6), pp.2083-2120.

Hanley, K.W. and Hoberg, G., 2010. The information content of IPO prospectuses. *The Review of Financial Studies*, *23*(7), pp.2821-2864.

Hanley, K.W. and Hoberg, G., 2012. Litigation risk, strategic disclosure, and the underpricing of initial public offerings. *Journal of Financial Economics*, *103*(2), pp.235-254.

Hauswald, R., & Marquez, R., 2006. Competition and strategic information acquisition in credit markets. The Review of Financial Studies, 19(3), 967-1000.

Herpfer, C., 2021. The role of bankers in the US syndicated loan market. *Journal of Accounting and Economics*, *71*(2-3), p.101383.

Hollander, S. and Verriest, A., 2016. Bridging the gap: the design of bank loan contracts and distance. *Journal of Financial Economics*, *119*(2), 399-419.

Hopkins, J.J., Maydew, E.L. and Venkatachalam, M., 2015. Corporate general counsel and financial reporting quality. *Management Science*, *61*(1), pp.129-145.

Houston, J. F., Lee, J., and Suntheim, F., 2018. Social networks in the global banking sector. *Journal of Accounting and Economics*, *65*(2-3), 237-269.

Ivashina, V. and Sun, Z., 2011. Institutional stock trading on loan market information. *Journal of Financial Economics*, *100*(2), pp.284-303.

Ivashina, V., 2009. Asymmetric information effects on loan spreads. *Journal of financial Economics*, *92*(2), pp.300-319.

Jensen, M. C., and Meckling, W. H., 1976. Theory of the firm: Managerial behavior, agency costs, and ownership structure. *Journal of financial economics*, *3*(4), 305-360.

Krishnan, C. N. V., and Masulis, R. W., 2013. Law firm expertise and merger and acquisition outcomes. *The Journal of Law and Economics*, *56*(1), 189-226.

Krishnan, J., Wen, Y. and Zhao, W., 2011. Legal expertise on corporate audit committees and financial reporting quality. *The Accounting Review*, *86*(6), pp.2099-2130.

Kwak, B., Ro, B.T. and Suk, I., 2012. The composition of top management with general counsel and voluntary information disclosure. *Journal of Accounting and Economics*, *54*(1), pp.19-41.

Li, N., Vasvari, F.P. and Wittenberg-Moerman, R., 2016. Dynamic threshold values in earnings-based covenants. *Journal of Accounting and Economics*, *61*(2-3), pp.605-629.

Lou, Y. and Otto, C.A., 2020. Debt heterogeneity and covenants. *Management Science*, *66*(1), pp.70-92.

Ma, Z., Owens, E., Stice, D., and Wang, D., 2021. Lending Relationships Along Ownership Lines: Institutional Cross-Ownership and Bank Loan Contracts. *Available at SSRN 3843919*.

Martin, X. and Roychowdhury, S., 2015. Do financial market developments influence accounting practices? Credit default swaps and borrowers′ reporting conservatism. *Journal of Accounting and Economics*, *59*(1), 80-104.

Moran, P. and Pandes, J.A., 2019. Elite law firms in the IPO market. *Journal of Banking & Finance*, *107*, p.105612.

Morse, A., Wang, W. and Wu, S., 2016. Executive lawyers: Gatekeepers or strategic officers? *The Journal of Law and Economics*, *59*(4), pp.847-888.

Murfin, J., 2012. The supply-side determinants of loan contract strictness. *The Journal of Finance*, *67*(5), 1565-1601.

Murfin, J. and Pratt, R., 2019. Who finances durable goods and why it matters: Captive finance and the coase conjecture. *The Journal of Finance*, *74*(2), pp.755-793.

Nikolaev, V. V., 2018. Scope for renegotiation in private debt contracts. Journal of Accounting and Economics, 65(2-3), 270-301.

Renneboog, L. and Zhao, Y., 2014. Director networks and takeovers. *Journal of Corporate Finance*, *28*, pp.218-234.

Roberts, M. R., 2015. The role of dynamic renegotiation and asymmetric information in financial contracting. *Journal of Financial Economics*, *116*(1), 61-81.

Ryan Jr, R.H., 2008. The role of lead counsel in syndicated lending transactions. *Bus. Law.*, *64*, p.783.

Semkow, B.W., 1984. Syndicating and rescheduling international financial transactions: a survey of the legal issues encountered by commercial banks. In *Int'l L.* (Vol. 18, p. 869).

Sufi, A., 2007. Information asymmetry and financing arrangements: Evidence from syndicated loans. *The Journal of Finance*, *62*(2), pp.629-668.

APPENDIX

Appendix A

This Table reports the definition of the main variables used in the analysis.

