3. INTERNATIONAL LOAN FINANCE

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INTERNATIONAL LOAN FINANCE

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The traditional and principal form of bank lending remains the loan or term loan. This applies both with regard to wholesale as well as corporate and retail lending. Term lending or loan finance remains a significant and profitable part of modern banking business.

The core function of banks and banking has always been to accept deposits from the general public and to advance loans or credit. Individuals and companies can obtain credit on a revolving (overdraft or card) basis. For larger, fixed or specific items, it is nevertheless more useful to take out a loan for an agreed term or duration. Personal and small business finance will be subject to consumer credit legislation in most countries.

Term loans take a number of different forms. The more simple facilities are either bilateral or direct loans or syndicated (bank group) loans. Parties to such facilities may also include guarantors and, in particular, related companies (group guarantors). Participated (or blind) syndications may also be entered into. A number of other types of contingent or revolving facilities may also be provided as well as multiple currency or multiple purpose facilities, committed facilities, guide facilities, back-to-back (or parallel loans). Loans may also be subordinated, secured, leveraged, securitised or guaranteed (including related company or group guarantors). The lending may also be entered into for general commercial use or tied to a specific purpose (project, property, asset, acquisition or lease finance).

Whichever type of facility is involved, the principal components remain the amount (principal), duration (term), advance (draw-down) and repayment (maturity) dates, interest and any additional conditions or obligations. These core determinants will then be set out in the relevant documentation. This may either be short and simple or long and complex depending on the nature and possibly purpose of the facility. A range of further options may also be provided for including with regard to calls or demands, instalments (including amortisation), bullets, swaps and convertibles.

The main difference between loans and security (bonds or equity) based financing relates to evidence of debt and transferability. While loans are inherently non-transferable, a number of transfer or substitution techniques have been developed including assignment (legal or equitable), novation and participation. Various devices have also been included in loan documentation to facilitate transfer including through the use of transferable loan instruments or certificates (TLIs and TLCs) or transferable participation certificates (TPCs).

While there had been some drop in the volume of syndicated lending in the Euro-dollar markets with the growth of bond financing and securitisation especially during the late 1970s and early 1980s, term lending increased again in the late 1980s especially with the development of TLFs and TLCs as well as Multiple Option Funding Facilities (MOFFs). International syndicated lending has also always been necessary where the credit standing of the borrowing has not allowed the issuance of debt instruments or more complex structures or purposes are involved. Term lending remains of significant importance at the national level especially in connection with corporate as well as house, car and other large value purchases.

The purpose of this chapter is to consider the nature of term lending and its main components and attributes. The various types of facilities available are reviewed. The principal terms and conditions included within a term loan are then considered in further detail. The nature of syndication and the syndication process is examined. The various devices available for loan transfer and delivery purposes are also considered.

EURO LOAN MARKET

The use of loans for fixed periods or term loans is as old as banking itself. The origins of modern banking are generally ascribed to the Italian financiers and financial families in the 11th and 12th centuries[1]. Early deposit, credit and payment practices developed with the local and then Great Fairs across Europe. The main financial centres were Amsterdam and then London with London's pre-eminence being secured as the centre for the international bill of exchange market and with London's key role in the Gold Standard until the beginning of WWI[2]. London would then again emerge as one of the principal international financial centres after WWII with the creation and subsequent massive growth and expansion of the euro-dollar markets.

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[1] Early deposit and credit facilities were used in Mesopotamia as early as 2500 BC which practices were taken forward by the Greeks and then the Romans. Chapter 2, section 1.

[2] Chapter 2, section

The euro-dollar markets are made up of three separate deposit (or inter-bank), loan and bond (security) markets. The original market was simply a deposit market with US dollars being moved to London to avoid the threat of forfeiture and loss. Chinese and then Russian dollar deposits were moved to London with the terms 'euro-bank' and 'euro-dollar' arising from the cable addresses of the earliest banks involved.[3]

US dollar deposits in London quickly accumulated with the official transfers and private investment.[4] London was also a major international centre for foreign currency and trade finance with American and then other foreign banks being attracted to the City of London due to the light regulatory environment maintained by the Bank of England. The original deposit market grew substantially with banks in London either using the inter-bank market or new certificate of deposit (CD market)[5]. The euro-dollar market grew by 300% between 1950 and 1959 and then doubled again in 1960. The market was worth US$3,000bn by 1989 with average outstanding euro CDs of US$100bn.[6]

The euro loan market consists of fixed term advances of euro-dollars generally by a group or syndicate of banks to spread credit risk and any reserve or regulatory costs. Syndicates were themselves often included consortium banks which were London subsidiaries formed by two or more overseas banks to participate in the new eurodollar market. The syndicated loan market grew more significantly during the 1970s with the recycling of petrol-dollars from the oil exporting countries to less developed and emerging market economies. [7] Excessive supply with many banks not maintaining the highest credit assessment standards as well as the turn-down in the global economy would lead to the Debt Crisis beginning with Mexico's rescheduling of its international debt in 1982.

The euro bond market consists of a parallel security-based bond or debenture market with governments or multinational corporations or other corporate entities issuing debt in a transferable and tradable form. The first euro bond was organised by S G Warburg for the Italian company Autostrade in 1963[8]. Euro bonds were attractive to wealthy individual investors due to the bearer form, consequent anonymity and absence of withholding tax. The market would increasingly become dominated by institutional investors from the 1980s onwards. Growth in the market was also stimulated by regulatory penalties in the US especially with Regulation . President Kennedy had introduced a tax of foreign bond issues in the US in 1963. The Autostrade US$15m issue was then attractive both to US investors wishing to avoid the new tax and European investors holding euro-dollars.[9] Although the US authorities re-opened the Yankee bond market in 1975 to foreign borrowers, this was not sufficient to draw the market back to the US.

Bond issues grew significantly during the early 1980s with deregulation in many markets and the declining interest rates between 1982 and 1986.[10] Variable interest floating rate notes (FRNs) and convertibles were created with the first Note Issuance Facilities (NIF) in 1983 and then even shorter euro commercial paper (ECP) programmes beginning in 1985. Shorter duration euro notes had also been developed to provide shorter maturity instruments with euro medium term notes (euro MTNs) becoming popular by 1987 onwards. Global bonds were introduced in 1989 by the World Bank. The bond market was nevertheless hit by the stock market crash 1987 and economic turnaround during the late 1980s and early 1990s. The market had nevertheless seen a substantial recovery subsequently.

Euro market activity increased again during the 1990s. Syndicated loan volumes grew substantially during the end of the 1980s as corporate institutions sought more flexible lines of credit especially with Multiple Option Facilities (MOFs),[11] growth in debt finance takeovers and management buy-outs as well as need for less

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[3] The new Chinese Government had transferred its assets to the Banque Commerciale pour L'Europe du Nord with the cable address 'eurobank'. The Russians had also moved funds to the Banque Commerciale and to the Moscow Narodny Bank in London. Arun Kumar Sarwal, *KPMG International Handbook of Financial Instruments and Transactions* (Butterworths London 1989) 89. Chapter 2(n). Some writers ascribe the origins of the syndicate of loan markets to 1968 although others put this earlier. Sarwal (n 3) 89 and

[4] Walker, *International Banking Regulation Law Policy and Practice* (Kluwer Law London, 2001) Chapter 1.

[5] Certificates of deposit (CDs) are transferable certificates evidencing underlying bank deposits. Chapter 3, section

[6] Sarwal (n 3) 89. See also Walker (n) chapter 1 (n).

[7] The market had grown to US$11.4bn by 1972 and increased to US$178bn by 1981 with the substantial new deposit volumes provided by the growth in petrol-dollars being recycled in London.

[8] Chapter 2, section ; and chapter

[9] Sarwal (n 3) 90

[10] The market had grown to US$135bn annual by 1985 and US$180bn by 1986. Euro-dollars made up a third of total outstanding bonds. George Dosoo, *The Euro Bond Market* (Woodhead-Faulkner New York and London 2 Ed 1992) 2 and . The market had grown from US$70m in 1980 to US$120m in 1981 and up to US$250m by 1991. Dosoo (n) 2

[11] MOFs provide for a number of credit and money market fund-raising mechanisms with a single agreement and agent bank acting on behalf of a syndicate of lenders. These would usually involve a committed revolving credit with other uncommitted facilities including the use of tender panels for multi-currency cash advances and bankers' acceptances or other known or commercial paper programme facilities. This allows borrowers to re-package all of their available credit facilities under a single documented agreement. While finer rates may be

creditworthy borrowers to use the loan rather than bond market. The period was also characterised by the development of subordinate or mezzanine debt in connection with mergers and acquisitions or buy-outs as well as project finance.[12] Loan transfers also became of particular importance as bankers attempted to copy the transferability inherent in the bond market. The market grew again between 1991 and 1995 and then turned following Russia's default in 1998.[13]

LOAN FACILITIES

Despite the simplicity of the underlying debt obligation and core contractual components involved (amount and advance, duration, interest and fees, repayment and additional obligations), a large number of different types of lending facilities may be used. These may also either be used independently or in combination such as under a Multiple Option Facility (MOF). The key provisions and principal terms and conditions of a large value term loan are considered in the following sections with loan syndication, loan transfers and loan rescheduling. Some of the main other types of loan facilities commonly used are outlined below.

(1) Euro Loans

A Euro loan is either a syndicated or participative loan drawn by a sovereign or corporate borrower from a single bank (a direct or bilateral loan) or a group (or syndicate) of banks. Syndication involves the arranging of a bank group to make available funds on a proportionate and several basis. A single amount will effectively be financed under a common agreement although these are legally separate parallel loans.

A participated loan will involve more than one lending bank, the identity of which will not be known to the borrower. The principal borrower will spread the lending commitments. Medium term participation agreements are used for individual loans and short term master participation agreements for rollovers. Where a several commitment is subsequently sold off, this is referred to as a sub-participation.[14]

The most common forms of syndicated loans are sovereign and corporate loans. Sovereign loans may be used for deficit, foreign exchange and rescheduling purposes, while corporates for capital, plant, asset or other acquisition uses.[15]

Sovereign loans may either be entered into with the state, the government or the central bank (often used to cover the country's reserves). Interest rates are calculated depending on the credit-standing of the country concerned. Covenants are generally restricted only to apply to external debt with limited events of default. Sovereign immunity will be waived and the borrower required to submit to the governing law and jurisdiction of a third country to avoid moratoria or exchange controls.[16] Sovereign loans are generally unsecured. A tied loan involves one sovereign lending to another on condition that the funds will be used to purchase goods and services from the credit provider.

Large corporate loans to public companies are often unsecured for administrative and cost reasons but also as this would limit alternative financing and prefer particular creditors. Smaller companies will grant universal fixed and floating charges although it is more common for them to use non-committed credit lines rather than term loans.[17] Group cross-guarantees are common.[18]

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available through the use of the uncommitted facilities, the institution can also rely on the committed amounts if necessary. 'Developments in the International Syndicated Loan Market in the 1980s' 30 *Bank of England Quarterly Bulletin* 71 (1990).

[12] US mezzanine practice would generally involve issuing 'below investment grade' (junk) bonds with Europe generally using bank debt with equity warrants attached. Bank of England (n).

[13] Medium term international bank loans reached US$370bn in 1995, dropping to US$345bn and US$289bn in 1996 and 1997. OECD, *Financial Market Trends* (October 1994) 69. During the mid-1990s, loan growth was used to refinance outstanding credits or finance acquisitions, infrastructure projects or the restructuring of national industries including telecommunications. The market was then dominated by 'jumble loans' to fund mergers and acquisitions during 1999 and 2000. R Bream, 'Surge in M&A comes to the rescue' *Financial Times* (19.5.2001). Banks then sought to reduce their exposures to weak sectors and borrowers in 2002. T Marshall, 'Portfolio management shows up loan books' *Euromoney* (July 2002) 122. For comment, Hal S Scott and Philip A Wellons, *International Finance* (Foundation Press New York 2003) 552-557. [Euro equities have also been created which involve distributing shares of multinational corporations through the same distribution network as euro bonds. These are distinct from global issues which are issued in more than one jurisdiction. Swaps have also been used to take advantage of the most attractive funding opportunities available in national and international markets. This has in turn led to an integration of the national and euro-dollar markets. Sarwal (n 3) 92.

[14] Sub-section

[15] Sub-section

[16] Philip Wood, 'International Banking Operations' *Encyclopaedia of Banking Law* (Butterworths Loose-leaf) vol.2, para.F-3201.

[17] Sub-section

[18] Wood (n 16) paras.F(3199)-(3200)

Parallel or back-to-back loans are used by companies to offset currency or interest rate advantages. The parent of one company will borrow to lend to the subsidiary of another company in the same country with the parent bank of that subsidiary borrowing an identical amount and for the same term to lend to the subsidiary of the first company in the other country. This may now be achieved more simply under a currency or interest rate swap although other tax advantages may still be available with the parallel loan.[19]

(2) Multi-Purpose and Multi-Currency Facilities

A multi-currency facility allows the principal advance to be drawn down in more than one currency at the borrower's option. Currency exchange arrangements may also be incorporated through the use of FX swaps.

Multi-purpose facilities allow borrowers to obtain funds under different facilities or different terms up to an agreed limit. This may be provided under a Multiple Option Facility (MOF) or Multiple Option Facility Funding (MOFF). Sub-advances, duration and maturity will be reset for each facility. These may either be committed or uncommitted with the bank only being able to provide funds under committed options.

A dual currency loan is one that allow the lenders to re-denominate the funds provided in an alternative currency. This may apply with regard to either or both the principal and interest payments made by the borrower. This may be of value to borrowers where they are borrowing in one currency with income receipts to be in another. This can allow both the borrower and lender to benefit from exchange or interest rate movements. As this is attractive to lenders, they may offer a reduced interest rate or up-front cash premium. The effect is to provide the lenders with a currency option. This may also be referred to as a currency conversion facility (CCF).[20]

Currency facility clauses provide for the close-out netting of unmatured FX payments, set-off and the settlement netting of deliveries of currencies due on the same day. The borrower will be prohibited from assignment, charging or otherwise disposing of set-off eligible contracts or deposits.[21]

Specialist US swing-line facilities may also be used to allow the borrower to obtain short-term US dollar funds.[22]

(3) Term and Revolving Facilities

Agreements can either provide for single payment or tranche (instalment) draw down or for revolving use of the amount provided up to the limit set. Under a revolving credit facility (or RCF), the borrower will be able to draw down again on amounts already repaid within the term set. Currency options may also be provided under a Multiple Currency Revolving Credit Facility (MRCF).

(3) Credit Lines

A line of credit (or credit line) is used to allow borrowers to draw variable amounts up to an agreed credit limit. This is the corporate equivalent of an individual or personal overdraft. Agreed facilities are referred to as advised lines of credit. This may either be committed with the bank being obliged to lend up to the limit specified or uncommitted with funds being made available at the bank's discretion. Unadvised lines of credit are internal bank limits.

Currency options may be provided under a multi-currency line of credit or a multi-currency revolving credit facility (MRCF). An FX line of credit is a specific facility to borrow to cover foreign exchange purchases. An LC line of credit provides for borrowing under trade finance related letters of credit up to specified amounts.

A standby credit is a contingent credit line. This may form part of a larger Multi-Option Facility (MOF) or Multi-Option Funding Facility (MOFF). Standby credits can also be used as back-up facilities for euro note issues.[23]

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[19] Sarwal (n 3) 252.

[20] Sarwal (n 3) 255

[21] Philip R Wood, *Title Finance, Derivatives, Securitisations, Set-off and Netting* (Sweet & Maxwell London 1995).

[22] These are often used to support commercial paper programmes to ensure that they are of prime quality and avoid prospectus registration under the US Securities Act 1933. This allows the issuer access to same-day funds in the US. Interest is calculated at the higher of the US prime commercial rate and federal funds rate with margin and reserve costs. For drafting, A Gooch and L Klein, *Loan Documentation* (2 Ed 1991). For discussion, Scott and Wellons (n 13) 557-563.

[23] Sarwal (n 3) 251.

(4) Asset or Property Finance

Single or syndicated loans or credit facilities may be used for specific asset or property purchases. These may include aircraft or engine leases or ship mortgages.

