The Influence of External Legal Counsels on Loan Contract Design and Performance

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, 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 investigate the previously unexplored role of ELCs acting as *transaction cost engineers* (TCE) in which they increase the overall value of the transaction. 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, thus lowering interest spreads, as well as the intensity and strictness of loan covenants. Furthermore, connected ELCs have a particularly strong influence on loan terms in settings characterized by high information asymmetries, when information asymmetries relate to the legal complexities of the borrower, and when loan parties have more limited contracting experience. Finally, in accordance with the TCE role, 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 seminar participants at Bocconi University, INSEAD, the 2023 Hawaii Accounting Research Conference, the 2023 Asian Bureau of Finance and Economic Research, the 2023 European Accounting Association Congress, the 2023 Bocconi Accounting Conference, Hami Amiraslani, Matthias Breuer, Daniel Cohen (Discussant), Emmanuel De George, Elia Ferracuti (Discussant), Sharon Katz, Laurel Mazur (Discussant), David Reeb, and Regina Wittenberg-Moerman for helpful feedback and discussions.

1. INTRODUCTION

Syndicated loans vary in features such as maturity, interest spread, and covenant intensity. The contractual features of syndicated loans 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. However, to the best of our knowledge, there is no empirical evidence on whether ELCs have any influence on the outcomes of syndicated loans. We contribute to the debt contracting literature by providing the first empirical evidence on the role of ELCs, and especially ELCs working for one counterparty with prior connections to the other counterparty.

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 legal entities 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 work with 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 counterparty, thus potentially communicating information that is not otherwise available 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. 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.

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, and borrower and lender characteristics? *ii*) If ELCs do have an impact, then what could be a potential mechanism for this effect? *iii*) What kind of information is provided by ELCs?, and *iv)* What are the consequences of their involvement?

We provide evidence that ELCs have a significant impact on the design of syndicated loan contracts. ELC effects are incremental to the influence of borrower and lender characteristics documented by prior 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 ELC effects manifest, we hypothesize and find that ELCs play an important role as *transaction cost engineers (TCE)*. Specifically, under the TCE role, ELCs reduce information asymmetry between contracting parties by acting as intermediaries and by providing information that might not be available through traditional channels or is too costly to acquire. We additionally find that the role of ELC is more crucial when information asymmetry is high. We shed light on the nature of the information provided by ELCs by documenting that loans involving firms with complex organizational structures and complex debt structures are more affected by the presence of an ELC. Finally, if ELCs reduce information asymmetry at the time loan terms are negotiated, then this should result in better future loan performance. We show that loans in which ELCs have more scope to reduce information asymmetries have better longer term credit market performance, i.e., they experience fewer defaults and are less likely to be downgraded.

We begin our analysis by addressing whether an ELC matters for syndicated loan design. Our primary specifications rely on a 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 selection issues by focusing our empirical analyses on loans for which both ELCs are observable, thus more effectively isolating the potential impact of ELCs on loan outcomes. 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 variation in lending outcomes 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 effects on loan pricing, although more limited. 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, we employ the R-squared decomposition of Shapley (1953) and Shorrocks (1982) to isolate the contribution of ELC fixed effects to the total adjusted R-squared. This approach ensures a fair, order-invariant, and complete decomposition of the contributions of groups of regressors. 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; Coffee, 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 (TCE) mitigate information problems in the negotiations, 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 TCE role primarily relates to the dimension of value addition that ELCs can bring to complex financing transactions. Hence, we study whether ELCs act as TCE in the context of syndicated lending.

To empirically capture ELCs' ability to facilitate the exchange of 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 had 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 lower interest rates and with more flexible covenant schedules, consistent with reduced information problems between

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

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.

While we employ a saturated fixed effect structure to control for omitted correlated variables, there may still be concerns about endogeneity. To address this issue, we identify multiple forms in which endogeneity can manifest, including a choice of an ELC by the borrower or lender that is not random and observed results being driven by relationship banking. We create multiple groups of fixed effects capturing the interaction between borrowers, lenders, and ELCs and re-run the analysis to show that the results are robust to the aforementioned endogeneity concerns.

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; Prilmeier 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). Our findings reveal the importance of connected ELCs in formulating loan contract terms when information frictions are most severe. Specifically, we show that the involvement of a connected ELC reduces loan spreads and relaxes covenant schedules more significantly 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. We document that the presence of a connected ELC reduces loan spreads and relaxes covenants strictness more when the lead arranger of a syndicate has less experience in the loan market.

Next, we focus on the potential nature of the information that could be communicated by the ELCs. While it is impracticable to directly observe private information transfers between contracting parties, we rely on situations where information with specific legal content might be of particular value. Specifically, we follow prior literature (Sikochi, 2020; Lou and Otto, 2020) and identify subsamples of borrowers characterized by significant organizational complexity or debt heterogeneity. Borrower organizational complexity and debt heterogeneity can increase the legal risk of recovery of residual claims borne by lenders, especially during times of distress (Ivashina et al, 2016). Through their expertise and the transfer of information with specific legal content, ELCs can help reduce information asymmetry arising from this risk and help set optimal contracts that can improve the overall value of the transaction. In cross-sectional analyses, we find that the effect of ELCs is more pronounced on borrowers with high organizational complexity and high debt heterogeneity. These tests help us shed more light on the potential nature of the information that ELCs can provide.

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 in their roles of 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 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 exogenously less informative to creditors we should expect the transaction cost engineer role of ELCs to become more significant, as the ELCs would be able to bridge the increasing wedge in information asymmetry between contracting parties. Following related studies (Rock 2013; Amiraslani et al. 2016; Sundaresh 2019), we look at the impact of a judicial decision that reduced directors' duties to creditors for borrowers incorporated in Delaware, thereby diminishing creditors' rights and the credit relevance of borrowers' financial information. Exploiting 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 several 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.

We also contribute 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; Hopkins, 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 in the loan market—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 knowledge and network to reduce information frictions and improve the loan contract characteristics.

Finally, this study sheds light on the active role played by transactional lawyers. Our findings emphasize the critical importance of these legal professionals, particularly in light of the potential threats posed by recent advancements in artificial intelligence (Economists, 2023). While technological developments have transformed various aspects of the legal profession, this study highlights that the expertise and nuanced judgment of transactional lawyers remain crucial in navigating complex transactions. By uncovering the value added by ELCs in reducing information asymmetries, promoting coordination, and improving contracting outcomes, this research underscores the role of transactional lawyers in facilitating effective and efficient loan deals in an ever-evolving legal landscape.

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 and the Role of ELCs

The corporate syndicated loan market in the U.S. is more than $4 trillion in size 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. 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. Although not legally required, both the borrower and lender can appoint their own individual ELC. From the perspective of a lending syndicate, the ELC hired by the lending syndicate protects 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 (Ryan, 2008).

2.2 The Role of Legal Experts in Financial Markets

There is growing literature on the role of legal experts 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 2016). 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 or transactional expertise.

