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Briefing note

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The limited obligations of agent banks

Agent banks often trouble over the extent of their duties to their syndicate and, in particular, how far they are required to act beyond the express scope of the duties set out in the transaction documentation. In a recent case, the English High Court has provided useful guidance for agent banks, illustrating that the courts will construe agents' responsibilities narrowly in accordance with the transaction documents, rather than implying wider duties. But the court also observed that if an agent acts outside its capacity as such, it can incur stricter extra-contractual liabilities to its syndicate.

Key issues

- An agent bank's obligations are those set out in the agreements
- Additional obligations will not generally be implied into LMA documents
- An agent must act in good faith and not perversely
- But if an agent acts outside its agency role, it could incur contractual or non-contractual liabilities

The description of the bank charged with administering a lending syndicate as an "agent" can excite lawyers. Centuries of case law establish that agents can have an extensive array of obligations to their principals. Why not impose those obligations on a syndicate agent?

In *Torre Asset Funding Limited v The Royal Bank of Scotland plc* [2013] EWHC 2670 (Ch), the judge answered this by highlighting that the obligations of an agent appointed under an agreement are to be found in that agreement - in *Torre*, lending documents based on LMA standard forms. These agreements imposed specific obligations on the agent regarding, in particular, disclosure of information to syndicate members, as well as providing that the agent's role was "solely mechanical and administrative in nature".

Faced with this, the judge declined to imply disclosure obligations going beyond those expressly set out in the agreements. Where parties negotiate complex documentation defining the parties' rights and obligations, it is neither necessary nor appropriate to imply additional terms into those documents.

This is not to say that an agent escapes with no obligations. It must do what the agreements require it to do. If the agent has a discretion (eg as to whether to disclose information it has in fact received, even if information the borrower was not required to give it), it must exercise that discretion in good faith and in a manner that is not arbitrary, capricious, perverse or irrational. This is a significantly lower threshold than an obligation to exercise a discretion in an objectively reasonable manner, but does not offer a completely free hand. The judge emphasised that, in deciding what to do, the agent must have regard to the interests of its syndicate, which might allow for only one course of conduct.

Commercial property

The *Torre* case concerned the highly leveraged financing of a commercial property portfolio. The structure included Super Senior, Senior and Senior Mezzanine layers, which were not involved in the litigation, and also Junior Mezzanine B1 and B2 loans, as well as equity ranking below that. The claimants were participants in these B1 loans. The agent for the B1 lenders was, unusually (and reluctantly), the group within the bank that held the B2 loans as well as being B2 agent.

The success of the commercial property portfolio depended on the ability of the managers to achieve better results than the previous owners. The financial problems of 2007 and on into 2008 made this increasingly difficult, and the structure became impossible following a collapse in the value of the portfolio. On 18 September 2008, administrative receivers were appointed. The eventual recoveries were just over a third of the sums

loaned. The Mezzanine lenders received nothing. The B1 lenders sought to recover their losses from the bank.

The complaint by the B1 lenders was that the agent had failed to pass to them information that would have revealed the full difficulties faced by the borrower. If the lenders had received that information, they would, they argued, have sold their participations at an earlier stage with no or lower losses. The B1 lenders also alleged that, in seeking consent to defer payment of interest on the B2 loan, the bank had misrepresented the facts.

An accidental event of default

The first piece of information that the B1 lenders alleged should have been given to them was that an event of default occurred in July 2007. At that time, the borrower approached the bank with financial projections that, after correction by the bank, indicated that the borrower would be unable to pay the interest due on the B2 loan. Faced with this, the borrower asked for the payment of the B2 interest to be deferred until the end of the facility. As B2 lender, the bank was prepared to agree to this.

The events of default in the Junior Mezzanine Facility Agreement included that the borrower "by reason of actual or anticipated financial difficulties, commences negotiations with one of more of its creditors with a view to rescheduling any of its indebtedness". The judge considered that the borrower's request fell within this event of default. Agreeing with Blair J in *Grupo Hotelero Urvasco SA v Carey Value Added SL* [2013] EWHC 1039 (Comm), he considered that this required the borrower's financial difficulties to be of a substantial nature, but he thought they were. The interest to be deferred might only be a small part of the total loan, but it was a significant part (7-8%) of the entire on-going interest burden. The request for deferment went beyond discussion in the ordinary course of a loan such as that in *Torre.*

An agent only becomes aware of an event of default if it knows both of the facts and also that those facts constitute an event of default.

The occurrence of an event of default was not, on its own, enough to get the B1 lenders home on this point. They had also to establish that the agent was obliged to notify them of the event of default or the circumstances creating the event of default. The judge did not accept this argument.

The Inter-Creditor Deed obliged an agent on one facility to notify the agents for all other facilities when it became aware of an event of default. The B1 lenders argued that the bank as B2 agent was aware of the event of default and was therefore obliged to notify itself as B1 agent. The B1 lenders went on to argue that, as B1 agent, the bank was then impliedly obliged to notify the B1 lenders of the event of default.

The judge rejected this argument. An agent only becomes aware of an event of default if it knows both of the facts and also that those facts constitute an event of default. In this case, the bank did not appreciate that the borrower's request to defer interest constituted an event of default. As a result, the obligation in the Inter-Creditor Deed was not triggered.