Aircraft finance is usually provided through the use of special lessor vehicles which purchase the aircraft or aircraft engines under a term loan with the aircraft or engines then being leased to the airline company. The rental payments are calculated having regard to the cost of the loan and lessor's profits. The aircraft and engines are mortgaged to the bank syndicate with a security assignment of all charters and earnings, manufacturer's warranties, insurances and requisition compensation.[24]

Ship finance will typically also use a single or syndicated loan agreement to purchase the ship through a 'one-ship company' registered in a flag of convenience state generally involving Cyprus, Liberia or Panama. A vessel mortgage is then granted in favour of the lending bank or banks with further security assignments of charters and earnings, insurances and requisition compensation as well as ship ledgers and guarantees.[25]

(5) Project Finance

Project or a construction finance involves the provision of funds for the completion and subsequent running of a specific project. Project finance was specifically during the late 1970s to fund construction projects in the Middle East and for oil exploration purposes elsewhere.[26] Other projects may include bridge or transport facilities, oil and gas pipelines, refineries, power stations or water or sewerage systems and more recently telecommunications and cable laying. Project finance is referred to as limited recourse financing or non-recourse financing depending upon the degree of risk and cover involved and residual personal liability of the parties concerned.

The funds are generally made available to a single purpose company or vehicle (SPC or SPV) with the loan being syndicated and the banks holding security over the project assets and income streams. The lending is otherwise non-recourse against the developers although the bank's risk is spread and secured over the overall project value. Additional guarantees and subordination through inter-creditor agreements will also be entered into.

The complexity and risk profile will initially have been assessed with a separate due diligence report being provided by the lawyers on all of the project contracts (including construction, supply, off-take, operating, joint venture/shareholders agreements, insurance, host government concessions and land-leasing agreements).[27] Documentation will also include currency and interest cover or hedging agreements, sponsor as well as group guarantees, inter-creditor agreements (for subordination and enforcement purposes) and preservation agreements allowing the lenders to take over the project in the event of default.

(6) Property Finance

Property finance is used to purchase commercial property to benefit from rental flows and capital accretion. As with project finance, loan repayments are offset by the rental receipts. The property may often be acquired by a single purpose company or special purpose vehicle with security being taken over the real property and income stream. Initial risk assessments will confirm the value of the property and income cover. The valuation will always exceed the loan by a margin (such as 20%) to provide cover in the event of a forced sale or disposal.[28]

(7) Acquisition Finance

Acquisition finance is used to allow companies to purchase other entities either public listed companies or private companies. This may include purchase by another company, a consortium or a management buy-out. Due

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24 Wood (n 16) para.F(3206)
25 Wood (n 16) para.F(3209)
26 Sarwal (n 3) 253
27 Wood (n 16) para.F(3205)
28 Other documents in addition to the loan agreement may include valuation and environmental reports, title reports, security and subordination agreements, interest hedging facilities and possibly completion, cost overrun guarantees and assumption agreements where construction or major development or refurbishment is involved. Wood (n 16) para.F(3207).

Under a leveraged aircraft lease, the plane is leased to the airline company although the lease is assigned to the credit providers with an aircraft mortgage as well as any other manufacturers' warranties, charters and earnings, insurance contracts and requisition compensation ( ). Capital tax allowances can be passed on to the lessee through rental reductions. Wood (n 16) para.F(3206)

diligence reports will be requested over the acquiring and target companies. The credit agreement and other security documentation will be revised to comply with relevant companies and takeover laws including the City Code on takeovers and mergers in the UK.[29] Separate subordinated finance may be provided with a separate inter-creditor agreement.

Leveraged bid finance is a specialist form of acquisition finance where a new single purpose or shell company is set up to acquire the target company or group. Separate senior syndicated lending and subordinated (mezzanine) credit may be provided or separate high interest rate (high yield or junk bonds) issued. Senior and mezzanine rights are controlled under an inter-credit agreement.[30] Security is shared by the senior and subordinated debt holders. This will include the offeror's assets, shares acquired and target assets subject to restrictions on the provision of financial assistance. The credit agreement may also allow for the refinancing of the target company or groups' existing debts or include a separate working capital facility.[31]

Credit agreements may provide for the payment of project proceeds into blocked accounts,[32] specific value and cash flow ratio requirements, ring-fence covenants,[33] additional events of default[34] and no action clauses restricting enforcement to majority voting.

(8) Subordinated Debt

Subordination provides for the postponement of one group of creditors as against another. The junior, subordinated or mezzanine debt is then ranked after either the agreed principal debt or all debt held by other creditors against the borrower. The inter-creditor agreement may provide for turnover subordination, a structural subordination or subordination of all debts.[35] The inter-creditor agreement provides for subordination and postponement, turnover, non-enforcement, new monies and co-operation.

LOAN STRUCTURES

The core contract involved in national and international lending is the bank loan. This consists of a personal debt obligation entered into between the borrower and bank or banking group (syndicate). This may also include a guarantor or guarantors (including related company or group guarantors).

Banks remain the principal providers of loan funds although governments and multinational companies or organisations as well as other public entities may also advance monies. Specialist lending may also be provided by particular groups of authorised or licensed institutions including building societies in the UK and savings and loans institutions in the US. Smaller loans and credit facilities to individuals or smaller companies are separately regulated under consumer credit legislation.[36]

The principal borrowers are sovereign entities, governments and other public bodies as well as multinational and national corporate entities. Sovereigns may borrow for budget deficit or foreign currency purposes as well as to restructure existing debt. Government and government entities will borrow to fund their specific statutory activities. Companies may borrow for working capital, plant or stock and export purposes. Funds may also be required by business acquisitions and takeovers and mergers. Super nationals borrow for general business purposes as well as for overseas expansion and acquisition.

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[29] Bidders must have sufficient funds to pay for shares in full. This may require the suspension of lender rights of action during the offer period with the offer price also being subject to relevant takeover requirements. Financial assistance restrictions also limit the security that the target company or group can provide. Wood (n 16) para.F(3204).

[30] This provides for debt subordination, restriction of junior rights (although possibly only for limited periods) and payment freezes or post-default receipt payments. Wood (n 16) para.F(3205).

[31] Wood (n 16) para.F(3205).

[32] Payments are then cascaded in accordance with predetermined priorities such as operating costs, debt service and reserves (buffers) or maintenance with any surplus only then being paid to shareholders or subordinated debt holders.

[33] These restrict the activities of the SPV including with regard to business, material contracts or borrowings.

[34] These are extended to apply to project contractors and lessees, contract termination, use or charter party loss, change of ownership of the SPV or other nationalisation or total loss events.

[35] Turnover subordination requires payment by junior creditors of recoveries before the senior debt has been paid off in full. Structural subordination involves lending to parent shell companies with senior advances being made to the full operating subsidiaries which hold the project assets and income streams with the junior creditors only being paid from any surpluses received by the parent from the subsidiary. All debt subordination ranks the junior creditor behind all other creditors of the borrower. Subordinated debt is attractive to issuers as this does not increase their outstanding equity with the additional accountability and control which may be involved. Debt holders also receive tax-deductible interest payments (not dependent on profit), security (or guarantee) and full repayment of principal on maturity. Subordinated debt issued by banks and securities firms should nevertheless be subject to capital adequacy restrictions. Bank debt for regulatory purposes must generally be of a minimum of five years and two years for capital adequacy purposes. [ ]

[36]

The loan is legally a private debt contract or obligation entered into between the borrower and the credit provider (and guarantors). This constitutes a pure claim under English law.[37] As a personal debt obligation, it is only transferable through legal or equitable assignment under English law.[38] The obligation to provide the credit may alternatively be replaced or substituted (novated) or covered by a separate commitment either in whole or part (participation or sub-participation). These are nevertheless not legal transfers as such with the original creditor remaining liable on the contract until it has been cancelled.

As a legal contract, this requires agreement on the principal terms. This will generally involve the execution of a written agreement although this is not strictly necessary. The principal terms and conditions relate to amount (principal), duration (term), cost (interest rate), commencement (advance) and repayment (on maturity) and any other additional obligations (including relevant terms and conditions, security or guarantee).

(1) Principal

The parties will agree on the amount to advanced. This will usually be expressed as a total figure although this may be drawn down in one or more tranches. Where the agreement provides that variable amounts may be drawn up to a defined limit, this would constitute a line of credit (or overdraft for an individual) rather than a term loan. Credit lines may either be committed or uncommitted or advised or unadvised with other multi-currency or standby options being available.[39] Permitted draw-downs are made during the specified commitment period.

The borrower may also be required to maintain an agreed deposit with the agent bank as a compensating balance. This is designed to provide some security although the effect is to reduce the total amount of the advance. This was common in the US until the late 1970s.[40]

(2) Term

The term or duration of the agreement will be set out in the loan document. Term loans may also be referred to as time loans. This may be for any short-term period (such as 30, 60, 90, 120, 180 or 360 days) up to medium to long-term (10-15 years) advances. A short-term loan or facility is generally one expiring within a year. The documentation on short-term loans may (but need not) provide for a rollover facility. Loans may also have no fixed maturity date and be repayable on call or demand. This may permit 'round tripping' where undrawn amounts are reinvested in the markets to take advantage of any preferential rates available.

(3) Interest

Interest may either be calculated on a fixed or revolving basis. Revolving loans are generally calculated having regard to an agreed generally used bank rate. The most commonly used rate in London is the London Inter-Bank Offer Rate (LIBOR) although other rates are available (including EURIBOR). The relevant rate will be calculated at the interest payment date. These will generally operate on six-monthly periods.

Floating rates were introduced into the euro-dollar market at an early stage to reduce the credit provider's exposure to interest rate risk or loss with adverse movements in interest rates. This became particularly necessary during the early 1970s following the abandonment of the earlier fixed exchange rate arrangement under the Bretton Woods regime.[41]

Where preferential rates are offered lower than market rates, these may be referred to as 'soft loans'. These are generally provided by governments or government agencies to promote business expansion or export growth.

(4) Repayment

Repayment of the principal amount is distinct from interest during term. Repayment may be by instalments (under an instalment loan) with proportionate payments of principal being made either monthly or annually.

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[37] Roy Goode, *Commercial Law* (Penguin London)
[38] Sub-section 5
[39] Paras
[40] Sarwal (n 3) 261
[41] Chapter 2, section

These may also be referred to as amortising loans. The straight or bullet loans provide for full repayment of principal on the agreed maturity date.

(5) Obligations

A number of additional obligations may also be imposed on the borrower by the bank or other credit provider. Term loan agreements will generally include a series of pre-agreement, pre-advance and post-advance conditions. These are usually referred to an initial representations and warranties (pre-agreement), conditions (pre-advance) and covenants (continuing post-advance obligations applicable until maturity and repayment). The effect of these is to ensure that the loan agreement will only come into effect once the credit provider is satisfied with regard to the creditworthiness and financial standing of the borrower and then that the advance is only made when certain further obligations have been satisfied. The credit provider may then either refuse to provide any additional funds up to the agreed total provided for or call in any outstanding amounts in the event of breach of one or more of the continuing obligations. The rights of the lender in the event of breach will be set out or restated in the events of default included within the agreement.[42]

Other conditions may also be imposed with regard to such matters as security or guarantees. One or more different types of security may be requested. This may either be provided by the borrower directly or indirectly by a third party. This may also provide for immediate exercise and asset sale or only on application to the court. The most commonly used securities include debentures (fixed or floating charges), mortgages (over heritable property or other assets such as ships, aircraft or investment portfolios) and other pledges or liens (arising automatically under law). Further support may be provided in the form of guarantees or possibly comfort letters although these are generally not legally binding.[43]

ISSUE PROCEDURE AND SYNDICATION

The functions of the arranging bank or banks are to prepare the information memorandum, solicit expressions of interest and to negotiate the loan documentation. The bank or banks involved will receive an arranging fee. They will initially participate in the syndicate directly although they may transfer their commitment to lend to another bank under a sub-participation arrangement[44] either before or after closing.

Care will be taken to ensure that no misrepresentation arises while no regulatory difficulties should arise provided the banks have permission to carry on banking business within the UK.[45] The arranging banks will also use a number of other contractual devices to limit any potential liability.[46]

Term loans may either be single bank (bilateral) or syndicated (group) loans. Smaller syndicates are referred to as 'club loans' although larger syndicates (such as for the Eurotunnel construction project) may involved over 100 banks. The purpose of the syndication is set up a group of banks to spread the credit (or counter party default) risk[47] and to reduce regulatory capital costs where applicable.

(1) Mandate Letter

The borrower will provide the arranging bank or group of banks with a mandate letter. This summarises the principal financial terms and provides authority to approach other banks with a view to forming a lending syndicate. This is expressed subject to contract and is not legally binding.[48] The mandate will also usually be

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[42] Sub-section

[43] These are referred to as 'letters of moral intent' (LOMIs) in the US. While they do not provide any legally enforceable rights of redress, they confirm the business and moral obligation of the guarantor to support the borrower. This will then generally be respected to avoid reputational damage rather than enforceable legal loss.

[44] Section

[45] UK banks must be authorised and hold the relevant permission to carry on banking business under ss19 and 21 and schedule 2 FSMA 2000. See RAO [ ]. For comment, Walker [ ].

[46] Section

[47] The principal risk on a loan is credit or counter party default. This relates to the non-payment of interest during the term of the loan and repayment of principal on maturity. The potential exposure is assessed by the bank as part of the initial credit assessment of the borrower. This allows the bank to make a determination as to whether it should lend and if so how much and at what rate. This forms the basis for the bank's internal credit rating. These were used to make decisions as to appropriate levels of reserves and are now consolidated under the internal ratings based (IRB) approaches included within the revised capital standards introduced by the Basel Committee on Banking Supervision and implemented in Europe under the Requirements directive and in the UK under the prudential sourcebook (PRU). Walker, 'Capital Supplement' in Walker (n); and Walker, 'Capital Adequacy' in Blair et al (n)

[48] Subject to contract is used to reverse the presumption that commercial arrangements are intended to create legally enforceable relations. *Edwards v Skyways Ltd* (1964) 1 WLR 349. A contract can still be created even where all of the terms are not agreed and formal

conditional[49] and exclusive.[50] The borrower nevertheless may be required to pay all relevant expenses which will be enforceable. The arranging bank may nevertheless only undertake to use best efforts to form the syndicate and advance the funds. The arrangers may also undertake severally to underwrite the loan and make the funds available according to their agreed proportions even if other participants are not found.

(2) Term Sheet

The core financial terms for the loan will be set out in a supporting term sheet. This will specify the proposed principal amount, duration, interest, repayment and relevant fees or charges. Any special obligations will be inserted with a note that the loan documentation will include other standard conditions, covenants and events of default.

(3) Information Memorandum

The arranging bank (or banks) will incorporate the term sheet into a more substantial information memorandum which is used to solicit interest from other potential participating banks in the syndicate. This also includes information concerning the borrower's business and business history, management and financial conditions. This is the equivalent of a 'prospectus' prepared for a security issue. This may be despatched either before or after invitee banks confirm their interest in participating.

Care has to be exercised in preparing the information memorandum to avoid any potential liability for misrepresentation. Misrepresentation may either be innocent, negligent and fraudulent at common law or statutory under the Misrepresentation Act 1967. There will generally be no action for damages in the event of innocent misrepresentation unless this has been made an express term of contract. Rescission should be available, failing which damages may arise under s2(2) of the Misrepresentation Act.[51] Negligent misrepresentation can arise where there is an implied duty to exercise reasonable care under the common law.[52] Damages and rescission may also be available in the event of fraudulent misrepresentation.[53] Liability may also arise under the Misrepresentation Act unless there is a reasonable ground for belief that the statement was true[54] or under the Theft Act 1968.[55]

Liability for misrepresentation may attach to the borrower and to the arranging bank or banks in the event of the borrower's insolvency. Due diligence is required to avoid any liability arising.

No separate regulatory liability should arise in normal cases. Soliciting interests in participating in a loan does not constitute offering securities or to arrange deals in securities.[56] The information memorandum will generally not constitute a prospectus.[57] The US Securities Act 1933 and Securities Exchange Act 1934 will also not apply to notes rather than securities and to loan participations.[58]

(4) Loan Procedure

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documentation is to be entered into subsequently. *Branca v Cobarro* [1947] KB 845; and *The Anemone* [1987] 1 Lloyds Rep 46. This can also arise where non-essential terms are left for future negotiation. *Pagnam SpA v Feed Products Ltd* (1987) 2 Lloyds Rep 601. On contract completion, *Chitty on Contracts* ( )

[49] The mandate may be conditional on final credit approval by the arranging banks, the satisfactory documentation being entered into and a no material adverse change clause or a 'market flex' provision allowing the arranging banks to revise any of the core financial provisions in the event of a change in market conditions.