Researchers have examined the roles ILCs play in settings such as compensation, audit, and disclosure decisions. In general, studies have found evidence consistent with ILCs 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). 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 extensive details about ILCs 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 there is an established focus on ILCs, recent studies have begun shedding light on the role of ELCs, indicating that they too can significantly influence corporations and financial markets. 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 (2021) 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, prior studies have documented that legal experts − both internal and external − fulfill 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 knowledge and mediation skills 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 study expands on De Franco et al. (2020) by examining the influence of ELCs on diverse contractual outcomes in the syndicated loan market. Unlike their focus on bond covenant restrictiveness, we explore pricing, covenant terms, loan performance, and introduce a novel mechanism of information transfer, namely ELC connectedness to counterparties. Furthermore, we specifically investigate the role of ELCs in the syndicated loan market, which differs from the bond market in terms of information opacity and contracting dynamics.

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. 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 the 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 (Blumenthal, 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, knowledge, and critical information 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 will 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; Ryan, 2008). Given the highly competitive nature of the syndicated loan market, lenders and borrowers might not necessarily utilize 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; Coffee 2003). Prior studies have largely concentrated on the advocate and gatekeeper roles of ELCs, leaving their role as transaction cost engineers less thoroughly examined. Under the

transaction cost engineer role, ELCs are seen as enhancing the value of complex transactions through reducing information asymmetries between involved parties and offering specialized skills and knowledge which might be inaccessible, unverifiable, or too expensive to acquire otherwise (Bernstein, 1995). By assuming this role, ELCs have the potential to shape more complete contractual outcomes which minimize information costs through risk allocation to the party best equipped to bear it (Gilson, 1984).[2]

In the sphere of syndicated loans, an ELC is likely to be engaged in all three stages of the syndicated loan process: namely, the mandate acquisition by the arranger, the primary market book-running, and the secondary market stage (Bruche et al., 2020). In the initial two stages, the ELC plays a key role by offering expert advice on the structure of the deal and taking part in negotiating the terms of the loan document. Given these functions, ELCs develop relationships with various parties over time and gain access to information not readily available through other sources. Building on this rationale, we suggest that ELCs can mitigate frictions between transaction parties by channeling this information through their inter-company networks. Specifically, if an ELC has previously represented a lender (or borrower) and is currently representing the borrower (or lender), the ELC could ease information frictions by fostering a smoother exchange of information between both sides of the deal, building trust, and facilitating conflict resolution. Following this discussion, and backed by the assertion that reducing agency problems can result in more favorable contractual outcomes (Jensen and Meckling, 1976), we propose our second hypothesis:

[2] In the context of syndicated lending, the TCE role of an ELC is arguably more consequential than the gatekeeper and client advocate roles. First, the gatekeeper role of an ELC, which envisions the ELC acting in the broader public interest, might be less critical in syndicated lending due to the sophistication of the contracting parties involved. As both borrowers and lenders in these scenarios are usually experienced entities with significant knowledge and resources, the necessity for a public-interest safeguard may not be as prominent. Second, although the client advocate role is important, its prominence could be less in the syndicated loan setting. Here, ELCs engage with both lenders and borrowers through repeated interactions, fostering a network of relationships that shapes their business prospects. If ELCs were to act solely in one party's interest, disregarding the needs and interests of the other party, they could jeopardize their reputation and invite substantial business risks. Therefore, focusing on the mutual interests of all parties becomes crucial. The TCE role, on the other hand, finds heightened importance in the syndicated loan market. This role sees the ELC reducing information asymmetry, designing more complete contracts, and providing specialized skills and information. In essence, while the gatekeeper and client advocate roles have their places in the legal landscape, the TCE role seems to be the most significant for an ELC in the syndicated lending market. This importance is due to the need for enhancing transaction value, reducing information asymmetry, and fostering a sustainable business relationship with all contracting parties. It is important to note, however, that these roles are not mutually exclusive. An effective ELC is likely to find ways to blend the roles, adapting to the unique needs of each transaction and the intricate dynamics of the syndicated lending market.

H2: A connected ELC (i.e., an ELC currently advising one party in the transaction and maintaining a recent working relationship with the counterparty), facilitates the reduction of information asymmetry between borrowers and lenders, leading to improved terms of the loan contract.

In essence, a decrease in information asymmetry facilitated by a connected ELC enables lenders to offer lower interest rates and relax covenant restrictions. This reflects decreased screening and monitoring costs and signifies greater confidence in the borrower's ability to fulfill their obligations.[3]

3.2.1 Severity of Information Asymmetries, Nature of Information Asymmetries, 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 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**.** Furthermore, the role of ELCs should be stronger when information asymmetry in the syndicated loan relates to the legal complexities of the counterparties. In particular, among the many different types of information, we would expect an ELC to have a

[3] While the existing literature, including this study, predominantly examines information asymmetries characterizing borrowers, it is important to recognize that borrowers may also have incentives to address information asymmetries that pertain to lenders. For instance, these asymmetries can arise from lenders' behaviours in off-equilibrium situations, such as when borrowers encounter the need for renegotiations or face financial difficulties. Additionally, borrowers may also be motivated to address information asymmetries regarding lenders' internal decision-making processes, including factors influencing credit decisions, loan pricing, or the criteria for initiating loan covenant enforcement. Understanding and addressing these lender-related information asymmetries is crucial for maintaining trust between borrowers and lenders, thus fostering effective coordination and reducing deadweight losses.

privileged role in transferring information close to its area of expertise and, thus, with specific legal content.

3.2.2 Expertise of Contracting Parties 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 critical to clients who have relatively less experience in the syndicated loan market. In essence, ELCs are more likely to complement the capabilities of inexperienced than experienced lenders by providing specialized knowledge and additional information that helps contract design. Consequently, we propose that the transaction cost engineer role of ELCs is more important in transactions where the lead arrangers are less experienced and resource-restrained as opposed to those managed by more experienced banks.

3.3 Do ELCs Affect Future Loan Performance?

As long as the 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 DESIGN

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.[4] 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), as updated to 2018. This results in 22,104 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.[5] 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.[6] 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. This process results in a sample comprising 6,097 loan facility-lender's ELC-borrower's ELC observations corresponding to 5,217 distinct loan facilities (Table 1, Panel A).[7]

[4] We ultimately constrain our sample to loans issued before 2018 since the latest available version of the DealScan-Compustat link file is updated as of April 2018. We thank Prof. Chava and Prof. Roberts for making this linking table available online.

[5] The results of our baseline analyses are robust to an alternative approach which requires that *either* the ELC of the lender *or* the ELC of the borrower is observable. When we require that only information on the ELC of the lender is available, our final sample includes 10,130 observations. When we require that only information on the ELC of the borrower is available, our final sample includes 8,606 observations. These results are available from the authors upon request.

[6] As clarified through multiple discussions with Refinitiv analysts, details on ELC are acquired from the texts of public loan contracts, press announcements, or through direct reporting to Refinitiv by the borrowers, lead arrangers, or ELCs themselves. While ELCs aren't legally mandated to disclose their participation in syndicated loans, they have strong incentives to do so. The information compiled by Refinitiv is utilized in the creation of law firm league tables, which serve as a key instrument for the market to assess an ELC's expertise and reputation.

