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EVENTS OF DEFAULT: RIGHTS, OBLIGATIONS AND RISKS FOR LENDERS

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A note examining the considerations and options for a lender if an event of default occurs under a facility agreement. The note also considers the extent to which there are limits on a lender's ability to exercise its discretion to take a particular course of action and the potential for a lender to incur liabilities in exercising its rights if an event of default occurs.

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SCOPE OF THIS NOTE

Typically, a lender does not have an inherent right to demand early repayment of a committed facility (that is, one that is not repayable on demand). Therefore, the facility agreement needs to specify events, conditions or circumstances (events of default) that, if they were to occur, would give the lender that right.

Events of default are purely contractual and need not be confined to breaches of the agreement. To that extent, the term is something of a misnomer and events of default are referred to in some agreements as acceleration events or events of repayment.

This note examines considerations and options for lenders where an event of default occurs, the extent to which there are limits to their discretion to take a particular course of action and the potential for lenders to incur liabilities in exercising rights if an event of default occurs.

For more information on the events or circumstances that typically constitute events of default in a facility agreement and the reasons behind these events of default provisions, see *Practice note, Finance documents: events of default*.

CONSEQUENCES OF AN EVENT OF DEFAULT

A lender will typically have several key rights once an event of default has occurred. These will usually include the right to:

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- Cancel any outstanding commitments so that no further utilisations may be made. Rollover of advances made under a revolving credit facility may also be blocked. The right to cancel will only be relevant if the facilities have not been fully drawn.

- Accelerate and demand immediate repayment of all amounts accrued and outstanding (see *Standard document, Demand for loan repayment*).

The provisions of a facility agreement sometimes also enable the lender to take other action if an event of default occurs, such as the ability to place the facilities on demand or to charge interest at a higher rate.

It is very rare for a facility agreement to specify automatic termination if an event of default occurs - it is a discretion of the lender.

For more information on the consequences of an event of default, see *Practice note, Finance documents: events of default: What are the consequences of an event of default?.*

ENSURING AN EVENT OF DEFAULT HAS OCCURRED UNDER THE TERMS OF THE AGREEMENT

Given the consequences of an unjustified declaration by a lender of an event of default (see *Effect of wrongful call*), a lender will want to ensure that an event of default has occurred, although a borrower may be able to argue that the lender is estopped from enforcing its rights or avail itself of a statutory or regulatory protection.

Ambiguous events of default

In practice, lenders rarely rely solely on events of default where there is any risk of the borrower successfully arguing that no event of default had in fact occurred.

By way of example, a lender may not be confident of relying on a material adverse change (MAC) event of default. This event of default is designed to capture unpredictable and unforeseen events or circumstances that would otherwise be difficult to cater for specifically in documentation so, by its very nature, usually requires a judgment to be made. Similarly, lenders will be wary of declaring an event of default based on any other event of default that contains a materiality threshold that could be open to interpretation.

There are very few cases that have come before the courts concerning the much-negotiated concept of "material adverse change". Those that have demonstrate the risk for the lender of the borrower claiming that no event of default has occurred. For more information on material adverse change clauses, see *Practice note, Material adverse change (MAC) clauses in finance documents*.

In *BNP Paribas v Yukos Oil [2005] EWHC 1321 (Ch)*, it was held in a preliminary hearing that there were no reasonable grounds for challenging an event of default for material adverse effect following the freezing of $3 billion of Yukos's assets.

In *Cukurova Finance International Limited and Cukurova Holding AS v Alfa Telecom Turkey Ltd [2013] UKPC 2*, the Privy Council held that the conditions of a MAC event of default clause had been met (see *Legal update, Material adverse change event established and appropriation not invalid but relief from forfeiture available (Privy Council)*). In that case, Cukurova Finance International Limited and its affiliate (together, Cukurova) granted Alfa Telecom Turkey Ltd (Alfa) share charges in support of funds advanced by Alfa. The English law share charges contained identical MAC event of default clauses. As drafted, each clause was satisfied if Alfa (as lender) honestly and rationally believed that an event had a material adverse effect. The Privy Council held that Alfa had provided evidence that it had formed the requisite opinion. The Privy Council held that the appropriation by Alfa of the shares which were the subject of the share charges was not invalid (that is, the MAC event of default clause was effective and the ensuing appropriation of the charged shares was legitimate). That notwithstanding, the Privy Council granted Cukurova relief from forfeiture of the shares in the circumstances.