Variable	Definition
Age	Years after a firm's first appearance in the Compustat database
Borrower Loan Experience	The number of loans taken by a borrower before the current loan
Covenants	Total number of covenants on the loan package
Covenants Mix	The ratio of the number of performance covenants to the number of performance and capital covenants as defined by Christensen and Nikolaev (2012)
Default	An indicator variable that takes the value of one if a borrower experiences a default rating from S&P ("D" or "SD") during the life of the loan, and zero otherwise
Downgrades	An indicator variable that takes the value of one if a borrower is downgraded by S&P during the life of the loan, and zero otherwise
ELC Connected	A dummy variable that equals one if either *ELC Connected with Borrower* or *ELC Connected with Lender* equals one, and zero otherwise
ELC Connected with Borrower	A dummy variable that equals one if the ELC representing the lender has advised the borrower in the three years leading to the issuance of a loan, and zero otherwise
ELC Connected with Lender	A dummy variable that equals one if the ELC representing the borrower has advised the lender in the three years leading to the issuance of a loan, and zero otherwise
Leverage	(Long-term debt (DLTT) + current debt (DLC))/total assets
Loan Size	Log of total loan amount (in dollars)
Loan Type	An index for whether a loan is a term loan, revolver, or other
Maturity	Loan maturity (in months)
MB	The Market-to-Book ratio of the borrower
Profitability	Operating income (OIBDP)/total assets
Secured Dummy	A dummy variable that equals one if the loan is secured, and zero otherwise
Senior	A dummy variable that equals one if the loan is senior, and zero otherwise
Size	Log of total assets (AT)
Spread	All-in-drawn loan spreads over LIBOR (in basis points)
Strictness	Covenant strictness as defined by Demerjian and Owens (2016).
Tangibility	Property, plant, and equipment (PPENT)/total assets

Appendix B

This Table reports simulated and actual F-statistics for the overall significance of OLS regression models of contractual outcomes on loan characteristics, borrower characteristics, and fixed effects. Restricted models include year, loan type, rating, borrower, and lead arranger fixed effects. Unrestricted models also include lender ELC and borrower ELC fixed effects. For each simulation, lender ELC and borrower ELC are randomly assigned to other loans in the sample, and the simulation is estimated with 1000 iterations. Columns (1), (2), and (3) respectively report the 90th, 95th, and 99th percentile of the simulated distribution of the F-statistics. Column (4) reports the F-statistics derived from OLS regressions which include actual lender ELC and borrower ELC fixed effects. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels.

	Simulated Distribution of F-stat			Actual F-stat	Actual minus 99th Percentile F-stat	
	(1) 90th Percentile	(2) 95th Percentile	(3) 99th Percentile	(4) Actual FE	(5)	
Spread	1.126	1.148	1.198	**2.285**	***1.087***	***
Covenants	1.124	1.149	1.194	**4.127**	***2.933***	***
Strictness	1.120	1.152	1.197	**3.847**	***2.649***	***
Covenant Mix	1.123	1.153	1.212	**3.539**	***2.327***	***

TABLES

Table 1
Panel A

This Table reports the main steps of the sample selection process.

	N
U.S. syndicated loan facilities over the period 1995-2021	126,989
Information available on primary borrower and loan characteristics	25,634
Information available on the legal counsel of the borrower and of the lead arranger	5,868
Borrower issuing at least two loans. Law firms representing at least two lead arrangers/borrowers	5,217
+ Loan facilities with more than one primary ELC advising the borrower or the lead arranger	880
Baseline Sample	**6,097**

Panel B

This Table reports sample statistics of the variables included in the main regressions.

Variable	N	Mean	p50	SD	p10	p90
Age	**6097**	10.756	11.000	4.852	4.000	17.000
Borrower Loan Experience	**6097**	5.817	5.000	3.769	2.000	11.000
Covenants Count	**6097**	1.735	2.000	1.183	0.000	3.000
Covenants Mix	**4878**	0.835	1.000	0.299	0.500	1.000
Default Dummy	**6097**	0.038	0.000	0.191	0.000	0.000
Downgrades Dummy	**6097**	0.310	0.000	0.462	0.000	1.000
ELC Connected with Borrower	**6097**	0.019	0.000	0.135	0.000	0.000
ELC Connected with Lender	**6097**	0.383	0.000	0.486	0.000	1.000
ELC Connected	**6097**	0.387	0.000	0.487	0.000	1.000
Leverage	**6097**	0.347	0.308	0.249	0.046	0.657
Loan Size	**6097**	5.443	5.521	1.318	3.689	7.131
Maturity	**6097**	54.443	60.867	21.854	12.233	85.200
MB	**6097**	1.676	1.418	0.856	0.999	2.616
Profitability	**6097**	0.126	0.120	0.088	0.043	0.222
Secured Dummy	**6097**	0.669	1.000	0.470	0.000	1.000
Senior Dummy	**6097**	0.999	1.000	0.031	1.000	1.000
Size	**6097**	7.591	7.476	1.651	5.588	9.825
Spread	**6097**	234.648	200.000	161.092	60.000	437.500
Strictness	**4313**	0.348	0.077	0.418	0.000	0.999
Tangibility	**6097**	0.314	0.236	0.248	0.041	0.701

Panel C

This Table reports correlation coefficients. * denotes significance at the 5% level.