[7] As in Bushman et al. (2021), we consider loan facilities rather than loan packages since interest spread and loan performance varies across facilities within the same loan package. Furthermore, we run the analysis at the loan facility-lender's ELC-borrower's ELC level due to cases where multiple external legal counsels are observed as the primary legal counsel of the borrower or the lead arranger. Therefore, the total number of observations in our study amounts to 6,097, surpassing the count of distinct loan facilities (5,217).

Table 1, Panel B presents the frequency distribution of the top 10 ELCs by borrowers and lenders separately. The market of ELCs providing services to borrowers and lenders for syndicated loans is competitive and is catered by a number of professional firms. In our sample, lenders are advised by 217 unique ELC firms and borrowers are advised by 380 ELC firms. The market advising lenders is relatively more concentrated with the top 10 ELC firms involved in 51% of the loans, whereas the market advising borrowers is less concentrated with the top 10 ELC firms having 32% of the market share by number of loans. The median (average) ELC advising lenders appears in 5 (26) deals whereas the median (average) ELC advising borrowers appears in 5 (16) deals. As can be seen from the Table, the same ELC can act for both lenders and borrowers (i.e., an ELC can act for the lender in one deal and the borrower in another deal; however, an ELC does not act for the borrower and the lender in the same transaction). This feature will be crucial for exploring a potential mechanism through which ELCs can matter in affecting the outcomes of a syndicated loan contract.

Table 1, Panel C reports the primary summary statistics describing our sample. The median loan amount (*Loan Size*) equals $250 million and the median loan maturity (*Maturity*) is 61 months. The median loan in our sample carries an interest spread (*Spread*) of 200 basis points above the reference market rate and contains 2 covenants (*Covenants Count*). The median borrower in our sample has a leverage ratio (*Leverage*) of 31%, total assets of $1.8 billion, and a tangibility ratio (*Tangibility*) of 24%. The median value of borrower loan experience (*Borrower Loan Experience*) is 5 which suggests that the median borrower in our sample has made use of syndicated loans 5 times.[8,9]

In measuring the connectedness of ELCs, we make use of three variables—*i*) *ELC Connected with Borrower*, *ii*) *ELC Connected with Lender*, and *iii*) *ELC Connected*. *ELC Connected with Borrower* (*ELC Connected with Lender*) is a dummy variable that equals one if the ELC representing

[8] In Table 1C and for regression analysis, we report and use the natural logarithm of borrower size and loan size. Looking at sample medians: ln (250$ million) = 5.521; ln (1,765$ billion) = 7.475.

[9] The Online Appendix presents a univariate analysis that compares the facilities in our final selection with facilities where the financial data of the firm is accessible, but no borrower-ELC and lender-ELC information is available. We observe that loans involving ELCs on both sides of the transaction are typically issued by larger, more leveraged companies and are characterized by greater loan size, increased spreads, and a higher number of covenants. This indicates that ELCs tend to be involved in sizable deals issued by borrowers confronting more elevated credit risk.

the lender (borrower) has advised the borrower (lender) in the three years leading to the issuance of a loan, and zero otherwise. *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 our sample, 38.7% of the observations have a *Connected ELC* where the ELC has represented the counterparty in a prior deal. In 38.3% of the observations, a *Connected ELC with Borrower* is involved and 1.9% of the observations involve a *Connected ELC with Lender*. This suggests that it is a common practice for an ELC who acted for the lender before to be hired by the borrower, but the converse is far less common. This finding is intuitive since availing of a syndicated loan is a specialized but infrequent activity for the borrower.

4.2 Research Design and Variable Measurement

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

$$Loan\ Term_{ijt} = \alpha + \beta_1 X_{it} + \beta_2 X_j + \sum \gamma_k + \theta_{ELC(B)} + \theta_{ELC(L)} + \epsilon_{ijb} \quad (1)$$

where in different models *Loan Term* is a contractual dimension including loan spread (*Spread*), number of covenants (*Covenants*), and covenant strictness (*Strictness*). *i* indicates the borrower, *j* indicates the loan facility, and *t* indicates the time. 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. $\theta_{ELC(B)}$ and $\theta_{ELC(L)}$ respectively denote fixed effects for the borrower ELC 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 ELC company websites, loan contract filings available in EDGAR, and financial news.[10] All variables are described in detail in the Appendix.

Following Bushman et al. (2021), we first assess the influence of ELCs on loan terms by estimating Equation 1 excluding ELC fixed effects. This establishes the ability of time-varying and time-invariant borrower and lender characteristics to explain lending outcomes. Then we observe the incremental adjusted R-squared statistics obtained when we include borrower ELC fixed effects, lender ELC fixed effects, and both. The incremental adjusted R-squared statistics capture the contributions of each category of ELC in explaining variation in contracting outcomes.

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:

$$Loan\ Term_{ijt} = \alpha + \beta_1 Connected_t + \beta_2 X_{it} + \beta_3 X_j + \sum \gamma + \sum \theta + \epsilon_{ijt} \quad (2)$$

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). As outlined in the previous section, *Connected* may take one of the following specifications: *ELC Connected with Borrower*, *ELC Connected with Lender*, and *ELC Connected*. Overall, the *Connected* variables capture those cases in which an ELC serving one side of the transaction has a recent advising relationship with the loan counterpart, thus potentially facilitating coordination and the flow of information between contracting parties. In Equation 2, we also augment X_{it} by including a control for borrower loan experience. *Borrower Loan Experience* is measured as the total number of loans obtained by a borrower prior to the current loan. This control variable aims to account for the potential influence of more experienced borrowers, who frequently engage in syndicated loan transactions, and their increased likelihood of sharing ELCs with lead arrangers. By including this control, we mitigate the possibility that the results are solely driven by the characteristics of more active borrowers in the syndicated loan market.

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

5. RESULTS

5.1 The Explanatory Role of ELCs on Loan Contract Design

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 (Column 1, coefficient of -163.632) on their loans and are bound by less tight covenants (Column 3, coefficient of -1.312). This baseline analysis also indicates that increasing firm leverage is associated with a higher cost of debt (Column 1 coefficient of 45.621), more numerous (Column 2, coefficient of 0.209) and stricter covenants (Column 3, coefficient of 0.459). Furthermore, we find that larger firms receive loans with lower spreads and fewer covenants. Overall, our analysis aligns with the findings of related research (e.g. Dennis et al. 2000) addressing the relationship between borrower time-varying characteristics and lending outcomes. This lends support to the notion that the facilities included in our final sample offer a balanced depiction of the range of loans procured by U.S. borrowers.

In Table 3 Panel A, Column 1 presents adjusted R-squared values from baseline regressions reported in Table 2. 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 Panel A 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 ELC fixed effects (Column 4), and *iii*) borrower ELC fixed effects (Column 5). By doing so, the results in Table 3 Panel A indicate how much variation in loan contracting outcomes is due to time-invariant lead arranger and ELC characteristics, respectively.