The case of *Grupo Hotelero Urvasco SA v Carey Value Added SL and another [2013] EWHC 1039 (Comm)* also considered MAC clauses (see *Legal update, MAC representation and rescheduling indebtedness event of default considered (High Court)*). In this case, the facility agreements included typical MAC clauses. One was a representation that there had been no material adverse change in the financial condition of the obligors. The High Court held that the "financial condition" of a company was to be assessed primarily by reference to a company's financial information (although other compelling information could be considered). It was further held that a change of financial condition would only be material if it significantly affected a company's ability to perform its obligations under the facility agreement (essentially its ability to repay). Further, in order to constitute a materially adverse change, there had to be a change from the circumstances known by the lender at the time the facility agreement was entered into and the change must not be temporary. Based on this analysis, no material adverse change was found to have occurred in relation to the relevant obligors.

Another clause considered in *Grupo Hotelero* was an event of default caused by an obligor beginning negotiations with another creditor to reschedule its indebtedness due to actual or anticipated financial difficulties. Such an event of default provision is not uncommon. The High Court had to decide whether the borrower's negotiations with certain creditors for the "rescheduling" of group indebtedness were by reason of actual or anticipated financial difficulties (rather than as part of its day to day discussions with creditors). On this ground, the High Court held that the negotiations went beyond the ordinary course of business and, therefore, that an event of default had occurred.

As the above cases demonstrate, calling an event of default can be complex and problematic for lenders if the default is less straightforward than, for example, a failure to make a scheduled payment when due.

Terms implied into a facility agreement by a court and the concept of good faith

A court will scrutinise the wording of the facility agreement to determine whether or not an event of default has occurred, but it will be reluctant to imply terms into the agreement. It is not necessary to import a requirement of reasonableness into a contract when assessing, for example, the exercise of a right based on a lender's opinion (see, for example, *Re SMP Trustees [2012] EWHC 772 (Ch); Legal update, Bond trustee can agree wholesale changes to bond payment provisions, as not materially prejudicial (High Court)*).

However, while it is well established that there is no general doctrine of good faith in English contract law there is a well-recognised duty of rationality under which a party must exercise a contractual discretion in good faith and not arbitrarily or capriciously. This is often referred to as the "Braganza duty".

The English courts have increasingly been willing to imply a duty of rationality into contracts, including those relating to financial contracts. This duty of rationality is implied, in the absence of clear language stating otherwise, such that the party with the right to exercise a contractual discretion must exercise it in good faith and not arbitrarily or capriciously and using proper decision-making processes (*Telefónica O2 UK Ltd [2014] v British Telecommunications plc [2014] UKSC 42* and *Braganza v BP Shipping Ltd [2015] UKSC 17*). Acting rationally requires good faith and a logical connection between the evidence and the apparent reasons for the decision made (*Hayes v Willoughby [2013] UKSC 17*). It can be distinguished, however, from a general duty to act reasonably, which is an objective standard (see *Practice note, Contracts: good faith: The duty of rationality (the Braganza duty)*).

However, the facts of each case will be essential to determining whether a *Braganza* duty may be implied. In *UBS AG v Rose Capital Ventures Ltd [2018] EWHC 3137 (Ch)*, the High Court held that a lender was not subject to an implied Braganza duty to act rationally when it exercised its absolute discretion to demand repayment of a loan in full (see *Legal update, Lender not subject to "Braganza" duty to act rationally when exercising contractual right to demand full repayment of loan (High Court)*). That case highlighted the differences in bargaining power between the parties in the *Braganza* case (an employment law matter) and the present case (a high value loan with an associated mortgage). Another relevant factor for the court in making its decision was that the lender owed a different, more limited, duty of good faith to the borrower and it would have been inappropriate to also apply the rationality duty.

See also *Practice note, Contracts: good faith*.

In the US, defaulting borrowers have claimed damages for a lender's alleged failure to meet an implied obligation of good faith in their dealings. Traditionally, however, English courts have consistently demonstrated the approach that the terms of the facility agreement itself are the paramount consideration and courts will be reluctant to imply additional duties into a contract (*Williams & Glyn's Bank Ltd v Barnes 1981 Com LR 205*).