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)
(1) Age	1.00																		
(2) Borrower Loan Experience	0.369*	1.000																	
(3) Covenants Count	-0.245*	-0.144*	1.000																
(4) Covenants Mix	-0.013	-0.069*	0.085*	1.000															
(5) Default Dummy	-0.025*	0.020	-0.011	0.056*	1.000														
(6) Downgrades Dummy	-0.012	0.078*	0.069*	0.041*	0.296*	1.000													
(7) ELC Connected	0.097*	0.103*	-0.167*	-0.006	-0.046*	0.000	1.000												
(8) ELC Connected with Borrower	-0.069*	0.027*	0.050*	-0.053*	-0.021	0.097*	0.173*	1.000											
(9) ELC Connected with Lender	0.096*	0.090*	-0.164*	-0.009	-0.044*	-0.001	0.992*	0.117*	1.000										
(10) Leverage	-0.078*	0.107*	0.066*	0.139*	0.103*	0.100*	-0.033	0.007	-0.037*	1.000									
(11) Loan Size	0.221*	0.328*	-0.201*	-0.148*	-0.026*	0.163*	0.190*	-0.016	0.187*	-0.047*	1.000								
(12) Maturity	-0.059*	-0.077*	0.107*	0.258*	0.002	0.166*	0.043*	0.057*	0.047*	0.063*	0.007	1.000							
(13) MB	-0.027*	-0.080*	0.004	0.058*	-0.072*	-0.101*	0.049*	-0.039*	0.053*	-0.115*	0.040*	0.043*	1.000						
(14) Profitability	0.026*	0.015	0.080*	0.023	-0.079*	0.007	0.082*	0.023	0.083*	0.005	0.100*	0.109*	0.448*	1.000					
(15) Secured Dummy	-0.177*	-0.136*	0.197*	0.353*	0.097*	0.083*	-0.130*	0.024	-0.132*	0.228*	-0.345*	0.283*	-0.137*	-0.116*	1.000				
(16) Senior Dummy	0.008	0.015	0.024	0.005	0.006	0.010	0.025	0.004	0.025	0.015	0.004	0.008	0.003	-0.006	0.011	1.000			
(17) Size	0.322*	0.385*	-0.314*	-0.209*	-0.007	0.143*	0.179*	-0.009	0.175*	0.010	0.661*	-0.139*	-0.149*	-0.087*	-0.379*	0.022	1.000		
(18) Spread	-0.008	-0.069*	-0.026*	0.268*	0.172*	0.029*	-0.150*	0.000	-0.149*	0.249*	-0.323*	0.031*	-0.197*	-0.208*	0.484*	-0.038*	-0.252*	1.000	
(19) Strictness	-0.124*	-0.060*	0.300*	0.137*	0.135*	-0.005	-0.182*	-0.093*	-0.179*	0.342*	-0.249*	-0.043*	-0.238*	-0.336*	0.286*	-0.009	-0.156*	0.353*	1.000

Table 2

This Table reports baseline OLS regressions of contractual outcomes on loan and borrower characteristics together with year, loan type, and rating fixed effects. Observations enter the regressions at the loan facility level. Standard errors are clustered by loan package. T-statistics are presented below the coefficients. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels.

	(1)	(2)	(3)	(4)
	Spread	Covenants	Strictness	Covenants Mix
Size	-7.692***	-0.146***	0.008	-0.007
	(-3.104)	(-5.666)	(0.816)	(-1.182)
Age	0.172	0.006	0.001	-0.001
	(0.290)	(1.196)	(0.425)	(-0.958)
Profitability	-163.632***	0.644**	-1.312***	0.117*
	(-4.841)	(2.192)	(-11.914)	(1.765)
Tangibility	23.004**	-0.083	0.040	-0.145***
	(2.511)	(-0.954)	(1.128)	(-6.279)
MB	-9.661***	-0.019	-0.015	0.031***
	(-3.685)	(-0.779)	(-1.436)	(4.384)
Leverage	45.621***	0.209**	0.459***	0.079***
	(4.407)	(2.022)	(10.602)	(3.962)
Maturity	-0.424***	0.003**	-0.001**	0.002***
	(-3.408)	(2.452)	(-2.082)	(5.562)
Loan Size	-14.842***	-0.005	-0.025***	-0.001
	(-6.347)	(-0.180)	(-2.866)	(-0.214)
Covenants Count	-13.434***			
	(-5.984)			
Secured Dummy	86.530***	0.263***	0.034	0.060***
	(15.576)	(4.371)	(1.506)	(3.433)
Spread		-0.001***	0.000***	0.000***
		(-5.771)	(4.279)	(5.375)
FE	Year, Loan Type, Rating	Year, Loan Type, Rating	Year, Loan Type, Rating	Year, Loan Type, Rating
Observations	6,097	6,097	4,313	4,878
Adjusted R-squared	0.526	0.281	0.337	0.295

Table 3

This Table reports adjusted R-squared from OLS regressions of contractual outcomes on different combinations of loan characteristics, borrower characteristics, and fixed effects. Adjusted R-squared reported in column (2) are estimated from OLS regressions which include year, loan type, and rating fixed effects as well as borrower and loan time-varying characteristics. Adjusted R-squared reported in column (5) are estimated from OLS regressions which include year, loan type, rating, borrower, lead arranger, lender ELC, and borrower ELC fixed effects as well as borrower and loan time-varying characteristics. Values in column (6) represent the combined effects of lender and borrower ELC fixed effects in explaining the variation in loan design outcomes.

