

Private Equity Sponsors, Law Firm Relationship, and Loan Contracts in Leveraged Buyouts

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Abstract

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Keywords: Leveraged Buyout, Private Equity, Loan Covenant, Law Firms

JEL Classifications: G21; G24; G32; G34; K22; L14

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Private Equity Sponsors, Law Firm Relationship, and Loan Contracts in Leveraged Buyouts*

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1. Introduction

Leveraged buyouts (LBOs), transactions that involve a private equity (PE) sponsor raising a substantial amount of debt to acquire a controlling equity stake in a target firm, are controversial. While the literature identifies several benefits associated with the buyout financing structure, it also raises concerns about excessive leverage incentivizing PE sponsors to extract value from creditors (see, e.g., Cumming, Siegel, and Wright, 2007; Kaplan and Strömberg, 2009; and Jenkinson, Kim, and Weisbach, 2023). Because covenants are important tools for creditor protection, a key question in this literature is how the involvement of PE sponsors shapes loan covenant design. Although PE sponsors, as repeated borrowers, can have reputational concerns that mitigate the incentive to exploit creditors (e.g., Malenko and Malenko, 2015), recent work also suggests that sophisticated PE sponsors leverage their bargaining power and debt expertise to push for more borrower-friendly loan terms (e.g., Badawi, Dyreng, de Fontenay, and Hills, 2022; Ivashina and Vallee, 2025).

In this paper, we highlight a previously overlooked venue through which PE sponsors exert influence in LBO financing: their relationships with the law firms that represent lenders (“lender law firms”).¹ Transactional lawyers play an integral role in drafting and bargaining over the loan contract terms, presumably in the interests of the parties they represent (e.g., Ryan, 2008; de Fontenay, 2015). However, in LBOs, instead of lenders independently selecting their legal advisors, PE sponsors often influence or even dictate which law firm represents the lending syndicate—a practice widely discussed by practitioners, journalists, and regulators as the “designated lender counsel”.² When a lender law firm also has long-standing relationships

¹ Throughout the paper, we use the terms “lead bank”, “bank”, and “lender” interchangeably to denote the lead bank of a syndicated loan in a leveraged buyout transaction. Lender law firms are those who advise the lead bank. In practice sometimes “lender law firms” are also called “lender-side law firms”, but we use “lender law firms” for conciseness.

² See, for example, “A Growing Conflict in Wall St Buyouts” in *The New York Times* (Jan. 4, 2016); “Law Firms in Focus as Leveraged Loan Docs Deteriorate” in *Reuters* (May 18, 2018); “Designated Lawyers Could Leave Lenders in the Lurch” in *Private Debt Investor* (July 1, 2019); “Private Lenders Lawyer Up as Unease Grows Over Appointed Counsel” in *Bloomberg* (July 5, 2022); “Why ‘Designated Counsel’ is the Most Problematic Issue in Corporate Law” in *Law.com* (Feb 28, 2023).

with the PE sponsor, the arrangement becomes controversial. Proponents argue that using a relationship counsel enhances efficiency by reducing information frictions. Others, however, express concerns that such arrangements may compromise the independence of legal advice provided to lenders, thereby weakening creditor protection (e.g., Coates, 2001; Polinsky and Rubinfeld, 2003; Susskind, 2008; de Fontenay 2015).³ These concerns are particularly acute in today’s buyout market. Under the originate-to-distribute (OTD) model, lead banks often retain only a small portion of the loan, reducing their “skin in the game” and potentially weakening their incentives to insist on strong creditor protection. At the same time, banks increasingly compete for mandates from PE sponsors—whose repeat deal flow can be highly lucrative—and face growing competition from private credit lenders. Therefore, banks may be willing to agree to sponsors’ preferences, including the use of relationship law firms, even when such arrangements potentially compromise the independence and rigor of lender counsel.

Using a sample of syndicated loans in U.S. LBOs from 1995 to 2025, we provide the first systematic empirical evidence on how PE sponsors’ ties with lender law firms, referred to as the PE–Lender Law Firm relationship, affect law firm choice in LBO transactions and shape loan contracting outcomes. We measure this relationship as the share of the PE sponsor’s loan volume over the prior three years involving a given law firm, whether on the borrower or lender side. In our sample, close to half of loans involve lender law firms that have previously worked with the PE sponsor, underscoring the empirical relevance of this channel.

Our empirical analysis proceeds in several steps. We begin by examining how the PE–Lender Law Firm relationship affects lender law firm selection. In the regressions, the PE–Lender Law Firm relationship emerges as a strong determinant of lender law firm choice. Holding all else equal, if a law firm has a stronger previous relationship with the PE sponsor,

³The International Organization of Securities Commissions (IOSCO) also highlighted that the PE sponsors-lender law firm connection potentially compromises the independence of legal advice received by lenders and thus harms creditors’ interest. See Consultation Report CR05/2023 (“Leveraged Loans and CLOs – Good Practices for Consideration.”)

this law firm is significantly more likely to be chosen as the lender's law firm. This finding and various anecdotes collectively suggest that PE sponsors significantly influence the selection of lenders' law firms.

We next examine how these relationships affect covenant design. Our findings show that when the PE-Lender Law Firm relationship is stronger, loan covenant terms indeed become more sponsor/borrower friendly. Specifically, loans are less likely to include dividend restriction covenants, and the total number of maintenance and incurrence covenants is significantly lower. The results remain robust and consistent after controlling an extensive set of loan, borrower characteristics, and fixed effects, reinforcing the concern that relationship law firm may weaken the quality of lender representation. Consistent with differences in bargaining power and reputational incentives, the effect is attenuated when either the lender's law firm or the lender itself holds greater market prominence. This pattern suggests that stronger reputational capital or negotiating leverage can mitigate, though not fully eliminate, the influence of PE sponsors on covenant design.

To address potential endogeneity, we implement two identification strategies. First, we exploit geographic distance between PE sponsors and law firms as an instrumental variable, drawing on research showing that proximity shapes law firm–client relationships (e.g., Henderson and Galanter, 2008; de Fontenay, 2016). Our two-stage least square (2SLS) regression results confirm a significant negative association between distance and the PE-Lender Law Firm relationship in the first stage (relevance condition). Meanwhile, it is unlikely that individual loan covenants are directly related to PE/Lender Law Firm headquarter locations, which were largely determined at these firms' founding time years ago (exclusion condition). The second stage regression shows that the impact of the PE-Lender Law Firm relationship on covenants remains robust.

In another test, we employ a difference-in-differences (DiD) design that exploits the

January 4, 2016 publication of Andrew Ross Sorkin’s New York Times article, “*A Growing Conflict in Wall St. Buyouts.*” This widely circulated and largely unexpected piece drew significant attention to the designated-counsel practice in LBOs and raised concerns about conflicts of interest when PE sponsors influence the selection of lender counsel.⁴ We treat the article as an exogenous increase in investor and market scrutiny of relationship lender law firms. Consistent with this interpretation, we find that PE sponsors with stronger pre-existing ties to lender law firms substantially reduced their reliance on relationship counsel after the shock, and the covenant packages in their post-shock loans became correspondingly tighter. These findings reinforce our baseline results by showing that reductions in PE–Lender Law Firm relationships lead to stronger creditor protections, supporting the view that our earlier evidence reflects sponsor influence rather than borrower fundamentals.

We then explore why lenders might accept potentially conflicted counsel. We show that lenders who accommodate sponsors’ preferred law firms are more likely to be included in the sponsor’s next loan syndicate, consistent with quid-pro-quo-type reciprocal arrangements (e.g., Fang, Ivashina, and Lerner, 2013; Jenkinson, Jones, and Suntheim, 2018). This dynamic is particularly concerning in the originate-to-distribute (OTD) environment, where lead banks retain limited skin in the game but are more motivated by deal volume, potentially weakening their incentives to insist on strong creditor protections (e.g., Sufi, 2007; Bord and Santos, 2011; Wang and Xia, 2014; Zhang, Zhang, and Zhao, 2023).

Finally, we examine how loan investors perceive designated-counsel arrangements. If fewer covenants simply reflected more efficient contracting or superior borrower quality, loan spreads should decline. If, instead, they signal weakened creditor protection arising from conflicts of interest, investors should demand compensation. Consistent with the latter view,

⁴ See, for example, “A Private Equity Conflict Grows on Wall Street” in *Fortune* (Jan 5, 2016); “Private Equity Firms Muscling Lenders by Choosing and Paying for Their Lawyers” in *Nakedcapitalism* (Jan 5, 2016); “What is a Designated Lender Counsel” by Sulaiman Law Group; “Designated Lender Counsel in Private Equity Loans” in *Harvard Law School Forum* (Jan 19, 2016).

we find that stronger PE–Lender Law Firm relationships are associated with significantly higher loan spreads, and that these loans experience higher ex post default and bankruptcy rates. Loan investors thus price-protect against the elevated credit risks created by potential conflicts of interest in the contracting process. Importantly, the resulting higher spreads are ultimately borne by the underlying portfolio company, representing an agency cost of PE sponsors’ influence over lender counsel.

Taken together, our paper makes contributions to several strands of literature. First, our paper contributes to the literature on private equity and leveraged buyouts by identifying a new channel through which PE sponsors shape debt contract outcomes. An important question concerning buyout transactions is the underlying sources of value creation.⁵ Earlier research attributes at least part of the return generated to a wealth transfer from other parties, such as creditors (Marais, Schipper, and Smith, 1989; Warga and Welch, 1993). Although reputational considerations in repeated borrowing can mitigate some agency conflicts (e.g., Demiroglu and James, 2010; Achleitner, Braun, Hinterramskogler, and Tappeiner, 2012; Huang, Ritter, and Zhang, 2014; Badoer, Emin, and James, 2023), recent studies emphasize that PE sponsors may still use their transactional expertise and bargaining power to extract value from creditors (e.g., Badawi, Dyreng, de Fontenay, and Hills, 2022; Buccola and Nini, 2024; Ivashina and Vallee, 2025). We contribute to this literature by documenting that PE sponsors’ pre-existing ties to lender law firms, an overlooked contracting channel, systematically weaken covenant protections and are viewed by creditors as a risk factor, as evidenced by higher spreads and default rates.

Second, our paper is related to the literature on the originate-to-distribute (OTD) model,

⁵ For example, see evidence on value creation from PE sponsors taking advantage of tax benefits of leverage (e.g., Guo, Hotchkiss, and Song, 2011), corporate governance improvement (e.g., Acharya, Gottschalg, Hahn, and Kehoe, 2013), operation performance gain (e.g., Kaplan, 1989; Cohn, Hotchkiss, and Towery, 2022), resolution of financial distress (e.g., Hotchkiss, Smith, and Stromberg, 2021). Haque, Mayer, and Wang (2024) study the substitution between PE sponsors monitoring and bank monitoring.

which argues that lead banks' screening and monitoring incentives may weaken when they can sell or securitize loans (e.g., Sufi 2007; Shivdasani and Wang, 2011; Wang and Xia 2014; Winton and Yerramilli 2021). We complement and extend this line of work by identifying a new mechanism through which a bank's monitoring efficacy can be compromised—the selection of the bank's legal counsel, which plays a central role in drafting and negotiating loan terms. Our evidence suggests that the organization of the contracting process itself can erode monitoring incentives, an effect that is likely further exacerbated when the lead bank's skin-in-the-game diminishes under the OTD model and when lead banks depend on PE sponsors to funnel deal flow and compete for future mandates with other lenders including private credit funds. While we find that reputational concerns of a lead bank can partially mitigate these distortions, they do not seem to fully offset the influence associated with PE sponsors' relationship counsel.