[50] The mandate letter will include a 'clear market' provision prohibiting any concurrent syndication by the borrower or the borrower's group.

[51] *Gilchester Properties Ltd v Gomme* [1948] 1 All ER 493.

[52] *Hedley Byrne v Heller & Partners* [1964] EC 465. A negligent bank reference had been provided with the defendants being considered to be under a special

[53] *Derry v Peek* [1889] 14 App Cas 337 (HL). The test was described as involving knowledge of falsity or being reckless in not caring whether the statement was true or false.

[54] s 2(1) provides for civil liability for damages for misrepresentation subject to the statutory defence that there was reasonable grounds to believe and the defendant believed that the statement was true. This operates in the same manner as fraudulent misrepresentation although the burden of proof is reversed.

[55] s 19 Theft Act 1968 applies with regard to intentional deceit by officers of a body corporate. *R v Kylsant* [1932] 1 KB 442 which involved a prospectus which gave a false impression by not disclosing secret reserves. *R v Bishirgian* [1936] 1 All ER 586. Finance had been raised to attempt to corner the world pepper supply.

[56] s 21 and schedule 2 Financial Services and Markets Act 2000.

[57] UKLA Listing Rules, paras.

[58] *United House Foundation Inc v Forman* 421 US 837 (1975) following *SEC v W J Howey Co* 328 US 293 (1946). See also *Banco Espanol de Credito v Security Pacific National Bank* 973 F 2d 51 (2dCir 1992) [ ]

The loan procedure is relatively straightforward although still involves a number of stages. The lead manager or arranging bank will initially approach the borrower or the borrower approach the lead bank with a view to putting together the bidding group and preparing the loan documentation. Initial fee letters and quotes will be exchanged and agreed at that stage. The borrower will award the lead bank or arranger a formal mandate which will be used to set up the management group. This may only be one bank. The lead bank will instruct its solicitors to prepare the first draft loan agreement with the information memorandum being prepared in co-operation with the borrower. The lead bank may bring other banks into the management group with the management then effectively being syndicated.

The complete syndicate will then be drawn together of the lead bank, co-managers and other syndicate lenders. The draft loan agreement is commented on and negotiated between the borrower and lead management group and then by the syndicate as a whole. The conditions precedent will be satisfied including the provision of all required documentation with other administrative arrangements being completed. The loan agreement and any supporting documentation will be entered into by all parties at a formal signing ceremony which will bring the facility into legal effect.

The entering into of any major agreement will be published included the insertion of a 'tombstone' advertisement in the financial press which includes the identity of the borrower, amount, management group, lending banks and the agent bank or banks. The borrower will then comply with any additional advance (or utilisation) conditions to draw down under the facility.

All of the participants in a major syndicate sign the principal loan agreement and any supporting documentation. This will include the primary borrower and any ancillary borrowers, other group companies as guarantors, the lead bank or arranging bank, any other members of the management group, the original lending or syndicate banks and the agent. Additional borrowers or guarantors may then be brought in subsequently usually using some form of accession letter attached as a schedule to the loan agreement. Either participants or guarantors may also cease to become liable under the agreement using a resignation or withdrawal request which will have to be consented to by the lending banks.

Any of the lending banks including the lead manager or managers may also transfer their commitment using an attached transfer certificate which will operate through novation. This will replace the original lender and its obligations and commitments with the new party. Lending banks may also sub-participate their rights and obligations to another institution but without ceasing to become parties to the original loan agreement. The term club loan or deal is sometimes used where all of the original lenders remain fully committed. A participated or participation rule can be used where the borrower is unaware of the identities of some or more of the participating syndicate.[59]

(5) Fees

Different types of fees may be charged by the arranging or participating bank. The three most commonly included are commitment, management and agency fees. A commitment fee is charged to confirm the availability of funds during term and will be calculated against the percentage of undrawn-up funds. A management fee is paid to the lead manager for putting the lending group together. This is paid after the agreement is entered into (typically 0.50% of the total amount involved). This will be calculated periodically in arrears (typically 0.75% per annum). Agency fees are paid to the agent bank for administering the loan including draw-downs, interest collection and distribution and repayment. This may be calculated on a flat or proportionate basis having regard to the amount involved or number of participating banks.

SYNDICATION

The purpose of syndication is to spread the credit risk on the loan as well as any additional regulatory costs including, in particular, with regard to capital adequacy. This was necessitated by the size of the loans requested in the euro dollar market. The syndicate is put together by the lead bank or manager. Depending upon the size of the facility, the lead manager will create a larger management group consisting of the lead manager, the managers and co-managers. The other lending banks are usually referred as participants.

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[59] Sarwal (n 3) 250-251.

The function of the lead bank is to set up the syndicate and to manage the preparation and negotiation of the documentation including the information memorandum and loan agreement. This will be based on the original mandate letter issued by the borrower and the supporting term sheet which will outline the facility to be entered into. The information memorandum is used to solicit expressions of interest from other banks.

Once established, the syndication will operate on the basis of a number of common rules. These essentially consist of severality, proportionality, equality, democracy and limited agency functions[60]. These govern the relationship between the lenders and borrower and between the lenders inter se.

(1) Severality

The obligations of the lending banks are several rather than joint and several and their rights against the borrower divided. The loan agreement will provide that the obligations of each finance party are several and that the failure by one party to perform its obligations will not affect those of any other and that no finance party is responsible for the obligations of any other party.[61] This allows bank to exercise their rights of set-off independently and avoids any joinder of actions.[62]

The rights of each party are also separate and independent of any debt created under the finance documents being a separate and independent debt.[63] Each party may enforce its rights separately under the documentation except as otherwise provided for.[64]

The effect is to create a series of separate parallel loans governed by a single set of documents on common terms with a single agent bank being appointed for administrative purposes. None of the banks underwrite or guarantee their several obligations nor are their arranger nor agent bank responsible for making up any shortfall.[65] Neither the arranger nor the agent bank will also usually be responsible for replacing any syndicate member who is unable to act such as through insolvency or otherwise.[66] Where a syndicate member fails to lend, the borrower's only remedy is in damages for alternative finance and any specially contemplated damages. Specific performance on obligations to lend is not available.[67] No separate liability as partners will arise as a syndicate will not generally be considered to amount to a partnership.[68]

(2) Proportionality

Lending banks are only liable up to their agreed proportion or commitment under the total facility. This will be agreed at the time the bank becomes a member of the syndicate and recorded in the schedules to the loan agreement.[69] The amount of each lender's participation will then be equal to its proportion of the available commitment.[70] The agent bank will notify each lender of the amount due on each advance or utilisation.[71]

Finance parties may generally set-off any matured obligations due from any obligor under the finance documents against any matured obligation owed regardless of the place of payment, booking or currency.[72] Obligors will generally have no rights of set-off.[73]

(3) Equality

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[60] Wood refers to the core syndication principles as consisting of several commitments, agent bank administration, syndicate democracy and pro rata sharing. Wood (n 16) ch.6.

[61] See Loan Market Association (LMA) *Single Currency Term Facility* clause 2.2(a).

[62] A bank can not otherwise exercise any right of set-off against deposits held where a separate loan is in undivided shares with other lenders. *Bowyear v Pawson* [1881] 6 QBD 540 [W 94].

[63] LMA 2.2(b).

[64] LMA 2.2(c).

[65] The arranger is generally stated to have no obligations of any kind to any party under or in connection with the finance documentation. LMA 25.3.

[66] The agent's duties under the finance documents are usually stated to be solely mechanical and administrative in nature. LMA 25.2(e). The agent is only required to promptly notify the other finance parties where there have been any non-payment of principal, interest, commitment fee or other fee payable under the documentation. LMA 25.2(d).

[67] Section

[68] A syndicate will not constitute a partnership under The Partnership Act 1890, s1(1) as there is no sharing of net profits. See generally

[69] See for example LMA schedule 1 Part I (Banks) and Part II (UK non-bank lenders).

[70] LMA 5.4(b).

[71] LMA 5.4(c).

[72] LMA 29.

[73] LMA 28.6.

Lending banks will only be able to benefit under the loan agreement in equal terms. While their rights are separate and divided, their exercise and the amount of payments received are subject to strict equality provisions under the loan documentation. The operation of these provisions may nevertheless be avoided in practice and their effectiveness limited.

The equal distribution of payments is generally secured under a pro rata sharing clause. This will provide that where any bank receives a greater proportion of its share under the loan agreement, this is to be paid to the agent bank which will redistribute the moneys proportionately.[74] The paying bank will usually then be subrogated to the rights of the banks sharing in the redistribution.[75]

The loan documentation will also usually provide for proportionate repayments in the event that the amounts received have to be refunded to the borrower.[76] Pro rata sharing will also not apply where other banks decided not to participate in any legal or arbitration proceedings after due notification[77] or where the receiving bank would not have a valid and enforceable claim.[78]

The objective is to ensure that banks share equally in any amounts received otherwise than through the agency procedures set up under the loan documentation. This may include direct payments as well as litigation or arbitral awards, guarantees and security or set-off. This then acts as a disincentive to solo or unilateral action except as otherwise provided for. This is particularly useful in government credits where there is otherwise no mandatory equal treatment of creditors or restrictions on fraudulent preferences.[79]

(4) Democracy

As the rights and obligations of the lenders are several, any collective action or decisions affecting the lenders are generally taken on a unanimous basis. This confirms their right to equality under the loan documentation.[80] Some limited majority voting will be permitted which will generally operate on a 63⅔ rather than 50% basis.[81] Where majority voting is permitted, the agency is given authority to act on any right, power, authority or discretion conferred and not be liable for any acts or omissions concerned.[82] The agent may refuse to act until it has received any necessary security for costs, losses or liabilities involved.[83] The loan documentation may limit the areas in which majority decision applies. This may include waivers of breaches of covenant or consents, representations and acceleration but not conditions precedent or altering payment maturities or amounts.[84]

Loan agreements may alternatively provide that majority lenders may bind all other finance parties unless otherwise provided.[85] This will generally not apply with regard to the conduct of legal or arbitration proceedings without prior lender consent.[86] In all other cases and in the absence of express instructions from the majority lenders, the agent is entitled to act (or refrain from acting) in a manner considered to be in the best interests of lenders.[87] This will generally be interpreted to mean in the best interests of the lenders as a whole including original lenders and any new parties or successors in title, permitted assigns and permitted transferees.[88]

The general objective of the loan documentation is accordingly to protect the several rights of individual lenders. As banks are sophisticated institutions and it is generally possible to consult and issue instructions, loan

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74 The LMA provides that where a finance party receives or recovers any amount from any obligor other than under the usual payment mechanics provisions included (LMA 28), that 'Recovery Finance Party' is to notify the agent bank within three days with the agent then determining whether this is in excess of any amount that would otherwise have been paid under the agreement and with any excess being proportionally distributed among the other lenders by way of a 'sharing payment'. LMA 27. The payment is then treated as if it had been made by the relevant obligor. LMA 27.2.

75 LMA 27.3. Where this right of subrogation is ineffective in practice, the relevant obligor is stated to be liable to the Recovering Finance Party for a debt equal to the Sharing Payment which is immediately due and payable. LMA 27.3(b).

76 LMA 27.4.

77 LMA 27.5(b).

78 LMA 27.5(a).

79 Wood (n 16) para.6.16. [Banks refused to share set-off receipts following the Iranian Revolution in 1979 and where British banks were not paid by the Argentinean Government following the Falklands crisis Wood (n 16) para.6.18.]

80 Para

81 LMA 1.1. This is calculated on the basis of 66⅔% of aggregate commitments or participations outstanding. Commitment means the original lender's proportionate obligation to lend under the loan agreement. LMA1.1. The term 'participation' is not separately defined under the LMA.

82 LMA 25.7(a)

83 LMA 25.7(c)

84 Wood (n 16) para.6.12.

85 LMA 25.7(b)

86 LMA 25.7(e)

87 LMA 25.7(d)

88 LMA 1.1 and 1.2(a)

provisions are not as proactive as bond clauses. Bond holders and bond trustees will generally be given considerably more extensive powers of majority action and intervention. This is to deal with difficulties in consulting all bond holders or overruling minority hold-out parties in more complex situations including restructurings. The majority voting provisions in bond documentation will be supported by separate no-action clauses preventing individual rights of enforcement and recovery. Loan documentation will protect the rights of individual bank action although the effectiveness of this is qualified by the parri passu distribution clause in most cases.

(5) Limited Agency Function

As the loans are several and the lending banks are acting as independent providers of credit, the duties of the agent bank will be expressly restricted under the loan documentation. The agent bank will only receive a small fee for its administrative and payment functions under the arrangement and so will also not wish to assume any additional responsibility and potential liability with regard to the management and operation of the facility. Loan documentation may also include express exclusions of function and liability in connection with the arranging bank as well.[89] The agent and arranger are nevertheless not required to account for any sums acquired on their own account nor prevented from conducting business (including deposit taking or lending) with the borrower or the borrower's group.[90]

The agent bank is appointed the agent of the lenders and not the borrower.[91] The agent is given the authority to exercise the rights, powers, authorities and discretions conferred under the loan finance documentation with any incidental, rights, powers, authorities and discretions necessary.[92]

The duties of the agent bank will generally be described as being of a mechanical and administrative nature.[93] The agent's duties are principally concerned with carrying out various confirmation (conditions of precedent), paying agency (collection and distribution), banking (determining relevant interest rates), notice and monitoring functions under the loan facility.

(a) Receipt Duties

The borrower will have to satisfy the conditions of precedent before drawing on any advance under the facility. This will require delivering any required documents and other evidence to the agent bank. The agent will notify the borrower and lenders on receipt.[94] The borrower will also confirm that any continuing (repeating) representations are true in all material respects and that there is no default.[95] The continuing conditions will be as specified.[96] This will generally involve confirming that all of the appropriate documents and other certificates or receipts specified have been delivered.

The agent will also receive any notices or requests from the borrower under the loan documentation. This may include request for advances (utilisations), adjustments in interest periods,[97] prepayments and cancellation,[98] change of control[99] and defaults.[100] The agent is also to notify the finance parties of any non-payment of principal, interest, commitment, fees or other fee.[101] The agent is required to properly forward any original or copy documents received.[102] The agent is not, however, required to review or confirm the adequacy, accuracy or completeness of any document forwarded unless otherwise specified.[103]

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89 The arranging bank is stated to have no obligations of any kind under the loan documentation and not to act as a trustee or fiduciary for any person. LMA 25.3 and 25.4(a). Neither the agent nor the arranger is required to account to any lender for any sum received on its own account. LMA 25.4(b).
90 LMA 25.4(b) and 25.5.
91 LMA 25.1(a).
92 LMA 25.1(b).
93 LMA 25.2(e).
94 LMA 4.1.
95 LMA 4.2(a) and (b).
96 LMA 1.1 and 18.14. See also the conditions of precedent set out in Schedule 2. Paras.
97 LMA 9.1 and Schedule 3.
98 LMA 7.1 and 7.3.
99 LMA 7.2.
100 LMA 25.2(c) and 22.
101 LMA 25.2(a).
102 LMA 25.2(a).
103 LMA 25.2(b).