	(1)	(2)	(3)	(4)	(5)	(6)
Borrower and Loan Level Controls	YES	YES	YES	YES	YES	
Year, Loan Type, and Rating FE	YES	YES	YES	YES	YES	
Borrower FE		YES	YES	YES	YES	
Lead Arranger FE			YES	YES	YES	
Lender ELC FE				YES	YES	
Borrower ELC FE					YES	
						Combined Law Firms FE
LOAN TERMS						
Spread						
Adj. R2	52.59%	71.85%	73.81%	74.96%	75.05%	
Incremental R2		*19.26%*	*1.96%*	***1.14%***	***0.09%***	***1.23%***
COVENANTS PACKAGE						
Covenants						
Adj. R2	28.07%	73.35%	74.08%	76.76%	79.17%	
Incremental R2		*45.28%*	*0.73%*	***2.69%***	***2.41%***	***5.09%***
Strictness						
Adj. R2	33.72%	70.65%	72.03%	75.29%	78.11%	
Incremental R2		*36.93%*	*1.38%*	***3.26%***	***2.82%***	***6.08%***
Covenant Mix						
Adj. R2	29.45%	86.32%	87.95%	89.29%	90.18%	
Incremental R2		*56.87%*	*1.64%*	***1.34%***	***0.89%***	***2.22%***

Table 4

This Table reports simulated and actual incremental adjusted R-squared from OLS regressions of contractual outcomes on loan characteristics, borrower characteristics, and fixed effects. For each simulation, lender ELC and borrower ELC are randomly assigned to other loans in the sample, and the simulation is estimated with 1000 iterations. Columns (1), (2), and (3) respectively report the 90th, 95th, and 99th percentile of the simulated distribution of the incremental adjusted R-squared above the adjusted R-squared from OLS regressions which only include year, loan type, rating, borrower, and lead arranger fixed effects. Column (4) reports the incremental adjusted R-squared derived from OLS regressions which include actual lender ELC and borrower ELC fixed effects. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels.

	Simulated Distribution of Incremental R^2			Actual Incremental R2	Actual minus 99th Percentile Simulated Incremental R2	
	(1) 90th Percentile	(2) 95th Percentile	(3) 99th Percentile	(4) Actual FE	(5)	
Spread	0.48%	0.59%	0.80%	**1.23%**	***0.43%***	***
Covenants	0.56%	0.70%	0.97%	**5.09%**	***4.13%***	***
Strictness	0.55%	0.71%	1.06%	**6.08%**	***5.02%***	***
Covenant Mix	0.27%	0.35%	0.50%	**2.22%**	***1.72%***	***

Table 5

This Table reports the Shapley decomposition of the model's R-squared and represents the percentages of the R-squared attributable to particular groups of explanatory variables.

	Percent of Model R2 Explained by Each Component			
	Spread	**Covenants**	**Strictness**	**Covenants Mix**
Time-Varying Factors	15.5%	7.3%	15.4%	7.4%
Year FE	8.2%	8.6%	2.3%	1.9%
Loan Type FE	6.5%	0.2%	0.2%	1.1%
Rating FE	12.1%	3.7%	5.8%	7.3%
Borrower FE	39.2%	59.2%	56.7%	67.6%
Lender FE	7.6%	2.8%	3.6%	2.3%
ELC Lender FE	**6.1%**	**7.7%**	**7.2%**	**5.3%**
ELC Borrower FE	**4.8%**	**10.5%**	**8.8%**	**7.3%**
Cumulative ELC FE	**10.9%**	**18.2%**	**16.0%**	**12.6%**

Table 6

This Table reports OLS regressions of contractual outcomes on loan characteristics, borrower characteristics, and time-invariant fixed effects. The *ELC Connected* dummies capture those ELCs representing the lender (borrower) and also connected with the borrower (lender) through a recent advising relationship (a full description of the variables is provided in Appendix A). The dependent variable in Panels A, B, and C respectively represent the loan interest *Spread*, the number of *Covenants*, and covenant *Strictness*. Observations enter the regressions at the loan facility level. Standard errors are clustered by loan package. T-statistics are presented below the coefficients. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels.

Panel A

	(1)	(2)	(3)
		Spread	
Lender ELC Connected with Borrower	**-68.620****		
	(-2.221)		
Borrower ELC Connected with Lender		**-18.771*****	
		(-3.089)	
ELC Connected			**-18.669*****
			(-3.095)
Size	-22.954***	-24.940***	-27.466***
	(-3.361)	(-3.585)	(-3.727)
Age	5.988**	2.997	4.253
	(2.390)	(1.053)	(1.610)
Profitability	-221.079***	-222.482***	-228.720***
	(-4.340)	(-4.018)	(-4.111)
Tangibility	103.160***	117.525***	125.311***
	(2.620)	(2.924)	(2.998)
MB	-19.010***	-17.462***	-18.396***
	(-3.734)	(-3.198)	(-3.374)
Leverage	42.487*	44.593	31.920
	(1.690)	(1.527)	(1.118)
Maturity	-0.144	-0.130	-0.126
	(-1.130)	(-1.015)	(-0.937)
Loan Size	-5.856**	-6.147***	-5.842**
	(-2.559)	(-2.581)	(-2.480)
Covenants Count	-7.068***	-6.395**	-7.330**
	(-2.604)	(-2.148)	(-2.457)
Secured Dummy	7.467	3.630	1.961
	(0.956)	(0.443)	(0.234)
Borrower Loan Experience	-1.792	-2.200	-2.416
	(-0.769)	(-0.852)	(-0.932)
Constant	419.451***	469.776***	482.914***
	(6.893)	(7.620)	(7.595)
Lender ELC FE	YES	NO	YES
Borrower ELC FE	NO	YES	YES
Borrower FE	YES	YES	YES
Year FE	YES	YES	YES
Loan Type FE	YES	YES	YES
Leading Bank FE	YES	YES	YES
Rating FE	YES	YES	YES
Observations	5,439	5,440	5,389
Adj. R-squared	0.750	0.742	0.751

