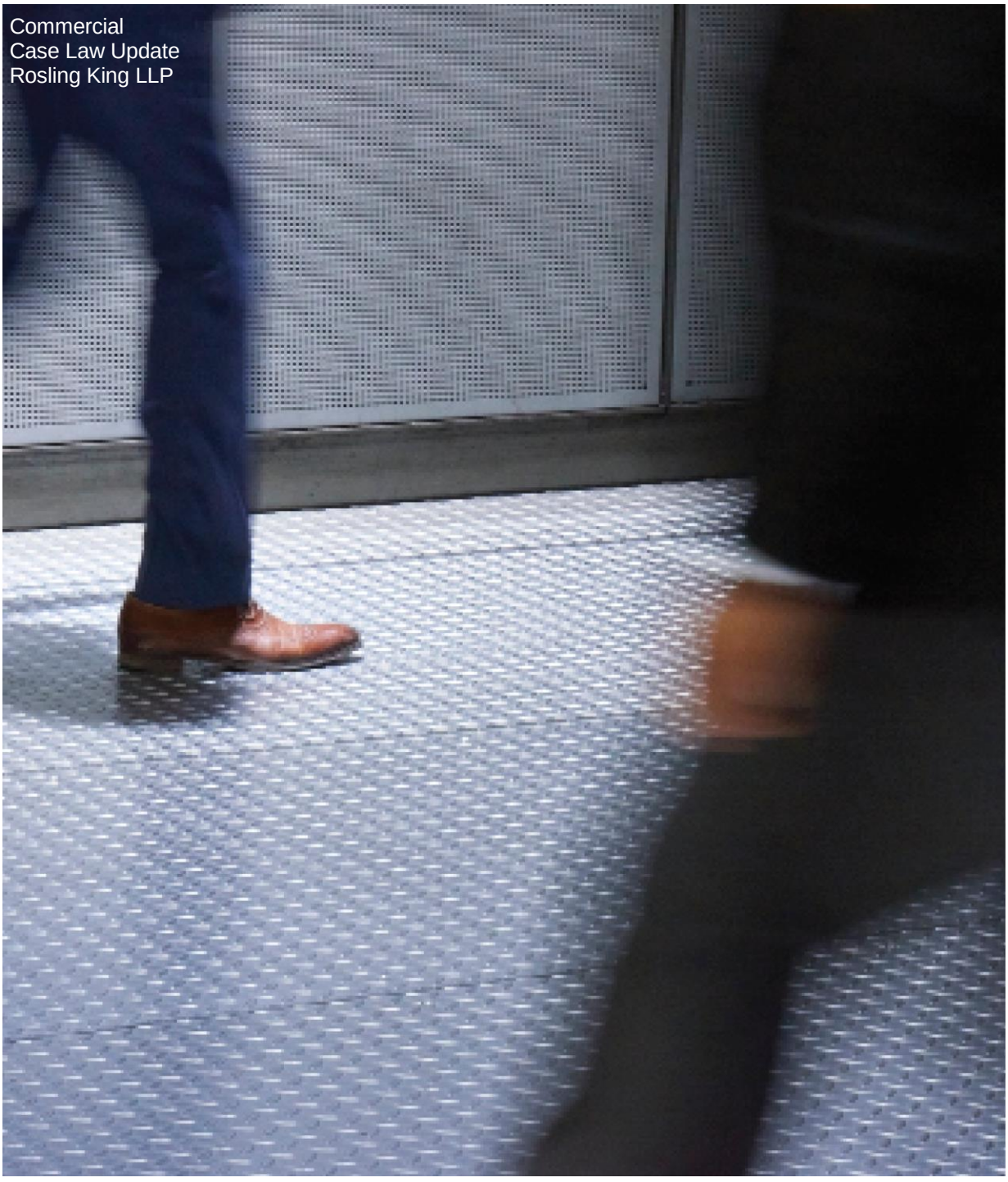
Commercial
Case Law Update
Rosling King LLP

Background

The case concerns a £50 million facility agreement between developer Olympia Securities Commercial Plc ("**OSC**") and Irish Bank Resolution Corporation Limited (formerly Anglo Irish Bank Corporation Limited) ("**IBRC**") (the "**Loan**"), and its associated hedging arrangements (the "**Swap**"). Both the Loan and the payments under Swap were secured under a debenture (the "**Debenture**"). Eventually the debt was sold by IBRC to a special purpose vehicle called LSREF III Wight Limited ("**LSREF**") in the course of IBRC's liquidation.

Subsequently, IBRC's rights under the Loan were assigned to WDW 3 Investments Limited ("**WDW**") (as LSREF's nominee). The Debenture was also assigned by IBRC to WDW who held it on trust for itself and for IBRC. It was further agreed that IBRC would remain the counterparty under the Swap but that WDW would take the benefit and the burden thereunder.

When OSC defaulted on the Loan, this triggered an event of cross-default under the International Swap Dealers Association ("**ISDA**") Master Agreement which governed the Swap. IBRC terminated the Swap and served a demand on OSC for an early termination payment ("**ETP**") of approximately £6 million.

