Bad deal drafting in good times is courting trouble

As the finance market booms again, quality of documentation can suffer in the rush to close deals. But recent cases highlight the danger of this, say Georgina Squire, head of dispute resolution and James Walton, commercial real estate finance partner at Rosling King

Europe's commercial real estate finance market shows no signs of slowing. The volume of loan originations continues to rise and private equity investors and financial institutions are also continuing to buy and sell their stakes in new and existing debt and debt instruments.

But while there is undoubtedly greater value in commercial real estate across Europe than there was five years ago, all too often problems still arise between parties involved in financing structures.

Given the ever-growing complexities of financing structures, and the increasingly new concepts which the finance documents seek to regulate, it is perhaps no surprise that more and more disputes are arising. Sometimes, disputes are resolved quickly and quietly, but occasionally they hit the headlines when they are left to the courts to resolve.

CMBS has been a particularly fertile ground for litigation in recent years, in particular the role the special servicer plays within CMBS structures. This summer, for the second time in just over a year, the High Court in London considered the interpretation of special servicer replacement provisions.

The case of Deutsche Trustee Company v Cheyne Capital followed hot on the heels of the 2014 case of US Bank v Titan Europe 2007-1. Both cases arose as a result of the attempted replacement of the special servicer and the decision of Fitch not to issue a rating agency confirmation (RAC) as to whether the appointment of a replacement special servicer would result in a downgrade or withdrawal of a rating.

Walton: more and more disputes are arising

Squire: poor documentation keeps courts busy

The wording of the servicing agreement differed in each of the two cases and ultimately the decision of the court swung on the wording, with Cheyne failing to replace the special servicer in the most recent decision.

Both cases are indicative of the problems that arise as a result of documentation that fails to adequately cater for what is likely to happen in practice. Interestingly, the Commercial Real Estate Finance Council Europe, in its CMBS 2.0 principles, has now recommended the introduction of a clause covering the possibility of a rating agency declining to provide a RAC upon a proposed special servicer replacement.

Aside from cases concerning the replacement of special servicers, CMBS continues to hit the headlines in the UK litigation arena in the context of professional negligence. The claim for around £172m being pursued by Gemini (Eclipse 2006-3) against both CBRE and the former King Sturge is due to be considered by the court in 2016, and Titan Europe 2006-3's successful €32m judgment against Colliers is due to be considered by the Court of Appeal this autumn.

INADEQUATE DOCUMENTATION

However, CMBS is not alone when it comes to recent disputes concerning the interpretation of commercial real estate finance transaction documents. Edgeworth Capital v Ramblas is a case that concerned breach of an upside fee agreement (UFA), one of a number of finance agreements entered into between Ramblas and RBS, which sold their interests to Edgeworth.

The UFAs were for a sizeable sum (€105m) and were challenged by Ramblas both in terms of the situations under which they were payable, and whether they

constituted penalties rather than a genuine pre-estimate of loss (and so should not be paid at all).

Ramblas lost on both counts. This case serves as a salutary reminder that one can never be too careful when drafting documents – the devil is always in the detail. Often, with a desire to see a deal done, and everyone working to very tight deadlines, provisions can be glossed over or accepted without enough thought as to the consequences if the deal goes wrong.

Another recent decision which demonstrates parties arguing after the event about the interpretation of finance documents is the Supreme Court decision in Tael One v Morgan Stanley. It has clarified how the Loan Market Association (LMA) secondary terms and conditions for par trading are to be interpreted.

The issue here was whether a payment premium could be claimed on the transfer of a debt. The claimant was one of a number of lenders under a syndicated loan agreement. During the loan's term the claimant assigned its rights to Morgan Stanley under a contract incorporating LMA terms.

The loan was subsequently repaid, together with a payment premium. The lender claimed the premium back from Morgan Stanley on the basis that at least part of it related to a period when the claimant owned the loan.

The Court was required to consider Condition 11.9 (a) of the LMA terms, which stated: "unless these conditions otherwise provide... (a) any interest or fees (other than PIK interest) which are payable under the credit agreement in respect of the purchased assets and which are expressed to accrue by reference to the lapse of time shall, to the extent they accrue in respect of the period before (and not including) the settlement date, be for the account of the seller and, to the extent they accrue in respect of the period after (and including) the settlement date, be for the account of the buyer..."

The Supreme Court, in upholding the Court of Appeal decision, distinguished between the method of calculating the payment premium and the accrual of the right to the premium. Accrual means the coming into being of the right, something which did not occur until the point of the sale. As the right had not accrued at the time of the sale by Tael One, the seller was not entitled to any part of it.

A QUESTION OF INTERPRETATION

Finally, the case of Rosserlane Consultants v Credit Suisse is an illustration of how loss of chance claims against lenders who choose to step in and sell off their security in the event of a breach of a loan agreement are not straightforward.

The claimant was the owner of CEG, which held a 51% stake in Shirvan Oil Company. Shirvan operated an oilfield under a joint-venture agreement with SOCAR, the state oil company of Azerbaijan. At the end of 2006, CEG was being pressured by its lenders to repay capital sums. Its only asset was its interest in the oilfield.

The claimant borrowed a large amount from Credit Suisse then defaulted, allowing Credit Suisse to enforce its security and sell CEG, which it did in February 2008, without CEG's explicit consent.

The claimant began proceedings against the bank, alleging that there was an implied term under the loan agreement that Credit Suisse, when exercising its right to sell the security, would take reasonable care to sell at the best price. The claimant alleged that this had caused it to lose the chance of selling to a potential bidder that was prepared to pay up to €400m.

The court held that no such term could be implied into the contract, and that the claim failed in any event because, although there was a chance that the potential bidder would have been prepared to buy the security for the alleged price, the evidence showed that the potential bidder would have required access to the site before making a bid.

The claimant failed to prove, on the balance of probabilities, that such access would have been granted. All it could say is that it would have been inconceivable for the potential bidder not to have been granted access.

The evidence suggested that there was no chance that access would have been granted and the presumption could not undermine the evidence that was actually provided to the court. The case demonstrates both the difficulty of proving loss of chance, and the limitations of the principle.

In conclusion, while Europe's CRE outlook is unquestionably more rosy than it was just a short time ago, the increasing complexities of financial structures, and the problems that continue to arise as a result of inadequate documentation, will keep the courts busy for the foreseeable future. ■

RECENT CASES INVOLVING REAL ESTATE FINANCE

Case	Point(s) in dispute	Deal/assets	Date
Deutsche Trustee Co v Cheyne Capital	Special servicer replacement provisions	DECO 15 - Pan Europe 6	Decision, Aug 2015
Edgeworth Capital v Ramblas	Breach of upside fee agreement	Santander's Madrid HQ	Decision, Jan 2015
Gemini (Eclipse 2006-3) v CBRE & King Sturge	Professional negligence	Valuation of UK 'Gemini' portfolio	To court, 2016
Rosserlane Consultants v Credit Suisse	Loss of chance in sale of security(s)	Stake in oil company	Decision, Feb 2015
Tael One v Morgan Stanley	Claiming payment premium on debt transfer	Loan to manufacturer Finspace	Decision, Mar 2015
Titan Europe 2006-3 v Colliers	Professional negligence	Valuation of Quelle building, Nuremberg	Appeal, autumn 2015

Source: *Rosling King*