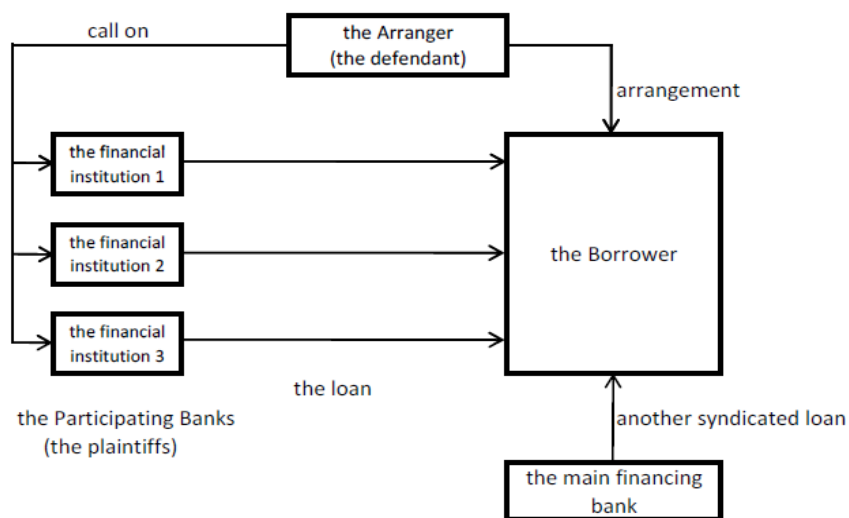


First High Court case in Japan - Arranger's liability in syndicated loan transactions

Introduction

On 14 April 2011, the Nagoya High Court issued a judgment ordering the arranger in a syndicated loan transaction to pay to the participating financial institutions a total of approximately JPY300 million in damages resulting from a breach of its obligation to provide information (Judgment). The Judgment came as the first High Court judgment in Japan to rule on the arranger's breach of this obligation. It has been attracting much attention and has been the centre of much discussion in the market. One of the reasons is that the Nagoya High Court overturned and affirmed the arranger's liability after such liability was previously denied by the Nagoya District Court in the first instance. This client briefing briefly explains the Judgment and discusses future actions to be taken in light of the Judgment.

Outline of the Judgment



This case revolves around the syndicated loan (Loan) arranged by the defendant bank (Arranger) and provided by three financial institutions which are the plaintiffs (Participating Banks) to a local company (Borrower). One month after the execution of the loan agreement, another syndicated loan which had been arranged by the Borrower's main financing bank was accelerated and, as a result, civil rehabilitation proceedings were commenced by the Borrower. Consequently, the Borrower defaulted on the Loan and the Participating Banks suffered considerable losses that led the Participating Banks to file this suit against the Arranger for damages.

Main Topics

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Arranger's Obligation to Provide Information and its Scope

Relationship between Obligation to Provide Information and Confidentiality Obligation

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The Nagoya High Court determined that (i) the Arranger was aware that the main financing bank had suspicion on fraudulent accounting by the Borrower, and (ii) the Arranger arranged the Loan without disclosing such material information to the Participating Banks. It was then concluded that the Arranger's failure to disclose such material information constituted a breach of its obligation as arranger to provide information and that the Arranger be liable for damages in tort in favour of the Participating Banks.

Main Issues

In the Judgment, among others, there are two main issues:

- An arranger's obligation to provide information to the participating financial institutions and its scope.
- The relationship between the obligation to provide information to the participating financial institutions and confidentiality obligation owed to the borrower.

Arranger's Obligation to Provide Information and its Scope

The Nagoya High Court ruled that an arranger in a syndicated loan transaction is obliged to provide "material information" (Material Information) to participating financial institutions under the principle of good faith if the arranger has obtained such Material Information through its past financial transactions with the borrower and it would be difficult for the participating financial institutions to obtain such Material Information. Material Information is information which is material in deciding whether or not to participate in a syndicated loan and is known by the arranger. The Nagoya High Court also ruled that if an arranger fails to provide the Material Information, intentionally or grossly negligently, to the participating financial institutions, such arranger is liable for breach of this obligation.

The Judgment provides that even if the Material Information is suspicion on the part of the arranger rather than fact, it could still be subject to the disclosure obligation by the arranger. Depending on the extent to which the Judgment will be applied, the scope of the arranger's obligation to provide information could be interpreted widely.

Relationship between Obligation to Provide Information and Confidentiality Obligation

The Nagoya High Court ruled that an arranger in a syndicated loan transaction is obliged to provide the Material Information to the participating financial institutions despite any confidential obligations owed to the borrower. The Nagoya High Court reasoned that the borrower has implicitly agreed to the disclosure of such Material Information by the arranger or that such disclosure is permitted as a matter of business practice. However, this reasoning has been criticised by some market players as they do not believe that the borrower has implicitly agreed to such disclosure nor is such disclosure permitted as a matter of business practice.

The Nagoya High Court further insisted that there is no substantial difference between the Judgment and the standards set out under the code of conduct and the practical guidelines of The Japan Syndication and Loan-trading Association (JSLA) (JSLA Regulations)¹. However, the JSLA Regulations provide that if an arranger obtains the Material Information at the stage of forming the syndicate, the arranger should request to the borrower to disclose such information, and if the borrower rejects such request, the arranger should terminate the formation of the syndicate. On the other hand, the Judgment requires the arranger to directly provide the Material Information to the participating financial institutions. Some market players argue that there is a substantial difference between the standard set out under the JSLA Regulations and one in the Judgment.

¹ "Code of Conduct in Loan Syndication Transactions" published by JSLA in December 2003 and "Practical Guidelines for Trading Participants in relation to Loan Syndication Transactions" published in December 2007.

Looking Forward

This case has been appealed to the Supreme Court. The judgment to be made by the Supreme Court may have great impact on the market. Whilst the Judgment is criticised because the assumptions made therein deviate from market practice, it is also pointed out that there were, in fact, problems in the Arranger's arrangement work. It will be interesting to see how the Supreme Court ultimately decides. In the meantime, it is recommendable to re-examine the normal practices of an arranger in a syndicated loan transaction while viewing this case as a lesson. On the other hand, a careful approach should be taken as to whether an arranger can indeed rely on the borrower's implicit agreement to the disclosure of Material Information to the participating financial institutions because the Supreme Court may have a different view on this issue.

Where Japanese legal concepts have been expressed in the English language, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.

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