Our study also adds to a growing law and finance literature on the role of law firms in the capital market.⁶ Prior studies argue that law firms reduce transaction frictions by certifying deal quality (e.g., Kraakman, 1986) and by leveraging their information advantages in negotiations (Gilson, 1984; de Fontenay, 2015, 2016). However, agency conflicts may distort lawyers' incentives when clients cannot effectively monitor them (e.g., Coates, 2001; Polinsky and Rubinfeld, 2003; Susskind, 2008; de Fontenay, 2015). Our evidence suggests that such distortions are economically meaningful: when lender counsel has strong ties to the sponsor, creditor protection weakens. Thus, the benefits of legal expertise may be partially offset by incentive misalignment in environments where relationship-driven counsel selection is feasible.

2. Data Sources and Sample Construction

2.1 Sample Construction

⁶ See studies examining the role of law firms in mergers and acquisitions (Krishnan and Masulis, 2013), venture capital (Cumming, Nguyen, Pham and Truong, 2023), and initial public offerings (Beatty and Welch, 1996; Moran and Pandes, 2019).

We collect a sample of loan tranches from the Refinitiv DealScan database. As an initial screen, we include loan tranches used to finance leveraged buyouts, syndicated in the United States, denominated in US dollars, borrowed by US firms with a single private equity sponsor, and issued between January 1, 1995, and March 31, 2025. We also require lender law firm information to be non-missing from DealScan.⁷ We obtain borrower financial information from Compustat (Chava and Roberts, 2008). We exclude loans to financial borrowers (SIC Code 6000-6999) and utility borrowers (SIC Code 4899-5000). Following the literature (e.g., Demiroglu and James, 2010; Guo, Hotchkiss, and Song, 2011; Shive and Forster, 2024), we also exclude loans with missing borrowers' financial information at the end of the fiscal year prior to the LBO transactions. Therefore, our sample consists of public-to-private buyout transactions. This criterion leaves us with 650 loan tranches.⁸ Our final baseline regression sample uses 432 observations at the loan tranche level with all non-missing regression variables and various fixed effects, with some minor variations in sample size depending on the regression specification used.

2.2 Key Variable Definition

We follow the relationship banking literature (e.g., Bharath, Dahiya, Saunders and Srinivasan, 2007, 2011; Ivashina and Kovner, 2011; Zhang, Zhang and Zhao, 2024) and construct two proxies for measuring the relationship between a PE sponsor and a law firm.⁹ Our main measure, *RelationAmt_PELaw*, is calculated as dividing the total dollar amount of loan tranches sponsored by the PE firm j in collaboration with the law firm l (either as lender or borrower side law firm), by the total dollar amount of loan tranches that PE firm j sponsored

⁷ To precisely determine the one-to-one relationship between the PE sponsor and the lender law firm, we retain loan tranches involving a single PE sponsor and a single lender law firm. Among the loan tranches that have lender law firm information, only a small portion (3%) involve multiple lender law firms.

⁸ We also conduct a test using private-to-private transactions (i.e., borrowers cannot be matched with Compustat). Our main results remain qualitatively similar. However, in this sample we are no longer able to control for borrower financial characteristics, which can give rise to potential omitted variable bias. Therefore, for subsequent analyses, we still focus on the public-to-private transaction sample.

⁹ To identify unique law firms and calculate relationships, we manually check the merger history of each law firm.

over the past three years. We construct the measure based on transaction count *RelationCount_PELaw* for robust checks. We also measure the relationship between the lender and its law firm to control for the potential effect of the lender–law firm relationship on law firm selection and loan terms. The variable is calculated by dividing the total dollar amount of loan tranches extended by the lender b in collaboration with the law firm l (as the lender side law firm), by the total amount of loan tranches that the lender b issued over the past three years.¹⁰¹¹ Since the interactions between PE sponsors and law firms, as well as those between lenders and law firms, likely extend beyond LBO loans to other sponsored loan tranches. Therefore, we calculate relationships based on the entire sample of sponsored loan tranches.

2.3 Summary Statistics

We present summary statistics for the key variables of 432 LBO loan tranches in Table 1. The key independent variable, *RelationAmt_PELaw* has a mean value of 0.18. *RelationAmt LenderLaw* has a mean value of 0.22. The mean values of profitability and leverage for borrowers is 13.5% and 31.9%, respectively. The mean value of modified Z-score is 1.48. The mean value of total assets is \$5.49 billion. Regarding loan-specific variables, the average value of All-in-Spread-Drawn is 398.71 basis points. The average loan amount is \$367.58 million. *Secured Dum* has a mean value of 92.4%, indicating that most loans in this sample are secured. *Maturity* shows an average value of 70.54 months or approximately 6 years. Finally, the *LoanDefault 3Years* and *Bankruptcy 3Years* dummies have mean values of 0.012 and 0.009, respectively, suggesting that 1.2% of loan tranches in our sample defaults within three years after the loan tranche active date, and 0.9% of borrowers file for bankruptcy within three years.

¹⁰ For robustness checks, we also measure the Lender–Law Firm relationship using the total dollar amount of loan tranches extended by lender b in collaboration with law firm l (whether acting as the lender-side counsel or the borrower-side counsel). The results remain consistent.

¹¹ A lender is defined the lead bank if it is reported in DealScan as the administrative agent. If no lender is reported as the administrative agent, we define a lender that acts as the agent, arranger, book-runner, lead arranger, lead bank, or lead manager as the lead bank by following Ivashina (2009); Zhang, Zhang and Zhao (2024).

3. Regression Results

3.1 PE-Law Firm Relationship and Lender Law Firm Selection

In this section, we investigate whether a stronger previous relationship between a PE sponsor and a law firm increases the likelihood that the law firm will be selected as legal counsel representing the lender in the current LBO loan deal. Following the method of Corwin and Schultz (2005) and Kuhnen (2009), we estimate a model at the loan tranche-eligible law firm level to explain law firm selection. For each loan, we create a list of eligible law firms from which lenders may choose. We define an eligible law firm as one that has served as either a borrower's or a lender's law firm in the three years preceding the current loan tranche issuance. Since each loan has multiple law firm candidates, we have 215,285 observations at the loan tranche-eligible law firm level. Using this sample, we estimate a linear probability regression as specified in Equation (1):

$$LenderLawFirm_Selection_{ilb} = \alpha + \beta * RelationAmount_PELaw_{ijlb} + Controls_{ijltb} + Fixed\ Effects + \varepsilon_{ijltb}, \quad (1)$$

where i , j , l , and b stand for loan tranche, PE sponsor, law firm, and bank, respectively. The dependent variable $LenderLawFirm_Selection_{ilb}$ takes the value of one if an eligible law firm l is chosen by the lender b in the loan tranche i . In the regressions, we also include year, PE sponsor, bank, law firm, and Fama-French 48 industry dummies to control for various fixed effects. Loan type fixed effects are also included to account for differences between term loans and revolvers (e.g., Ivashina and Kovner, 2011; Berlin, Nini, and Yu, 2020).¹²

The regression results are reported in Table 2. In Column (1), the coefficient on the

¹² Berlin, Nini, and Yu (2020) show that, while terms loans can go covenant-lite, revolving credit lines in the same package almost always retain traditional financial covenants, if any. Therefore, it is important to use both revolvers and term loans when we examine covenants.

variable *RelationAmt_PELaw* is 1.05 and is statistically significant at the one percent level. This result suggests that, all else equal, a strong PE-Law Firm relationship is associated with a significantly higher likelihood of the eligible law firm being selected as the lender law firm. It is possible that a lender selects a law firm because of the lender's pre-existing relationship with this law firm. To account for this potential confounding factor, we further include *RelationAmt_LenderLaw*, which measures the total loan amount jointly handled by the lender and the law firm over the past three years. Our result in Table 2 Column (2) shows that the coefficient on *RelationAmt_PELaw* remains positive and statistically significant at the one percent level. These findings suggest that PE-Law Firm relationship itself plays a significant role in affecting lender law firm choice, even after controlling for the potential effect of the lender-law firm relationship. The result is consistent with the "designated counsel" practice.

3.2 PE-Law Firm Relationship and Loan Covenant Structure: Baseline Results

Results in Table 2 show that a law firm with closer relationships with the PE sponsor is more likely to be chosen as the lender's law firm. These findings naturally raise concerns about whether this law firm can still impartially represent the lender's interests when negotiating with the PE sponsor. To empirically examine how PE-Lender Law Firm relationship affects loan covenant design, we estimate the following regression:

$$Covenant_i = \alpha + \beta_1 * RelationAmtPELaw_{ijlb} + Controls_{ijltb} + Fixed\ Effects + \varepsilon_{ijltb}, \quad (2)$$

where i, j, l, b stands for loan tranche, PE sponsor, law firm, and bank, respectively. In the equation, the dependent variable is either *Dividend Restriction_{it}*, which is a dummy variable that takes one if there is a dividend restriction in the loan tranche i , and zero otherwise, or *NumCovs_{it}*, which includes three other covenant measures (*Number of Maintenance Covenants*, *Number of Incurrence Covenants*, and *Number of All Covenants*) in the loan

tranche *i*. We incorporate various borrower loan characteristics controls. We also include the borrower's industry, year, lender, law firm, loan type, and PE fixed effects. We report the adjusted within-R-squared to demonstrate that our model's explanatory power is not solely coming from the fixed effects (Breuer and deHaan, 2024).

We report the estimation results in Table 3. Column (1) examines the impact of the PE-Lender Law Firm relationship on the likelihood of imposing dividend payout restrictions. The coefficient on *RelationAmt_PELaw* is statistically significant and negative at the one percent level. Economically, a one-standard-deviation increase in *RelationAmt_PELaw* decreases the likelihood of imposing dividend restriction by 22.64% (0.861×0.263). Columns (2) to (4) of Table 3 show the impact of the PE-Lender Law Firm relationship on the number of different covenants. The coefficients on *RelationAmt_PELaw* are all negative and statistically significant across the columns.¹³ In Column (2), all else equal, a one-standard-deviation increase in *RelationAmt_PELaw* is associated with a reduction of the total number of maintenance covenants by 0.56, which represents approximately 66% of the standard deviation of the dependent variable. In Column (3), the number of incurrence covenants decreases by 0.92 (or 25.1% of its standard deviation) with a one-standard-deviation increase in *RelationAmt_PELaw*. In Column (4), a one-standard-deviation increase in *RelationAmt_PELaw* leads to a decrease in the number of all covenants by 1.47 (or 33.6% of its standard deviation).

3.3 PE-Law Firm Relationship, Market Prominence, and Covenant Restriction

Results in Tables 3 show that closer relationships between lender law firms and PE sponsors are associated with fewer covenants. In this section we examine whether this association varies with relative bargaining power and reputational concern of the law firm and

¹³ The findings remain robust if we use the logarithm forms of the number of all covenants as dependent variables for Columns (2) to (4).

lender. Larger law firms are generally less economically dependent on any single client and operate with more institutionalized governance structures (Gilson and Mnookin, 1984; Schneyer, 1991; Krishnan and Masulis, 2013). In our setting, a lender's law firm with a larger market share should therefore possess greater reputational concerns and stronger bargaining power, potentially enabling it to mitigate the influence of PE sponsors on covenant design. We follow Krishnan and Masulis (2013) and construct the lender law firm market prominence, *MarketShare_Law*, defined as the total dollar volume of LBO loans represented by a given law firm over the previous three years divided by the total dollar volume of LBO loans in our sample during the same period. The estimation results are presented in Panel A of Table 4. The interactions between *MarketShare_Law* and the PE-Lender law firm relationship in Columns (2) to (4) are all positive and statistically significant at the one percent level. The coefficient of the interaction term in Column (1) also has a positive sign, albeit insignificant. Taken together, these results indicate that the effect of PE-Lender Law Firm relationships on covenant design is weaker among lender law firms with larger market shares, consistent with these law firms' relatively stronger bargaining positions and heightened reputational concerns.