Estoppel

Even where a lender has acted in accordance with the terms of the agreement (and there are no implied terms to the contrary), a borrower may be able to raise a defence that the lender should be estopped from enforcing its rights. If there has been a clear and unequivocal representation by the lender, on which the borrower has relied to its detriment, then the doctrine of promissory estoppel may be available to prevent the lender enforcing its rights.

In *Paragon Mortgages Ltd v McEwan-Peters [2011] EWHC 2491 (Comm)*, a borrower attempted (unsuccessfully, on the facts) to rely on this doctrine on the grounds that a lender had promised not to enforce its loan until rent was at least three months in arrears.

In *Royal Bank of Scotland plc v Luwum [2008] EWCA Civ 648*, the bank was estopped from seeking a possession order after it was found that an employee had promised the borrower a three-month grace period before that occurred and the borrower had altered his position in reliance by borrowing from friends and family in an attempt to reduce the overdraft.

In *ING Bank NV v Ros Roca SA [2011] EWCA Civ 353*, a bank was prevented from enforcing its engagement letter on its terms because of an estoppel by convention (a shared assumption on which it would be unjust to allow one party to go back) to the effect that an estimate of its fees had led the counterparty to believe that the parties were assessing the fees on a different basis than that which was set out in the contract (see *Legal update, Estoppel forces bank to charge fees in line with their estimate rather than with the contract (Court of Appeal)*).

These cases, and especially the *ING Bank* case, can have dangerous implications for lenders, bearing in mind that in most lending arrangements there is likely to be an ongoing dialogue between employees of the lender and the borrower before an event of default is called. The borrower may derive rights from representations, promises or shared assumptions which vary from the terms of the facility agreement.

Statutory and regulatory protection

Certain statutes or codes of practice may prevent a lender relying on an event of default set out in a facility agreement:

- The *Unfair Contract Terms Act 1977* (UCTA) applies between contracting parties where one of them deals on the other's written standard terms of business, subject to exemptions (*section 3*, *UCTA*). It may, therefore, often apply to loan facilities as many business loans, particularly to small businesses, will be on the bank's standard terms. Certain contractual provisions to which UCTA applies when dealing on one party's standard terms (broadly, those that limit liability, directly or indirectly or have a similar effect) are subject to a reasonableness test in *section 11(1)* of UCTA. This requires that each contract term is "... a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made". There is guidance in *Schedule 2* to UCTA about the factors that can be taken into account in assessing reasonableness (see *Practice note, Limiting liability: statutory and common law controls on limitation clauses*).

- Consumer (or "retail") borrowers have protection in relation to unfair terms in both standard form and individually negotiated contracts under the *Consumer Rights Act 2015* (CRA). The CRA provides that an unfair term of a consumer contract is not binding on the consumer (*section 62(1), CRA*). A term is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer (*section 62(4), CRA*). Whether a term is fair under the CRA is determined by the nature of the subject matter of the contract, the circumstances at the time the term was agreed and all other terms of the contract or of any other contract on which it depends (*section 62(5), CRA*) (see *Practice notes, Unfair terms in financial services contracts under CRA 2015* and *Consumer Rights Act 2015: overview: Unfair terms*).

- The *Consumer Credit Act 1974* (CCA) will also apply to facility agreements with an individual and to a facility of any value (although certain exemptions do apply, including regulated agreements secured by a mortgage over land and agreements that are, or form part of, a regulated home purchase plan). Under *section140A* of the CCA courts have the power to intervene and amend a credit relationship if the relationship between the creditor and the debtor is considered to be unfair because of any of the terms of the relationship, including the provisions for enforcement of the creditor's rights. Unlike UCTA and the CRA, the CCA does not offer any guidance as to what is meant by "unfair", potentially leaving room for a wide interpretation by the courts in relation to any repayment or enforcement terms. See *Practice note, Unfair relationships under the Consumer Credit Act 1974*.

- The *Standards of Lending Practice for Business Customers* (SLP) is a code of conduct for lenders that have subscribed to it. Among other things, subscribers undertake that business customers in financial difficulty, or in the early stages of the collections process, will receive appropriate support and fair treatment, to help them deal with their debt(s) in the most suitable way. In particular:

  - firms should apply an appropriate level of forbearance where, if after having made contact with the customer, it is clear that this would be appropriate for their situation; and

  - if a firm is aware that a customer is, or suspects that it is, in financial difficulty but is able to uphold its borrowing commitments to the firm, the customer should be given the opportunity to take action to turnaround the business.