Panel B

	(1)	(2)	(3)
		Covenants	
Lender ELC Connected with Borrower	**-0.648** **(-2.475)**		
Borrower ELC Connected with Lender		**-0.110*** **(-1.947)**	
ELC Connected			**-0.145**** **(-2.473)**
Size	-0.024	0.063	0.011
	(-0.379)	(1.001)	(0.175)
Age	0.010	0.036	0.030
	(0.297)	(1.412)	(1.110)
Profitability	0.491	0.527	0.387
	(0.986)	(1.026)	(0.730)
Tangibility	0.013	-0.343	-0.172
	(0.033)	(-0.908)	(-0.437)
MB	0.007	0.041	0.020
	(0.148)	(0.816)	(0.381)
Leverage	-0.356*	-0.461**	-0.391**
	(-1.927)	(-2.545)	(-2.135)
Spread	-0.000**	-0.000**	-0.000**
	(-2.550)	(-2.092)	(-2.393)
Loan Size	-0.000	0.002	0.009
	(-0.035)	(0.238)	(0.889)
Maturity	0.001	0.002*	0.001
	(1.134)	(1.780)	(1.166)
Secured Dummy	0.334***	0.369***	0.364***
	(4.572)	(4.666)	(4.649)
Borrower Loan Experience	0.023	-0.012	0.010
	(0.940)	(-0.492)	(0.399)
Constant	1.560**	0.859	1.189*
	(2.423)	(1.437)	(1.936)
Lender ELC FE	YES	NO	YES
Borrower ELC FE	NO	YES	YES
Borrower FE	YES	YES	YES
Year FE	YES	YES	YES
Loan Type FE	YES	YES	YES
Leading Bank FE	YES	YES	YES
Rating FE	YES	YES	YES
Observations	5,439	5,440	5,389
Adj. R-squared	0.769	0.774	0.792

Panel C

	(1)	(2)	(3)
		Strictness	
Lender ELC Connected with Borrower	**-0.170***		
	(-1.913)		
Borrower ELC Connected with Lender		**-0.076****	
		(-2.559)	
ELC Connected			**-0.062****
			(-2.016)
Size	0.059*	0.106***	0.074**
	(1.771)	(2.925)	(2.033)
Age	-0.040	-0.063	0.035
	(-0.546)	(-0.692)	(0.362)
Profitability	-1.572***	-1.430***	-1.383***
	(-5.348)	(-5.195)	(-4.706)
Tangibility	0.038	0.027	0.040
	(0.192)	(0.132)	(0.184)
MB	0.026	0.027	0.024
	(0.955)	(1.012)	(0.854)
Leverage	0.357***	0.273***	0.339***
	(3.376)	(2.611)	(3.049)
Spread	0.000	0.000	0.000
	(0.925)	(0.646)	(0.638)
Loan Size	-0.004	-0.001	-0.003
	(-0.965)	(-0.321)	(-0.911)
Maturity	0.000	0.000	0.000
	(0.338)	(0.682)	(0.695)
Secured Dummy	0.062*	0.039	0.021
	(1.823)	(1.110)	(0.629)
Borrower Loan Experience	0.008	0.001	0.004
	(0.660)	(0.086)	(0.345)
Constant	0.256	0.226	-0.601
	(0.308)	(0.228)	(-0.574)
Lender ELC FE	YES	NO	YES
Borrower ELC FE	NO	YES	YES
Borrower FE	YES	YES	YES
Year FE	YES	YES	YES
Loan Type FE	YES	YES	YES
Leading Bank FE	YES	YES	YES
Rating FE	YES	YES	YES
Observations	3,810	3,817	3,771
Adj. R-squared	0.754	0.753	0.782

Table 7

This Table reports OLS regressions of contractual outcomes on loan characteristics, borrower characteristics, and time-invariant fixed effects for sub-samples where the lender is either a relationship or a non-relationship lender with the borrower (Panel A); or the lender has close or remote geographical proximity with the borrower (Panel B). The *ELC Connected* dummies capture those ELCs representing the lender (borrower) and also connected with the borrower (lender) through a recent advising relationship (a full description of the variables is provided in Appendix A). The dependent variables in columns (1-2), (3-4), and (5-6) respectively represent the loan interest *Spread*, the number of *Covenants*, and covenant *Strictness*. Observations enter the regressions at the loan facility level. Standard errors are clustered by loan package. *p*-values for the equality of coefficients are one-sided. T-statistics are presented below the coefficients. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels.