Next, we examine if the impact of PE-Lender Law Firm relationships on covenant design changes with market power of the lender itself. Following Rau (2000) and Bao and Edmans (2011), we measure the market prominence of lenders, *MarketShare_Lender*, as the total dollar volume of loans issued by a lender over the previous three years divided by the overall dollar volume of sponsored loans in our sample during the same period. We then include an interaction term between *RelationAmt_PELaw* and *MarketShare_Lender* into Equation (2). The estimation results are reported in Panel B of Table 4. Across Columns (1) to (4), we observe that the coefficients on the interaction term are all positive and statistically significant. These positive interaction coefficients imply that stronger lender market prominence mitigates the influence of PE-Lender Law Firm relationships on covenant.

3.4 Addressing the Potential Endogeneity of PE-Lender Law Relationship

3.4.1 Two Stage Least Square (2SLS) Regression

In this section, we try to address the potential endogeneity of PE-lender law firm relationship. It is possible that unobserved factors affect both the covenant terms and the PE-lender law firm relationship, creating a classic omitted variable bias. For instance, it could be that a PE sponsor tends to recommend its relationship law firms in cases where the target companies are less risky. If this is true, it is the unobservable quality of the target firms that drives our results.

We first use an instrumental variable (IV) approach to mitigate this concern. The IV we use is the logarithm of one plus the distance (in kilometers) between the PE headquarter city and the lender law firm headquarter city. Extensive research has demonstrated the crucial role of geographical distance in the development and sustainment of law firm-client relationships (e.g., Henderson and Galanter, 2008; Henderson and Alderson 2016; and de Fontenay 2016).¹⁴ Our conversations with law professionals suggest that, even although law firms can have regional offices, the headquarter office always has the law firm's most senior and specialized lawyers, particularly in complex areas like mergers and acquisitions. When a major high-profile deal such as a large LBO is involved, the head office lawyers would typically be heavily involved, if not leading the transaction.¹⁵ We therefore expect a negative association between PE-law firm geographical distance and PE-law firm relationship. Meanwhile, since PE/law firm headquarter location decisions were typically made many years ago at their initial

¹⁴ Although the information asymmetry created by geographic distance has been mitigated by the development of internet technology, human interactions and information obtained through closer geographical proximity remain critical in the information-gathering process. Human-interaction-based and non-human-interaction-based information are not easily substitutable (Bai and Massa, 2021). However, to address concerns that the impact of geographic distance on PE-lender law firm relationships may have been further mitigated by virtual technologies in recent years, we used our pre-COVID sample to run the 2SLS regression. The results remain robust.

¹⁵ For a key deal such as an LBO, the law firm would want to ensure that the best possible resources and expertise are brought to bear. Even if a regional office has some involvement, the head office would likely oversee the deal to ensure all aspects are handled with the highest level of competence. Lawyers from local offices may contribute local knowledge or handle certain aspects of the deal such as specific local jurisdictions or regulatory issues under the guidance of the head office team.

establishments, the geographical distance is unlikely to directly affect today's covenant terms under negotiation through ways other than fostering a PE-law firm relationship.

We present the 2SLS regression in Table 5. Column (1) reports the first-stage regression results. The coefficient on the IV (*Distance_PELaw*) is negative and statistically significant at the one percent level. This result means that, all else equal, the farther away a PE sponsor is from a law firm, the weaker is the transaction relationship between the two. In the second stage regressions, we use the dummy variable for dividend restriction as the dependent variable in Column (2). The impact of the instrumented PE-Lender law firm relationships on the likelihood of imposing dividend restrictions is still negative and statistically significant, consistent with the baseline regressions reported in Table 3. From Columns (3) to (5), we estimate the impacts of the instrumented measure for PE-Lender Law Firm relationships on the number of maintenance covenants, the number of incurrence covenants, and the total number of all covenants. The results are broadly similar to the baseline results. Furthermore, the Cragg-Donald Wald F statistic rejects the null hypothesis of a weak instrument.¹⁶

3.4.2 A Quasi-Natural Experiment

In another test, we exploit the publication of Andrew Ross Sorkin's article "*A Growing Conflict in Wall St. Buyouts*" in *The New York Times* on January 4th 2016, as an exogenous shock to public awareness of the PE-Lender Law Firm relationship. Sorkin, a highly influential financial journalist and co-anchor of CNBC's *Squawk Box*, highlighted the "designated law firm" practice in the LBO loan market and raised concerns about potential creditor exploitation. The article triggered substantial follow-up coverage and debate, increasing scrutiny of law firm-sponsor ties in LBO transactions. Because the publication was arguably unexpected and directly targeted this specific market practice, we use it as an exogenous shock that increases

¹⁶ In Table OA6, we show that the IV does not have a significant impact on the Lender-Law Firm relationship, which alleviates a concern that the IV might affect the PE-Lender Law Firm relationship indirectly through the Lender-Law Firm relationship (i.e., exclusion restriction).

in public attention to this issue. We expect that rising public attention discourages the usage of designated law firms, in particular among sponsors who relied on designated law firms more often in their past transactions.

Specifically, we employ a difference-in-differences (DiD) framework to examine how the designated law firm practice changes and its impact on covenant terms before and after the January 4, 2016 news shock. We create two variables *NYTShock* and *HighRelationship_Group*. *NYTShock* is a dummy variable that takes one if the loan tranche is issued after 4th January 2016 and zero otherwise. *HighRelationship_Group* is a dummy variable that takes a value of one if PE sponsor j belongs to the group of PE firms with stronger PE–Lender Law Firm relationships prior to the shock, and zero otherwise. We classify a PE sponsor as having stronger PE–Lender Law Firm relationships if the median value of its pre-2016 *RelationAmt_PELaw* is larger than the median of *RelationAmt_PELaw* of all loan tranches issued pre-2016. We then create an interaction term, $NYTShock \times HighRelationship_Group$, to test whether PE sponsors with previously strong PE–Lender Law Firm ties alter their behavior in covenant negotiations following the shock.

We report the estimation results in Table 6. We begin by validating our identification strategy by examining whether the news shock affected PE–Lender Law Firm relationships. In Column (1), where the dependent variable is *RelationAmt_PELaw*, we find that the coefficient on the interaction term $NYTShock \times HighRelationship_Group$ is negative and statistically significant at the one percent level. This result suggests that PE sponsors with stronger pre-shock law firm relationships substantially reduced their reliance on relationship law firms after the shock.

From Columns (2) to (5), we estimate the shock’s impacts on covenant restrictions. All coefficients on the interaction term $NYTShock \times HighRelationship_Group$ are positive and significant. These results imply that the post-shock decline in PE–Lender Law Firm

relationships among high-relationship sponsors is accompanied by relatively tighter covenant terms. In other words, the decline of usage of relationship law firms among these PE sponsors after the shock leads to a relative increase in covenants in their buyout loans, reaffirming our baseline findings.

3.5 PE-Law Firm Relationship and the Lender of PE's Next Deal

In this section, we address another question that rises naturally: Why would banks accept to use law firms that might not fully align with their interests? A possible explanation is that banks accept the relationship law firms of private equity sponsors in exchange for securing the current loan mandate and/or being compensated by subsequent business opportunities from the PE sponsor. These reciprocal arrangements have been documented by prior studies (e.g., Petersen and Rajan, 1994, 1995; Boot and Thakor, 1994, 2000; Fang, Ivashina, and Lerner, 2013). We therefore empirically investigate whether these lenders are more likely be included in the next transactions of the PE sponsor. We estimate the following model:

$$Next\ Lender\ Choice_{jbi+1} = \alpha + \beta_1 * RelationAmt_{PELaw_{ijlb}} + Controls_{ijlb} + Fixed\ Effects + \varepsilon_{ijlb}, \quad (3)$$

where the dependent variable is $Next\ Lender\ Choice_{jbi+1}$ that takes a value of one if the lead bank b of the current loan is in the syndicate (either as the lead bank or participant bank) of the same PE sponsor's next loan and zero otherwise.

We report our estimation results in Table 7, the coefficient on $RelationAmt_PELaw$ is positive and statistically significant at the one percent level. This finding indicates that a lead bank who uses a law firm that has a deeper relationship with a PE sponsor in the current LBO transaction is more likely to get involved in the next deal of this PE sponsor, consistent with a reciprocal arrangement. In Column (2), we further incorporate $RelationAmt\ LenderLaw$ and

RelationAmt_PELender into our regression to control for the impact of the Lender-Law Firm relationship and the impact of PE-Lender relationship on the next lender selection, respectively. The coefficient on *RelationAmt_PELaw* continues to be statistically significant.

3.6 PE-Law Firm Relationship and Loan Spread

The next and important question is how loan investors perceive PE-Lender Law Firm relationship. On the one hand, PE-Lender Law Firm relationship may proxy unobservable PE sponsor reputation or fewer covenants may result from more efficient negotiation or unobserved superior borrower quality. If fewer covenants simply reflect more efficient contracting, we shall expect lower loan spread. On the other hand, if loan investors view the PE-Lender Law Firm relationship (and associated reduced covenant protection) as a manifestation of conflict of interests that weaken creditor protections, they should demand higher spread for compensation.

Table 8 provides evidence consistent with the latter view. In Column (1), the dependent variable in the regression is *Log (All-in-Spread-Drawn)*. The result shows that loans with a closer PE-Lender Law Firm relationship have higher spreads, indicating investors demand for higher risk premium. In Column (2), the coefficient on *RelationAmt PELaw* remains positive and statistically significant at the one percent level after we control for the impact of lender-law firm relationship. Economically, a one-standard-deviation increase in PE-Lender Law Firm relationship is associated with an approximately increase of loan spread by 57.1% of its standard deviation. Evaluated at the average loan size (\$367.58 million) and assuming non-amortization, it means approximately an increase of interest expense for the borrower by \$3.99 million per annum. These findings do not support the view that hiring a relationship lender law firm enhances syndication efficiency or reflects better borrower fundamentals. Instead, the higher spreads demanded by loan investors are more consistent with concerns about potential exploitation arising from PE sponsors' influence over lender counsel.

3.7 PE-Law Firm Relationship and the Likelihood of Loan Default

Lastly, we explore the association between the PE-Lender Law Firm relationship and the likelihood of loan default or borrower bankruptcy. If weaker covenants compromise creditors' ability to monitor, we expect that these loans are more likely to default. We obtain loan-level default information from Pitchbook. Since Pitchbook only has default information on institutional tranches, in this analysis we use the subsample of term loans. In this sample, approximately 1.2% of loans experienced default within 3 years of issuance, and 2% of loans experienced default within 4 years.

We present our findings in Table 9. In Column (1), we estimate a linear probability model where the dependent variable is *Loan_Default_3Years*, a dummy variable that equals one if the loan defaults within three years from the loan tranche's activation date and zero otherwise. In the regression, the coefficient on *RelationAmt_PELaw* is positive and significant at the one percent level, indicating that LBO loans originated with lender law firms who have closer relationships with PE sponsors are more likely to default within the three years. Economically, a one-standard-deviation increase in the closeness of the PE-Lender Law Firm relationship corresponds to a 2.34% (0.089×0.263) higher likelihood of default, which is 24.4% of the standard deviation of *Loan_Default_3Years*. In Column (2), the dependent variable is a dummy variable that takes a value of one if the loan defaults within four years following the loan tranche active date. We continue to find similar result.