  The SLP apply to business customers, where at the point of lending the business has:

  - an annual turnover of no more than £6.5 million in its last financial year (exclusive of VAT and other turnover related taxes), and;

  - which does not have a complex ownership structure (for example, businesses with overseas, multiple, or layered ownership structures).

They also apply to a more limited extent to business customers with a consolidated turnover of up to £25 million.

There are similar standards in relation to personal customers and business customers with an annual turnover of no more than £6.5 million in relation to asset finance products, namely hire purchase and leasing products (but excluding trade loans and invoice financing): the *Standards of Lending Practice - Personal Customers* (SLP Personal) and the *Standards of Lending Practice Business Customers - Asset Finance* (SLP Asset Finance).

Complaints made under the SLP, SLP Personal and SLP Asset Finance may be referred to the Financial Ombudsman.

EFFECT OF WRONGFUL CALL

It seems that an unjustified declaration by a lender of an event of default does not, in itself, amount to a breach of contract – it is merely an ineffective act (*Concord Trust v Law Debenture Trust plc [2004] EWCA Civ 1001*). In the *Concord Trust* case, the court was not convinced there would be any tortious liability either.

However, a lender will be in breach of contract where an unjustified declaration of an event of default is used as the basis for a refusal to honour an obligation to advance further sums, and will be liable for losses resulting from that breach (*Mulvenna v Royal Bank of Scotland [2003] EWHC Civ 1112*).

Similarly, wrongful enforcement of security may render a lender or a security agent liable in trespass or conversion and a borrower may be awarded substantial damages for loss arising out of the forced sale of its assets and loss of future profits from the business.

Even taking into account the *Concord Trust* decision referred to above, a lender will undoubtedly be concerned about potential liability if a wrongful declaration of an event of default triggers adverse reputational issues for the borrower or a cross-default under other borrowings (which may be triggered by a "declared" event of default even if the lender was not justified in declaring it).

LENDER'S OPTIONS IF AN EVENT OF DEFAULT OCCURS

Relevant factors a lender will take into account

How a lender reacts once an event of default has occurred will depend upon a combination of the following factors.

Identity and motivation of lender

Lenders range from major financial institutions, in the business of maintaining wide-ranging and long-standing relationships with borrower customers to more opportunistic lenders. The former may be more sensitive to reputational issues than the more opportunistic lenders, who may be more willing to enforce defaulting loans and may even pursue a loan to own strategy (see *Loan to own*).

Reputation and identity of borrower

In a minority of cases, lenders (particularly, banks and other large financial institutions) will be concerned about the adverse publicity of enforcing against a borrower that performs essential services for the public or that commands strong popular support (for example, hospitals or football clubs).

Terms of the loan

If market developments have caused a loan to be unprofitable, then a lender may be more inclined to look to re-price the loan following an event of default. This means that a lender may present the borrower with the alternatives of having to repay the loan early, or entering into a new facility on less favourable terms.

Strength of the lender/borrower relationship

If the relationship between the lender and borrower has broken down, the lender may be inclined to take a harsher view if an event of default occurs. Conversely, the longevity and closeness of a lender/borrower relationship usually has a positive bearing from the borrower's perspective (athough not always).

Financial strength and size of borrower

A strong borrower with a lot to offer a lender is more likely to get the benefit of the doubt than a weak borrower or one with a small turnover employing few people.

Nature of the default

Events of default can be classified into several different categories, including but not limited to:

- Events that typically indicate a riskier lending proposition. Examples include non-payment, breach of financial covenants, insolvency events and default under other borrowing arrangements (cross-default). These are the most common reasons for a declared default, in part because they often point to serious borrower difficulties and in part because the occurrence of the event is usually beyond argument.

- Events that could potentially lead to a riskier lending proposition. Examples include litigation, breaches of law, environmental issues and the departure of key management. Such events may be cause for discussion between borrower and lender, and the action a lender takes in respect of such an event will depend on the materiality of the issue in the circumstances.

- Events that prejudice the effectiveness of any security the lender has for the facilities. The action a lender takes in respect of such an event will depend on the materiality of the issue.