Panel A

	(1)	(2)	(3)	(4)	(5)	(6)
	Spread		Covenants		Strictness	
	Relationship Lender	Nonrelationship Lender	Relationship Lender	Nonrelationship Lender	Relationship Lender	Nonrelationship Lender
ELC Connected	**-19.573** **(-2.559)**	**-41.168**** **(-2.339)**	**-0.110** **(-1.235)**	**-0.278*** **(-1.884)**	**-0.038** **(-0.802)**	**-0.208**** **(-2.421)**
Time-varying controls	YES	YES	YES	YES	YES	YES
Lender ELC FE	YES	YES	YES	YES	YES	YES
Borrower ELC FE	YES	YES	YES	YES	YES	YES
Borrower FE	YES	YES	YES	YES	YES	YES
Year FE	YES	YES	YES	YES	YES	YES
Loan Type FE	YES	YES	YES	YES	YES	YES
Leading Bank FE	YES	YES	YES	YES	YES	YES
Rating FE	YES	YES	YES	YES	YES	YES
p-value for equality of coefficients	0.078		0.069		0.068	
Observations	2,728	2,392	2,728	2,392	1,928	1,658
R-squared	0.799	0.742	0.826	0.901	0.813	0.923

Panel B

	(1)	(2)	(3)	(4)	(5)	(6)
	Spread		Covenants		Strictness	
	Close Lender	Remote Lender	Close Lender	Remote Lender	Close Lender	Remote Lender
ELC Connected	**-22.552***** **(-2.853)**	**-20.209**** **(-2.220)**	**-0.124** **(-1.368)**	**-0.223**** **(-2.331)**	**-0.033** **(-0.632)**	**-0.174***** **(-3.573)**
Time-varying controls	YES	YES	YES	YES	YES	YES
Lender ELC FE	YES	YES	YES	YES	YES	YES
Borrower ELC FE	YES	YES	YES	YES	YES	YES
Borrower FE	YES	YES	YES	YES	YES	YES
Year FE	YES	YES	YES	YES	YES	YES
Loan Type FE	YES	YES	YES	YES	YES	YES
Leading Bank FE	YES	YES	YES	YES	YES	YES
Rating FE	YES	YES	YES	YES	YES	YES
p-value for equality of coefficients	0.197		0.078		0.026	
Observations	2,403	2,464	2,403	2,464	1,703	1,664
R-squared	0.790	0.744	0.818	0.852	0.824	0.847

Table 8

This Table reports OLS regressions of contractual outcomes on loan characteristics, borrower characteristics, and time-invariant fixed effects for sub-samples where the lender is either experienced or inexperienced (Panel A); or the borrower has strong or weak in-house legal counsel (Panel B). The *ELC Connected* dummies capture those ELCs representing the lender (borrower) and also connected with the borrower (lender) through a recent advising relationship (a full description of the variables is provided in Appendix A). The dependent variables in columns (1-2), (3-4), and (5-6) respectively represent the loan interest *Spread*, the number of *Covenants*, and covenant *Strictness*. Observations enter the regressions at the loan facility level. Standard errors are clustered by loan package. *p*-values for the equality of coefficients are one-sided. T-statistics are presented below the coefficients. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels.

Panel A

	(1)	(2)	(3)	(4)	(5)	(6)
	Spread		Covenants		Strictness	
	Inexperienced Lender	Experienced Lender	Inexperienced Lender	Experienced Lender	Inexperienced Lender	Experienced Lender
ELC Connected	**-39.758*** **	**-22.229*** **	**-0.244***	**-0.127**	**-0.110***	**-0.021**
	(-3.461)	**(-2.842)**	**(-1.796)**	**(-1.493)**	**(-1.936)**	**(-0.461)**
Time-varying controls	YES	YES	YES	YES	YES	YES
Lender ELC FE	YES	YES	YES	YES	YES	YES
Borrower ELC FE	YES	YES	YES	YES	YES	YES
Borrower FE	YES	YES	YES	YES	YES	YES
Year FE	YES	YES	YES	YES	YES	YES
Loan Type FE	YES	YES	YES	YES	YES	YES
Leading Bank FE	YES	YES	YES	YES	YES	YES
Rating FE	YES	YES	YES	YES	YES	YES
Test equality of coefficients (p-value)	0.058		0.127		0.048	
Observations	2,503	2,603	2,503	2,603	1,696	1,882
R-squared	0.742	0.787	0.849	0.823	0.865	0.831