In Columns (3) and (4), the dependent variables are dummy variables that take the value of one if the borrower files for bankruptcy within three years or four years following the loan tranche active date. We find that a closer PE-Lender Law firm relationship is associated with a higher likelihood that the borrower files for bankruptcy. Taken together, the results in Tables 8 and 9 suggest that investors price protect themselves against the higher ex post likelihood of

default by demanding a higher ex ante spread.¹⁷

4. Conclusion

In this paper, we document the significant influence of pre-existing relationships between PE sponsors and lender law firms on structuring loan contracts. Our findings underscore that a closer PE-Lender Law Firm relationship tends to skew loan terms in favor of PE sponsors/borrowers: fewer restrictions on dividends payout and an overall reduction in covenants. This finding is robust using the PE-law firm headquarters' geographical distance as an instrument for the PE-Law Firm relationship. We further show that loan investors price-protect against these potential conflicts: Loans involving relationship lender counsel carry higher spreads. Ultimately, the higher borrowing costs fall on the underlying portfolio companies, implying a real economic cost.

Our results highlight an agency problem on the part of lead banks in today's buyout loan market. Under the originate-to-distribute model, lead banks retain limited exposure to the loans they originate and increasingly rely on PE sponsors for repeat deal flow. These incentives may make banks more willing to accept sponsors' preferred law firms, even at the expense of creditor protection. Together, our findings suggest that mechanisms that align lead bank's interests with loan investors and strengthening the independence of lender counsel could have meaningful welfare implications for credit markets.

¹⁷ We also conduct robust checks by excluding loan tranches post-2022 for the regression in Columns (1) and (3) of Table 9 and tranches post-2021 for the regression in Columns (2) and (4) of Table 9. This adjustment ensures at least three years of observation for each loan tranche in the first analysis to assess the impact of the PE-lender law firm relationship on the likelihood of a default and bankruptcy within three years, and at least four years for each loan tranche in the second analysis to assess the impact within four years.

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Table 1
Summary Statistics

This table presents the descriptive statistics of the variables used in the analysis. It includes the number of observations (N), mean, standard deviation (SD), and the percentile values (p1, p25, p50, p75, p99) for each variable. The variables include PE-Law Firm relationships, PE-Lender Law relationships. In addition, we have borrower financial information (*Profitability*; *MTB*, *MZscore*, *Log (Total Assets)*; *Total Assets (\$billion)*; *Asset Turnover*; *Cashholding*; *Leverage*) and loan terms (*Log (All-in-Spread-Drawn)*; *All-in-Spread-Drawn (bps)*; *Log (LoanAmt)*; *LoanAmt (\$million)*; *Secured Dum*; *Log (Maturity)*; *Maturity (Months)*; *Performance Dum*; *Dividend Restriction*; *Number of Maintenance Covenants*; *Number of Incurrence Covenants*; *Number of All Covenants*). In addition, we have some term loan tranche level variables (*LoanDefault_3Years*; *LoanDefault_4Years*; *Bankruptcy 3Years*; *Bankruptcy 4Years*). The detailed definitions of variables are provided in the Appendix A. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	N	Mean	SD	p1	p25	p50	p75	p99
<i>RelationAmt PELaw</i>	432	0.178	0.263	0.000	0.000	0.000	0.266	1.000
<i>RelationCount PELaw</i>	432	0.160	0.238	0.000	0.000	0.000	0.273	1.000
<i>RelationAmt LenderLaw</i>	432	0.218	0.232	0.000	0.000	0.152	0.372	0.923
<i>RelationCount LenderLaw</i>	432	0.199	0.209	0.000	0.000	0.167	0.295	0.818
<i>Profitability</i>	432	0.135	0.086	-0.036	0.092	0.119	0.170	0.496
<i>MTB</i>	432	1.450	0.874	0.401	0.940	1.150	1.775	5.325
<i>MZscore</i>	432	1.476	1.418	-5.520	0.715	1.408	2.319	4.780
<i>Log (Total Assets)</i>	432	7.308	1.385	4.526	6.298	7.241	7.984	11.196
<i>Total Assets (\$billion)</i>	432	5.489	19.108	0.092	0.544	1.396	2.935	72.861
<i>Asset Turnover</i>	432	1.068	0.756	0.138	0.565	0.852	1.302	3.962
<i>Cashholding</i>	432	0.121	0.140	0.000	0.026	0.074	0.152	0.705
<i>Leverage</i>	432	0.319	0.239	0.000	0.110	0.289	0.474	0.933
<i>Log (All-in-Spread-Drawn)</i>	432	5.879	0.473	4.828	5.521	5.927	6.215	6.830
<i>All-in-Spread-Drawn (bps)</i>	432	398.711	189.044	125.000	250.000	375.000	500.000	925.000
<i>Log (LoanAmt)</i>	432	5.177	1.300	2.303	4.317	5.254	6.215	7.456
<i>LoanAmt (\$million)</i>	432	367.579	443.244	10.000	75.000	191.250	500.000	1730.000
<i>Secured Dum</i>	432	0.924	0.266	0.000	1.000	1.000	1.000	1.000
<i>Log (Maturity)</i>	432	4.207	0.373	2.485	4.094	4.277	4.431	4.564
<i>Maturity (Months)</i>	432	70.544	16.846	12.000	60.000	72.000	84.000	96.000
<i>Performance Dum</i>	432	0.222	0.416	0.000	0.000	0.000	0.000	1.000
<i>Dividend Restriction</i>	432	0.312	0.464	0.000	0.000	0.000	1.000	1.000
<i>Number of Maintenance Covenants</i>	432	0.530	0.845	0.000	0.000	0.000	1.000	3.000
<i>Number of Incurrence Covenants</i>	432	2.426	3.649	0.000	0.000	0.000	5.000	10.000
<i>Number of All Covenants</i>	432	2.956	4.389	0.000	0.000	0.000	6.000	12.000
<i>LoanDefault 3Years</i>	432	0.012	0.107	0.000	0.000	0.000	0.000	1.000
<i>LoanDefault 4Years</i>	432	0.019	0.135	0.000	0.000	0.000	0.000	1.000
<i>Bankruptcy 3Years</i>	432	0.009	0.096	0.000	0.000	0.000	0.000	0.000
<i>Bankruptcy 4Years</i>	432	0.016	0.126	0.000	0.000	0.000	0.000	1.000

Table 2
PE-Law Firm Relationship and Lender Law Firm Selection

This table presents the results from OLS regression models examining the influence of relationships between PE firms and law firms on the selection of lender law firms. The dependent variable, *LenderLawfirm_Selection*, is a dummy that takes the value of one if the lender law firm *l* is selected as the lender law firm in loan tranche *i*, and zero otherwise. The variable of main interest is the prior relationship between the PE sponsor *j* and law firm *l* (*RelationAmt_PELaw*) in loan tranche *i*. Additionally, we control for the prior relationship between lender *b* and lender law firm *l* (*RelationAmt LenderLaw*). Control variables include *Profitability*, *MTB*, *MZscore*, firm size (*Log (Total Assets)*), the ratio of asset turnover (*Asset Turnover*), *Cashholding*, *leverage*, loan spreads (*Log (All-in-Spread-Drawn)*) and the amount of the loan (*Log (LoanAmt)*), and loan maturity (*Log (Maturity)*). Dummy variables for whether the loan is secured (*Secured*) and performance pricing (*Performance Dum*). Fixed effects for industry, year, lender, law firm, and loan type are incorporated. Standard errors are clustered at the tranche level and are in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	(1) <i>LenderLawfirm Selection</i>	(2) <i>LenderLawfirm Selection</i>
<i>RelationAmt PELaw</i>	1.050*** (0.144)	0.909*** (0.142)
<i>RelationAmt LenderLaw</i>		2.470*** (0.193)
<i>Profitability</i>	-0.308* (0.160)	0.413 (0.416)
<i>MTB</i>	0.038 (0.027)	-0.045 (0.077)
<i>MZscore</i>	-0.025* (0.014)	-0.044 (0.042)
<i>Log (Total Assets)</i>	-0.037*** (0.011)	-0.015 (0.030)
<i>Asset Turnover</i>	-0.040* (0.023)	-0.209*** (0.060)
<i>Cashholding</i>	-0.179 (0.149)	-0.200 (0.459)
<i>Leverage</i>	-0.055 (0.077)	0.010 (0.253)
<i>Log (All-in-Spread-Drawn)</i>	-0.018*** (0.006)	0.002 (0.021)
<i>Log (LoanAmt)</i>	-0.006** (0.002)	-0.005 (0.006)
<i>Secured Dum</i>	-0.030** (0.013)	0.090* (0.052)
<i>Maturity</i>	0.005 (0.008)	-0.039 (0.024)
<i>Performance Dum</i>	0.012* (0.007)	-0.026 (0.019)
Observations	215,285	215,285
Adjusted Within R-squared	0.006	0.028
Industry FE	YES	YES
Year FE	YES	YES
Lender FE	YES	YES
Law firm FE	YES	YES
Loan type FE	YES	YES

Table 3
PE-Lender Law Firm Relationship and Loan Covenants

This table displays the estimation results from OLS regression analyses investigating the effect of PE-Lender law firm relationships on the likelihood of imposing dividend restrictions and the number of different covenants in credit agreements. Columns (1) to (4) are four different models specified with the dependent variables being *Dividend Restriction*, *The Number of Maintenance Covenants*, *The Number of Incurrence Covenants*, and *The Number of All Covenants*, respectively. The independent variable of interest is the prior relationship between the PE sponsor j and law firm l (*RelationAmt_PELaw*) in loan tranche i . The models also control for firm characteristics such as the prior relationship between the lender b and law firm l (*RelationAmt LenderLaw*), *profitability*, *MTB*, *MZcore*, *Log (Total Assets)*, *Asset Turnover*, *Cashholding*, *Leverage*. In addition, we control for loan characteristics such *Log (All-in-Spread-Drawn)*, *Log (LoanAmt)*, *Secured Dum*, *Maturity*, *Performance Dum*. Each regression model includes fixed effects for industry, year, lender, law firm, loan type and PE. Standard errors are clustered at the PE sponsor level, denoted in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	(1) <i>Dividend Restriction</i>	(2) <i>The Number of Maintenance Covenants</i>	(3) <i>The Number of Incurrence Covenants</i>	(4) <i>The Number of All Covenants</i>
<i>RelationAmt_PELaw</i>	-0.861** (0.381)	-2.122** (0.899)	-3.479*** (1.002)	-5.601*** (1.876)
<i>RelationAmt_LenderLaw</i>	1.012*** (0.321)	0.521 (0.674)	0.108 (0.797)	0.629 (1.427)
<i>Profitability</i>	1.703** (0.780)	6.315*** (2.302)	27.582*** (2.737)	33.897*** (4.903)
<i>MTB</i>	0.004 (0.196)	1.231** (0.538)	2.244*** (0.620)	3.475*** (1.130)
<i>MZscore</i>	-0.030 (0.123)	-0.325 (0.287)	-1.900*** (0.322)	-2.225*** (0.603)
<i>Log (Total Assets)</i>	-0.217*** (0.047)	-0.043 (0.146)	0.257 (0.159)	0.215 (0.282)
<i>Asset Turnover</i>	-0.031 (0.203)	1.536** (0.671)	6.007*** (0.649)	7.543*** (1.262)
<i>Cashholding</i>	1.566** (0.762)	-0.431 (2.172)	2.864 (2.346)	2.434 (4.425)
<i>Leverage</i>	2.778*** (0.268)	3.364*** (0.660)	11.427*** (0.708)	14.791*** (1.339)
<i>Log (All-in-Spread-Drawn)</i>	-0.002 (0.006)	-0.027 (0.032)	-0.059 (0.101)	-0.086 (0.131)
<i>Log (LoanAmt)</i>	-0.005 (0.004)	-0.014 (0.013)	-0.028 (0.022)	-0.042 (0.031)
<i>Secured Dum</i>	-0.020* (0.011)	-0.018 (0.065)	0.098 (0.155)	0.079 (0.211)
<i>Maturity</i>	0.007 (0.012)	0.064 (0.077)	0.222 (0.218)	0.286 (0.287)
<i>Performance Dum</i>	0.030** (0.013)	0.121** (0.055)	0.134 (0.118)	0.255* (0.145)
Observations	432	432	432	432
Adjusted Within R-squared	0.922	0.546	0.824	0.826
Industry FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Lender FE	YES	YES	YES	YES
Law firm FE	YES	YES	YES	YES
Loan type FE	YES	YES	YES	YES
PE FE	YES	YES	YES	YES