- Events or circumstances that change the lending proposition, not necessarily for the worse, but so that the borrower's business is materially different from that analysed by the lender before making its decision to lend on the terms of the facility agreement. Events falling within this category include a change of control, a listing of the borrower's business, a material acquisition or disposal or a change in the nature of the borrower's business. These events of default are more often used as tools of control for the lender, prompting borrowers to seek lender consent to avoid triggering an event of default. Lenders may take a dim view of borrowers that deliberately breach consent requirements.

- Failure to provide information, for example non-provision or late provision of accounting information. Even where the delay is inadvertent or due to other pressures on management time (rather than deliberate withholding of information or time spent trying to spin or recalibrate disappointing data), the delay is likely to cause the lender to draw adverse inferences about the borrower's systems, level of organisation or its estimation of its relationship with the lender.

Special factors a lender may take into account

A lender may also take into account a number of special factors when it decides how to react to an event of default.

Lender liability as shadow director

If a borrower is in significant difficulties so that it is effectively dependent on the lender for survival, the lender is likely to be wary of being too prescriptive about actions to be taken in case it incurs liability on the basis of being a shadow director (as defined in *section 251* of the *Insolvency Act 1986* (IA 1986)).

A shadow directorship could potentially have serious repercussions for the lender under *section 214* of the IA 1986 whereby it may be liable to contribute to the assets of the insolvent company if there has been wrongful trading. However, dicta in a number of cases (for example, *Secretary of State for Trade and Industry v Deverell [2001] Ch 340*) suggest that it would be unlikely for a lender to satisfy the criteria of shadow directorship in the ordinary course.

A lender is sometimes cautious about having a representative attend board meetings as an observer - but unless the directors are, in fact, following such an appointee's instructions, the risk of doing so should be minimal. However, a lender may run a risk if it appoints directors to the board or intervenes on behalf of the borrower, but this would be unusual. If a lender makes its suggested proposals a pre-condition of the continuation of availability of facilities then, strictly speaking, the borrower has a choice whether or not to agree, even if the alternative is not at all attractive.

For more information about shadow directors, see *Practice note, Types of director: overview: Shadow director.*

Agent acting on behalf of multiple lenders

Most agreements for syndicated facilities, including, for example, the standard Loan Market Association facility documents, will provide that the agent may enforce an event of default and must do so if directed by the majority lenders (usually a two-thirds majority by commitments).

Unless and until the agent takes this action, an individual lender in a syndicate is not entitled to take individual action against the borrower. Following the declaration of an event of default, unless the agreement specifies otherwise, an individual lender may be entitled to sue the borrower in its own right. However, lenders rarely do so due to the operation of the security trustee provisions (if relevant) and the provisions directing payments to be made via the agent and relating to payment sharing among finance parties (which obliges lenders to share recoveries unless they have been obtained by separate proceedings and other lenders were given the opportunity, but declined, to take part).

It is possible that an agent declaring an event of default without the requisite approval may be liable to the lenders if that action proves unsuccessful. To avoid this risk, in the case of any disagreement between lenders, an agent will typically act on the instructions of the required majority or not at all. In the *Concord Trust* case, a trustee declined to declare a default under a bond issue unless it was indemnified to its satisfaction against a potential counterclaim by the issuer if it wrongfully called a default. The parties applied for directions as to whether the trustee faced such potential liability (it was decided that it did not in this case, so the court was not required to decide on the indemnity point).

Challenges to majority decisions

In syndicated financings, if the majority lenders and borrower wish to amend the facility agreement in response to an event of default, it may not be as simple as obtaining majority lender consent to do so (if the amendment is not one requiring unanimous consent). Minority lenders can, and often do, raise challenges to such amendments, and case law shows that having a majority in support is not necessarily enough to effect a change.

In *Redwood Master Fund Ltd and others v TD Bank Europe Limited and others [2002] EWHC 2703 (Ch)*, although one class of creditors was proportionally more disadvantaged than another, a restructuring was permitted because the reason for the method of restructuring (drawing on a revolving credit facility to prepay part of a term facility) was driven by cash flow requirements, rather than a desire to discriminate against the minority lenders. Rimer J commented in his judgment that his assessment might have been different if it was only possible to conclude that the majority's decision "must have been motivated by dishonest considerations".