Panel B

	(1)	(2)	(3)	(4)	(5)	(6)
	Spread		Covenants		Strictness	
	Weak ILC	Strong ILC	Weak ILC	Strong ILC	Weak ILC	Strong ILC
ELC Connected	**-24.259*** **	**-3.430**	**-0.179** **	**-0.133**	**-0.021**	**-0.107**
	(-3.294)	**(-0.167)**	**(-2.081)**	**(-0.826)**	**(-0.531)**	**(-1.275)**
Time-varying controls	YES	YES	YES	YES	YES	YES
Lender ELC FE	YES	YES	YES	YES	YES	YES
Borrower ELC FE	YES	YES	YES	YES	YES	YES
Borrower FE	YES	YES	YES	YES	YES	YES
Year FE	YES	YES	YES	YES	YES	YES
Loan Type FE	YES	YES	YES	YES	YES	YES
Leading Bank FE	YES	YES	YES	YES	YES	YES
Rating FE	YES	YES	YES	YES	YES	YES
Test equality of coefficients (p-value)	0.045		0.399		0.170	
Observations	3,909	1,251	3,909	1,251	2,767	819
Adjusted R-squared	0.771	0.745	0.819	0.851	0.827	0.911

Table 9

This Table reports OLS regressions of contractual outcomes on loan characteristics, borrower characteristics, and time-invariant fixed effects. *Post Ruling* denotes loans issued after the Delaware court rulings reducing creditors' rights (i.e., from the year 2007). *Delaware* is an indicator that is equal to one if a borrower's state of incorporation (at the time of the loan issuance) is Delaware, and zero otherwise. The dependent variables in columns respectively represent the loan interest *Spread*, the number of *Covenants*, and covenant *Strictness*. Observations enter the regressions at the loan facility level. Standard errors are clustered by loan package. p-values for the equality of coefficients are one-sided. T-statistics are presented below the coefficients. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels.

	(1)	(2)	(3)
	Spread	Covenants	Strictness
ELC Connected X Post Ruling X Delaware	**-31.875**	**-0.358***	**-0.209****
	(-1.638)	**(-1.774)**	**(-2.480)**
Time-varying controls	YES	YES	YES
Borrower FE	YES	YES	YES
Industry FE	YES	YES	YES
Year FE	YES	YES	YES
Loan Type	YES	YES	YES
Rating FE	YES	YES	YES
Observations	5,178	5,178	3,652
Adjusted R-squared	0.740	0.754	0.723

Table 10

This Table reports linear probability regression models from *Downgrades*, and *Defaults*. *Downgrades* is an indicator variable that takes the value of one if a borrower is downgraded by S&P during the life of the loan, and zero otherwise. *Default* is an indicator variable taking the value of one if a borrower defaults before the maturity of a loan, and zero otherwise. Observations enter the regressions at the loan facility level. Standard errors are clustered by loan package. T-statistics are presented below the coefficients. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels.

	(1)	(2)	(3)	(4)
	Downgrade Dummy		Default Dummy	
	Probit		Probit	
	Coefficients	Marginal Effect	Coefficients	Marginal Effect
ELC Connected	**-0.126****	**-0.039****	**-0.181***	**-0.015***
	(-2.226)	**(-2.223)**	**(-1.783)**	**(-1.757)**
Size	0.092***	0.028***	-0.013	-0.001
	(3.946)	(3.977)	(-0.423)	(-0.423)
MB	-0.229***	-0.070***	-0.215	-0.018
	(-4.354)	(-4.415)	(-1.533)	(-1.546)
Leverage	0.601***	0.184***	0.915***	0.078***
	(3.759)	(3.778)	(3.477)	(3.358)
Profitability	0.511	0.157	-0.284	-0.024
	(1.113)	(1.115)	(-0.411)	(-0.412)
Tangibility	-0.038	-0.012	0.350	0.030
	(-0.218)	(-0.218)	(1.170)	(1.164)
Z-Score	0.008	0.003	-0.142***	-0.012**
	(0.493)	(0.493)	(-2.578)	(-2.566)
Loan Size	0.158***	0.049***	0.032	0.003
	(6.453)	(6.545)	(0.857)	(0.856)
Industry FE	YES		YES	
Year FE	YES		YES	
Loan Type FE	YES		YES	
Rating FE	YES		YES	
Observations	6,050		6,050	
Pseudo R-squared	0.127		0.203	

Online Appendix

Appendix OA1

This Appendix reproduces our baseline results on an alternative sample. To define this sample, we follow the same approach as for the baseline analysis but we require that only the ELC of the borrower is observable. The final sample includes 8,606 facilities.

Table OA1.1

This Table reports adjusted R-squared from OLS regressions of contractual outcomes on different combinations of loan characteristics, borrower characteristics, and fixed effects

	(1)	(2)
Borrower FE	YES	YES
Year, Loan Type, and Rating FE	YES	YES
Borrower and Loan Level Controls	YES	YES
Lead Arranger FE	YES	YES
Borrower ELC FE		YES
LOAN TERMS		
Spread		
Adj. R2	72.05%	72.63%
Incremental R2		***0.57%***
Maturity		
Adj. R2	54.27%	55.19%
Incremental R2		***0.92%***
COVENANTS PACKAGE		
Covenants		
Adj. R2	71.41%	73.73%
Incremental R2		***2.32%***
Strictness		
Adj. R2	68.75%	71.29%
Incremental R2		***2.55%***
Covenant Mix		
Adj. R2	84.76%	86.44%
Incremental R2		***1.68%***

Table OA1.2

This Table reports OLS regressions of contractual outcomes on loan characteristics, borrower characteristics, and time-invariant fixed effects. The *ELC Connected* dummies capture those ELCs representing the lender (borrower) and also connected with the borrower (lender) through a recent advising relationship. Observations enter the regressions at the loan facility level. Standard errors are clustered by loan package. T-statistics are presented below the coefficients. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels.