Table 4
Market Prominence and the Impact of PE-Lender Law Firm Relationship on Covenants

This table presents whether the impact of PE-Lender law firm relationships on various types of covenant restrictions is reversed with the enhanced market prominence of the lender's law firm (Panel A) and lender (Panel B). Columns (1) to (4) represent four different models, each specified with different dependent variables: *Dividend Restriction*, *The Number of Maintenance Covenants*, *The Number of Incurrence Covenants*, and *The Number of All Covenants*. The independent variable of interest is the interaction term *RelationAmt_PELaw*MarketShare_Law* in Panel A and *RelationAmt PELaw*MarketShare_Lender* in Panel B. *MarketShare_Law* is defined as the market share of a lender law firm, calculated by dividing the total dollar volume of LBO loans handled by the lender law firm over the past three years by the overall dollar volume of LBO loans in our sample during the same period. *MarketShare_Lender* is defined as the market share of a lender, calculated by dividing the total dollar volume of loans issued by the lender over the past three years by the overall dollar volume of LBO loans in our sample during the same period. The models control for the Lender-Law Firm relationship (*RelationAmt LenderLaw*) and firm characteristics such as profitability, market to book ratio (*MTB*), modified Z score (*MZscore*), firm size (*Log (AT)*), asset turnover ratio (*Asset Turnover*), cash holding ratio (*Cashholding*), leverage. We also control for loan-level characteristics, including *Log (All-in-Spread-Drawn)*, *Log (LoanAmt)*, *Maturity*, and dummy variables for secured loans (*Secured_Dum*) and performance pricing (*Performance_Dum*). Each regression model includes fixed effects for industry, year, lender, law firm, loan type and PE. Standard errors are clustered at the PE sponsor level, denoted in parentheses. ***, ** and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

Panel A: Market Prominence of the Lender's Law Firm				
VARIABLES	(1) <i>Dividend Restriction</i>	(2) <i>The Number of Maintenance Covenants</i>	(3) <i>The Number of Incurrence Covenants</i>	(4) <i>The Number of All Covenants</i>
<i>RelationAmt_PELaw</i>	-1.612 (0.980)	-5.939*** (1.740)	-10.266*** (2.577)	-16.205*** (4.274)
<i>RelationAmt_PELaw*MarketShare_Law</i>	0.029 (0.029)	0.148*** (0.053)	0.261*** (0.081)	0.409*** (0.132)
<i>MarketShare_Law</i>	0.009 (0.025)	0.017 (0.043)	-0.095 (0.062)	-0.079 (0.105)
Observations	427	427	427	427
Adjusted Within R-squared	0.942	0.637	0.843	0.865
Controls	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Lender FE	Yes	Yes	Yes	Yes
Law firm FE	Yes	Yes	Yes	Yes
Loan type FE	Yes	Yes	Yes	Yes
PE FE	Yes	Yes	Yes	Yes

Panel B: Market Prominence of the Lender				
VARIABLES	(1) <i>Dividend Restriction</i>	(2) <i>The Number of Maintenance Covenants</i>	(3) <i>The Number of Incurrence Covenants</i>	(4) <i>The Number of All Covenants</i>
<i>RelationAmt_PELaw</i>	-2.609*** (0.792)	-6.193*** (1.655)	-9.144*** (3.342)	-15.337*** (4.861)
<i>RelationAmt_PELaw*MarketShare_Lender</i>	0.212** (0.088)	0.517*** (0.179)	0.697* (0.381)	1.214** (0.545)
<i>MarketShare_Lender</i>	-0.033 (0.022)	-0.030 (0.049)	-0.086 (0.109)	-0.116 (0.156)
Observations	432	432	432	432
Adjusted Within R-squared	0.947	0.635	0.839	0.862
Controls	YES	YES	YES	YES
Industry FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Lender FE	YES	YES	YES	YES
Law firm FE	YES	YES	YES	YES
Loan type FE	YES	YES	YES	YES
PE FE	YES	YES	YES	YES

Table 5

Two-Stage Least Squares (2SLS) Regression

This table reports the results of a 2SLS regression analysis that evaluates the impact of prior relationships between PE firms and lender law firms on various loan contract covenants. The first column presents the first-stage result, where *Distance_PELaw* is the logarithm of the distance (in kilometers) between the PE headquarter and the lender law firm headquarter plus one. The subsequent columns present the second-stage analysis, where the variable of interest is *RelationAmt_PELaw*. Definitions of the control variables can be found in the Appendix A. Standard errors are clustered at the PE sponsor level, denoted in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	(1) <i>RelationAmt PELaw</i>	(2) <i>Dividend Restriction</i>	(3) <i>The Number of Maintenance Covenants</i>	(4) <i>The Number of Incurrence Covenants</i>	(5) <i>The Number of All Covenants</i>
<i>Distance PELaw</i>	-0.750*** (0.194)				
<i>RelationAmt PELaw</i>		-2.162*** (0.325)	-6.061*** (1.217)	-6.162*** (1.217)	-12.223*** (2.209)
<i>RelationAmt LenderLaw</i>	0.441*** (0.122)	1.711*** (0.264)	2.637*** (0.774)	1.550** (0.652)	4.187*** (1.266)
<i>Profitability</i>	0.982** (0.487)	1.663 (1.114)	6.196** (2.450)	27.500*** (2.608)	33.696*** (4.852)
<i>MTB</i>	0.206 (0.129)	-0.098 (0.333)	0.921 (0.783)	2.033*** (0.747)	2.954* (1.504)
<i>MZscore</i>	0.133** (0.060)	0.206 (0.129)	0.388 (0.463)	-1.414*** (0.322)	-1.026 (0.769)
<i>Log (Total Assets)</i>	0.218*** (0.075)	-0.214*** (0.062)	-0.033 (0.176)	0.264 (0.161)	0.231 (0.312)
<i>Asset Turnover</i>	0.157 (0.172)	-0.229 (0.295)	0.934 (0.782)	5.597*** (0.590)	6.531*** (1.308)
<i>Cashholding</i>	-0.510 (0.582)	1.882 (1.480)	0.526 (3.784)	3.516 (3.319)	4.042 (7.025)
<i>Leverage</i>	-1.118*** (0.325)	2.249*** (0.585)	1.763 (1.273)	10.336*** (1.208)	12.100*** (2.434)
<i>Log (All-in-Spread-Drawn)</i>	0.008 (0.005)	0.012 (0.008)	0.015 (0.041)	-0.031 (0.103)	-0.016 (0.139)
<i>Log (LoanAmt)</i>	0.002 (0.001)	0.002 (0.002)	0.007 (0.011)	-0.013 (0.019)	-0.006 (0.023)
<i>Secured Dum</i>	0.004 (0.005)	0.005 (0.010)	0.057 (0.069)	0.149 (0.163)	0.206 (0.224)
<i>Maturity</i>	-0.014* (0.008)	-0.016 (0.012)	-0.008 (0.087)	0.173 (0.222)	0.165 (0.299)
<i>Performance Dum</i>	-0.002 (0.002)	0.014* (0.007)	0.072 (0.046)	0.100 (0.116)	0.173 (0.134)
Observations	432	432	432	432	432
Cragg-Donald Wald F statistic		117.789	117.789	117.789	117.789
Industry FE	YES	YES	YES	YES	YES
Year FE	YES	YES	YES	YES	YES
Lender FE	YES	YES	YES	YES	YES
Law firm FE	YES	YES	YES	YES	YES
Loan type FE	YES	YES	YES	YES	YES
PE FE	YES	YES	YES	YES	YES

Table 6
New York Times Article as an Exogenous Shock

This table shows the impact of *NYTShock*, an exogenous shock marked by the New York Times article on January 4, 2016, on PE-Lender Law Firm relationships and loan contract covenants. *NYTShock* is a dummy variable set to one for loan tranches activated after this date. *HighRelationship_Group* is another dummy variable that equals one for PE sponsors with stronger PE-Lender Law Firm relationships prior to the shock, and zero otherwise. The table assesses the interaction between *NYTShock* and *HighRelationship_Group*, controlling for firm and loan characteristics with fixed effects for industry, lender, law firm, and loan type. Standard errors are clustered at the PE sponsor level, denoted in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	(1) <i>RelationAmt PELaw</i>	(2) <i>Dividend Restriction</i>	(3) <i>The Number of Maintenance Covenants</i>	(4) <i>The Number of Incurrence Covenants</i>	(5) <i>The Number of All Covenants</i>
<i>NYTShock</i> ×					
<i>HighRelationship Group</i>	-0.401*** (0.149)	0.550*** (0.168)	0.840*** (0.243)	2.080* (1.231)	2.920** (1.431)
<i>HighRelationship Group</i>	0.174*** (0.052)	-0.346*** (0.098)	-0.692*** (0.160)	-2.032** (0.817)	-2.723*** (0.955)
<i>NYTShock</i>	0.440*** (0.141)	-0.398*** (0.146)	-0.672*** (0.157)	-2.338** (1.014)	-3.009** (1.144)
<i>RelationAmt LenderLaw</i>	0.185 (0.115)	0.055 (0.154)	-0.237 (0.273)	-0.402 (1.190)	-0.639 (1.412)
<i>Profitability</i>	-0.204 (0.324)	0.297 (0.700)	-0.232 (1.322)	2.131 (5.563)	1.899 (6.738)
<i>MTB</i>	0.020 (0.026)	-0.010 (0.050)	0.058 (0.096)	0.075 (0.398)	0.134 (0.481)
<i>MZscore</i>	0.029 (0.023)	0.015 (0.038)	-0.041 (0.061)	-0.095 (0.265)	-0.136 (0.319)
<i>Log (Total Assets)</i>	-0.003 (0.013)	-0.056** (0.024)	-0.135*** (0.045)	-0.493*** (0.152)	-0.628*** (0.191)
<i>Asset Turnover</i>	-0.004 (0.033)	-0.067 (0.075)	0.039 (0.117)	-0.691 (0.606)	-0.653 (0.705)
<i>Cashholding</i>	0.062 (0.163)	0.772** (0.363)	1.652** (0.692)	6.479** (3.069)	8.131** (3.729)
<i>Leverage</i>	0.069 (0.110)	0.348* (0.197)	0.695** (0.329)	2.195 (1.427)	2.890* (1.717)
<i>Log (All-in-Spread-Drawn)</i>	-0.015 (0.032)	-0.142** (0.062)	-0.271*** (0.089)	-1.135** (0.451)	-1.406*** (0.529)
<i>Log (LoanAmt)</i>	0.005 (0.012)	0.019 (0.021)	-0.061* (0.035)	-0.058 (0.158)	-0.119 (0.189)
<i>Secured Dum</i>	0.088 (0.062)	-0.062 (0.072)	-0.079 (0.109)	-0.012 (0.338)	-0.091 (0.428)
<i>Maturity</i>	-0.093** (0.040)	0.038 (0.069)	0.094 (0.083)	0.351 (0.361)	0.445 (0.423)
<i>Performance Dum</i>	-0.020 (0.042)	0.359*** (0.056)	0.502*** (0.117)	2.447*** (0.438)	2.949*** (0.532)
Observations	432	432	432	432	432
Adjusted Within R-squared	0.272	0.327	0.393	0.337	0.358
Industry FE	YES	YES	YES	YES	YES
Lender FE	YES	YES	YES	YES	YES
Law firm FE	YES	YES	YES	YES	YES
Loan type FE	YES	YES	YES	YES	YES