The agent may rely on any representation, notice or document believed to be genuine, correct and appropriately authorised as well as any statement made by a director, authorised signatory or employee reasonably falling within the scope of their authority or power to verify. The agent may assume that no default has occurred unless it has received actual knowledge of default or non-payment. It can assume that any right, power, authority or discretion vested by any party or majority lender has not been exercised and that any notice or request made by the borrower is made on behalf of and with the consent and knowledge of all of the other borrowers or obligors.[104] The agent bank may act through its personnel and agents and engage or rely on the advice and services of any lawyers, accountants, surveyors or other experts.[105] The agent may disclose to any party any information reasonably believed it has received as agent bank under the agreement.[106] Neither the agent nor the arranger is obliged to do or admit anything that would reasonably be expected to constitute a breach of any law or regulation or a breach of a fiduciary duty or duty of confidentiality.[107]

Neither the agent nor the arranger will be responsible for the adequacy, accuracy or completeness of any information (oral or written) supplied under the information memorandum or any finance document nor responsible for the legality, validity, effectiveness, adequacy or enforceability of any finance document or related agreement,[108] The agent is not liable for any action taken by under any financial document unless directly caused by its gross negligence or wilful misconduct.[109] The agent is not liable for any delay in crediting accounts under the facility.[110] Neither the agent nor the arranger is responsible for carrying out 'know your customer' or other money laundering checks in connection with any borrower or other obligor under the facility.[111] The lenders are required to indemnify the agent for any costs, losses or liability suffered in acting as agent under the finance documentation unless separately reimbursed by an obligor.[112] The agent is entitled to invoice the lender separately for any management time.[113] The agent may exercise any right of set-off against any payment due to any party under the finance documents.[114]

(b) Payment Duties

The agent bank will receive all payments required to be made under the finance documents. This includes payments by the lender to the borrower and payments by the borrowers or other obligors on behalf of the lenders.[115] Payment will be made on the due date and time specified and to such accounts in the principal financial centre of the country of the currency as notified.[116] The agent will then distribute the payments received in accordance with the terms of the agreement. This will include making payment to the specified accounts requested.[117]

Most loan documentation will include a claw-back clause. The agent is only required to make any payments required under the finance documents once it has received the corresponding amount due. Where an amount payable was not actually received, the person to whom any payment has been made by the agent is required to refund the same on demand with interest from the date of payment to the date of receipt calculated having regard to the agent bank's cost of funds.[118]

Any partial payments received from the borrower or another obligor under the documents will be applied in accordance with a specified order.[119] The borrower and any other obligors are required to make payments without set-off or counter claim.[120] Payments will be made on business days.[121] Provision will be included for

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[104] LMA 25.6(b).
[105] LMA 25.6(d) and (c).
[106] LMA 25.6(e).
[107] LMA 25.6(f).
[108] LMA 25.8.
[109] LMA 25.9(a).
[110] LMA 25.9(c).
[111] LMA 25.9(d).
[112] LMA 25.10.
[113] LMA 25.16.
[114] LMA 25.17.
[115] LMA 28.1(a).
[116] LMA 28.1(b).
[117] LMA 28.2.
[118] LMA 28.4(a) and (b).
[119] This will usually include pro rata unpaid fees, costs and expenses of the agent; pro rata any accrued interest, fee or commission due, pro rata any principal due but unpaid; and any other sum due but unpaid. LMA 28.5. The order may be varied on direction of the majority lender. LMA 28.5(b). These provisions will override any appropriation made by an obligor. LMA 28.5(c).
[120] LMA 28.6.
[121] A business day is usually specified as a day other than a Saturday or Sunday on which banks are open for general business in London (or New York City) or which is a TARGET where the loan is in euros. TARGET refers to the Trans-European Automated Real-

payments on non-business days.[122] Payments will be made in the currency of the loan. This will apply with regard to any cost, expenses or taxes.[123] The loan documentation was include a provision for conversion from one currency to another where a country uses more than one currency or currency unit.[124]

(c) Banking Duties

The agent bank may be required to determine and confirm the applicable interest rate under the loan. This was common with regard to floating rates. The agent will then be required to notify the lenders and borrower of the applicable rate of interest under the agreement.[125] This may be specified to include the relevant LIBOR or EURIBOR[126] rate including margin and any mandatory costs. Margin refers to the lending bank's profit margin above the cost of funds calculated having regard to either the LIBOR or EURIBOR rate. Mandatory costs are only included if applicable.[127]

The borrower is required to pay accrued interest for each advance and standing on the last day of each interest period.[128] Borrowers may be entitled to select their own interest periods having regard to each advance under the facility subject to notice being provided to the agent bank.[129] The agent bank may also shorten interest periods on notice to the borrower and lenders.[130]

The borrower will be required to pay default interest on any amount not properly paid under the finance documentation on its due date. This will accrue from the due date to that of actual payment. The loan documentation will provide for a specified default rate. Unpaid default interest will then be compounded with the overdue amounts at the end of each interest period which will remain immediately due and payable.[131]

The loan agreement may include separate provision for the calculation of interest in the event of a significant market disruption. A 'market disruption event' may be defined such as where screen rate LIBOR or EURIBOR is unavailable.[132] Interest will then include the relevant margin with the rate notified to the agent bank by each lender having regard to its costs of funds at that time and any mandatory cost if any.[133] The loan documentation will generally provide for the use of either a screen rate or reference bank rate. Only where both of these are unavailable will a separate cost of fund rate be required. It may also be provided that the agent and borrower can

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Time Gross settlement express transfer payment system. A TARGET day is a day on which TARGET is open for settlement of payments in euros. LMA 1.1. http://www.

[122] Payments will generally be made on the next business day in the same calendar month (if there is one) or the preceding business day (if there is not). LMA 28.7(a).

[123] LMA 28.8(a) and (b).

[124] The LMA allows translation from one currency or currency unit at the official rate of exchange recognised by the local central bank subject to rounding up or down. LMA 28.9. [The loan agreement may provide that any term of the finance documentation may be amended or waived with the consent of the majority lenders and the obligors subject to specified exceptions. The exceptions will generally include the definition of majority lenders, an extension of the day of payment of any amount, a reduction in the margin or a reduction in the amount of any payment of principal, interests, fees or commission, an increase or extension of any commitment, a change to the borrowers or guarantors (other than as permitted, LMA 24), finance parties' rights and obligations and changes to lenders as well as any other express or specified provisions. LMA 34.1 and 34.2.]

[125] LMA 8.4.

[126] LIBOR is the London Inter-Bank Offered Rate. This will be determined from the relevant screen rate which will be defined according to the British Bankers' Association (BBA) interest settlement rate for the relevant currency or the percentage rate determined by the Banking Federation of the European Union for the relevant period for euros. These are displayed on the appropriate page of the Telerate or Reuters screens. The agent bank may specify another page or service where the relevant rate is unavailable following consultation with the principal borrower and lenders.

Where no screen rate is available, LIBOR will be calculated as the arithmetic mean of the rates (rounded upwards to four decimal places) as supplied to the agent on request by the reference banks to leading banks in the London inter-bank market. The reference banks will be separately identified for the purposes of the particular loan agreement.

EURIBOR will similarly be calculated according to the applicable screen rate or the arithmetic mean of the rates quoted by the specified reference banks in the European inter-bank market. In all cases, the rate will be calculated having regard to the 'specified time' (Schedule 11) on the relevant 'Quotation Day' for a period equivalent to 'Interest Period' for the particular loan.

The meaning of Quotation Day varies depending upon whether the loan is in sterling, US dollars or another currency or euros. Sterling loans are calculated with regard to the first day of the relevant period. US dollar or other non-sterling or non-euro loans, two business days before the first day of the relevant period. The Quotation Day in respect of euro loans is two TARGET days before the first day of the period. LMA 1.1.

[127] Mandatory costs are generally calculated in accordance with a specified formula such as that provided by the LMA. LMA available http://www. [ ]

[128] LMA 8.2. If an interest period is longer than six months, interest will be payable at six-monthly intervals.

[129] The LMA provides for borrowers to select relevant interest periods for any loan using a selection notice provided in Schedule 3. LMA 9.1.

[130] LMA 9.2.

[131] LMA 8.3(a), (b) and (c).

[132] See, for example, LMA 10.2(b).

[133] LMA 10.2(a).

negotiate (for up to 30 days) to agree another substitute basis for determining the relevant rate of interest. This will be binding on all parties provided that all agree.[134]

The borrower will also be required to cover any separate 'break costs'. This refers to the amount that a lender would have been able to obtain by placing a sum on deposit in the inter-bank market equivalent to that which should have been received on an interest payment day.[135] The agent bank will be advised of any break costs with the borrower paying within three business days of demand.[136]

Break costs and mandatory costs are in addition to any commitment fees, arrangements fees or agency fees due.[137] The borrower will also be required to make any additional payments in respect of tax grossing up, increased costs or currency or other indemnities. Payments to the lenders will generally be made without withholding tax. Where this applies, any payments are to be grossed-up to ensure that the lender receives the full amount due irrespective of the tax charged. Grossing-up may be required even in the absence of express provision to avoid default.[138] This may also be extended to include to other direct taxes.[139]

The borrower is generally required to make all payments without withholding unless this is imposed by law.[140] In such cases, the agent is to be notified promptly. The amount of the payment due will then be increased to cover the amount of tax deducted.[141] The documentation may also included specific exclusions with regard to permitted qualified lenders under relevant Inland Revenue rules or Treaty arrangements.[142] Separate provisions apply with regard to tax credits, stamp taxes, VAT and PTR schemes.[143] The lenders may be required to return any amounts received by way of tax credit although the drafting may be non-specific.[144]

The lenders will be under a general obligation to mitigate any grossing-up charges as well as any other costs (such as those arising as a result of illegality, increased costs or mandatory costs).[145] Other protection may also be included in favour of the borrower although these will generally be resisted by bank negotiators.[146]

The borrower will also be generally required to pay any other increased costs incurred by the lending banks.[147] Increased costs will generally be defined with regard to any reduction in the rate of return or receipt under the loan or facility, any additional or increased costs or any reduction in any other amount due and payable under any finance documents.[148] In practice, this will apply with regard with regulatory costs (including capital adequacy or liquidity), central bank reserve requirements or other special taxes or unforeseen costs. Exceptions may be included (such as tax deductions, amounts already compensated by way of tax indemnity or mandatory costs or otherwise attributable to the wilful action of any lender or affiliate lender).[149] The lenders will be subject to a general mitigation duty again with the borrower possibly having rights of repayment or loan transfer.

The borrower will also be required to pay any other costs arising as a result of currency conversion[150] or default or otherwise.[151] This will include break or breakage costs where payments are made before the end of a relevant interest period and the bank suffers loss where the rate at which it can re-lend is less than its costs of funds.[152].

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134 LMA 10.3(a) and (b).
135 LMA 1.1.
136 LMA 10.4(a) and (b).
137 LMA 8.1(c), 10.4, 11.1, 11.2 and 11.3. Paras.
138 *Indian and General Investment Trust Co Ltd v Borax Consolidated Ltd* [1920] 1 KB 539 [Wood para.4.2]
139 This may apply where tax is collected from the bank's branch in the borrower's country under the 'effective connection' doctrine. The LMA includes a general tax indemnity in 12.3 [ ] [Wood]
140 LMA 12.2(a).
141 LMA 12.2(b) and (c).
142 See, for example, LMA 12.2(d) and (g).
143 LMA 12.4, 12.5, 12.6 and 12.7. PTR refers to any Provisional Treaty Relief scheme as set out in the Inland Revenue guidelines issued in January 2003 and administered by the Inland Revenue's Centre for Non-Residents. http://www.
144 Wood notes that tax credits depend on local tax law and applicable double taxation treaties. Banks prefer not to have detailed obligations imposed on them to avoid discovery of their tax affairs by the borrower, consequential tax effects of pay tax credits, loan allocation problems, date of receipt confirmation difficulties and administrative inconvenience. Wood (n 16) para.4.3.
145 LMA 15.1.
146 These may include a right to pre-payment or loan transfer. Taxes may be limited to the borrower's country of incorporation. Bank will also resist exclusions of taxes on net income which would include withholding taxes. Wood (n 16) para.4.4. [ ]
147 LMA 13.1.
148 LMA 13.1(b).
149 LMA 13.3.
150 LMA 14.1.
151 LMA 14.2 and 14.3.
152 LMA 10.4.

The borrower will also be required to pay any separate transaction expenses, amendment costs or enforcement costs.[153]

(d) Notification Duties

The agent bank is required to notify the lenders of any non-payment or default under the finance documentation.[154] The lender is also required to forward on original or copies of any documents received under the loan documentation.[155] The extent of the monitoring or oversight required is nevertheless limited. The agent is not required to review or confirm the adequacy, accuracy or completeness of any document forwarded[156] while the agent may rely on any representation or statements made and assume that no default has occurred unless actual notice is provided.[157]

(e) Default Duties

The agent bank is only required to notify the lenders of any notice of default or actual non-payment.[158] There may be a power to accelerate the loan in the event of a default although the agent will generally not be entitled to enforce the agreements without lender consent.[159] The agent will only otherwise be entitled to act on majority instructions.[160]

The agent bank cannot be sued for breach of duty by its principal such as in respect of non-payment of advance or commitment. While the agent will generally owe fiduciary duties to its principal (including no conflict, no secret profit and due diligence), these may be expressly disapplied under the terms of the loan agreement.[161]

The loan agreement will include provision for the resignation and replacement of the agent bank.[162]

The agent bank's agency division will be treated as a separate legal entity with the agent not being deemed to have notice of any information received by another division or department.[163]

The loan agreement will provide that each lender is solely responsible for conducting its own independent credit assessment and appraisal of the borrower and other companies within the borrower's group.[164] Neither the agent nor the arranger will be responsible for the adequacy, accuracy or completeness of the information memorandum or any other information provided under the loan documentation.[165] The agent is only liable in the event of gross negligence or wilful misconduct.[166]

No provision of the loan documentation will interfere with the right of any finance party to arrange its affairs (tax or otherwise) in any manner whatsoever. This will include investigating or claiming any credit, relief, remission or repayment available or disclosing any information with regard to its tax or other affairs.[167]

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[153] Transaction expenses apply with regard to any costs in negotiating, preparing, printing, executing or syndicating the loan. LMA 16.1. Amendment costs apply with regard to any requests for amendment, waiver or consent including change of currency. LMA 16.2. Enforcement costs apply with regard to costs and expenses (including legal fees) incurred in enforcing or preserving any rights under the finance documentation. LMA 16.3.

[154] LMA 25.2.(c) and (d). [The borrower is required to notify the agent of any default or certify the note of fault is continuing. LMA 19.5(a) and (b)]

[155] LMA 25.2 (a).

[156] LMA 25.2(b).

[157] LMA 25.6(a) and (b).

[158] LMA 25.2(c) and (d) and 22.1.

[159] LMA 25.7(e).

[160] LMA 25.7(a) and (b).

[161] LMA 25.4(a).

[162] LMA 25.11.

[163] LMA 25.12.

[164] This will apply with regard to the financial condition, status and nature of any member of the group; the legality, validity, effectiveness, adequacy or enforceability of any document or any other agreement or arrangement entered into. LMA 25.14(a) and (b). Each lender is also responsible for determining whether it has recourse and the nature and extent of that recourse against any party or assets under the loan documentation. LMA 25.14(c). Each lender is also responsible for determining the adequacy, accuracy and completeness of the information memorandum and any other information provided by the agent or any other party under the loan documentation. LMA 25.14(d).

[165] LMA 25.8(a).

[166] LMA 25.9(a).

[167] LMA 26.

LEAD BANK AND AGENT BANK LIABILITY

The lead bank and agent bank may be considered liable to other syndicate members for breach of fiduciary duty[168] and misrepresentation as well as possibly incur separate regulatory liability. A number of provisions will be included within the loan documentation to attempt to exclude liability in this area. The lead bank will include provisions in the information memorandum and loan agreement confirming that the other banks have made their own credit assessment and that no representations or warranties are given in this regard.[169] An indemnity will also be taken although this will be of little effect if the borrower is insolvent.

The agent bank will also attempt to limit the scope of its agency role, exclude any fiduciary relationship and an express non-reliance clause as well as incorporate a number of general and specific immunities from actions. Exclusion clauses are valid at common law although they will not cover fraud and may be overridden by some subsequent contrary oral warranty. Exclusion clauses are subject to statutory control and under the Unfair Contract Terms Act 1977, Misrepresentation Act 1967 and European Regulations.

LOAN CONDITIONS AND OBLIGATIONS

A series of requirements and conditions are imposed on the borrower under a loan agreement. These are classified in different ways, are designed to carry out different functions and impose different obligations. The most commonly used requirements are generally referred as conditions precedent, representations and warranties and covenants. Their meaning and legal effect are nevertheless subject to some controversy.

The general purpose of such obligations is to provide the bank creditors with sufficient information concerning the legal status and financial condition of the borrower. This is linked to the bank's initial credit assessment and can accordingly be referred to as being credit linked. Others have to be satisfied before the loan agreement comes into effect while others suspend the bank's specific obligation to lend until particular conditions have been satisfied and then re-satisfied on each subsequent drawn-down. These might be referred to as being legal agreement and advance link. The purpose of others is to provide the bank with information concerning the condition of the borrower after the funds have been provided while others impose obligations on the activities of the borrower on a continuing basis during the term of the loan. These might be referred to as being information and activity or business linked.

These various sets of obligations are generally imposed on a pre-agreement, pre-advance (and subsequent advance) and post-agreement or post-advance basis. The most obvious correspondents with the main sets of terms imposed would then appear to be that the conditions precedent are pre-agreement, the representations and warranties pre-advance and the covenants post-advance. The legal effect of the conditions precedent is nevertheless to suspend the obligation to lend under the loan agreement[170] while separate conditions subsequent (rather than precedent) are also imposed which have to be satisfied on each draw-down.[171] The conditions precedent (and subsequent) are then more closely tied to the particular advances made under the agreement.