Some borrowers or issuers seek to encourage consent from the lending syndicate, or bondholders, by offering a consent payment (that is, a fee payable in exchange for consent). Although these were challenged as bribes in *Azevedo and another v Imcopa Importacao, Exportacao E Industria De Oleos Ltd and others [2013] EWCA Civ 364*, the Court of Appeal agreed with the High Court's decision that the consent payments in that case were not bribes and were legal and valid because:

- The payments were openly disclosed to all noteholders before the relevant vote took place.
- The payments were payable on an equal basis to all noteholders voting in favour of the proposed amendments.
- All noteholders were free to vote.

For more information, see *Legal update, Consent payments for noteholder votes are lawful (Court of Appeal)*.

Exit consents are an alternative (and controversial) method of procuring consent that have been used in restructurings. These have been used more extensively in the US but came before the English court in *Assenagon Asset Management SA v Irish Bank Resolution Corp Ltd (formerly Anglo Irish Bank Corp Ltd) [2012] EWHC 2090 (Ch)* (see *Legal update, Exchange offer exit consent unlawful (High Court)*). Here, an issuer invited bondholders to exchange their bonds for new bonds on better terms, although those accepting the offer also irrevocably consented to vote at an upcoming bondholder meeting to amend the terms of the existing bonds, rendering them less favourable. This method meant that bondholders who did not agree to the proposed exchange and voted against the proposed amendments to the terms of the existing bonds risked being left with devalued bonds. Briggs J held that the strategy in this case was unlawful, finding that this type of exit consent was at its essence, "oppression of a minority". That being said, an exit consent strategy structured in a less disadvantageous and controversial manner could potentially be approved by the courts in the future.

Loan to own

These transactions have been popular for some time in the US and are becoming increasingly common in the UK.

A typical target for this type of transaction will be a borrower with a fundamentally sound business that is, however, saddled with a high level of debt (for example, it may have gone through a leveraged transaction in recent more benign economic times). A lender may assign the benefit of debt owed to it by the borrower to a would-be buyer of the borrower. The new lender will be more interested in acquiring control of the borrower than being its lender.

If the loan is in default (or at the first opportunity) the lender can demand repayment of the loan. When payment is not forthcoming the lender can (usually) appoint an administrator over the borrower's assets and "bid the debt" (that is, buy the borrower's assets through a newly established special purpose vehicle (newco)). The newco assumes the burden of the debt owing to the investor in its capacity as lender (often on a restructured basis). Junior and unsecured creditors will usually be left out of pocket.

For more information on "loan to own", see *Practice notes, Distressed debt trading: overview: To own part of the debtor company* and *Restructuring and insolvency jargon buster: Loan to own*.

Similar results can be achieved via a scheme of arrangement under Part 26 of the *Companies Act 2006*. For more information on schemes of arrangement, see *Practice note, Schemes of arrangement: overview*.

Possible courses of action for a lender following an event of default

Facility agreements are invariably drafted so that a lender is not obliged to exercise any of its rights that arise if an event of default occurs. Declaring an event of default is not the only option available to a lender when faced with a defaulting or troubled borrower. If the lender works with the borrower it may be able to negotiate a mutually acceptable solution or find another indirect solution to the problem (for example, assigning its rights). Some of its options are discussed below.

Take no action

It may be that a default is a one-off event that is not continuing, and which the lender does not consider is material (for example, a one-off late submission of management information). Alternatively, changes in market conditions may lead to, for example, a loan to value covenant being breached but the lender deciding not to enforce its rights if the business is still profitable and meeting other covenants.

If a lender takes no action in respect of an event of default it could, potentially, act at a later date if the facility agreement provides that an event of default is continuing until it has been waived in writing by the lender. However, despite most facility agreements containing a "no waiver" clause (see, for example, *Standard document, Facility agreement: clause 23.2*), the case of *Tele2 International Card Co SA and others v Post Office Ltd [2009] EWCA Civ 9* established that such a clause would not protect a party that continued to perform the contract for nearly a year afterwards, as that party must by that action be taken to have elected to affirm the contract and abandon the right to terminate for that breach. Accordingly, despite the typical protective provisions in a facility agreement, a lender might lose its right to act on an event of default if it delays acting when it initially discovers the event of default and is found to have elected to affirm the contract.

Issue a reservation of rights letter

If the lender wishes to take time to consider the best course of action, it is advisable for it to issue a reservation of rights letter to avoid a finding that it has elected to affirm the contract (see *Take no action*). It should also take advice to ensure that it does not take any other action that may be interpreted as affirming the contract. The advisable action will vary according to the circumstances, but the lender should view issuing a reservation of rights letter as a temporary measure while it considers whether or not to take further action.