Table 7
Likelihood of Lead Banks Receiving Next Deals from PE Sponsor

This table displays the estimation results for the impact of PE-Lender Law Firm relationships on the selection of a lender for the PE's next deal. The dependent variable, *Next Lender Choice*, a dummy variable that is assigned a value of one if lender b is chosen again as the lender (either lead bank or participant bank) in the subsequent deal by the same PE sponsor j in the current transaction. Definitions of the control variables can be found in the Appendix A. Each specification controls for fixed effects across industry, year, lender, law firm, loan type and PE to account for potential confounding factors. Standard errors are clustered at the PE sponsor level, with their values provided in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	(1) <i>NextLender Selection</i>	(2) <i>NextLender Selection</i>
<i>RelationAmt PELaw</i>	1.374** (0.580)	1.092*** (0.310)
<i>RelationAmt LenderLaw</i>		1.343*** (0.424)
<i>RelationAmt PELender</i>	1.455*** (0.332)	1.752*** (0.349)
<i>Profitability</i>	0.106 (1.003)	-3.994** (1.675)
<i>MTB</i>	0.988*** (0.175)	0.530** (0.245)
<i>MZscore</i>	-0.220** (0.088)	0.184 (0.120)
<i>Log (Total Assets)</i>	-0.141 (0.105)	-0.456*** (0.134)
<i>Asset Turnover</i>	0.430 (0.279)	-0.610 (0.442)
<i>Cashholding</i>	-4.870*** (0.983)	-3.536*** (1.023)
<i>Leverage</i>	1.042*** (0.345)	1.080*** (0.306)
<i>Log (All-in-Spread-Drawn)</i>	0.006 (0.009)	0.004 (0.008)
<i>Log (LoanAmt)</i>	0.002 (0.002)	0.003* (0.002)
<i>Secured Dum</i>	0.007 (0.009)	0.018 (0.013)
<i>Maturity</i>	0.030** (0.014)	0.021* (0.011)
<i>Performance Dum</i>	-0.008 (0.006)	-0.005 (0.005)
Observations	432	432
Adjusted Within R-squared	0.776	0.853
Industry FE	YES	YES
Year FE	YES	YES
Lender FE	YES	YES
Law firm FE	YES	YES
Loan type FE	YES	YES
PE FE	YES	YES

Table 8
PE-Law Firm Relationship and Loan Spread

This table reports the results from OLS regression models that investigate how the relationships between PE firms and lender law firms affect loan spreads. The dependent variable is loan spreads (*Log (All-in-Spread-Drawn)*). Independent variable of interest is the prior relationship between the PE sponsor j and lender law firm l (*RelationAmt_PELaw*) in loan tranche i . Definitions of the control variables can be found in the Appendix A. Industry, year, lender, law firm, loan type and PE fixed effects are included in all specifications. Standard errors are clustered at the PE sponsor level, with their values provided in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	(1) <i>Log (All-in-Spread-Drawn)</i>	(2) <i>Log (All-in-Spread-Drawn)</i>
<i>RelationAmt PELaw</i>	1.003** (0.399)	0.973*** (0.350)
<i>RelationAmt LenderLaw</i>		0.072 (0.584)
<i>Profitability</i>	-2.407** (1.190)	-2.564 (2.046)
<i>MTB</i>	-0.021 (0.231)	-0.043 (0.304)
<i>MZscore</i>	-0.095** (0.036)	-0.080 (0.137)
<i>Log (Total Assets)</i>	-0.203*** (0.052)	-0.213* (0.115)
<i>Asset Turnover</i>	-0.045 (0.284)	-0.085 (0.466)
<i>Cashholding</i>	0.482 (0.836)	0.548 (0.954)
<i>Leverage</i>	0.167 (0.450)	0.144 (0.461)
<i>Log (LoanAmt)</i>	-0.124*** (0.034)	-0.124*** (0.034)
<i>Secured Dum</i>	-0.105 (0.074)	-0.104 (0.076)
<i>Maturity</i>	0.135 (0.131)	0.134 (0.131)
<i>Performance Dum</i>	-0.039 (0.076)	-0.038 (0.078)
Observations	432	432
Adjusted Within R-squared	0.185	0.181
Industry FE	YES	YES
Year FE	YES	YES
Lender FE	YES	YES
Law firm FE	YES	YES
Loan type FE	YES	YES
PE FE	YES	YES

Table 9
PE-Lender Law Firm Relationship and the Likelihood of Loan Default

This table reports the results from OLS regression models investigating how the relationships between PE firms and lender law firms affect subsequent loan default. Four different models are presented, and each column corresponds to a different specification in which the dependent variable is either the default or bankruptcy dummy. *Loan_Default_3years* is a dummy variable that takes a value of one if the loan defaults within three years after the loan tranche's active date, and zero otherwise. *Loan_Default_4years* is a dummy variable that takes a value of one if the loan defaults within four years after the loan tranche's active date, and zero otherwise. *Bankruptcy_3Years* is a dummy variable that takes a value of one if the borrower files for bankruptcy within three years after the loan tranche's active date, and zero otherwise. *Bankruptcy_4Years* is a dummy variable that takes a value of one if the borrower files for bankruptcy within four years after the loan tranche's active date, and zero otherwise. The independent variable of interest is the prior relationship between PE sponsor j and lender law firm l (*RelationAmt_PELaw*) in loan tranche i . Definitions of the control variables are provided in the Appendix A. Industry, year, lender, law firm, loan type and PE fixed effects are included in all specifications. Standard errors are clustered at the PE sponsor level, with their values provided in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	(1) <i>LoanDefault</i> <i>3Years</i>	(2) <i>LoanDefault</i> <i>4Years</i>	(3) <i>Bankruptcy</i> <i>3Years</i>	(4) <i>Bankruptcy</i> <i>4Years</i>
<i>RelationAmt PELaw</i>	0.089* (0.050)	0.206*** (0.077)	0.125*** (0.020)	0.241*** (0.056)
<i>RelationAmt LenderLaw</i>	0.009 (0.028)	0.063 (0.067)	0.015 (0.021)	0.069 (0.048)
<i>Profitability</i>	-0.069 (0.134)	0.663** (0.260)	-0.152* (0.083)	0.580*** (0.180)
<i>MTB</i>	-0.106*** (0.011)	-0.202*** (0.038)	-0.102*** (0.015)	-0.199*** (0.026)
<i>MZscore</i>	0.039*** (0.007)	0.017 (0.018)	0.036*** (0.004)	0.014 (0.015)
<i>Log (Total Assets)</i>	-0.047*** (0.011)	-0.107*** (0.020)	-0.055*** (0.003)	-0.115*** (0.016)
<i>Asset Turnover</i>	-0.222*** (0.017)	-0.423*** (0.063)	-0.219*** (0.020)	-0.420*** (0.043)
<i>Cashholding</i>	0.367*** (0.026)	0.899*** (0.130)	0.373*** (0.052)	0.905*** (0.101)
<i>Leverage</i>	0.037** (0.017)	0.046 (0.051)	0.042** (0.020)	0.051 (0.037)
<i>Log (All-in-Spread-Drawn)</i>	0.036 (0.046)	0.081 (0.064)	-0.005 (0.006)	0.040 (0.052)
<i>Log (LoanAmt)</i>	0.001 (0.004)	0.006 (0.007)	-0.001 (0.001)	0.004 (0.006)
<i>Secured Dum</i>	-0.003 (0.009)	-0.001 (0.012)	-0.007 (0.007)	-0.005 (0.008)
<i>Maturity</i>	-0.004 (0.016)	-0.003 (0.020)	0.006 (0.008)	0.007 (0.011)
<i>Performance Dum</i>	0.008 (0.005)	0.012 (0.009)	0.004 (0.004)	0.008 (0.008)
Observations	432	432	432	432
Adjusted Within R-squared	-0.019	0.107	-0.008	0.125
Industry FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Lender FE	YES	YES	YES	YES
Law firm FE	YES	YES	YES	YES
Loan type FE	YES	YES	YES	YES
PE FE	YES	YES	YES	YES

Appendix A. Variable Definitions

Variable	Definition	Source
<i>RelationAmt_PELaw</i>	This ratio is calculated based on the total amount of loan tranches sponsored by sponsor j in collaboration with the law firm l (either lender or borrower law firm), divided by the total amount of loan tranches that the PE firm j sponsored over the past three years.	DealScan
<i>RelationAmt_LenderLaw</i>	This ratio is calculated based on the total amount of loan tranches issued by the lender b in cooperation with the law firm l (act as the lender-side law firm), divided by the total amount of loan tranches that the lender b issued over the past three years.	DealScan
<i>RelationAmt_PELender</i>	This ratio is calculated based on the total amount of loan tranches sponsored by the sponsor j in cooperation with the lender b , divided by the total amount of loan tranches that the PE firm j sponsored over the past three years.	DealScan
<i>RelationCount_PELaw</i>	This ratio is calculated based on the total number of loan tranches sponsored by sponsor j in collaboration with the law firm l (act as either lender or borrower law firm), divided by the total number of loan tranches that the PE firm j sponsored over the past three years.	DealScan
<i>RelationCount_LenderLaw</i>	This ratio is calculated based on the total number of loan tranches issued by the lender b in cooperation with the law firm l (act as the lender-side law firm), divided by the total number of loan tranches that the lender b issued over the past three years.	DealScan
<i>RelationCount_PELender</i>	This ratio is calculated based on the total number of loan tranches sponsored by the sponsor j in cooperation with the lender b , divided by the total number of loan tranches that the PE firm j sponsored over the past three years.	DealScan
<i>Profitability</i>	EBITDA divided by total assets	Compustat
<i>MTB</i>	The market value divided by the book value	Compustat