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[168] Lead banks will not generally be considered to owe any fiduciary duties to a future syndicate unless special duties are assumed or a special relationship is created in the circumstances. Co-promoters have been held to owe fiduciary duties to a future company including not to make secret profits. *Boyle & Sykes, Gore-Brown on Companies* (44th Ed) para.8.1. A special relationship may be considered to arise where the syndicate is holding security and it is represented that the borrowers are sound and profitable. *UBAF Ltd v European American Banking Corp* [1984] QB 713, [1984] 2 All ER 226 CA [Leggatt J].

[169] A separate warranty as to no reliance may also be taken. Wood (n 16) paras. 5151-5249.

[170] The legal effect of a condition precedent is that if it is not satisfied, there is no obligation to lend. The bank can also withdraw from the agreement at any time before the conditions have been satisfied. *Pym v Campbell* (1856) 6 E&E 370. For comment, Gabriele (n) 43-49 and Clarke and Taylor, 'Representations and Conditions Precedent in Euro Currency Loan Agreements' *International Financial Law Review* (July 1982) 28. Where the conditions are only precedent to the draw-down under the loan agreement rather than the agreement itself, the bank will be in breach of contract if it refuses to lend at any time before the conditions have been satisfied. *Mr Smith v Butler* [1900] 1 QB 694; *Felixstowe Dock & Railway Co v British Transport Docks Board* [1976] 2 Lloyds' Rep 656; and *Alan Estates Ltd v W G Stores Ltd* [1981] 3 WLR 892. See also Gabriele (n) 44. While the loan agreement may stress the right of the borrower to borrow under the facility, an express provision may be included specifying that the contract itself will not come into effect until the conditions precedent have been complied with. In other cases, it may unclear whether either party can withdraw or whether a best efforts obligation may be imposed to satisfy the condition or both parties prevented from obstructed compliance of continuing information and business or asset obligations for so long as amounts are outstanding under the loan agreement. Re *Anglo-Russian Merchant Traders* [1917] 2 KB 679; and *MacKay v Dick* (1881) 6 App Cas 251. Alternatively, it may be possible that neither party can withdraw. Gabriele (n) 44. For discussion, see also Graham A Penn, Anthony M Shea and Anu Arora, *The Law and Practice of International Banking* (Sweet & Maxwell London 1987), para. 6.42 and (n) 71. The LMA only provides that the lenders will make available the term loan facility under the loan agreement (LMA 2.1) with the borrower being able to make demand (deliver a utilisation request) provided that the conditions precedent have been satisfied and that there is no default and the repeating representations complied with. LMA 4.1 and 4.2, 18.9, 18.14 and Schedule 2.

[171] A representation generally consists of a statement of fact rather than of opinion or law. *Leaf v International Galleries* [1950] 1 All ER 693. A warranty is an undertaking or promise. Many of the commonly issued representations and warranties are only representations rather than warranties. Representations are generally made before the loan agreement is entered into and deemed to be accurate as at the date

The representations and warranties are also generally information and legal effect based. These generally consist of separate legal and commercial warranties the purpose of which is establish the general contractual basis on which the parties are prepared to transact. Some are nevertheless repeated such as through an evergreen clause or provision. The effect of this is to restate the representation and warranty on each draw-down under the loan facility.

The covenants imposed are a series. The purpose is to ensure that the business of the borrower is run in such a manner that its financial condition does not deteriorate in any way.[172] It is also important that the legal identity of the borrowers is preserved[173] and its assets protected.[174] Other covenants are concerned with preserving the equal ranking of claims between creditors[175] or simply imposed continuing information obligations on the borrower and its affiliates.[176]

The representations and warranties would generally then appear to be more pre-loan agreement conditions with the covenants post-agreement. The conditions precedent would constitute more specific requirements tied to initial and subsequent advances.

This classification of representations and warranties as being pre-agreement and covenants post-agreement with the conditions precedent being pre-advance generally corresponds with the terms of the standard LMA facility agreement. The conditions precedent (Part I of Schedule 2) are imposed on draw-down (utilisation).[177] Draw-down (utilisation) can also not occur if there has been any default (either generally or in respect of the warranties and representations given).[178] Certain continuing obligations (Repeating Representations) must also have been satisfied.[179] The conditions precedent must also be satisfied by any new obligor.[180] The representations and

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of agreement. Breach will make the borrower liable for misrepresentation either under the common law or the Misrepresentation Act 1967 as well as under any express contractual provisions. Representations are not, however, incorporated as terms of the contract directly. *Oscar Chess Ltd v Williams* [1957] 1 WLR 370; and *Dick Bentley Production Ltd v Howard Smith (Motors) Ltd* [1965] 1 WLR 623. Even if a term is incorporated as a warranty, breach will only entitle the bank to damages rather than rescission. *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26, [1962] 2 All ER 474.

The lender will be entitled to terminate the contract where a term is a condition rather than a warranty. Some intermediate terms may also arise between conditions and warranties. *Bunge Corporation v Tradex SA* [1981] 2 All ER 513; *Tradex International SA v Goldschmidt SA* [1977] 2 Lloyd's Rep 604; and *Wallis v Pratt* [1911] AC 394. The classification of a term as either a condition or warranty may also be inconclusive with the court looking to the seriousness of the breach to determine whether it would be reasonable or unreasonable to expect the other party to continue to be bound under the contract. *Bunge Corporation v Tradex SA*.

Most non-agreements will then either state that the borrower 'warrants and represents' or issues a specified 'representations and warranties' to equate representations (as non-contractual terms) with warranties (contractual terms). The legal effect of the latter may still be questionable as a court may still consider individ'ual terms as being either representations or warranties as appropriate. It may then be preferable to provide that the borrower expressly 'represents and warrants'. The LMA only refers to the issuance of 'representations and warranties'. LMA 18. As the legal effect of these terms as conditions is still unclear, a series of express events of default are incorporated. This will include non-payment, breach of financial covenants and any other obligations under the loan documentation as well as express misrepresentations. LMA 22.1, 22.2, 22.3 and 22.4. The representations are only stated to be valid from the date of the agreement although the information undertakings, financial covenants and general undertakings are to be complied with on a continuing basis from the date of the agreement. LMA 18, 19, 20 and 21. Draw-down (utilisation) is only conditional on satisfying the conditions precedent, the repeating representations and there being no default. LMA 4.1 and 4.2. There would accordingly appear to be no specific remedy for breach of the non-repeating representations. [ ].

172 A number of financial covenants are imposed often tied to complying with specific ratios including minimum net worth, borrowing limits (the leverage ratio), interest cover and dividend protection. [ ] There may also be restrictions imposed on the type of business carried out and restrictions on growth. General change in business restrictions will be included and other more specific obligations imposed such as with regard to the maintenance of compliance certificates or consents, prudent and safe operations, insurance, repairs, payment of taxes and other regulatory, administrative or environmental compliance.

173 Restrictions will be imposed on mergers or amalgamations or other changes in control. Obligations may be imposed on subsidiary and group structures. A requirement for consent or 'poison pill' may be imposed on new controllers. [ ] The borrower will also be generally required to comply with relevant company laws to protect its corporate status and avoid breach of any relevant requirements including corporate governance rules.

174 Obligations will be imposed on disposals, loans or guarantees, leases and security. Repair and insurance obligations will be imposed with other restrictions on investments, acquisitions or other significant capital expenditure. These will be supported by more specific financial covenants. The financial ratios will also prevent the assumption of excessive liabilities while separate liquidity conditions may have to be complied with. General requirements will again be imposed with regard to material adverse changes and the avoidance of liquidation or insolvency.

175 Ranking is protected through the pari passu and negative pledge clauses supported by the prohibition on disposals which is also asset protection related. Paras.

176 Information obligations will be imposed with regard to accounts (individual or solo and group or consolidated), financial reports, other compliance certificates, material change or default or any other information reasonably requested supported by possible access and inspection rights. Paras.

177 LMA 4.1 and Schedule 2 Part I. Paras.

178 LMA 4.2(a) and 18.9 (Representations and Warranties).

179 LMA 4.2(b) and 18.14 (Repetition). The repeating representations are to be listed in the relevant definition in LMA 1.1.

180 LMA Schedule 2 Part II.

warranties are stated to take effect as of the date of the agreement under the LMA.[181] The non-financial covenants (General Undertakings) are to remain in force from the date of agreement.[182] The financial covenants are to be imposed separately on a case-by-case basis although breach is stated to be an express event of default.[183] Breach of any other provision of the finance documents including the loan agreement is also an event of default.[184]

(1) CONDITIONS PRECEDENT

The loan contract will impose a number of obligations on the borrower. The effect of these is either to suspend the coming into legal effect of the loan agreement or the right of the borrower to draw down under the facility to be provided.[185] These will generally apply with regard to the provision of documentation concerning the legal status and powers of the borrower, any security or guarantees to be provided and legal opinions confirming the enforceability of the contractual rights created.

(a) Constitutional Documentation

Each borrower will be obliged to provide copies of its constitutional documentation, including its Memorandum and Articles of Association in the UK or other corporate formation certification.[186] This will also include relevant resolutions and signature confirmations.[187]

(b) Sovereign Confirmations

Where a sovereign state is involved, the agreement will provide for the provision of any relevant declarations and authorisations from the government in force. Separate undertakings, confirmations or permissions may also be required from the central bank.

(c) Security

Where the loan is to be secured, the condition precedent will also include appropriate evidence confirming the validity of the collateral. This may include valuation certificates, transfer documentation, evidence of good title, any perfection papers (such as registrations or filings) repair, maintenance or insurance certificates and any relevant notices of assignment (including relevant contracts, charter parties and leases).

The loan documentation will include equivalent conditions precedent with regard to guarantees and guarantors. This will apply with regard to the validity and enforceability of the guarantee as well as the constitutional validity and financial condition of the party providing the guarantee.[188]

(d) Legal Opinions

The conditions precedent will also include the provision of legal opinion with regard to the validity and enforceability of the documentation entered into. Separate opinions will be provided in England (or other UK jurisdiction) and from each overseas country involved.[189] This may apply with regard to any borrowers, guarantors or security. The legal opinions will generally relate to the representations and warranties given and the general validity and enforceability of the documentation entered into. These will provide the lending banks

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[181] LMA 18.

[182] LMA 21.

[183] LMA 22.2.

[184] LMA 1.1 and 22.3(a). Under the loan agreement rather than the agreement itself, the bank will be in breach of contract if it refuses to lend at any time before the conditions have been satisfied. *Mr Smith v Butler* [1900] 1 QB 694; *Felixstowe Dock & Railway Co v British Transport Docks Board* [1976] 2 Lloyds' Rep 656; and *Alan Estates Ltd v W G Stores Ltd* [1981] 3 WLR 892. See also Gabriele (n) 44.

[185] See para above.

[186] LMA Schedule 2, para 1(a).

[187] A Board Resolution of each borrower will be requested approving the terms of the loan, authorising execution of the documentation by the specified person or persons and authorising completion and submission of any relevant requests (including advance or utilisation letters). LMA para 1(b). Specimen signatures will be required (LMA para 1(c)), with equivalent documentation from any guarantor (LMA para 1(d)). Certificates will also be requested confirming that the borrowing or guarantee does not breach any obligations imposed on the borrower or guarantor and that all information or documentation provided is correct, complete and in full force and effect. LMA para 1(f).

[188] LMA Schedule 2, Part II.

[189] LMA Schedule 2, para 2(a) and (b).

with a substantial degree of assurance, although they do not constitute legal guarantees in their own terms and do not provide for recovery in the event of inaccuracy.

(e) Confirmations or Other Evidence

The borrower will also be required to provide financial statements relating to each borrower and that any process agent has accepted appointment.[190] The borrower may be required to provide any other authorisation or documentation, opinion or insurance reasonably required by the agent bank.[191] Confirmation will also be required that any fees, costs and expenses have been paid.[192]

(f) Conditions Subsequent

The loan agreement may also provide for the imposition of certain conditions subsequent which will generally have to be satisfied before each subsequent advance or drawdown under the facility. This can be most easily achieved by providing that the conditions precedent are restated on each drawdown. The alternative is either to impose repeating or evergreen representations and warranties.[193]

(2) REPRESENTAITONS AND WARRANTIES

The loan agreement will require that the borrower makes a number of representations and warranties. The effect is generally to suspend the coming into legal effect of the loan agreement.[194] Most agreements require for the provision of representations and warranties to include representations as legal terms of the contract.[195] The agreement may also provide that these are restated on each drawdown on an evergreen basis.[196]

The content and extent of the warranties will be negotiated on an individual loan by loan basis. Various qualifications may be included, such as with regard to materiality in the financial and commercial clauses. Such warranties should not be subject to the reasonable knowledge and belief of the borrower as they are matters of fact, legal warranties may be made subject to the legal opinions although this is often resisted to allow the banks to exercise a right of default in the event of breach.

The representations and warranties generally apply with regard to legal validity or financial condition.

(a) Legal Warranties

The legal warranties will cover such matters as the status of the borrower and its subsidiaries[197] and binding obligations with each of the obligations set out in the finance documentation being legal, valid, binding and enforceable. This may be subject to any general principles of law specified in the legal opinions provided.[198] Other provisions include no conflict,[199] power and authority,[200] authorisation,[201] governing law and enforcement[202] and possibly no immunity from action or waiver or immunity. These may also include no withholding tax[203] and that no litigation, actual or contemplated, is threatened.

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190 LMA Schedule 2, para 3(a) and (c).

191 LMA Schedule 2, para 3(b).

192 LMA Schedule 2, para 3(d).

193 The LMA term facility provides for the restatement of certain specified 'Repeating Representations' on each advance (utilisation). LMA 4.2 and 18.14.

194 Para .

195 Para .

196 Para .

197 The borrower is a corporation duly incorporated and validly existing under the law of its jurisdiction of incorporation and that it and each of its subsidiaries has power to own its assets and carry on its business. LMA 18.1.

198 LMA 18.2.

199 The entry into and performance of the loan agreement will not conflict with any law or regulation, any constitutional documents of the borrower or its subsidiaries and any agreement or instrument binding on the borrower or any of its subsidiaries or relevant assets. LMA 18.3.

200 The borrower has power to enter into, perform and deliver under the finance documentation. LMA 18.4.

201 All authorisations required or desirable to enter into the loan documentation or to make the documentation admissible in evidence in the local jurisdiction have been obtained and are in full force and effect. LMA 18.5.

202 The choice of law provided for is recognised and enforced in the jurisdiction of incorporation of the borrower and any judgement will be recognised and enforced. LMA 18.6.

203 The borrower will warrant that it is not required to make any deduction of tax on any payments made under the loan documentation. LMA 18.7. It may also be specified that there is no need to file, record or enrol the finance documentation in any court or with any other authority or that any stamp, registration or similar tax is applied. LMA 18.8.

(b) Financial or Commercial

The borrower will confirm that its financial statements were prepared in accordance with the relevant accounting standards[204] and that these fairly represent the financial condition and operations of the borrower.[205] There will also be no material adverse change.[206] The borrower will also be required to confirm that no misleading information has been provided.[207] The borrower will warrant that no litigation, arbitration or administrative proceedings are pending or threatened[208] and that the payment obligations under the loan documentation will rank, at least, pari passu with the claims of any other unsecured and unsubordinated creditors.[209] There will also be a general warranty that there has been no default under the agreement or that any event or circumstances has arisen which would constitute a default.[210]

(3) COVENANTS

The borrower will enter into a number of separate covenants or undertakings with which it will comply for so long as any amounts are outstanding under the loan agreement. The general objective is to preserve the financial condition, asset quality and legal identity of the borrower to ensure that no additional credit risk arises.[211] The effect of the covenants is to give the banks a significant degree of control over the activities of the borrower. Care must nevertheless be exercised to ensure that the banks are not deemed to be acting as shadow directors or to exercise control under company laws with the possible lender liability that may consequently arise.[212]

The scope and extent of the covenants will be negotiated on a loan by loan basis again. The most important covenants either relate to corporate or financial matters. The most important corporate covenants relate to security, ranking and disposals.

(a) Corporate Covenants

(i) Negative Pledge

The negative pledge clause provides that the borrower nor any of its subsidiaries will create or permit any security to exist over its assets.[213] This will also be extended to include transactions with equivalent effect. This may include sale and lease-backs, recourse financing, account charges or other preferential arrangements with the effect of increasing debt or asset finance.[214] Other extensions may include general financial leasing, set-off arrangements, hire purchase, title retention or conditional sale and stock borrowings as well as sale and re-purchase arrangements (repos).