For a form of reservation of rights letter, see *Standard document, Reservation of rights letter: facility agreement.*

Issue a waiver letter

A waiver letter will typically waive a specific event of default, either permanently or for a temporary period only, but this may be subject to certain conditions, including payment of a fee. The letter will need to be countersigned by the borrower to confirm its agreement to its terms.

For a form of waiver letter, see *Standard document, Waiver letter.*

Amend the facility

The parties may agree to amend the facility agreement on a permanent basis if the borrower is willing to borrow on new terms (or has no realistic alternative). This is most likely to happen if any of the following apply:

- The event of default is continuing.
- The event of default is symptomatic of a material change in the condition of the borrower, as a result of which the original terms are no longer appropriate.
- The lender wishes to take advantage of the breach to continue the facility on more favourable terms.

The amendment may be made using an amendment agreement or, if there are a number of changes or if the facility agreement has been amended previously, an amendment and restatement agreement.

For a form of amendment agreement, see *Standard document, Amendment agreement and for a form of amendment and restatement agreement*, see *Standard document, Amendment and restatement agreement.*

Demand (additional) security

In leveraged deals, there will typically be no more security a borrower can give, but in facilities advanced for general corporate purposes, this may be a sensible option.

However, granting (additional) security may be difficult for the borrower as the granting of such security is likely to be in breach of negative pledge clauses in facilities with other lenders (if any). The new security could also potentially be set aside as a reviewable transaction under insolvency legislation. For more information on reviewable transactions, see *Practice note, Reviewable transactions in corporate insolvency.*

Place the facility on demand, cancel any further commitments or increase interest rate

Following an event of default and provided the facility agreement allows, a lender may take various actions that stop short of accelerating the facilities, including:

- Placing the facility on demand.
- Refusing to make further advances.
- Applying an increased interest rate (if the terms of the facility agreement permit this).

However, this type of action is not particularly common. If a borrower previously had committed funds, then it may prefer to negotiate revised terms for renewed committed funds, even at a higher price, than rely on on-demand facilities. Equally, if the facility previously contemplated further drawdowns then it is likely that the borrower will still need further funds from the lender or elsewhere, so it will again be motivated to agree revised terms.

Provisions for automatic interest rate rises on a default are not particularly common, and again are most likely to be a temporary measure pending a more permanent amendment of the facilities or a refinancing.

Assign the loan

This is a popular route for institutional lenders.

There have been many large debt portfolio sales by large banks, especially in the real estate sector. The terms of these sales are generally confidential, but they usually involve the purchase of debt at a significant discount to face value, and a sale portfolio will typically comprise a mixture of performing and non-performing debt. Often, buyers are more prepared than institutional lenders to take enforcement action.

Sometimes, lenders assign loans in default on a bespoke basis (rather than as part of a portfolio), typically to an assignee that is prepared to take enforcement action.

Demand repayment/enforce security

This is usually the last resort for a lender, for several reasons. Borrowers will rarely have funds available to repay the loan in full, meaning that the lender will be required to enforce any security it has or sue the borrower for repayment. In adverse market conditions, the lender may consider that it will be difficult to realise the security except after a considerable delay or at a price much lower than the open market value of the charged assets. The lender's relationship with the borrower will usually be irreparably damaged following an enforcement. Also, institutional lenders are generally keen to be seen to support ailing businesses rather than "pull the plug" on them, although in a deteriorating financial situation a lender may want to minimise losses by acting promptly, regardless of adverse publicity.

If a lender decides to take this route, it should formally demand repayment of the loan. For a form of demand for repayment, see *Standard document, Demand for loan repayment.*

Courts have been reluctant to imply a term to give reasonable notice before a lender refuses further finance under an overdraft or on demand facility (*Socomex Ltd v Banque Bruxelles Lambert SA [1996] 1 Lloyds's Rep 156*). Equally, once demand has been made for repayment the borrower's time to repay will be very short. In *Bank of Baroda v Panesar [1987] Ch 335*, the bank was held to be entitled to appoint a receiver within one hour and further cases have followed the line that the borrower should only be allowed the time to effect payment from its funds assuming it has the means to repay in immediate funds.

For information on how to enforce security, see *Practice note, Enforcing security: overview.*