Several results are worth highlighting. First, ELC fixed effects account for a significant proportion of the unexplained variation in loan covenant characteristics. Both lender ELC fixed

effects (Column 4) and borrower ELC fixed effects (Column 5) contribute to explanatory power. When we consider both lender ELC and borrow ELC fixed effects together (Column 6) the increase in explanatory power is 5.1 percent in the *Covenants* model and 6.1 percent in the *Strictness* model. To contextualize the economic significance of these findings for the roles played by ELCs, when we add lead arranger fixed effects (Column 3) the incremental adjusted R-squared statistics increase by only 0.7 percent and 1.4 percent respectively. Second, we find that ELCs have a more limited effect on loan pricing. ELC fixed effects explain an additional 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 pricing outcomes than ELC fixed effects.

Overall, these 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 prior 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 Panel A. Specifically, we are interested in understanding whether the explanatory power of ELC fixed effects for lending outcomes is due to the specific role played by the ELCs in the loan market or whether it is a result of statistical overfitting of the regression model in Equation 1. We test the significance of our findings by re-estimating regressions for 1,000 simulated samples where we randomly assign lender ELCs and borrower ELCs to loan facilities. The simulation produces a distribution of adjusted R-squared values that serves as a benchmark for comparison with the actual incremental adjusted R-squared statistics reported in Panel A. Results in Panel B support the statistical significance of our fixed effects analysis. In particular, we observe that the incremental explanatory power of ELCs (Column 4) exceeds the 99th percentile of the simulated distribution (Column 3) for all loan contracting variables. Corroborating the findings in Panel A, we also observe that the relative

difference between the actual and the 99th percentile of the simulated distribution of the adjusted R-squared is sizable for the *Covenants* and *Strictness* outcomes, while being more moderate for loan *Spread*. In particular, based on the 99th percentile of the distribution of adjusted R-squared statistics, randomly allocated ELCs fixed effects increase the explanatory power of the *Strictness* and *Covenants* models by only 1%, whereas actual ELCs fixed effects enhance the explanatory power of these models by more than 5%.[11]

While the stepwise decompositions presented above look at the marginal contribution of ELC 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 statistic in a regression model after accounting for the correlation between the regressors and by considering all their possible permutations. Larger Shapley values indicate a higher marginal contribution of a set of regressors in explaining variations in the dependent variable (e.g., Wells 2020; Abdalla and Carabias 2022). In Table 3 Panel C, the Shapley decomposition analysis shows that the explanatory power contributed by lender ELC fixed effects and borrower ELC fixed effects is significant across all the specifications. They are also larger than the contribution of lender fixed effects. ELC fixed effects account for 18.2% of the total adjusted R-squared for *Covenants* and 16.0% of the total adjusted R-squared for *Strictness*.

5.2 Channel Analysis—Transaction Cost Engineer

[11] As reported in the Online Appendix, we obtain similar inferences supporting the significance of our ELC fixed effects models when we rely on simulated F-statistics instead of incremental adjusted R-squared values.

Having provided evidence that ELCs are important in shaping loan contract design, we now attempt to shed light on one of the potential economic channels 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 information and reducing information frictions between contracting parties (Gilson, 1984; Gordon, 1990; Coffee, 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 and exploit empirical proxies designed to capture ELCs' connectedness with loan transacting parties.

We investigate the impact of connected ELCs on the loan *Spread*, the number of *Covenants*, and the covenant *Strictness* by estimating Equation 2 and report the results in Table 4.[12] Panel A highlight significant effects when a connected ELC is involved in the loan transaction. We find that loans with a connected ELC demonstrate a reduction in loan spreads by approximately 18 basis points, representing an 8% decrease relative to the average loan spread of 235 basis points. Additionally, the presence of a connected ELC is associated with a substantial decrease in the number of covenants by 0.145, corresponding to an 8% reduction (i.e., -0.145/1.735) in covenant numerosity compared to the average covenant count of 1.735. Moreover, covenant strictness is also mitigated by approximately 0.062, amounting to an 18% reduction (i.e., -0.062/0.348) relative to the average strictness level of 0.348.

[12] Following deHaan (2021), we form our baseline sample by dropping singleton observations. As shown in the 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.

In Panel B, we independently explore the effects of ELCs advising the borrower and being connected with the lender (*Borrower ELC Connected with Lender*) and ELCs advising the lender and being connected with the borrower (*Lender ELC Connected with Borrower*). The results indicate a similar directional impact, with loans becoming cheaper and less constraining when at least one ELC acts on the deal, bridging the connection between the contracting parties. Specifically, when considering the individual effects of ELCs connected with borrowers and lenders separately, we observe that lender ELCs connected to the borrower, although infrequent, have the most substantial impact on the contracting process. These results align with the rationale that a significant component of information asymmetry in a syndicated loan originates from the borrower.

Overall, the analysis in Table 4 provides support that ELCs act as transaction cost engineers in the syndicated lending market. Connected ELCs can act as intermediaries and facilitate the flow of 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.[13]

5.2.1 Robustness to Endogeneity Concerns

Results documented in Table 4 rely on individual fixed effects to control for various time, lender, borrower, loan type, rating, and ELC invariant characteristics. However, individual fixed effects may not address the concern of inherent endogeneity due to selection between borrowers, lenders, and ELCs. We repeat the baseline analysis with varying interacted fixed effect structures to control for this potential issue. Specifically, we address endogeneity concerns arising from *i*) assortative

[13] While our empirical analysis indicates that engaging connected ELCs can alleviate information asymmetries and minimize the deadweight losses stemming from contractual frictions, there are legitimate reasons why parties may opt not to engage such ELCs. First, cost is a critical factor. Engaging a well-connected ELC can entail considerable expense. A thorough cost-benefit analysis is, therefore, necessary to assess whether the potential reductions in loan spreads and increased covenant flexibility offset the costs of employing a connected ELC. If these potential savings fail to justify the expenditure, it may not make financial sense to involve these counsels. Second, issues of privacy and confidentiality can arise. Some firms might forgo the option of hiring a connected ELC due to concerns about potential conflicts of interest and maintaining confidentiality. Specifically, an ELC with a recent working relationship with the counterparty might raise concerns about the integrity of some sensitive information. In these instances, avoiding potential risks to proprietary information may outweigh the potential benefits of improved coordination and decreased information asymmetry. Therefore, while our findings highlight the average advantages of employing connected ELCs and show that a consistent proportion of deals (38%) entail the involvement of connected ELCs, it is not surprising to observe that connected ELC are not involved in every deal.

matching of ELC with borrowers and lenders by replacing individual borrower, lender, and ELC fixed effects with *Borrower* × *Borrower ELC* and *Lender* × *Lender ELC* fixed effects and *ii*) assortative matching of borrowers and lenders (i.e., relationship banking) by including *Borrower* × *Lender* fixed effects. Results from the various specifications are presented in Table 5. The majority of our results are robust to the alternate fixed effects structures that control for various forms of selection concerns. Specifically, we continue to find lower *Spread* and *Covenants* for loans with a connected ELC. Results on *Strictness* remain directionally similar but lose statistical significance in the specifications that include *Borrower* × *Borrower ELC* and *Lender* × *Lender ELC* fixed effects (Columns 1 and 3).