The purpose of the negative pledge is to preserve the bank's position against the assets of the borrower. This preserves the bank's ranking and equality between creditors. This can also be considered to allow the bank to exercise indirect control over the liabilities incurred by the borrower, prevent difficulties with second mortgages and control allocation of foreign reserves in government loans.[215] The objective is nevertheless not to prevent the borrower from carrying on its normal business operations by over-extending the scope of restriction. An appropriate balance between credit protection and business continuity must be achieved in practice.

The term security will often be defined specifically to include all forms of security including mortgages, charges, pledges, liens and any other security interests. A mortgage is used to confer registerable security over heritable property. A pledge refers to any asset that is delivered into the possession of the security holder either actually or

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204 This will usually mean the General Auditing and Accounting Practices (GAAP) as provided for in the local jurisdiction. LMA 1.1 and 18.11(a).

205 LMA 18.11(b).

206 LMA 18.11(c).

207 This will apply with regard to the information memorandum and include any financial projections or omissions. LMA 18.10(a), (b) and (c).

208 LMA 18.13.

209 This may exclude any preferred creditors under law. LMA 18.12.

210 LMA 18.9.

211 Para .

212 Where the banks exercise a significant degree of control, they may be considered to constitute shadow directors or controllers. They then may be considered to be liable for the debts of the company in the event of the company's failure to pay or collapse on the company's insolvency and liquidation. The extent of this liability will depend on the local laws. Legal advice will have to be taken in each case.

213 LMA 21.1.3.

214 LMA 21.3.

215 Wood (n) para 3.11.

constructively. A lien refers to any right of retention of an asset arising by operation of law such as by a hotelier over the property of a resident or a garage proprietor over a car pending payment of a repair bill. Security will also include any other security interest securing any obligation of a person or other agreement or arrangement having similar effect.[216] The restriction will apply with regard to existing and future security as well as cover any borrowing or credit.

The prohibition will also apply with regard to the borrower of any of its subsidiaries. The term subsidiary will be interpreted having regard to the local law.[217]

The clause will be subject to various exceptions to allow the borrower and its related companies to continue with their normal business operations. Common exceptions will include any express security disclosed and permitted at the time the loan agreement is entered into, any usual netting or set-off arrangements with the borrower's bank, general liens, existing security over after acquired assets, security issued by after acquired companies, security required under the finance documentations or as otherwise provided for.[218] A general minimum or *de minimis* amount will also usually be excluded[219] or otherwise with the bank's consent.

Breach of the negative pledge will constitute an event of default. The negative pledge does not create security as such although an automatic security clause may be included. This will provide for the creation of equal collateral although the legal effectiveness of the clause will depend on the local law.[220] The security would also have to comply with any local registration or completion formalities including notarisation if applicable. This would include filing under s 396 of the Companies Act 1985 in the UK or US UCC Art 9.[221]

(ii) Pari Passu

The pari pasu clause provides that the obligations created under the loan agreement will rank pari pasu with all other unsecured and unsubordinated obligations of the borrower.[222] This may either be included as a representation and warranty or covenant or as a repeating representation.[223] This provides for the equal ranking of claims on insolvency. This does not require any payment in a pre-insolvency situation, nor for actual payment post-insolvency. The objective is only to preserve legal ranking. This nevertheless only applies with regard to unsecured liabilities as otherwise this would constitute a negative pledge.[224]

(iii) Disposals

The borrower is also generally required not to enter into any transaction or series of transactions to dispose of all or a substantial part of its assets. This will extend to include other group companies and possibly through voluntary or involuntary disposals. The disposals may also take the form of sales, leases, transfers or otherwise.[225] The purpose is to preserve assets, in particular, through possible asset stripping following the acquisition of the borrower by another company.

As companies will have to make some disposals in carrying on their business, a number of standard exclusions will usually be incorporated. These may include disposals in the ordinary course of trade, where equivalent value assets are provided, or subject to a minimum de minimis limit.[226] Other exceptions may include majority bank

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216 LMA 1.1. The meaning of the terms covered will be determined in accordance with the governing law of the contract. Contracts (Applicable) Law Act 1990 implementing the Rome Convention on the Law Applicable to Contractual Obligations 1980. [ ]. See also US Conflicts Restatement s204. [ ].
The term can also be held to include a charge under the Law of Property Act 1925.[217] *Re Bernstein* [1925] Ch 12. A charge covers any type of security under s 396 of the Companies Act 1985. Willes J stated that this would include [ ]. *Halliday v Holgate* (1868) LR3Exch 299 at 302.

218 LMA 21.3(c).

219 LMA 21.3 (viii).

220 English law will recognise the automatic creation of a security provided that it is sufficiently identified. The security will cover a future asset provided that it is capable of being considered to be subject to the agreement at the time of its creation. *Talby v Official Receiver* [1888] 13AC 523; *Syrett v Egerton* [1957] 3 All ER331; and *Holroyd v Marshall* [1862] HL Cas 191. This will not be effective over matching or equivalent assets as the asset would then not be sufficiently specified. Wood (n 16) para 3.24. [An affirmative covenant can be created in the US which would constitute an equitable lien over the assets concerned. *Commercial Cov New York NH and HRR Co* 94 Conn 13,107 A 646 (1990).

221 Section

222 LMA 18.12.

223 Pari pasu is included as a representation under the LMA. LMA 18.12.

224 For recent case law, Wood, *'International Banking Operations'* in *Encyclopaedia of Banking Law* (n) para 3283.

225 LMA 21.4(a).

226 LMA 21.4(b).

consent, arms-length consideration, intra group disposals, investment securities, obsolete assets or cash disposal.[227]

(b) Financial Covenants

A series of more specific financial covenants would also be imposed. This will require the borrower and other group companies to comply with set financial conditions. These usually take the form of a series of financial ratios.

The obligations will generally be imposed on a continuous basis or, at least, require regular re-confirmation at specific intervals such as on subsequent draw-down. The most commonly used ratios include minimum net worth,[228] earnings to interest (EBITDA),[229] debt to earnings,[230] dividend limits[231] and liquidity[232] and leverage.[233]

(c) Information

A number of information covenants will be imposed requiring the provision of specific information with regard to the activities and condition of the borrower. These may include financial statements or accounts,[234] compliance certificates,[235] standards compliance and director certification,[236] any other documents required by the agent bank,[237] or default.[238] More recent documentation may allow the borrower to satisfy its information obligations by providing data through designated websites.[239] Borrowers may also be required to provide necessary information to support 'know your customer' or equivalent identification procedures.[240] These are generally imposed for anti-money laundering and anti-terrorist financing purposes.[241]

(d) General Undertakings

A series of further general undertakings or covenants may be imposed. These may include complying with any local requirements with regards to authorisation or certification,[242] compliance with all relevant laws,[243] entering

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227 Wood (n 16) para 3.31 and para (3284).

228 Minimum net worth is a solvency test. This is calculated with regard to paid-up share capital with consolidated reserves less intangibles (including goodwill or research and development) and other deductions (such as minorities, cumulated losses, revaluations and deferred tax). This essentially represents paid-up share capital with retained earnings. This corresponds with the definition of tier one capital for capital adequacy purposes. This may include subordinated debt, although this will be subject to specified regulatory limits[228]. The deductions specified are necessary to remove assets which cannot be realised on a winding-up.

229 The purpose of the earnings to interest ratio (EBITDA) relates net operating profits to interest charges. This allows the bank to ensure that the borrower will be able to meet its debt service costs. This is generally calculated on the basis of net earnings before interest, tax, depreciation and amortisation as against total fixed interest charges. Earnings to interest must generally not be less than 1.

230 This provides that consolidated net debt will not be a specific proportion in excess of consolidated earnings to interest (EBITDA). This expresses the total debt of the group as against its total service ability as defined in terms of EBITDA. This will again apply on a consolidated or a group basis. Typical ratios may include [ ].

231 Restrictions will be imposed on dividend payments to preserve liquid assets. This allows creditors to be paid ahead of shareholders. This will be calculated to a percentage of consolidated net after-tax profits after deduction of extraordinary items and minorities..

232 Specific limits may be imposed on the retention of cash or near cash (such as government securities including UK Government gilts or US Treasury bills). Specific limits may be imposed on working capital (current assets less current liabilities), the ratio of current assets to current liabilities or the ratio of realisable current assets to current liabilities. Specific liquidity obligations are imposed on banks for regulatory purposes. These are either calculated on a sterling stock or basis. The current requirements are contained in IPRU (BANK) within the Financial Services Authority's Handbook of Rules and Guidance. This will be replaced by the revised obligations imposed under the liquidity chapter within PRU. Walker .

233 The leverage ratio is expressed in terms of total group or consolidated debt as against tangible net worth. Tangible net worth consists of paid up share capital less deductibles. (m). Ratios may vary but typical figures include .

234 LMA 19.1.

235 LMA 19.2.

236 The financial statements will be certified by an approved director of the company as fairly representing its financial condition as at the date of issuance and be prepared in accordance with relevant generally accepted accounting principles (GAAP) in the relevant jurisdiction. LMA 19.3.

237 LMA 19.4. This may include shareholder distributions or details of any impending litigation, arbitration or administrative proceedings.

238 The borrower will be required to notify the agent bank of any default as soon as possible on becoming aware of its occurrence. LMA 19.5(a). The agent bank may also request the company to certify that no default has occurred. LMA 19.5(b).

239 LMA 19.6.

240 LMA 19.7.

241 Walker.

242 LMA 21.1.

243 LMA 21.2.

into any mergers or amalgamations[244] or undertaking any substantial change of business.[245] Unless otherwise dealt with, other covenants may be considered with regard to such matters as legal and regulatory compliance, payment of taxes, maintenance and repair, prudent and safe operations, insurance, acquisitions (as well as joint ventures, subsidiaries or substantial investments), issuing guarantees or entering into loans or credits, capital expenditures and environmental compliance.[246]

LOAN DEFAULT

The rights and remedies available to the lending banks are defined in terms of the express events of default included within the loan documentation as well as general principles of contract law. The conditions and obligations imposed on the borrower are defined in terms of the conditions precedent, representations and warranties and covenants (financial and non-financial). The ability of the banks to take action in the event of breach of any of these obligations is then defined in terms of the events of default.

The express remedies available to the banks will be defined in terms of cancellation of any further commitments and declaring all amounts outstanding (including the principal and interest) to be immediately due and payable. The loan document may include a separate right to make demand.[247] Acceleration does not amount to a penal forfeiture and there is no requirement to act in an unreasonable or unconscionable manner.[248]

In practice, the banks will rarely exercise the right to accelerate unless the financial condition of the borrower has deteriorated to such an extent that there is no possibility of payment. Banks would rather negotiate with the borrower to attempt to agree alternative arrangements which will allow full or, at least, substantial recovery of all amounts due. Banks either impliedly waive their rights through non-exercise or expressly waive identified breaches on specific conditions. In a syndicated facility, these rights will generally exercise through the agent bank on instruction of the majority banks.[249]

Defaults may be classified in a number of ways. These are principally concerned with actual non-payment or breach of any of the other obligations imposed under the loan document. Some of these are referred to as being anticipatory in nature.[250] This simply means that breach of more minor obligations may provide the banks with warning of possible more severe or significant breaches subsequently. The remedies in each case will be determined in terms of the express rights of action on breach of the default.

The main events of default are generally defined in terms of non-payment, contractual breach, possible mis-representation, cross default, insolvency and creditor processes, ownership changes, illegality, repudiation and material adverse change.

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[244] LMA 21.5.

[245] LMA 21.6.

[246] Wood (n 16) para 3.36 and Wood (n 16) para 3336.

[247] The loan agreement may also provide that the loan can be declared to be payable on demand LMA 22.13 (a) and (v) (cancellation and immediately due and payable) and LMA 22.13 (c) (payable on demand). The effect of the demand is to trigger the right to request repayment. The word demand is not necessary provided that there is a clear intimation that payment is required. *Re Colonial Finance Mortgage, Investment and Guarantee Corporation Ltd* [1905] 6 SR NSW 6 accepted in *Re A Company* [1985] BCLC 37 and approved in *Bank of Credit and Commerce International SA O V Blattner* (20 November 1986 unreported) (CA) (Civil Division) transcript No 1176, 1986. The amount need not be specified with a general all monies demand being sufficient. *Bank of Baroda -v- Panessar* [1987] Ch 335, [1986] 3 All ER 751.

The debtor will only have a few hours to obtain the necessary money where the debt is payable on demand. *Cripps Pharmaceuticals -v- Wickenden* [1973] 2 All ER 606; *the Brimnes* [1974] 3 All ER 88, CA (ship charter forfeiture); *Sport International Bussum BV -v- International Footwear Ltd* [1984] 1 All ER 376 CA (licence forfeiture). The borrower should be given sufficient time to make the necessary arrangements, although if it will not be able to pay, the bank can act immediately. Receivers can be appointed within one hour after making demand for payment. *Shepherd &Cooper Ltd -v- TSB Bank Plc (No 2)* [1996] 2 All ER 654. A 'mechanics of pain' test is adopted with the creditor not being required to provide the debtor with a reasonable time to pay. *Bank of Baroda -v-Panessar* following *Brightly-v-Norton* (1862) 2 B&S 305.

[248] English courts will allow strict enforcement of the express rights available. *Shepherd & Cooper -v-TSB Bank Plc (No 2); Bank of Baroda -v- Panessar*; *The Brimnes*; *The Laconia* [1977] AC 850 (forfeiture of a ship charter for non-payment one weekend late); *The Chikuma* [1981] 1 All ER 652 (cancellation of a ship charter following an $80 shortfall through bank interest and charges; and *The Angelic Star* [1988] 1 Lloyds's Rep 122 CA (immediate acceleration of a secured ship loan). For further discussion, Wood (n 16) para f (3402). Equitable principles may be applied under the laws of other countries including in New York. Lenders may be prevented from acting in an oppressive, unreasonable or unconscionable manner or disproportionate manner. Proportionality will be considered having regard to materiality of the default. *One Hundred Eighth Avenue Corp -v- Morgenstern* 4 AD 2 D 754, 164 NYS 2d 812 (1957); and *Domus Realty Corp -v- 3440 Realty Co* 179 Nisc 749, 40 NYS 2 d 69 (1943) affirmed 226 AD 725, 41 NYS 2 d 940 (1943). For discussion, Michael Gruson, [163-165].

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[250] Wood para f (3338); Wood (n 16) para 3.38; and Penn, Shea and Arora (n 170) para 9.04.

(a) Non-Payment

The loan agreement will provide that an event of default occurs where the borrower fails to make payment on a due date in the place and currency specified.[251] A grace period may be provided for, allowing one or more business days within which payment is to be made, although this would usually be tied to an administrative or technical error condition.[252]

(b) Financial Covenants

Breach of any of the financial covenants may be stated to be an express event of default.[253] The effect is to allow the banks to exercise their rights of acceleration in the event that the borrower's financial condition deteriorates to the extent that it breaches any of the financial ratios specified.[254] The breach may be minor, in which case the banks will waive exercise of their rights. It may, nevertheless, be considered appropriate to have an express right of action in the event of breach of any of the financial obligations imposed. This may accordingly be considered to be anticipatory in nature, although clearly if the breach is serious, the banks will exercise their full rights immediately.[255]

(c) Non-financial Breach

It will be an event of default for the borrower to breach any of the other obligations imposed under the loan documents. This may include the conditions precedent, representations and warranties and other covenants. As these will generally be considered to not be as serious as breach of the payment obligations or financial ratios, appropriate grace periods may be included.[256] Different periods may be incorporated, depending on the specific obligations concerned. This will be specified in the agreement.[257]

Incorporation of a materiality condition. While this may be considered appropriate with regard to breach of representations and warranties, this will often be resisted in connection with other covenants.[258] This, nevertheless, creates uncertainty and dilutes the effectiveness of the bank's rights both to waive the breach or accelerate. It may accordingly be more appropriate to provide for different grace periods depending on the specific obligations breached.

(d) Misrepresentation

The loan agreement may provide that it is an express event of default if the borrower has made any representation or statement that is incorrect and misleading in any material respect at the time made or deemed to be made.[259] The bank will have a general right to damages for misrepresentation under the common law as well as under the Misrepresentation Act, although any right to rescission may be limited depending on the nature of the representation concerned. It is accordingly appropriate to include an express event of default in the event of any material misrepresentation being made.