OSC entered administration and after WDW had been repaid the entire principal under the Loan there remained a surplus available for distribution. WDW contended that it was a secured creditor under the Swap and therefore was entitled to the monies held by the administrators for payment of the ETP. The sole shareholder of OSC, Arazim (Gibraltar) Limited ("**Arazim**"), who was also an unsecured creditor of OSC, disputed WDW's entitlement to payment of the ETP. Accordingly, the administrators applied to the Court for a determination as to how the monies should be distributed.

The Issues

In reaching their decision, the High Court had three key issues to consider:

1. Was the assignment of the Loan from IBRC to WDW valid;
2. Was IBRC entitled to terminate the Swap and demand payment by OSC of the ETP; and
3. If the ETP had become payable by OSC, was that payment secured by the Debenture.

The Decision

Whether the assignment of the Loan from IBRC to WDW was valid turned on whether, as a matter of construction, WDW was a 'financial institution'. The permitted assignment clause of the facility agreement stated:

"The Lender may (and the Borrower shall assist as required and irrevocably appoints the Lender to execute any requisite document on its behalf) at any time transfer, assign or novate all or any part of the Lender's rights, benefits or obligations under this agreement to any one or more banks or other financial institutions".

Arazim argued that that the definition of 'financial institutions' could not include WDW as it was a company with £1 capital, which had not been trading at the date of the relevant assignment. However, the High Court disagreed, citing earlier case law that a 'financial institution' can be any entity that is a legally recognised form or being, whose business concerns commercial finance, irrespective of whether or not its business includes the lending of money on the primary or secondary lending market. Applying this definition, WDW fell within the class of financial institutions to whom the Loan could be assigned and therefore the assignment was valid.

Termination of the Swaps

As IBRC had been placed into special liquidation in February 2014, a ‘bankruptcy’ event of default had occurred under the ISDA Master Agreement. The IBRC default was continuing when OSC later defaulted on the Loan. OSC was entitled to terminate the Swap due to IBRC’s default but had chosen not to do so. However, when OSC subsequently defaulted on the Loan, IBRC chose to terminate the Swap.

Pursuant to the ISDA Master Agreement, when there is an event of default, the non-defaulting party was entitled to serve notice on the defaulting party to terminate the Swap. Arazim argued that IBRC had not been entitled to serve a termination notice under the ISDA Master Agreement because it was not a ‘Non-defaulting Party’ based on the continuing ‘bankruptcy’ event of default (i.e. IBRC being in Special Liquidation). However, the Court held that the first “Defaulting Party” is fully entitled to serve an early termination notice in relation to the subsequent default as long as the non-defaulting party in respect of the first default has not itself served a notice in relation to that default.

Consequently, as OSC had not served a notice to terminate the Swap as a consequence of IBRC’s default, IBRC could properly serve a termination notice in respect of the Swap based upon OSC’s payment default under the Loan.

Was the ETP a Secured Liability under the Debenture?

Arazim accepted that OSC had a liability to pay the ETP; however it disagreed that WDW had a right to receive it. Arazim argued that, following the assignment of the Debenture, WDW had become the lender but IBRC had retained the right to receive the ETP. WDW submitted that the wording of the Debenture conferred on it a specifically enforceable right to have OSC’s property appropriated to the payment of the ETP even though WDW had no right to receive it itself.

The High Court agreed with WDW that the liabilities that were secured by Debenture included the liability to pay the ETP, subject to the qualification that the obligation had to be one owing to the 'lender and/or the hedging counterparty …'. The 'lender' as defined in the Debenture was IBRC, and it was not in dispute that the right to receive the ETP had not been assigned to WDW. However the 'parties' section of the Debenture clearly contemplated that a hedging

counterparty might not only be the lender as defined or an affiliate of the lender but could also be someone else entirely. The Debenture also contemplated that the lender might in the future want to assign or novate the benefit and burden of its rights and obligations under it. It had been contemplated by the parties at the time when the facility agreement (and later the Debenture) had been entered into that rights might be transferred to a variety of third parties even though they were all secured by the Debenture. Therefore, the payment by the company of the ETP was secured by the Debenture, notwithstanding the assignment of the Debenture by IBRC to WDW.

Commentary

This is a welcomed decision for lenders and debt purchasers due to the Court's wide construction of the term 'financial institution' which builds on existing case law. This decision indicates that many special purpose vehicles will be classified as a 'financial institution' simply by taking an assignment of a commercial loan. From a borrower's point of view, if they want to limit the assignment of the debt to an express list of banks or affiliates, they should ensure that they negotiate into the finance documents a so-called "white list" of pre-approved assignees.

The decision also reaffirms the English law principle that security creates a specifically enforceable right to insist that the assets subject to a charge are appropriated towards the relevant liability irrespective of whether or not the holder of the security can insist on payment of it.

If you would like to discuss this case, or commercial matters in general, then please do not hesitate to contact Alexander Pelopidas of this firm who would be happy to assist.