The judge also refused to imply a term into the Facility Agreement obliging the agent always to disclose to the lenders the occurrence of an event of default. The Facility Agreement included various disclosure obligations, which rendered it inappropriate for the court to imply other obligations trespassing on the same ground (even assuming that it was ever appropriate to imply obligations of this sort into detailed and technical documentation). The agent had an express discretion to pass information received as such to its lenders. In exercising that discretion, the agent's only obligation is to act in good faith, and not capriciously, arbitrarily, perversely or irrationally. The agent had no absolute obligation to give to the lenders all information it received.

When is an annual budget an Annual Budget?

The B1 lenders' second argument was similarly based on the agent's failure to pass information to them. In October 2007, the agent received from the borrower a business plan and cashflow. According to the B1 lenders, this constituted an Annual Budget, and the agent was obliged to send the borrower's Annual Budgets to the lenders.

The Facility Agreement required the borrower to supply to the agent, with sufficient copies for all the lenders, a copy of its Annual Budget. Though there was no express obligation to pass on the copies to lenders, the judge accepted that the agent was obliged to do so; why otherwise require the borrower to supply sufficient copies for all the lenders?

The Annual Budget was defined as a document prepared by the borrower and approved by the agent. However, when the borrower sent the documents to the agent in October

2007, the borrower did not say that they represented its Annual Budget, nor did it seek the agent's approval. The documents did not therefore constitute an Annual Budget for the purposes of the Facility Agreement. Accordingly, there was no obligation on the agent to pass the documents to the lenders.

The judge also rejected the submission that there was an implied obligation on the agent to give to the lenders all financial information it received about the borrower. As indicated above, the judge considered that the agent was obliged to consider whether to pass information to the lenders, but that obligation only required it to act in good faith, and not capriciously, arbitrarily, perversely or irrationally.

Stepping out of the agent's shoes

Deferring interest on the B2 loan required the consent of all lenders. The bank, as B2 lender, sought that consent in an email of December 2007 to the B1 lenders. The email suggested that the reason for deferral was in order to allow the borrower to make capital expenditure to improve the properties rather than because the borrower was unlikely to have the money to pay the B2 interest.

The judge considered that the bank had an obligation in tort to take reasonable care to ensure that its explanation of the reasons for the deferral request was accurate. The judge considered that the bank had failed to meet this obligation. The bank was, therefore, prima facie liable to the B1 lenders for losses suffered as a result of the breach of duty provided that the losses fell within the scope of the bank's duty.

In this case, the losses claimed by the B1 lenders did not fall within the scope of the bank's duty of care. The bank's email had been sent for the purpose of enabling the lenders to decide whether or not to agree to the deferral of B2 interest. The B1 lenders' claim had nothing to do with that decision (which was, in any event, rejected because another lender refused its consent). The B1 lenders' claim was that it would have sold its participation had it been given correct information. In sending an email soliciting consent to defer interest, the bank did not assume responsibility for the B1 lenders' decision to hold on to or to dispose of their participations.

(The judge would have reached a similar conclusion if he had decided that the B1 lenders' earlier claims would otherwise have succeeded. He considered that the provision of information by an agent to lenders was for the purpose of enabling the lenders to decide how to exercise their rights under the Facility Agreement. Any duty did not extend to investment decisions by the lenders.)

The bank had an obligation to take reasonable care to ensure that its explanation of the reasons for the interest deferral request was accurate.

If the bank had been liable, it would not have been able to rely on the exclusions of liability in favour of the agent. These only applied if the bank was acting in its capacity as agent. In soliciting the consent of the other lenders, the bank was acting as B2 lender, not B1 agent. The judge did, however, accept that if the exclusions had been relevant, they would have applied to the agent's failure to disclose information even though they only excluded liabilities for "actions taken by it". The judge considered that a failure to act was an action for these purposes.

Other reasons for the bank to be cheerful

The judge also decided, even if the bank had otherwise been liable, whether as B1 agent or B2 lender, the B1 lenders had failed to prove that they had in fact suffered any loss caused by the bank's conduct. The judge concluded that, if the B1 lenders had been given the relevant information in July and October 2007, they would not have sold their participations. He also concluded that the B1 lenders would not have sold their participations even if they had been given in December 2007 a correct explanation of the reasons for requesting deferral of the B2 interest. He further considered that, in early 2008, the market was such that the B1 lenders would not in fact have been able to sell their participations.

Conclusion

Torre is unusual in that the group within the bank that was responsible for the B2 loan was also the agent on the B1 loan, despite having no experience of agency work and being reluctant to take on the role. It therefore received information from the borrower in a dual capacity, which triggered the B1 lenders' claim (no attempt was made to argue that the information in the heads of those in the relevant group could be split between agency information and lender information). An agency operation would more normally be distinct from those responsible for the lending, avoiding this problem.

Nevertheless, Sales J's decision is to be welcomed. He recognised that LMA documents really do mean what they say. The agent's obligations are stated to be "solely mechanical and

administrative in nature", and that is how he interpreted them. An agent must comply with its express obligations, but no more onerous requirements will be implied.

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