(e) Cross Default

All agreements will include a cross-default clause. The effect of this is to allow the banks to exercise their rights in the event that the borrower fails to meet its obligations under any other transactions or any other debt is accelerated or event of default occurs. The objective is to ensure that the bank is not placed at any disadvantage in the event of a separate default. This supports the pari passu clause.[260]

The cross-default of essential importance to protect the bank's rights under the loan contract. Breach may nevertheless have devastating consequences for the borrower in that any event that triggers breach of a particular clause may also result in default under all of its other financing arrangements. Breach and acceleration under one

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251 LMA 22.1
252 LMA 22.1 (a) and (b)
253 LMA 22.2
254 Paras
255 (n)
256 LMA 22.3 (a) and (b)
257 LMA 22.3 (d)
258 Wood (n 16) (f) 3341; Wood (n 16) para 3.40 and 3.41; and Penn, Shea and Arora (n 170) paras 9.07-9.09
259 LMA 22.4
260

contract may then trigger default under all other outstanding credit commitments. As every creditor will then attempt to exercise its rights in full, the borrower may go into immediate insolvency with all unsecured lenders only obtaining proportionate final payments. Even where banks may be prepared to exercise grace rights or waivers, this would be impracticable with all of the other acceleration rights being exercised. The lawyers acting on behalf of each bank will also attempt to ensure that their clients are able to exercise their rights as quickly and as fully as possible to protect their interests. The effect of this may then be to further destabilise the financial position of the borrower and undermine the possibility for any negotiated arrangement or settlement.[261]

The most comprehensive clauses will be drafted to include any financial indebtedness, any indebtedness of the borrower and of any group company, any commitment of both sets of parties is cancelled or suspended and any creditor has a right to accelerate.[262] Appropriate concessions are exclusions may then be negotiated in light of the seriousness of breach. These may include type of debt limits (such as borrowings and guarantees but excluding all other financial transactions), threshold amounts,[263] external debt, actual acceleration, defined defaults and possible grace periods.

Further operational difficulties also arise with regard to the exercise of the rights conferred under the clause in practice. While lenders under a particular transaction may be provided with information with regard to a borrower's total indebtedness at the time of negotiation, they will generally have very limited information with regard to the content of the specific obligations under which any other credit has been provided. Banks will wish to keep their dealings with their clients as secret as possible, while lawyers will be subject to strict confidentiality obligations.[264] The loan agreement will provide that the particular lender is to be advised in the event that there is an event of default[265] which will include breach of any other financial obligations under the cross-default clause.[266] Whether the borrower will immediately notify all of its creditors that there has been a default and that the cross-default clauses in other contracts have been triggered is questionable. Further difficulties may also arise where grace periods are provided or where default only begins on notification rather than the original trigger event. In practice, particular lenders may only find out that the cross-default has been triggered when action has been taken by other creditors. It will then be too late to negotiate any alternative repayment arrangements. It is likely that the borrower will then be forced into liquidation with the unsecured creditors ranking equally after secured and any preferential parties.

It is accordingly essential that borrowers monitor the possible operation of cross-default clauses. They must ensure that all payments are made on time and that any tied covenants including, in particular, financial covenants are complied with. In the event that any potential breach may arise, they should contact all relevant lenders immediately to negotiate appropriate waivers to prevent defaults arising which would then trigger cross-default in other agreements. The borrower and its solicitors should then attempt to ensure that appropriate flexibility is possible especially through the use of waivers. In the event that this is not possible, it has to be expected that one core breach will then trigger cross-default which will result in the immediate acceleration and consequent insolvency of the borrower.

(f) Insolvency

It is common to include an express insolvency and insolvency proceedings clause. The effect is to create an express event of default in the event that the borrower or any member of the borrower's group becomes insolvent or insolvency proceedings are commenced against them.[267] The borrower will generally be in default in any case under most laws, although express rights of action should be provided for in the loan documentation. This will

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[261] For discussion, Penn, Shea and Arora (n 170) paras 9.10-9.15 [ ]

[262] LMA 22.5 (a), (b), (c), (d) and (e)

[263] LMA 22.5 (e)

[264] Clark and Taylor, 'events of default in Euro currency loan agreements' (1982) *IFLR* (September 15, 13).

[265] LMA 19.5 (a) and (b). (n)

[266] LMA 22.5

[267] The LMA provides that it is an event of default where any member of the borrower's group is unable or admits inability to pay its debts as they fall due, suspends making payments on any of its debts or commences negotiations with one or more of its creditors with a view to re-scheduling any of its indebtedness for reasons or actual or anticipated default, the value of the assets of any member of the group is less than its liabilities or a moratorium is declared on any indebtedness of a group member. LMA 22.6 (a), (b) and (c).
It is also a default where any corporate action, legal proceedings or other procedure or step is taken in relation to suspension of payments moratorium, winding-up, dissolution, administration or re-organisation of any member of the group, composition, compromise, assignment or arrangement with any creditor or member of the group, a liquidator is appointed or security is enforced over any assets of any member of the group. LMA 22.7 (a), (b), (c) and (d).

allow the lenders to act where, in particular, any voluntary arrangement is entered into or another creditor appoints an administrative receiver under a floating charge.[268]

(g) Creditor Processes

A separate event of default may be created where there is any expropriation, attachment, sequestration, distress or execution affecting any asset or assets of a group member.[269] This simply extends the rights of the bank to act where any other creditor process is exercised. As such action may only relate to more minor claims, it is nevertheless common to include some qualification. This may take the form of either a financial threshold or de minimis and appropriate grace period.

(h) Control

It is usually an event of default where there is a change in the control of the borrower or the structure of the borrower's group is altered. The effect of this is to change the financial environment against which the original credit assessment was undertaken by the bank. The bank will, accordingly, wish to re-consider its position in the event of a change of corporate control. It is possible that the bank may not have any concerns with the particular re-structuring that takes place. It will then simply waive the default.

The clause may be drafted in different ways. This may be restricted to the borrower ceasing to be a subsidiary of a particular company[270] or under the voting control of a particular shareholder or group of shareholders. It will not usually be a default where the borrower disposes of or acquires new subsidiaries itself, although this may affect its ability to comply with its financial covenants. The borrower's subsidiaries will also often be included as guarantors, any new subsidiaries will then be brought in as additional guarantors[271] with provision for the release of retiring guarantors.[272] It will be for the borrowing group and the banks to determine in the initial negotiations which companies will be included as original borrowers (obligors) and which as guarantors.

(i) Illegality

An express default may be included where it becomes unlawful for any obligor to perform any of its obligations under the finance documents.[273] The validity of any acquired rights will nevertheless be protected.[274]

(j) Repudiation

An express default may be included where the borrower repudiates the loan documentation or evidences an intention to repudiate the documentation.[275]

(k) Material Adverse Change

The lenders will be entitled to accelerate the loan in the event of any material or adverse change in the financial condition or operation of the borrower. The clause may be drafted in various ways.[276]

The difficulty that arises from the borrower's perspective is that the clause is based on the opinion or judgement of the banks and will be triggered where they subjectively consider that any material event has arisen. This

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268 An administrative receiver can be appointed by any party having security over all or substantially all of the assets of the company, including a floating charge. Insolvency Act 1986, ss 9 and 10. [ ]. Some concessions may be negotiated in connection with the proceedings, such as where a petition is made which may be unfounded. This may, nevertheless, be resisted as it may delay action under the particular contract.

269 LMA 22.8

270 LMA 22.9

271 LMA 24.4 and schedule 6

272 LMA 17.8 and schedule 7

273 LMA 22.10

274 Where any provision may become illegal, invalid or unenforceable in any particular country, it may be provided that the legality, validity or enforceability of the remaining provisions is protected in that country and the enforceability of all provisions in any other jurisdiction is not in any way impaired or affected. LMA 32

275 LMA 22.11

276 No express provision is included within the LMA. The clause may refer to any change (financial or otherwise) which affects the borrower in a manner which is materially adverse in the opinion of the bank or an event occurs which would materially and adversely affect the ability or willingness of the borrower to perform its obligations under the agreement in the judgement of the bank. Wood F(3381); and Wood para 3.48. Penn, Shea and Arora (9.22).

creates an enormous amount of discretion on the part of the creditor banks.[277] This may also be considered to undermine the objectivity and specificity of the other provisions including, in particular, the covenants and the other defaults. The clause is, nevertheless, common in sovereign and corporate loans as well as credit facilities provided by the World Bank and regional development banks.[278]

In exercising their discretion, banks are only required to act honestly and in good faith.[279] Where materiality is to be assessed on an objective basis, the courts will look at the importance of the event, having regard to the circumstances of the particular transaction.[280]

DEFAULT REMEDIES

The loan agreement will typically provide for default interest in the event of non-payment of any amount.[281] This will be supported by any general indemnity to cover any costs, loss or liability suffered by the lendors.[282] Specific performance will generally not be available.[283] Injunctions may, nevertheless be available. Separate rights of lien or set-off may also be exercised.

If a bank refuses to lend, specific performance is not available to the borrower.[284] The borrower will be able to claim either reasonably foreseeable loss or any specially contemplated losses. Foreseeable losses will include additional interest or other administrative costs in arranging a replacement loan.[285] This will not include losses arising as a result of a decline in the borrower's credit standing.[286] Special contemplated losses may be available where the bank has notice of the purpose of the loan and the consequences of loss of funding. This may include the borrower's breach of contract or loss of profit subject to an obligation to mitigate loss.[287]

Draw-down on the loan facility is at the borrower's option. The banks cannot obtain an order for specific performance even if the borrower is committed. The bank can only claim reasonably foreseeable loss and any specially contemplated damages.[288]

LOAN TRANSFERS

Banks may use one or more of a number of techniques to transfer loans as with other balance sheet assets. Asset sales or transfers have become increasingly common in recent years. This has been associated with the development of active secondary markets in loan and other asset sales as risk management techniques have become more sophisticated and regulatory obligations more intense.

Banks may wish to transfer assets for a number or reasons. This will be principally concerned with releasing funds for alternative use. Banks will constantly monitor lending and credit opportunities as against available sources of funds. Such decisions will mainly be taken in accordance with internal lending allocations and limits and business development strategies. Product and portfolio diversification will also be affected by regulatory obligations, especially with regard to concentration limits or large exposures with regard to particular clients or groups of clients and capital adequacy support. Lead banks will wish to be involved in all large syndicates, although their participation may breach their existing concentration limits with the particular clients involved. Some form of disposal will then have to be considered. Lead banks may also wish to dispose of their credit commitments immediately to avoid having to maintain capital against the loan exposure created. Disposals may

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[277] It may be argued that the effect is to transform the credit from being a term loan into a demand loan. Wood (n 16) 3.49.

[278] Wood (n 16) para F3381

[279] They must not act capriciously or in an arbitrary or perverse manner in defiance of reason. *Abu Dhabi Tanker Co -v-Product Star Shipping Co Ltd* [1993] 1 Lloyd's Rep 397, 404; and *Ludgate Insurance Co Ltd -v-Citibank Na* [1998] Lloyd's Rep IR 221, 239.

[280] *National Westminster Bank Ltd -v- Halesowen Pressworks Assemblies Ltd* [1972] AC 785 HL (material change on passing of resolution to wind up a company); *Lewis -v- Farin* [1978] 2 All ER 1149 (adverse change in net assets); *Retr Technology Investment Trust Plc* (1988) 4 BCC 244 (no financial statements against which to judge whether an adverse change had occurred). See also *Tesco Stores Ltd -v- Secretary of State for the Environment* [1995] 2 All ER 636 (material considerations with regard to planning applications); and *DB Rare Books Ltd -v- Antiq Books* [1995] 2 BCLC 306 (material breach in partnership agreement). See Wood (n 16) F (3381).

[281] LMA 8.3 (a).

[282] [LMA 17.1(c)]

[283] (n)

[284] *South African Territories v Wallington* [1898] AC 309.

[285] *Prehn v Royal Bank of Liverpool* [1870] LR 5 Axch 92.

[286] *Bahamas (Inugua) Sisal Plantation v Griffin* (1897) 14 TLR 139.

[287] *Manchester & Oldham Bank v Cook* (1883) 49 LT 674; and *Wallis Chlorine Syndicate Ltd v American Alkali Co Ltd* [1901] TLR 656.

[288] *Rogers v Challis* (1859) 27 Beav 175.

also be made for country risk, fiscal (taxation) and reserve requirement reasons. The bank may also wish to develop its loan trading capability through its separate sales division.

A number of transfer options are available. These include legal or equitable assignment, novation, funded participation (or sub-participation), risk participation and securitisation. Trusts and agency or broking structures can also be used.[289] All of these have different consequences in terms of priority and enforceability depending on the new relationship created between the original debtor and the transferee. A number of other consequences will also arise in terms of credit risk transfer, regulatory recognition, tax implications, governing law and jurisdictional recognition, impact on rights of lien and set-off as well as other regulatory and potential legal liability issues.

The principal means of transfer are as follows.

(a) Assignment

Debt obligations create purely personal rights. They exist as pure intangibles under English property law and were historically incapable of transfer.[290] Debts can now be transferred either by legal or equitable assignment.

Legal assignment is effected under the Law of Property Act 1925, section 136. This requires that the assignment is made in writing, notice is given to the debtor and that the debt is for an unconditional amount. An equitable assignment is any other agreement to assign not complying with the statutory conditions prescribed. The legal effect of the assignment is then dependent on the giving of notice to the debtor. A legal assignment is ineffective without notice, while an equitable assignment only protects its priority from the date of notice. An equitable assignor must still join the assignor as plaintiff in any action on the debt, although any other difference between legal and equitable assignment is procedural rather than substantive.[291]

The determining factor is accordingly the giving of notice to the debtor. This determines the priorities between equitable assignments and prevents the debtor from continuing to make payments to the original assignor. The assignee's remedies would then only be in tracing.[292] The debtor is also prevented from setting up any new rights of set-off, counterclaim or other equities against the assignor.[293] A bona fide legal purchaser will still acquire the debt subject to any prior equities over the right of the assignee.[294] Notice can be given by either the assignor or the assignee. Only express notice in writing is required under a legal assignment.[295]

An assignment takes effect to transfer rights and benefits under the original contract but not the assignor's obligations.[296] The original bank will accordingly remain liable to provide any committed funds under the loan contract subject to contrary agreement. Many standard term loan agreements will provide for assignment although this will only be of rights with rights and obligations only being transferred through novation.[297]

The loan documentation may require the consent of the borrower for the assignment although this is not necessary in law. This will nevertheless constitute notice with the effect of determining priorities and requiring the debtor to make any payments to the assignee from the date of notice.[298] The contract may provide that consent is not to be unreasonably withheld or delayed.[299] Consent is not to be withheld only by reason that this may increase the mandatory costs imposed under the contract.[300] The borrower may also wish to ensure that any assignee (new lender) assumes the same obligations as if it had been an original party to the agreement.[301]

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[289] Wood (n 16) para 7.2; and Penn (n) para 8.07

[290] Roy Goode, *Commercial Law* (Penguin third ed 2004) 25 and 47. Debt obligations were considered to be purely personal between the participating parties and problems of maintenance may arise with parties abusing remedies against debtors in connection with which they would otherwise have no legitimate interest. The courts of equity did allow the assignor's name to be used by the assignee in common law actions, this became unnecessary under the Law of Property Act 1925, S136.

[291] CPRr 19.4. Goode (n) 48. See also Penn (n) para 8.03.

[292] Goode (n) 52-54 and 452

[293] Penn (n) para 8.03

[294] LPA, S136 see also *Dearle -v- Hall* (1828) 3 Russ. Where the assignor fraudulently assigns the same debt to a third party, the first to give notice to the debtor obtains priority. Goode (n) 56, 745 and 749-750. See also Penn (n) para 8.03 and (n) 11.

[295] LPA S136. Contrast *Lloyd -v- Banks* [1868] Ch App 488 (the debtor was given notice through a newspaper).

[296] *Trend Tex Corp -v- Credit Suisse* [1980] QB 629; *Tolhurst -v- Associated Portland Cement* [1902] to KB 660; and *United Dominions Trust -v- Parkway Motors* [1955] to All ER 557.

[297] LMA 23.1 (a) and (b).