<i>MZscore</i>	This variable is the modified version of Altman Z-score without the leverage, which is calculated based on $(1.2 \times \text{Working Capital} + 1.4 \times \text{Retained Earnings} + 3.3 \times \text{EBIT} + 0.999 \times \text{Sales})$ divided by total assets following Graham, Lemmon, Schallheim (1998) and Chava, Livdan and Purnanandam (2009).	Compustat
<i>Log (Total Assets)</i>	The logarithm of total assets	Compustat
<i>Asset Turnover</i>	Total sales divided by total assets	Compustat
<i>Cashholding</i>	Cash and cash equivalents divided by total assets.	Compustat
<i>Leverage</i>	The total debt divided by total assets	Compustat
<i>Log (All-in-Spread-Drawn)</i>	The logarithm of AISD	DealScan
<i>Log (LoanAmt)</i>	The logarithm of loan amount	DealScan
<i>Secured Dum</i>	A dummy variable that equals one if the borrower is collateralized in a loan	DealScan
<i>Log (Maturity)</i>	The logarithm of the tranche maturity	DealScan
<i>Performance Dum</i>	A dummy variable that equals one if a loan has performance-based pricing associated with it.	DealScan
<i>Dividend Restriction</i>	Restrictions on payment of dividends as stipulated within credit agreement	DealScan
<i>Number of Maintenance Covenants</i>	The number of maintenance covenants including debt to cash flow, tangible net worth, interest coverage ratio, leverage ratio, net worth, fixed charge coverage ratio, debt service coverage ratio, senior debt to cash flow, cash interest coverage ratio, current ratio, debt to tangible net worth, debt to equity ratio, and loan to value ratio.	DealScan
<i>Number of Incurrence Covenants</i>	The number of incurrence covenants including asset sales sweep, equity issuance sweep, debt issuance sweep, excess cash flow sweep, insurance proceeds sweep, dividend restriction, percentage of net income, percentage of excess cash flow, required lenders, term changes, collateral release, and capex.	DealScan
<i>Number of All Covenants</i>	The total number of maintenance covenants plus incurrence covenants.	DealScan
<i>LoanDefault_3Years</i>	A dummy variable equal to one if the borrower defaults within three years after the loan tranche's active date, and zero otherwise.	Pitchbook

<i>LoanDefault_4Years</i>	A dummy variable equal to one if the borrower defaults within four years after the loan tranche's active date, and zero otherwise.	Pitchbook
<i>Bankruptcy_3Years</i>	A dummy variable that takes the value of one if the borrower files for bankruptcy within three years after the loan tranche's active date.	Pitchbook
<i>Bankruptcy_4Years</i>	A dummy variable that takes the value of one if the borrower files for bankruptcy within four years after the loan tranche's active date.	Pitchbook

Online Appendix

This section provides descriptions for several robustness checks.

Tests for Parallel Trend

In Table 6, we apply a DiD model to examine the effect of the NYT article as an exogenous shock. In this section, we conduct a test for the parallel trend assumption. Specifically, we create four variables to examine the effects surrounding the event date, January 4th, 2016. The first variable, $yr2014 \times HighRelationship_Group$, is an interaction term linking a dummy variable $yr2014$ (assigned a value of one if a tranche's active date falls in 2014 and zero otherwise) and the dummy variable $HighRelationship_Group$. The second variable, $yr2013 \times HighRelationship_Group$, is an interaction term linking a dummy variable $yr2013$ (assigned a value of one if a tranche's active date falls in 2013) and the dummy variable $HighRelationship_Group$. The third variable, $yr2012before \times HighRelationship_Group$, is an interaction term linking a dummy variable $yr2012before$ (assigned a value of one if a tranche's active date falls before 2012 and zero otherwise) and the dummy variable $HighRelationship_Group$. The fourth variable, $NYTShock2016 \times HighRelationship_Group$, is an interaction term linking a dummy variable $NYTShock2016$ (it takes the value of one if the loan tranche's active date falls after January 4th, 2016, and within the year 2016, and zero otherwise) and the dummy variable $HighRelationship_Group$. Then we create similar interaction terms for year 2017, 2018 2019 and years after 2020. To capture the dynamic effects in the post-event period, we further construct similar interaction terms for $yr2017 \times HighRelationship_Group$, $yr2018 \times HighRelationship_Group$, $yr2019 \times HighRelationship_Group$, and $yr2020after \times HighRelationship_Group$.

Table OA2 presents the regression results. Column (1) reports the estimates for the dependent variable $RelationAmt_PELaw$. The year 2015 is omitted from the regression and

serves as the baseline year. The coefficients on $yr2012before \times HighRelationship_Group$, $yr2013 \times HighRelationship_Group$, and $yr2014 \times HighRelationship_Group$ are statistically insignificant, suggesting no systematic differences between the treatment and control groups prior to the event. This confirms that the parallel trend assumption holds. The coefficient on $NYTShock2016 \times HighRelationship_Group$ is negative and statistically significant, indicating that the treatment effect emerges after the event. The coefficients capturing the dynamic effects in the post-event period remain significant in some cases, although their magnitudes and significance levels gradually decline over time, suggesting that the treatment effect weakens in later years.

Column (2) demonstrates no difference in dividend restrictions on loan tranches before 2016; however, a significant positive impact on dividend restrictions is observed post-2016, coinciding with the decline of the PE-Lender Law Firm relationship. Columns (3) to (5) yield similar findings using other covenant measures.

Tests Using Loan Counts Instead of Amount for Measuring Relationships

In another robustness test, we use the count of loan tranches as a proxy to measure the PE-law firm relationship ($RelationCount_PELaw$). This ratio is derived from the total count of loan tranches arranged by sponsor j in partnership with law firm l (acting as either the lender or borrower's law firm), divided by the aggregate number of loan tranches that PE firm j sponsored in the preceding three years. We adopt this alternative measure to substitute $RelationAmt_PELaw$ in Equation (1). Similarly, $RelationAmt_LenderLaw$ is replaced by $RelationCount_LenderLaw$. The findings are detailed in Table OA3 and are consistent with the results presented in Table 2. Furthermore, we apply these alternate relationship proxies to estimate Equation (2), with the estimation results reported in Table OA4. The results are broadly consistent with the estimation results in Table 3.

Tests Using Alternative Fixed Effects

In Table OA5 we estimate Equation (2) but with alternative (and fewer) fixed effects and report the results. From Columns (1) to (4), we use only industry fixed effects, year fixed effects, law firm fixed effects, loan type fixed effects, and lender fixed effects. All coefficients on *RelationAmt_PELaw* are still negative and statistically significant across these specifications. These results confirm that our original findings on the influence of PE-Lender Law Firm relationships on loan covenants are not driven by the exhaustion of fixed effects.

Tests of The Impact of PE-Lender Law Firm Relationship on LBO Transaction Leverage

In Table OA7, we report the impact of *RelationAmt_PELaw* on LBO leverage in Columns (1) to (2) and the impact of *RelationAmt_PELaw* on LBO leverage in Columns (3) to (4). We use *Loan Amount/EBITDA* as the dependent variable to measure LBO leverage, respectively. All the coefficients for *RelationAmt_PELaw* are positive and statistically significant in Column (1), and they remain positive, although slightly less significant, in Column (2) after controlling for the Lender–Law Firm relationship (*RelationAmt_LenderLaw*). The results suggest that a stronger PE-Lender Law Firm relationship is associated with an increased LBO transaction leverage. In Columns (3) and (4), we replace *RelationAmt_PELaw* with *RelationCount_PELaw*. The coefficients for *RelationCount_PELaw* are all positive and statistically significant at the one percent level.

Table OA1
Correlation Matrix

This table displays the correlation matrix with the correlation coefficients between the variables. The detailed definitions of each variable are provided in the Appendix A. Significance levels are denoted with *** for p<0.01, ** for p<0.05, and * for p<0.10.

VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
<i>RelationAmt PELaw</i>	1								
<i>RelationAmt LenderLaw</i>	0.058	1							
<i>Profitability</i>	-0.114**	-0.097**	1						
<i>MTB</i>	0.038	-0.014	0.419***	1					
<i>MZscore</i>	-0.101**	-0.058	0.438***	0.062	1				
<i>Log (Total Assets)</i>	0.142***	0.054	-0.039	-0.094*	0.058	1			
<i>Total Assets (\$billion)</i>	0.129***	0.073	-0.013	-0.011	0.009	0.589***	1		
<i>Asset Turnover</i>	-0.106**	-0.110**	0.226***	-0.079	0.593***	-0.113**	-0.067	1	
<i>Cashholding</i>	0.049	0.054	0.066	0.465***	0.046	-0.187***	0.011	-0.133***	1
<i>Leverage</i>	0.172***	-0.107**	0.096**	-0.193***	-0.201***	0.175***	0.032	0.077	-0.466***
<i>Log (All-in-Spread-Drawn)</i>	0.052	-0.125***	-0.056	0.073	-0.113**	0.032	0.05	-0.003	0.141***
<i>All-in-Spread-Drawn (bps)</i>	0.06	-0.128***	-0.072	0.076	-0.115**	0.032	0.03	-0.009	0.134***
<i>Log (LoanAmt)</i>	0.151***	0.113**	0.001	-0.029	0.01	0.280***	0.123**	-0.083*	-0.052
<i>LoanAmt (\$million)</i>	0.149***	0.079	-0.006	-0.024	0.008	0.335***	0.177***	-0.083*	-0.02
<i>Secured Dum</i>	-0.132***	0.041	0.059	-0.139***	0.01	-0.132***	-0.029	0.073	-0.006
<i>Log (Maturity)</i>	-0.097**	0.045	0.026	0.073	-0.039	-0.092*	-0.009	-0.018	0.05
<i>Maturity (Months)</i>	-0.07	0.044	0.01	0.066	-0.051	-0.078	-0.027	-0.031	0.061
<i>Performance Dum</i>	-0.124**	0.145***	-0.022	-0.089*	0.043	-0.071	-0.052	0.039	-0.066

Table OA1 (cont.)

VARIABLES	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)
<i>Leverage</i>	1								
<i>Log (All-in-Spread-Drawn)</i>	-0.013	1							
<i>All-in-Spread-Drawn (bps)</i>	-0.013	0.963***	1						
<i>Log (LoanAmt)</i>	0.083*	-0.081*	-0.058	1					
<i>LoanAmt (\$million)</i>	0.076	-0.097**	-0.098**	0.839***	1				
<i>Secured Dum</i>	0.032	-0.027	-0.039	-0.001	-0.028	1			
<i>Log (Maturity)</i>	-0.061	0.015	0.015	0.008	-0.01	0.376***	1		
<i>Maturity (Months)</i>	-0.059	0.137***	0.156***	0.130***	0.078	0.382***	0.944***	1	
<i>Performance Dum</i>	-0.048	-0.387***	-0.354***	-0.018	-0.019	0.049	0.02	-0.029	1