	(1)	(2)	(3)
	Spread	Covenants	Strictness
ELC Connected	**-13.568*** **	**-0.102** **	**-0.038***
	(-2.750)	**(-1.999)**	**(-1.672)**
Size	-16.371***	0.061	0.043
	(-3.140)	(1.279)	(1.628)
Age	3.774	-0.009	0.050
	(1.506)	(-0.368)	(0.736)
Profitability	-198.479***	0.559	-1.516***
	(-5.153)	(1.538)	(-7.843)
Tangibility	87.894***	0.004	-0.046
	(2.693)	(0.013)	(-0.267)
MB	-14.733***	0.032	0.006
	(-3.846)	(0.836)	(0.383)
Leverage	19.628	-0.187	0.310***
	(0.903)	(-1.215)	(3.827)
Maturity	-0.070	0.003***	0.000
	(-0.662)	(4.048)	(1.084)
Loan Size	-8.018***	0.000	-0.001
	(-3.684)	(0.013)	(-0.113)
Covenants Count	-3.428		
	(-1.337)		
Secured Dummy	9.866	0.415***	-0.018
	(1.486)	(6.298)	(-0.649)
Spread		-0.000	0.000*
		(-1.335)	(1.727)
Constant	370.925***	1.082**	-0.373
	(7.860)	(2.293)	(-0.558)
Borrower ELC FE	YES	YES	YES
Borrower FE	YES	YES	YES
Year FE	YES	YES	YES
Loan Type FE	YES	YES	YES
Leading Bank FE	YES	YES	YES
Reported ELC Lender FE	YES	YES	YES
Rating FE	YES	YES	YES
Observations	8,606	8,606	6,152
R-squared	0.730	0.737	0.715

Appendix OA2

This Appendix reproduces our baseline results on an alternative sample. To define this sample, we follow the same approach as for the baseline analysis but we require that only the ELC of the lender is observable. The final sample includes 10,130 facilities.

Table OA2.1

This Table reports adjusted R-squared from OLS regressions of contractual outcomes on different combinations of loan characteristics, borrower characteristics, and fixed effects

	(1)	(2)
Borrower FE	YES	YES
Year, Loan Type, and Rating FE	YES	YES
Borrower and Loan Level Controls	YES	YES
Lead Arranger FE	YES	YES
Lender ELC FE		YES
LOAN TERMS		
Spread		
Adj. R2	73.20%	74.16%
Incremental R2		***0.95%***
Maturity		
Adj. R2	52.34%	53.46%
Incremental R2		***1.12%***
COVENANTS PACKAGE		
Covenants		
Adj. R2	68.35%	70.44%
Incremental R2		***2.09%***
Strictness		
Adj. R2	70.43%	73.18%
Incremental R2		***2.74%***
Covenant Mix		
Adj. R2	86.58%	88.14%
Incremental R2		***1.56%***

Table OA2.2

This Table reports OLS regressions of contractual outcomes on loan characteristics, borrower characteristics, and time-invariant fixed effects. The *ELC Connected* dummies capture those ELCs representing the lender (borrower) and also connected with the borrower (lender) through a recent advising relationship. Observations enter the regressions at the loan facility level. Standard errors are clustered by loan package. T-statistics are presented below the coefficients. ***, ** and * denote statistical significance at the 1%, 5% and 10% levels.

	(1)	(2)	(3)
	Spread	Covenants	Strictness
ELC Connected	**-8.341****	**-0.141*****	**-0.036***
	(-2.106)	**(-3.190)**	**(-1.926)**
Size	-27.608***	-0.024	0.029
	(-5.501)	(-0.536)	(1.179)
Age	2.478	-0.021	-0.015
	(0.970)	(-0.868)	(-0.312)
Profitability	-237.381***	0.363	-1.431***
	(-5.598)	(1.027)	(-6.887)
Tangibility	20.211	-0.178	-0.001
	(0.633)	(-0.612)	(-0.007)
MB	-9.164**	-0.030	-0.037*
	(-2.462)	(-0.832)	(-1.896)
Leverage	39.789**	-0.056	0.361***
	(2.007)	(-0.369)	(4.108)
Maturity	-0.127	0.002***	0.000
	(-1.367)	(2.596)	(0.369)
Loan Size	-6.837***	-0.003	-0.008*
	(-3.596)	(-0.266)	(-1.887)
Covenants Count	-4.509**		
	(-2.382)		
Secured Dummy	26.365***	0.506***	0.051*
	(4.783)	(9.336)	(1.947)
Spread		-0.000**	0.000
		(-2.377)	(1.038)
Constant	462.653***	1.728***	0.381
	(9.910)	(3.894)	(0.706)
Lender ELC FE	YES	YES	YES
Borrower FE	YES	YES	YES
Year FE	YES	YES	YES
Loan Type FE	YES	YES	YES
Leading Bank FE	YES	YES	YES
Reported ELC Borrower FE	YES	YES	YES
Rating FE	YES	YES	YES
Observations	10,130	10,130	6,319
R-squared	0.741	0.733	0.733