[298] LMA 23.2 (a)

[299] LMA 23.2 (b)

[300] LMA 23.2 (c)

[301] LMA 23.2 (d)

(b) Novation

Novation involves the cancellation of the original debt and its replacement by a new obligation between the original debtor and the transferee on the same terms as before. The original and new contracts are effectively substituted with the transfer of all rights and obligations. The borrower's agreement to repay the new debt effectively releases the original lender from the old debt.[302]

The difficulty that arises with regard to novation is securing agreement by all parties to the replacement contract. This can, nevertheless, be easily achieved by incorporating appropriate language and procedures in the original loan documents.[303] These were previously referred to as Transfer Loan Certificates (TLCs) or Transferable Loan Instruments (TLIs) although this is less commonly used.[304]

The loan documentation will initially provide for consent, with consent not being unreasonably withheld or delayed.[305] Consent is deemed to have been given where the assignment or transfer is to another existing lender or affiliate of an existing lender.[306] The agent bank will be required to execute (sign) a duly completed transfer certificate in the form provided.[307] The transfer clauses will provide that with effect from the transfer date, all existing rights and obligations are cancelled, corresponding new rights and obligations are assumed and the assignee becomes an original lender under the novated arrangements.[308] A copy of the transfer certificate will be sent to the borrower as soon as possible with any transfer fees being paid by the new lender.[309] Any bank lender will also be given power to exchange information with its affiliates or assignee or transferee it considers appropriate.[310] There will also be an exclusion of liability for any representations or warranties made with the new lender having to discharge any relevant 'know your customer' obligations and notify the agent bank accordingly.[311]

(c) Participation

A funded participation or sub-participation involves the transfer of the lending commitment and payment benefits by an original lending bank to a transferee. The participating transferee will then be funding the credit (or portion of the credit transfer) and receiving the benefits of the payments made by the borrower. This will, however, be on a non-recourse basis with the transferring bank assuming no separate liability to the transferee. Sub-participations are commonly used by lead banks to offload their lending commitment in whole or part to other banks not in the lead management group. These will commonly take effect on the date of the original loan agreement with the effect that the transferring bank assumes no separate financial or regulatory liability, although they do remain responsible for the credit risk of the borrower.

The sub-participations may be used where transfer restrictions are imposed under the original loan documentation. The difficulty for the participant is that it assumes the double credit risk of original borrower and the transferring lender's default. This is important where the payments that the participant will receive are made through the original lender via the agent bank. The participant will also have no direct rights and remedies under the original contract documentation although the participation agreement will generally allow it to veto or direct the consents given or withheld by the transferring bank.[312]

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302 This avoids any problem with consideration under English Law. 'Selling loan assets under English Law: a basic guide' *International Financial Law Review* (May 1986) 29.

303 [Julien Bailey, 'Novation' (1999) 14 *JCL* 189. Novation is distinct from variation or waiver. With variation, only the agreed terms are amended with the rest of the contract remaining in effect. Waiver is concerned with the voluntary surrender of a right or remedy. Sean Wilken, *The Law of Waiver, Variation and Estoppel* (2 ed 2002); Tony Dugdale and David Yates, *Variation, Waiver and Estoppe l- a Reappraisal* (1976) 39 MLR 680; P S Atiyah, 'Consideration and Estoppel: the thawing of the ice' (1975) 38 MLR 65. See also Goode (n) 104-107].

304 Arun Kumar Sarwal, *International Handbook of Financial Instruments and Transactions* (Butterworth London 1989 254-255). A transferable loan facility is a loan structured to allow portions of a medium term loan to be readily traded between lenders. A TLI is used to make transfer by way of legal assignment. A Transferable Loan Certificate (TLC) takes effect by way of novation which transfers rights and obligations. A Transferable Participation Certificate (TPC) involves novation of a sub-participation. This then combines a TLC with a sub-participation to avoid multi-tiering of participations. A subsequent participant will replace the prior participant to make funds directly available to the original lending bank. Paras

305 LMA 23.2 (a) and (b).

306 LMA 23.2 (a)

307 LMA 23.5 (a) and schedule 5. The transfer certificate is only provided in connection with novations. No separate form of assignment is provided under the LMA.

308 LMA 23.5 (c) (I) (II) and (III)

309 LMA 23.6 and 23.3

310 LMA 23.7

311 LMA 23.4 and 23.5 (b)

312 Penn (n) para 8.06 and 8.14

A sub-participation is distinct from a participated loan. This involves the borrower entering into a loan contract with one bank with any other participating institutions being unknown to the borrower.[313] These may either be medium-term participation agreements or short-term master participation agreements with a rollover facility. US participations are also distinct.[314]

(d) Risk Participation

A risk participation is used where the bank has a non-funded asset, usually in the form of a contingent liability, such as a guarantee or a confirmed letter of credit or accepted bill of exchange. The participant will undertake to compensate the original bank in the event of default by the borrower. This then takes the form of a credit guarantee or insurance undertaking. This is less common especially with the growth of the credit derivatives market.

Credit derivatives are used to package and sell credit risk by banks to other market counterparties. These can take a number of forms, with different regulatory conditions being applied. The key determinant is generally the extent to which credit risk is effectively transferred from the protection buyer to the protection seller.[315]

(e) Securitisation

Securitisation involves the repackaging of categories or classes of loans into single portfolios which are then sold to Special Purpose Companies (SPVs). Bonds or other debt securities are sold by the SPV secured on the underlying loan portfolio. The effect is to convert the underlying loan based instruments into a securitised and tradable form.

LOAN RESTRUCTURING

Loan or debt restructuring is concerned with the subsequent agreed adjustment and rescheduling of debt obligations following the borrower's inability to service outstanding obligations. The credit standing of the borrower will have been assessed as part of the initial credit determination made by the lending bank or banks. Funds will not usually be made available where the creditors consider that there is a reasonable prospect that the borrower may be unable pay interest or repayment of principal at some point in the future. Circumstances may nevertheless arise where the borrower's financial condition deteriorates to such an extent that this may occur.

The banks will also have a number of rights of action and remedy under the negotiated documentation. This will principally involve the provision of information on a regular basis and compliance by the borrower with specified financial ratios as set out in the financial covenants. Changes in these ratios should indicate where problem areas may arise. The careful monitoring of this information by the lending banks should provide some reasonable warning of possible crises and allow the banks to take necessary corrective action. The events of default specifically will allow banks to exercise a number of options in the event of one or more specified breaches of the covenants or other conditions imposed.

A number of difficulties nevertheless arise where creditors attempt to take action either on an individual or collective basis. The relationship between the lenders to a particular facility will be governed by the syndicate provisions including, in particular, those that secure equality and pro rata treatment.[316] Some majority decision-taking will be permitted, although not with regard to core conditions such as interest amendments, maturity extensions or principal reductions.

Apart from these internal difficulties, separate problems will arise where creditors attempt to take action across a number of different debt arrangements. The initial problem that arises is that the cross-default clause may trigger default in a large number of lending contracts in the event of one breach. Where this occurs, the borrower can be faced with insolvency very quickly unless some collective agreement can be arrived at. This of itself will be particularly difficult with the non-transparent nature of many of the lending arrangements entered into and tied

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[313] Sarwal (n 3) 251. The difference between a participated loan and a sub-participation would then depend on whether the participants were committed at the time the original loan comes into effect or only acquired their commitment subsequently. As an original bank lender may enter into the sub-participation contract before the original loan agreements comes into effect with effect from the same date and time, the distinction in practice may be minimal.

[314] Reade Ryan, *International Financial Law Review* (October 1984) *IFLR*.

[315] Section

[316] Wood (n 16) para 6.11-18.

confidentiality obligations involved. Even where agreement may be possible between a group of lenders, problems will arise with regard to non-participating (holdout) parties who may insist on exercising their rights to accelerate and sue on an individual basis. Borrowers are often then forced to negotiate separate terms of settlement with holdout creditors to prevent disruptive and even calamitous litigation. Whether these parties will then be prepared to share the benefits received with the other creditors will depend on the specific contractual relations involved. Even where legal obligations to share are imposed, certain creditors or groups of creditors may refuse to do so in practice.

These problems become even more significant where multiple asset classes are involved with large numbers of distinct types and amounts of debt being outstanding, including both loan or bank based debt and bond or securities indebtedness. Negotiating a comprehensive package for the rescheduling of all debt in a complex corporate or sovereign situation is almost impossible. Rescheduling will accordingly tend to focus on groups of debt claims within common classes. While this may be possible with sovereign creditors who cannot be liquidated as such, corporate entities may be forced into insolvent liquidation unless some protective mechanism is available such as through a US Chapter 11 or UK Administration procedure. The purpose of these mechanisms is to provide protection against immediate creditor action to allow companies to attempt to reorganise and trade through their immediate financial difficulties. This may involve entering into various more specific rescheduling arrangements or more general voluntary arrangements with its creditors as a whole.

(a) Loan Rescheduling

Where a loan rescheduling is to take place, this will generally commence with some form of moratorium on repayment or a declaration that a sovereign country is no longer able to meet its payment obligations. A corporate moratorium may begin with the appointment of an administrative receiver or the company going into Chapter 11 in the US. Subsequent restructuring will then be managed under the powers and procedures concerned.

With regard to sovereign debtors, a steering committee will usually be appointed, made up of the principal debt holders, with various sub-committees also being appointed to carry out specific tasks. The scope of the debt to be covered will initially have to be agreed. This will have to be limited in some form such as with regard to 'external debt' or Euro currency debt. The debt may also be defined in terms of maturity or amount or, at least, maturity and amount limits imposed. All relevant creditors would then be contacted and invited to participate in the rescheduling process.

The parties will then have to agree the terms of the restructuring. This will include rescheduling all outstanding existing debt to avoid default, the provision of new credit and the establishment of appropriate inter-bank lines of credit.[317] The existing debt will have to be rescheduled to avoid default. This will include extending maturities and adjusting interest payment dates and possible interest levels. As the borrower will be unable to service the debt directly, additional or new money will have to be provided. This will generally be made available through a separate loan agreement with all of the existing banks making new funds available in proportionate amounts. Lenders prefer to separate the old and new money obligations with even more strict controls usually being included in the new provisions such as with regard to conditions precedent, covenants and default. Separate credit lines may also have to be negotiated to allow the borrower to have sufficient funds to carry on its normal operations. These will generally be negotiated through revised short term facilities. In addition to the usual pari passu sharing clauses, negative pledges and cross-default provisions, additional clauses will be included with regard to comparable indebtedness covenants and mandatory prepayment provisions.[318]

(b) London and Paris Clubs

The London and Paris Clubs are informal organisations that attempt to re-negotiate either commercial bank or government debt. The Paris Club originally met in 1956 to discuss Argentinean debt repayments after the fall of Peron.[319] Meetings are convened where a debtor country requests negotiated debt relief with a number of other

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[317] Clark and Hughes in Gruson (AD) 131-137; K Karat, 'Corporate and sovereign restructurings compared' (1983) *IFLR* (November) 35-36; Horn, 'The restructuring of international loans and the international debt crisis' (1984) *IPL* 400-409; Clark, 'Problems and solutions to solving debt restructuring' (October 1984) *IFLR* 4-8. [Penn para 9.35].

[318] Comparable indebtedness covenants are designed to ensure that other creditors with comparable debt are not paid in advance of the rescheduling lenders. Problems may, nevertheless, arise in monitoring and enforcing this, especially where this may be considered to amount to the tort of inducing breach of third party contractual relations. Penn (n) para 9.44.

Mandatory prepayment provisions require proportionate amounts of any prepayment on non-scheduled debt is shared between the scheduling creditors. The objective is to ensure that any participating and non-participating debt is reduced by equivalent amounts.

[319] Andreas Lowenfeld, *International Economic Law* (OUP Oxford 2002) 624-627.

creditor countries. Meetings are usually held under the chairmanship of a senior official of the French Treasury, with representatives from the IMF, World Bank, OECD and UNCTAD usually attending. Negotiations are conducted on the basis that debt relief should be provided where necessary, subject to appropriate adjustment and provided that all creditor countries are dealt with in a fair and proportionate manner.

The Paris Club agreed specific measures to assist heavily indebted low income borrowers (IDAs) in 1988-91. These are referred to as the 'Toronto Terms'. The principles governing lower middle-income country adjustments are referred to as the 'Trinidad Terms'. Agreement is conditional on a comprehensive IMF adjustment programme being in place, with upper-credit IMF resources continuing. The categories of eligible countries and grace periods in maturities were subsequently adjusted under the London Terms and the Naples Terms.[320]

Formal debt relief is now made available through the IMF and World Bank special initiative for heavily indebted poor countries (HIPC). Qualifying countries can be permitted to reduce their debt levels to sustainable levels subject to a Poverty Reduction Strategy Paper and other conditions being agreed with the IMF. Twenty-six countries have applied for debt reduction under HIPC. Eight have already qualified for debt reduction with eighteen others becoming entitled to some debt relief. A total of 41 billion dollars of commitments have been agreed although the effectiveness of this in practice remains to be seen in connection with sovereign borrowers.[321]

(c) IMF and World Bank

The IMF and World Bank have increasingly become involved in debt restructurings. The IMF and World Bank provide assistance to countries under various facilities either to assist with balance of payment imbalances or for development purposes. They have, nevertheless, increasingly become involved in ordered work-outs of outstanding debt in a number of high profile situations. These include Mexico (1982 and 1994), Asia (1997), Russia (1998), Ecuador (1999), Turkey (2000) and Argentina (2001).[322] These crises have, nevertheless, involved a number of different causes and elements.[323]

While the earlier crises tended to be syndicated loan based, later events involved bond based debt. While historically there had been a tendency for countries to always service their bond obligations while attempting to re-negotiate their loan facilities, this practice has broken down more recently, especially with the Argentinean default and subsequent restructuring.

The roles of the IMF and World Bank have also changed over time. Any restructurings have become conditional on appropriate IMF programme agreement and support. Conditionality has become more rather than less important, with the IMF often lending increasingly large amounts in excess of its own resources. Some commentators also consider that the IMF has become increasingly political in its relations with particular borrower countries and, in particular, in Russia.[324]

Hold out creditors and 'vulture funds' that buy up distressed debt for profit purposes have become an increasing complication. In particular problems have, for example, arisen with the involvement of Elliott Associates in the Peru restructuring and Kenneth Dart action in connection with Argentinean debt.[325] This confirms the difficulty of attempting to agree comprehensive and fair and proportionate restructurings with aggressive holdout creditors.

A number of reforms have been proposed to attempt to assist restructuring at the international level. These are included, altering the rule and function of the IMF, in particular, following the Meltzer Commission report in 1998.[326] The Council on Foreign Relations Report (CFR) recommends that international bonds include collective action clauses (CACs) to facilitate rescheduling and reduce moral hazard. The IMF has also revised its earlier

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320 Lowenfeld (n) 627. Toronto had generally provided for 25 year maturities and 20 years under Trinidad.

321 IMF, *Debt relief under the heavily indebted poor countries initiative, a fact sheet* (March 2002). For comment, [Scott para 19.228 - 230].

322 Chapter 2.

323 Scott para 19.231

324 Lowenfeld (n) 615 - 616.

325 Scott and Wellons (n 13) 1300 - 1301 and Scott (n) para 19.163.

326 The report was issued by the International Financial Institutions Advisory Commission, set up by the US Congress in November 1998 under the chairmanship of Allan Meltzer. The Commission recommended, in particular, that the IMF be restructured to carry out three principal functions: (a) Collect financial and economic data; (b) Provide advice without conditions relating to economic policy; and (c) Act as a quasi-lender of last resort to sovereign emerging market countries through the provision of short-term liquidity assistance without allowing any abuse of liquidity assistance or undermining their development process. [Scott para 19.171].

Supplemental Reserve Facility (SRF) and the Contingency Credit Line (CCL) and reversed its earlier policy of not ‘lending into arrears’ where funds were provided after a sovereign borrower was in default. Other means of forcing emerging market countries to accept Collective Action Clauses (CACs) have been discussed while more fundamental mandatory Sovereign Debt Restructuring Mechanisms (SDRMs) have since been suspended.[327]

A number of difficulties accordingly remain to be resolved in terms of organised restructuring in connection with specific classes of debt including, in particular, loan facilities and bond issuances. Some progress may have been made in identifying possible options, although little progress achieved in agreeing any final operable solutions. Many also continue to criticise the levels of support and bail-out provided by the IMF which increases moral hazard and undermines market mechanisms. Achieving an appropriate balance between market stability and inappropriate support is nevertheless difficult to achieve or agree. The activities of isolated hold-out creditors and aggressive vulture funds pursuing individual enforcement actions in different countries. It remains to be seen how all of this will be resolved over time.

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327 Scott paras 19.205 – 19.227.