5.3 Cross-Sectional Tests

5.3.1 Severity of Information Asymmetries

We explore cross-sectional heterogeneity of the connected ELC effect to better understand underlying mechanisms. Since ELCs can enhance coordination and the flow of 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. We introduce two measures of information asymmetry based on prior research. First, we exploit the different information sets to which relationship and non-relationship lead arrangers have access. Greenbaum and Thakor (1995), Boot (2000), and Bharath et al. (2008) show that outside lenders are at an information disadvantage relative to inside lenders and, 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 the corporate headquarters of the two counterparties (*Geographical Distance*). To develop our cross-sectional analysis, we partition our sample separately by *i*) relationship and non-relationship lead arrangers; and *ii*) above- and below-median 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 6.

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 coefficients on *ELC Connected* are −41.168 for the *Spread* model, −0.278 for the *Covenant* model, and −0.208 for the *Strictness* model. In the relationship lender partition, the corresponding coefficients are, respectively, −19.573 (i.e., the magnitude of the economic effect is 51% lower), −0.110 (61% lower), and −0.038 (81% lower). The differences between estimated coefficients are also statistically significant in all cases. We find similar directional evidence when we analyze our second proxy of information frictions based on the geographical distance between 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 mainly concentrated in loan facilities involving more remote lenders.

5.3.2 Nature of Information Asymmetries

In the next analysis, we attempt to throw light on the incremental nature of the information that an ELC can provide to mitigate information asymmetry. While we cannot directly examine the nature of private information transfers between the parties, we focus on settings where legal complexities might arise during the contracting process and where, consequently, information with specific legal content might be of particular value to contracting parties. To conduct our empirical analysis, we identify two scenarios involving significant legal complexities. First, we rely on situations where

borrowers have complex organizational structures. Organizational structures can present additional legal complexity in a loan deal since multiple legal entities can increase the risks arising from the terms of any debt claim. A lender might be wary of a firm transferring its resources to subsidiaries if this could reduce the residual claim of the lender on assets or increase the recovery risk and costs (Demiroglu and James, 2015). Following related literature (Craswell and Francis, 1999; Hope and Langli, 2010; Sikochi, 2020), we proxy for the organizational complexity of a borrower by counting the number of its subsidiaries. The second source of legal complexity we examine is debt structure heterogeneity (Colla et al., 2013). When a borrower has multiple and heterogenous debt types, there is a risk of coordination failure among the lenders (Ivashina et al, 2016). Coordination failure can occur because the interests of different lenders are not fully aligned and the risk from non-coordination is especially high in the event of distress or default. Following related research (e.g., Lou and Otto, 2020; John et al. 2021), we proxy for debt structure heterogeneity by computing a Herfindahl–Hirschman Index (HHI) among different debt types and by defining *Debt Heterogeneity* as 1-HHI. We expect legal complexity arising from organizational complexity and debt heterogeneity to increase information asymmetry and predict that ELCs help mitigate the associated risks through their legal expertise.

Results from the analyses are presented in Panels A (*Organizational Complexity*) and B (*Debt Heterogeneity*) of Table 7. We find that when the borrower's organizational complexity is high, connected ELCs are associated with a reduction in loan *Spread* of approximately 20 basis points more than when organizational complexity is low. Similarly, the reduction in the number of *Covenants* is also higher for firms with high organizational complexity. Tests on the equality of coefficients across the models show that these differences are statistically significant. Results for the sample with high *Debt Heterogeneity* reveal a similar story. In particular, we find that *Spread* and *Covenants* are lower for loan deals involving connected ELCs when borrowers have more heterogenous debt structures.

Although direct observation of coordination challenges and information communication involving ELCs is not possible, the insights gleaned from Table 7 help elucidate potential sources of

their critical activities. Through their specialized expertise and prior interactions, ELCs have a potentially better understanding of the legal implications arising from organizational and debt structure complexities that might be relevant to contracting outcomes. By reducing these information frictions, ELCs can improve the overall contracting terms in transactions.

5.3.3 Expertise of Contracting Parties

We perform a series of additional cross-sectional tests to better understand ELC effects on loan contracting outcomes. Specifically, we posit that connected ELCs are more likely to enhance the capabilities of inexperienced lenders in providing specialized knowledge and additional information relevant to contract design. Therefore, we expect that connected ELCs affect loan terms more materially 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 at the median.

We present the results of these cross-sectional analyses in Table 8. As predicted, we find that the effect of connected ELC is mostly driven by loans arranged by relatively less experienced lenders. In particular, we find a significantly larger decrease in *Spread* and *Strictness* through connected ELCs for facilities in the *Inexperienced Lender* partition (*ELC Connected* coefficients respectively equal to −39.758 and −0.110) compared to other loans (*ELC Connected* coefficients respectively equal to −22.229 and −0.021).

In summary, our cross-sectional findings indicate that the connectedness of ELCs becomes particularly significant under conditions of heightened information asymmetry between contracting parties, increased relevance of borrower's legal complexities, and weaker market experience of

lenders. It is within these contexts that the information flow facilitated by connected ELCs and their coordination role is more likely to influence lending outcomes.[14]

5.4 Additional Robustness Analysis

To provide explorative causal evidence supporting our main arguments, we also exploit arguably exogenous variations in the level of agency conflicts and information asymmetry between lenders and borrowers affecting demand for transaction engineering by 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*. The 2006 rulings effectively constrain the scope of directors' fiduciary duties to creditors in financially distressed firms and, as documented by extant research (Rock 2013; Amiraslani et al. 2016; Sundaresh 2019), the debt contracting relevance of financial information produced by borrowers. We predict that connected ELCs would have a more critical role in shaping loan contracting outcomes through information transfer and coordination between borrowers and lenders when the fiduciary duties of the borrower's board to creditors diminish.

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.[15] We then interact the *ELC Connected* indicator with *Post Ruling* and

[14] We further propose that the impact of connected ELCs on loan contracting outcomes becomes more relevant when borrowers have less established in-house legal counsels (ILCs) that lack well-structured internal practices for advising executives and directors on key contracts. To capture the strength of a borrower's internal legal expertise, we adopt Kwak et al.'s (2012) approach and utilize ExecuComp data to identify the top five highest-paid executives at the borrower-year level. Specifically, we identify a borrower as having a strong ILC if its general counsel/chief legal officer is included within this group. In unablated analysis, we find some preliminary evidence suggesting that ELCs have a more pronounced effect on lending terms when borrowers' in-house legal counsels hold a less prominent role within the firm, potentially indicating reduced influence in their internal advisory capacity.

