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Briefing note March 2015

Case: Tael One – construction of LMA terms and conditions for secondary debt trading – take three

That a dispute over construction of the terms of a secondary debt trade on standard Loan Market Association (LMA) terms ended up in the Supreme Court is itself noteworthy. Even more so is that during the case's evolution three different courts (the trial judge, the Court of Appeal and the Supreme Court themselves) came to three different conclusions as to the meaning of an interest allocation clause in the standard LMA terms. The case highlights the limitations of using standard form documents in non-standard contexts and will be instructive reading not only for those operating in the secondary loan market but also for anyone involved with the drafting, and construction, of financial contracts generally.

Summary

The dizzying ascent to the Supreme Court's rarefied heights of a dispute concerning a secondary loan trade on standard LMA terms seems a little surprising. However, it reinforces the sometimes harsh reality that even the most standard of standard forms can only do so much and that sometimes tailoring might be needed.

Tael was a Lender under a syndicated loan and sold part of that loan to Morgan Stanley on the then current LMA standard terms and conditions for par trading ("**LMA Terms**"). However, the yield provisions in the loan were unusual: the borrower paid normal floating rate interest but also a "*prepayment premium*". This was a one-off amount payable on repayment of the loan and had the effect of giving the Lenders a specified all-in rate of return on the loan assessed by reference to the period for which the loan was drawn. Much later the borrower repaid the loan in full and the then Lenders received the prepayment premium. Should Morgan Stanley pay Tael a portion of that prepayment premium?

As you would expect, the LMA Terms had sophisticated provisions relating to the allocation of interest and fees between Buyer and Seller. These focused primarily on interest and fees under the loan which accrued "***up to** the [date that the Loan was transferred to Morgan Stanley]".* Detailed drafting addressed a variety of specific scenarios and matters such as the parties' entitlements to these amounts, corresponding payment obligations and eventualities like borrower payment default and any subsequent clawback by the facility agent. None of that helped Tael because it was agreed that the prepayment premium had not "*accrued*" **at** completion of the trade: it came into existence only much later when the borrower repaid the Loan.

Instead Tael relied on a shorter and more general sweeper provision at the end of the interest and fee allocation provisions. This specified that "[*other than as provided elsewhere] any interest or fees [under the relevant loan] which are expressed to accrue by reference to the lapse of time, shall, to the extent that they accrue **in respect of the** period before (and not*

including) [completion of the debt trade] be for the account of the Seller". Tael argued (i) that the prepayment premium was a fee (it couldn't claim that it was interest for other reasons) that had "*accrued by reference to the lapse of time...in respect of the period before [completion of the trade*] and (ii) that the phrase "*shall be for the account of the Seller*" required Morgan Stanley to pay Tael an amount equal to the prepayment premium attributable to the period for which Tael owned the loan.

The trial judge agreed with Tael's arguments (see *TAEL One Partners Ltd v Morgan Stanley & Co International Plc [2012] EWHC 1858 (Comm) (09 July 2012)*). This was reversed on appeal: the Court of Appeal considering that whilst the prepayment premium had indeed "*accrued by reference to the lapse of time*" and had accrued "*in respect of the period before [completion of the debt trade]"* the general sweeper provision was not intended to constitute an entitlement to any amounts not provided for in the more specific provisions. (see *Tael One Partners Ltd v Morgan Stanley & Co International Plc [2013] EWCA Civ 473 (01 May 2013)*).

Tael went to the Supreme Court where things went from bad to worse for them, with the court finding against it on both parts of its argument.

(1) The prepayment premium had not "*accrued by reference to the lapse of time*". "*Accrue*" meant the coming into being of a right and the prepayment premium did so not by reference to the lapse of time but on a defined event – repayment of the loan. It was irrelevant that time entered into the calculation of the amount of the prepayment premium. Had the LMA Terms talked about a fee ***calculated*** by reference to the lapse of time the analysis might have been different. But they didn't. This interpretation was also consistent with the commercial context of a loan trading market where loans would be sold and on-sold and it was unlikely that the trade was intended to create continuing payment rights and obligations existing over a substantial period of time.

(2) This was enough to dispense with the matter, but the Supreme Court went on to consider whether the general sweeper provision in the LMA Terms provided a payment obligation additional to those in the more specific provisions. The Supreme Court agreed with the Court of Appeal that it did not. The other provisions in the LMA Terms which addressed interest and fees imposed obligations to "***pay***" any relevant amounts. The absence of a similar express payment obligation from the general sweeper provision, together with the absence of any provisions addressing eventualities such as borrower payment default indicated that there was no intention to confer an additional right to payment, notwithstanding that amounts were expressed to be "*for the account of*" a specified party.

Tael One Partners Limited (Appellant) v Morgan Stanley & Co International PLC (Respondent) [2015] UKSC 12

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