Table OA2
Parallel Trend for Exogenous Shock

This table presents a parallel trend of the exogenous shock analysis in Table 6. *HighRelationship_Group* is a dummy variable that takes a value of one for PE sponsors with stronger PE-Lender Law Firm relationships. *yr2012before* is assigned a value of one if a tranche's active date falls before 2012 and zero otherwise. *yr2013* is assigned a value of one if a tranche's active date falls in 2013 and zero otherwise. *yr2014* is assigned a value of one if a tranche's active date falls in 2014 and zero otherwise. *yr2017* is assigned a value of one if a tranche's active date falls in 2017 and zero otherwise. *yr2018* is assigned a value of one if a tranche's active date falls in 2018 and zero otherwise. *yr2019* is assigned a value of one if a tranche's active date falls in 2019 and zero otherwise. *yr2020after* is assigned a value of one if a tranche's active date falls after 2020 and zero otherwise. Additionally, *NYTShock2016* is dummy variable that takes the value of one if the loan tranche's active date falls after January 4, 2016, and within the year 2016, and zero otherwise. Standard errors are clustered at the PE sponsor level and are provided in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	(1) <i>RelationAmt PELaw</i>	(2) <i>Dividend Restriction</i>	(3) <i>The Number of Maintenance Covenants</i>	(4) <i>The Number of Incurrence Covenants</i>	(5) <i>The Number of All Covenants</i>
<i>yr2012before</i> × <i>HighRelationship_Group</i>	-0.119 (0.076)	0.266 (0.293)	0.450 (0.681)	2.468 (2.161)	2.918 (2.768)
<i>yr2013</i> × <i>HighRelationship_Group</i>	-0.031 (0.140)	-0.009 (0.384)	-0.025 (0.763)	0.203 (2.626)	0.178 (3.305)
<i>yr2014</i> × <i>HighRelationship_Group</i>	-0.026 (0.151)	-0.146 (0.339)	-0.255 (0.743)	-0.135 (2.497)	-0.390 (3.147)
<i>NYTShock2016</i> × <i>HighRelationship_Group</i>	-0.538*** (0.170)	0.911*** (0.328)	1.056* (0.614)	4.097* (2.415)	5.153* (2.961)
<i>yr2017</i> × <i>HighRelationship_Group</i>	-0.570*** (0.167)	0.657** (0.298)	1.571** (0.659)	4.417* (2.228)	5.989** (2.805)
<i>yr2018</i> × <i>HighRelationship_Group</i>	-0.141 (0.193)	0.676* (0.356)	1.170* (0.700)	3.875 (2.580)	5.045 (3.196)
<i>yr2019</i> × <i>HighRelationship_Group</i>	-0.513** (0.218)	0.461 (0.343)	0.962 (0.711)	3.676 (2.502)	4.637 (3.096)
<i>yr2020after</i> × <i>HighRelationship_Group</i>	-0.756*** (0.185)	0.224 (0.363)	1.202 (0.796)	1.978 (2.822)	3.181 (3.527)

<i>HighRelationship Group</i>	0.244*** (0.079)	-0.482 (0.307)	-0.975 (0.684)	-3.626 (2.295)	-4.601 (2.914)
<i>NYTShock</i>	0.388** (0.147)	-0.440*** (0.139)	-0.713*** (0.161)	-2.577** (1.008)	-3.290*** (1.142)
<i>RelationAmt LenderLaw</i>	0.147 (0.114)	0.114 (0.199)	-0.085 (0.348)	-0.027 (1.468)	-0.112 (1.771)
<i>Profitability</i>	-0.052 (0.368)	0.197 (0.870)	-1.044 (1.486)	-0.096 (6.364)	-1.139 (7.694)
<i>MTB</i>	0.020 (0.027)	-0.026 (0.055)	0.084 (0.094)	0.076 (0.437)	0.159 (0.522)
<i>MZscore</i>	0.038** (0.019)	0.017 (0.043)	-0.040 (0.058)	-0.103 (0.273)	-0.143 (0.326)
<i>Log (Total Assets)</i>	0.006 (0.018)	-0.035 (0.031)	-0.117** (0.050)	-0.367** (0.179)	-0.484** (0.220)
<i>Asset Turnover</i>	-0.035 (0.031)	-0.075 (0.079)	0.068 (0.125)	-0.658 (0.636)	-0.590 (0.743)
<i>Cashholding</i>	0.100 (0.196)	0.842* (0.441)	1.801** (0.726)	7.121** (3.464)	8.923** (4.159)
<i>Leverage</i>	0.104 (0.098)	0.370* (0.199)	0.729* (0.378)	2.227 (1.561)	2.956 (1.904)
<i>Log (All-in-Spread-Drawn)</i>	-0.018 (0.031)	-0.093 (0.066)	-0.183** (0.088)	-0.748* (0.443)	-0.931* (0.520)
<i>Log (LoanAmt)</i>	0.004 (0.012)	0.022 (0.023)	-0.049 (0.036)	-0.015 (0.172)	-0.064 (0.206)
<i>Secured Dum</i>	0.077 (0.056)	-0.029 (0.069)	-0.059 (0.101)	0.094 (0.372)	0.035 (0.459)
<i>Maturity</i>	-0.102** (0.047)	0.041 (0.068)	0.096 (0.084)	0.362 (0.358)	0.457 (0.427)
<i>Performance Dum</i>	0.004 (0.042)	0.321*** (0.056)	0.460*** (0.110)	2.231*** (0.401)	2.691*** (0.481)
Observations	432	432	432	432	432
Adjusted Within R-squared	0.355	0.367	0.419	0.361	0.382
Industry FE	YES	YES	YES	YES	YES
Lender FE	YES	YES	YES	YES	YES
Law firm FE	YES	YES	YES	YES	YES
Loan type FE	YES	YES	YES	YES	YES

Table OA3
**Using Counts for Robustness: The Impact of PE-Law Firm Relationship
on Lender Law Firm Selection**

This table presents the results from OLS regression models examining the influence of relationships between PE firms and lender law firms on the selection of lender law firms. The dependent variable, *LenderLawfirm_Selection*, is a dummy that takes the value of one if the law firm *l* is selected as the lender law firm in loan tranche *i*, and zero otherwise. The variable of main interest is the prior relationship between the PE sponsor *j* and law firm *l* (*RelationCount_PELaw*) in loan tranche *i*. Additionally, we control for the prior relationship between lender *b* and lender law firm *l* (*RelationCount_LenderLaw*). The control variables are consistent with those used in Table 2. Fixed effects for industry, year, lender, law firm, loan type and PE are incorporated. Standard errors are clustered at the tranche level and shown in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	(1) <i>Lender Law Firm Selection</i>	(2) <i>Lender Law Firm Selection</i>
<i>RelationCount_PELaw</i>	0.617*** (0.082)	0.523*** (0.082)
<i>RelationCount_LenderLaw</i>		2.004*** (0.160)
Observations	215,285	215,285
Adjusted Within R-squared	0.006	0.026
Controls	YES	YES
Industry FE	YES	YES
Year FE	YES	YES
Lender FE	YES	YES
Law firm FE	YES	YES
Loan type FE	YES	YES
PE FE	YES	YES

Table OA4
Using Counts for Robustness: The Impact of PE-Lender Law Firm Relationship on Covenants

This table presents the results examining the impact of PE-Lender Law Firm relationships (measured by *RelationCount PELaw*) on covenant restrictions. This table controls for the same set of control variables as Table 3, and the models include fixed effects for industry, year, lender, law firm, loan type, and PE. Standard errors are clustered at the PE sponsor level and shown in parentheses. **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	(1) <i>Dividend Restriction</i>	(2) <i>The Number of Maintenance Covenants</i>	(3) <i>The Number of Incurrence Covenants</i>	(4) <i>The Number of All Covenants</i>
<i>RelationCount_PELaw</i>	-0.366** (0.152)	-1.547*** (0.529)	-3.310*** (0.860)	-4.856*** (1.268)
<i>RelationCount_LenderLaw</i>	2.742*** (0.548)	4.688*** (1.574)	6.292** (2.722)	10.980** (4.247)
Observations	432	432	432	432
Adjusted Within R-squared	0.969	0.551	0.814	0.817
Controls	YES	YES	YES	YES
Industry FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Lender FE	YES	YES	YES	YES
Law firm FE	YES	YES	YES	YES
Loan type FE	YES	YES	YES	YES
PE FE	YES	YES	YES	YES

Table OA5
The Impact of PE-Lender Law Firm Relationships on Covenants
with Alternative Fixed Effects

This table shows the results that examine the impact of PE-Lender Law Firm relationships on various loan covenants with reduced fixed effects. These regression models assess the likelihood of imposing covenant restrictions in loan agreements. The primary independent variable is the relationship between the PE sponsor and the lender law firm (*RelationAmt_PELaw*). Control variables include all variables controlled in Table 3. Standard errors are clustered at the PE sponsor level and shown in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	(1) <i>Dividend Restriction</i>	(2) <i>The Number of Maintenance Covenants</i>	(3) <i>The Number of Incurrence Covenants</i>	(4) <i>The Number of All Covenants</i>
<i>RelationAmt PELaw</i>	-0.156 (0.122)	-2.122** (0.899)	-3.479*** (1.002)	-5.601*** (1.876)
<i>RelationAmt LenderLaw</i>	0.245 (0.193)	0.521 (0.674)	0.108 (0.797)	0.629 (1.427)
Observations	443	432	432	432
Adjusted Within R-squared	0.173	0.546	0.824	0.826
Controls	YES	YES	YES	YES
Industry FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Lender FE	YES	YES	YES	YES
Law firm FE	YES	YES	YES	YES
Loan type FE	YES	YES	YES	YES
PE FE	NO	NO	NO	NO

Table OA6
The Impact of PE-Lender Law Firm Geographic Distance on Lender-Law firm Relationship

This table investigates whether the geographic distance between PE headquarters and lender law firm headquarters (*Distance_PELaw*) affects the lender-law firm relationship. Firm-level control variables include *Profitability*, *MTB*, *MZscore*, *Log (Total Assets)*, *Asset Turnover*, *Cashholding and Leverage*. Loan level control variables include *Log (All-in-Spread-Drawn)*, *Log (LoanAmt)*, *Secured Dum*, *Maturity* and *Performance Dum*. Definitions of the control variables can be found in the Appendix A. Standard errors are clustered at the PE sponsor level and shown in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	(1) <i>RelationAmt LenderLaw</i>	(2) <i>RelationAmt LenderLaw</i>	(3) <i>RelationAmt LenderLaw</i>
<i>Distance PELaw</i>	0.046 (0.365)	0.155 (0.308)	0.202 (0.318)
<i>RelationAmt PELender</i>	-0.358*** (0.107)		-0.222 (0.143)
<i>RelationAmt PELaw</i>		0.467** (0.197)	0.310 (0.214)
Observations	432	432	432
Adjusted Within R-squared	0.797	0.799	0.812
Controls	YES	YES	YES
Industry FE	YES	YES	YES
Year FE	YES	YES	YES
Lender FE	YES	YES	YES
Law firm FE	YES	YES	YES
Loan type FE	YES	YES	YES
PE FE	YES	YES	YES

Table OA7
The Impact of PE-Lender Law Firm Relationships on LBO leverage

This table reports the results from OLS regression models that investigate the impact of PE-Lender Law Firm relationships on LBO leverage (measured as *Loan Amount/EBITDA* or *Loan Amount/Total Assets*). Independent variable of interest is the prior relationship between the PE sponsor j and lender law firm l (*RelationAmt_PELaw* or *RelationCount_PELaw*) in loan tranche i . Firm-level control variables include *Profitability*, *MTB*, *MZscore*, *Log (Total Assets)*, *Asset Turnover*, and *Cashholding*. Loan level control variables include *Log (All-in-Spread-Drawn)*, *Secured Dum*, *Maturity* and *Performance Dum*. Definitions of the control variables can be found in the Appendix A. Standard errors are clustered at the PE sponsor level and shown in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

VARIABLES	(1) <i>Loan Amount to EBITDA</i>	(2) <i>Loan Amount to EBITDA</i>	(3) <i>Loan Amount to EBITDA</i>	(4) <i>Loan Amount to EBITDA</i>
<i>RelationAmt_PELaw</i>	10.966** (5.084)	9.869 (6.190)		
<i>RelationAmt_LenderLaw</i>		3.217 (6.058)		
<i>RelationCount_PELaw</i>			26.026*** (2.916)	25.574*** (2.661)
<i>RelationCount_LenderLaw</i>				2.246 (8.030)
Observations	432	432	432	432
Adjusted Within R-squared	0.084	0.080	0.105	0.101
Controls	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Lender FE	Yes	Yes	Yes	Yes
Law firm FE	Yes	Yes	Yes	Yes
Loan type FE	Yes	Yes	Yes	Yes
PE FE	Yes	Yes	Yes	Yes

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