[15] 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.

Delaware. Results in Table 9 show that the coefficient on the triple interaction is significantly negative in the *Covenants* (coefficient equal to −0.358) model and the *Strictness* model (coefficient equal to −0.209). The coefficient on the triple interaction is statistically insignificant in the *Spread* model. Collectively, these findings indicate that the influence of connected ELCs on loan contracting terms becomes particularly important in scenarios where reduced creditor rights and increased information asymmetry between lenders and borrowers are present. This supports the interpretation that connected ELCs facilitate coordination and information flow between the contracting parties.

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 is associated with lower spreads and fewer, less restrictive covenants, finally we analyze 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 stronger ex post economic performance in the presence of connected ELCs. Lenders should be less likely to grant loans to borrowers who experience subsequent credit rating downgrades or credit defaults 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. Specifically, we observe that the coefficient on the *ELC Connected* variable is negative and statistically significant in the credit *Downgrades* model and the *Default* model.[16] The probit analysis suggests that when a connected ELC acts in a deal *Downgrades* are 4 percent less likely and *Defaults* are 2 percent less likely. In general, the results in

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

Table 10 confirm that the influence of ELCs goes beyond lending terms and also relates to the future performance of loans.

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 borrowers or lenders to provide their specialized services during the loan negotiation process. In this study, we ask whether ELCs impact on loan contracting beyond factors documented in prior research. By using a large-scale dataset on the identities of ELCs involved in loan facility contracting, we find evidence 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 the role of ELCs as transaction cost engineers 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 efficiency of contracting by providing information that is not otherwise available to the transacting parties, thus mitigating information asymmetries and facilitating coordination in the negotiating process. ELCs employed by one party who are connected to the other party are most likely to be in positions to facilitate the flow of information between borrowers and lenders. Consistent with the transaction cost engineer hypothesis, we find that loans involving connected ELCs have lower spreads and more relaxed convent packages. We also show that the reduction in information asymmetry through ELCs leads to better loan performance in the future.

DATA APPENDIX

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 obtained by a borrower before the current loan
Covenants	Total number of covenants in the loan package
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
Debt Heterogeneity	1-HHI where HHI is a Herfindahl–Hirschman Index (HHI) of debt concentration computed as in John et al. (2021) relying on debt structure data from CapitalIQ
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
Geographical Distance	The length of the shortest path between a borrower and a lender's corporate headquarters
Leverage	Long-term debt plus current debt scaled by total assets
Lender Experience	The total dollar amount of the loans syndicated by a lender in the three years leading to the issuance of a loan
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
Organizational Complexity	The number of subsidiaries of a borrower as retrieved from the WRDS Company Subsidiary database
Profitability	Operating income scaled by total assets

Relationship Lender	A lender that has syndicated more than 50% of a borrower's loan deals by volume over the three-year period preceding the loan issuance
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
Spread	All-in-drawn loan spreads over LIBOR (in basis points)
Strictness	Covenant strictness as defined by Demerjian and Owens (2016)
Strong ILC	A dummy variable that equals one if the General Counsel/Chief Legal Officer of a borrower is one of its top five highest paid executives based on ExecuComp data
Tangibility	Property, plant, and equipment (PPENT)/total assets

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TABLES

Table 1
Panel A

This Table reports the main steps of the sample selection process. We run the analysis at the loan facility-lender's ELC-borrower's ELC level due to cases where multiple external legal counsels are observed as the primary legal counsel of the borrower or the lead arranger. Therefore, the total number of observations in our study amounts to 6,097, surpassing the count of distinct loan facilities (5,217).

	N
U.S. syndicated loan facilities over the period 1995-2021	126,989
Information available on the borrower, the leading bank, and loan characteristics	22,104
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 multiple ELCs advising the borrower or the lead arranger	+ 880
Baseline Sample	6,097

Panel B

This Table reports the identity of the top ELCs respectively active on the borrower and the lender side of loan deals in our sample.

Borrower ELC – Top 10 by Number of Deals	**Freq.**	**Percent**
Skadden, Arps, Slate, Meagher & Flom	330	5.41
Simpson, Thacher & Bartlett	275	4.51
Kirkland & Ellis	205	3.36
Jones Day	204	3.35
Latham & Watkins	192	3.15
Weil, Gotshal & Manges	185	3.03
Gibson, Dunn & Crutcher	160	2.62
Davis, Polk & Wardwell	147	2.41
Ropes & Gray	144	2.36
Vinson & Elkins	126	2.07

Lender ELC – Top 10 by Number of Deals	**Freq.**	**Percent**
Simpson, Thacher & Bartlett	461	7.56
Shearman & Sterling	430	7.05
Cahill, Gordon & Reindel	427	7.00
Cravath, Swaine & Moore	419	6.87
Moore & Van Allen	264	4.33
Latham & Watkins	261	4.28
Davis, Polk & Wardwell	260	4.26
White & Case	205	3.36
Mayer, Brown, Rowe & Maw	184	3.02
Milbank, Tweed, Hadley & McCloy	183	3.00

Panel C

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

Variable	N	Mean	p50	SD	p10	p90
Age	6,097	10.756	11.000	4.852	4.000	17.000
Borrower Loan Experience	6,097	5.817	5.000	3.769	2.000	11.000
Covenants Count	6,097	1.735	2.000	1.183	0.000	3.000
Default Dummy	6,097	0.038	0.000	0.191	0.000	0.000
Downgrades Dummy	6,097	0.310	0.000	0.462	0.000	1.000
ELC Connected with Borrower	6,097	0.019	0.000	0.135	0.000	0.000
ELC Connected with Lender	6,097	0.383	0.000	0.486	0.000	1.000
ELC Connected	6,097	0.387	0.000	0.487	0.000	1.000
Leverage	6,097	0.347	0.308	0.249	0.046	0.657
Loan Size	6,097	5.443	5.521	1.318	3.689	7.131
Maturity	6,097	54.443	60.867	21.854	12.233	85.200
MB	6,097	1.676	1.418	0.856	0.999	2.616
Profitability	6,097	0.126	0.120	0.088	0.043	0.222
Secured Dummy	6,097	0.669	1.000	0.470	0.000	1.000
Senior Dummy	6,097	0.999	1.000	0.031	1.000	1.000
Size	6,097	7.591	7.476	1.651	5.588	9.825
Spread	6,097	234.648	200.000	161.092	60.000	437.500
Strictness	4,313	0.348	0.077	0.418	0.000	0.999
Tangibility	6,097	0.314	0.236	0.248	0.041	0.701

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-lender's ELC-borrower's ELC 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
Size	-7.692***	-0.146***	0.008
	(-3.104)	(-5.666)	(0.816)
Age	0.172	0.006	0.001
	(0.290)	(1.196)	(0.425)
Profitability	-163.632***	0.644**	-1.312***
	(-4.841)	(2.192)	(-11.914)
Tangibility	23.004**	-0.083	0.040
	(2.511)	(-0.954)	(1.128)
MB	-9.661***	-0.019	-0.015
	(-3.685)	(-0.779)	(-1.436)
Leverage	45.621***	0.209**	0.459***
	(4.407)	(2.022)	(10.602)
Maturity	-0.424***	0.003**	-0.001**
	(-3.408)	(2.452)	(-2.082)
Loan Size	-14.842***	-0.005	-0.025***
	(-6.347)	(-0.180)	(-2.866)
Covenants Count	-13.434***		
	(-5.984)		
Secured Dummy	86.530***	0.263***	0.034
	(15.576)	(4.371)	(1.506)
Spread		-0.001***	0.000***
		(-5.771)	(4.279)
FE	Year, Loan Type, Rating	Year, Loan Type, Rating	Year, Loan Type, Rating
Observations	6,097	6,097	4,313
Adjusted R-squared	0.526	0.281	0.337

Table 3

Panel A

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 variation in loan design outcomes.

	(1)	(2)	(3)	(4)	(5)	(5) − (3)
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	
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%***	***1.24%***
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%***

Panel B

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%***	***

Panel C

This Table reports the Shapley decomposition of the model's adjusted R-squared (Shapley, 1953). Each row represents the percentage of the adjusted R-squared that is explained by a group of variables.

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

Table 4

This Table reports OLS regressions of contractual outcomes on loan characteristics, borrower characteristics, and fixed effects. The *ELC Connected* dummies capture those ELCs representing the lender (borrower) and also connected with the borrower (lender) through a recent counselling relationship (a full description of the variables is provided in the Appendix). The dependent variables respectively represent the loan interest *Spread*, the number of *Covenants*, and covenant *Strictness*. Observations enter the regressions at the loan facility-lender's ELC-borrower's ELC 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	Covenants	Strictness
ELC Connected	**-18.669*** **	**-0.145** **	**-0.062** **
	(-3.095)	**(-2.473)**	**(-2.016)**
Size	-27.466***	0.011	0.074**
	(-3.727)	(0.175)	(2.033)
Age	4.253	0.030	0.035
	(1.610)	(1.110)	(0.362)
Profitability	-228.720***	0.387	-1.383***
	(-4.111)	(0.730)	(-4.706)
Tangibility	125.311***	-0.172	0.040
	(2.998)	(-0.437)	(0.184)
MB	-18.396***	0.020	0.024
	(-3.374)	(0.381)	(0.854)
Leverage	31.92	-0.391**	0.339***
	(1.118)	(-2.135)	(3.049)
Maturity	-0.126	0.001	0.000
	(-0.937)	(1.166)	(0.695)
Loan Size	-5.842**	0.009	-0.003
	(-2.480)	(0.889)	(-0.911)
Covenants Count	-7.330**		
	(-2.457)		
Spread		-0.000**	0.000
		(-2.393)	(0.638)
Secured Dummy	1.961	0.364***	0.021
	(0.234)	(4.649)	(0.629)
Borrower Loan Experience	-2.416	0.010	0.004
	(-0.932)	(0.399)	(0.345)
Lender ELC FE	YES	YES	YES
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
Rating FE	YES	YES	YES
Observations	5,389	5,389	3,771
Adj. R-squared	0.751	0.792	0.782

Panel B

	(1)	(2)	(3)	(4)	(5)	(6)
	Spread	Covenants	Strictness	Spread	Covenants	Strictness
Borrower ELC Connected with Lender	**-18.771*** **	**-0.110***	**-0.076** **			
	(-3.089)	**(-1.947)**	**(-2.559)**			
Lender ELC Connected with Borrower				**-68.620** **	**-0.648** **	**-0.170***
				(-2.221)	**(-2.475)**	**(-1.913)**
Time-varying controls	YES	YES	YES	YES	YES	YES
Borrower ELC FE	YES	YES	YES	NO	NO	NO
Lender ELC FE	NO	NO	NO	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
Observations	5,440	5,440	3,817	5,439	5,439	3,810
Adj. R-squared	0.742	0.774	0.753	0.75	0.769	0.754

Table 5

This Table reports OLS regressions of contractual outcomes on loan characteristics, borrower characteristics, and various fixed effects structures. The *ELC Connected* dummies capture those ELCs representing the lender (borrower) and also connected with the borrower (lender) through a recent counselling relationship (a full description of the variables is provided in the Appendix). 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-lender's ELC-borrower's ELC 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	Spread	Spread
ELC Connected	**-32.59*** (-3.38)**	**-25.083*** (-3.99)**	**-28.743*** (-3.74)**
Time-varying controls	YES	YES	YES
Borrower FE × Borrower ELC FE	YES	NO	YES
Lender FE × Lender ELC FE	YES	NO	YES
Borrower FE × Lender FE	NO	YES	YES
Borrower FE	NO	YES	NO
Lender FE	NO	YES	NO
Year FE	YES	YES	YES
Loan Type	YES	YES	YES
Rating FE	YES	YES	YES
Observations	4,915	5,034	4,697
Adjusted R-squared	0.752	0.769	0.860

Panel B

	(1)	(2)	(3)
	Covenants	Covenants	Covenants
ELC Connected	**-0.158** (-2.14)**	**-0.165** (-2.28)**	**-0.204** (-2.28)**
Time-varying controls	YES	YES	YES
Borrower FE × Borrower ELC FE	YES	NO	YES
Lender FE × Lender ELC FE	YES	NO	YES
Borrower FE × Lender FE	NO	YES	YES
Borrower FE	NO	YES	NO
Lender FE	NO	YES	NO
Year FE	YES	YES	YES
Loan Type	YES	YES	YES
Rating FE	YES	YES	YES
Observations	4,915	5,034	4,697
Adjusted R-squared	0.851	0.834	0.920

	Panel C		
	(1)	(2)	(3)
	Strictness	Strictness	Strictness
ELC Connected	**-0.052**	**-0.063***	**-0.040**
	(-1.23)	**(-1.68)**	**(-0.89)**
Time-varying controls	YES	YES	YES
Borrower FE × Borrower ELC FE	YES	NO	YES
Lender FE × Lender ELC FE	YES	NO	YES
Borrower FE × Lender FE	NO	YES	YES
Borrower FE	NO	YES	NO
Lender FE	NO	YES	NO
Year FE	YES	YES	YES
Loan Type	YES	YES	YES
Rating FE	YES	YES	YES
Observations	3,425	3,549	3,295
Adjusted R-squared	0.841	0.896	0.913

Table 6

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 counselling relationship (a full description of the variables is provided in the Appendix). 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-lender's ELC-borrower's ELC 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	Non-relationship Lender	Relationship Lender	Non-relationship Lender	Relationship Lender	Non-relationship Lender
ELC Connected	**-19.573****	**-41.168****	**-0.110**	**-0.278***	**-0.038**	**-0.208****
	(-2.559)	**(-2.339)**	**(-1.235)**	**(-1.884)**	**(-0.802)**	**(-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	
	Remote Lender	Close Lender	Remote Lender	Close Lender	Remote Lender	Close Lender
ELC Connected	**-22.55*** **	**-20.21** **	**-0.223** **	**-0.124**	**-0.174*** **	**-0.033**
	(-2.853)	**(-2.220)**	**(-2.331)**	**(-1.368)**	**(-3.573)**	**(-0.632)**
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	2,464	2,403	1,664	1,703
R-squared	0.790	0.744	0.852	0.818	0.847	0.824

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 borrower has a low or a high number of subsidiaries (Panel A); or the borrower has low or high debt structure heterogeneity (Panel B). The *ELC Connected* dummies capture those ELCs representing the lender (borrower) and also connected with the borrower (lender) through a recent counselling relationship (a full description of the variables is provided in the Appendix). 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-lender's ELC-borrower's ELC 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	
	Low Organizational Complexity	High Organizational Complexity	Low Organizational Complexity	High Organizational Complexity	Low Organizational Complexity	High Organizational Complexity
ELC Connected	**-15.189**	**-35.199*** **	**-0.016**	**-0.315** **	**-0.074**	**-0.027**
	(-1.366)	**(-3.043)**	**(-0.113)**	**(-2.366)**	**(-1.387)**	**(-0.380)**
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)	0.064		0.040		0.047	
Observations	1,688	1,767	1,688	1,767	1,173	1,247
Adjusted R-squared	0.773	0.793	0.845	0.854	0.900	0.856

Panel B

	(1)	(2)	(3)	(4)	(5)	(6)
	Spread		Covenants		Strictness	
	Low Debt Structure Heterogeneity	High Debt Structure Heterogeneity	Low Debt Structure Heterogeneity	High Debt Structure Heterogeneity	Low Debt Structure Heterogeneity	High Debt Structure Heterogeneity
ELC Connected	**-7.677**	**-21.520****	**0.007**	**-0.219***	**-0.018**	**-0.081**
	(-0.643)	**(-2.091)**	**(0.078)**	**(-1.866)**	**(-0.390)**	**(-1.427)**
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)	0.084		0.057		0.062	
Observations	2,138	2,341	2,138	2,341	1,489	1,678
Adjusted R-squared	0.764	0.775	0.840	0.860	0.872	0.881

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. The *ELC Connected* dummies capture those ELCs representing the lender (borrower) and also connected with the borrower (lender) through a recent counselling relationship (a full description of the variables is provided in the Appendix). 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-lender's ELC-borrower's ELC 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)	(4)	(5)	(6)
	Spread		Covenants		Strictness	
	Inexperienced Lender	Experienced Lender	Inexperienced Lender	Experienced Lender	Inexperienced Lender	Experienced Lender
ELC Connected	**-39.758*** (-3.461)**	**-22.229*** (-2.842)**	**-0.244* (-1.796)**	**-0.127 (-1.493)**	**-0.110* (-1.936)**	**-0.021 (-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

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-lender's ELC-borrower's ELC 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
Leading Bank 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-lender's ELC-borrower's ELC 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

Online Appendix A

This Table reports a univariate analysis that compares the facilities in our final selection with facilities where the financial data of the firm is accessible, but no borrower-ELC and lender-ELC information is available.

	With ELC on Both Sides of the Deal			Without ELC on Both Sides of the Deal			Diff. In Means	*p-value*
	N	**Mean**	**p50**	**N**	**Mean**	**p50**		
Loan Characteristics								
Spread	6,097	234.648	200.000	16,007	185.251	162.500	49.397	***0.000***
Maturity	6,097	54.443	60.867	16,007	44.734	48.700	9.710	***0.000***
Covenants Count	6,097	1.735	2.000	16,007	1.413	1.000	0.322	***0.000***
Strictness	4,313	0.348	0.077	7,873	0.410	0.170	-0.061	***0.000***
Loan Size	6,097	5.443	5.521	16,007	5.067	5.165	0.376	***0.000***
Secured Dummy	6,097	0.669	1.000	16,007	0.470	0.000	0.199	***0.000***
Senior Dummy	6,097	0.999	1.000	16,007	0.999	1.000	0.001	*0.352*
Borrower Characteristics								
Size	6,097	7.591	7.476	16,007	7.360	7.245	0.231	***0.000***
Age	6,097	10.756	11.000	16,007	8.253	8.000	2.503	***0.000***
Profitability	6,097	0.126	0.120	16,007	0.127	0.122	-0.002	*0.202*
Tangibility	6,097	0.314	0.236	16,007	0.314	0.259	0.000	*0.899*
MB	6,097	1.676	1.418	16,007	1.700	1.407	-0.024	***0.080***
Leverage	6,097	0.347	0.308	16,007	0.335	0.313	0.012	***0.000***
Lender Characteristics								
Experienced Lender	6,097	0.504	1.000	16,007	0.567	1.000	-0.063	***0.000***

Online 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	(4) − (3)	
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***	***

Online Appendix C

This Table reports correlation coefficients among the primary variables. * 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)
(1) Age	1.00																	
(2) Borrower Loan Experience	0.369*	1.000																
(3) Covenants Count	-0.245*	-0.144*	1.000															
(4) Default Dummy	-0.025*	0.020	-0.011	1.000														
(5) Downgrades Dummy	-0.012	0.078*	0.069*	0.296*	1.000													
(6) ELC Connected	0.097*	0.103*	-0.167*	-0.046*	0.000	1.000												
(7) ELC Connected with Borrower	-0.069*	0.027*	0.050*	-0.021	0.097*	0.173*	1.000											
(8) ELC Connected with Lender	0.096*	0.090*	-0.164*	-0.044*	-0.001	0.992*	0.117*	1.000										
(9) Leverage	-0.078*	0.107*	0.066*	0.103*	0.100*	-0.033	0.007	-0.037*	1.000									
(10) Loan Size	0.221*	0.328*	-0.201*	-0.026*	0.163*	0.190*	-0.016	0.187*	-0.047*	1.000								
(11) Maturity	-0.059*	-0.077*	0.107*	0.002	0.166*	0.043*	0.057*	0.047*	0.063*	0.007	1.000							
(12) MB	-0.027*	-0.080*	0.004	-0.072*	-0.101*	0.049*	-0.039*	0.053*	-0.115*	0.040*	0.043*	1.000						
(13) Profitability	0.026*	0.015	0.080*	-0.079*	0.007	0.082*	0.023	0.083*	0.005	0.100*	0.109*	0.448*	1.000					
(14) Secured Dummy	-0.177*	-0.136*	0.197*	0.097*	0.083*	-0.130*	0.024	-0.132*	0.228*	-0.345*	0.283*	-0.137*	-0.116*	1.000				
(15) Senior Dummy	0.008	0.015	0.024	0.006	0.010	0.025	0.004	0.025	0.015	0.004	0.008	0.003	-0.006	0.011	1.000			
(16) Size	0.322*	0.385*	-0.314*	-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		
(17) Spread	-0.008	-0.069*	-0.026*	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	
(18) Strictness	-0.124*	-0.060*	0.300*	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