The Disclosure Duties Owed by Banks as Agents to Lenders

The Chancery Division recently handed down its judgment on a hedge fund law suit brought against an agent bank for failing to disclose certain information regarding the borrower's declining financial health and the occurrence of certain purported events of default. The High Court focused on the duties specifically delegated to the agent in the finance documents and found in favour of the agent. It held that there are no clearly defined set of general duties as a matter of common law that are automatically imposed upon the agent and there is limited scope for implying additional obligations into detailed finance contracts between sophisticated parties. However, it warned that an agent's role is not merely that of a postal service and will require the exercise of some level of judgment. In addition if the agent acts outside its agency role it might impose upon itself a heightened duty of care to the lenders.

In syndicated lending, the role of agent is generally considered to be one of a functionary acting for the lenders, whose duties under the finance documents are (as expressly set out in the Loan Market Association (**LMA**) recommended forms of facilities agreement) "*solely mechanical and administrative in nature*". Nevertheless, as the Court pointed out in *Torre Asset Funding Ltd* v *The Royal Bank of Scotland Plc* [2013] EWHC 2670 (Ch) (***Torre* v *RBS***), this provision has to be read subject to the specific terms in the relevant agreements which impose duties or confer discretions on the agent. This qualification is important because it means that, in relation to the discharge of its agency functions for the lenders, the agent's role is not merely, for example, to act as a postal service to transmit documents or communications to the lenders that are clearly labelled as such. The agent is usually required to exercise some level of discretion in relation to how it discharges its functions.

Where the agent has discretion to act, it may choose to take action or refrain from taking action. However, in *Torre* v *RBS* the Court confirmed that the agent must exercise that discretion in accordance with the principles stated by the Court of Appeal in *Socimer International Bank ltd* v *Standard Bank London Ltd* [2008] EWCA Civ 116 (**Socimer**). Those principles are that a decision maker's discretion will be limited by concepts of honesty, good faith and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality.

Importantly, Sales J in *Torre* v *RBS* stipulates that what will qualify as an arbitrary, capricious, perverse or irrational decision will be conditioned by the contract. In the context of a syndicated facilities agreement, where the agent's role is to facilitate the exercise of certain rights and powers of the lenders, it is open to the lenders to claim that the discretion to act in question was exercised perversely where the act was clearly not in their best interest. However, importantly, the claimant lenders in *Torre* v *RBS* did not claim any improper exercise of an express discretion by the agent.

The Background

The finance structure in this case involved, among other things, super senior, senior, senior mezzanine, junior mezzanine (B1 and B2 loans initially provided by RBS) debt lent to Dunedin Property Industrial Fund (Holdings) Limited (the **Borrower**) in connection with its commercial property portfolio. In 2007, RBS sold on the mezzanine B1 loans to the claimants (two hedge fund vehicles (**Torre**)) and to a related company, but continued to hold the B2 debt. Unusually, RBS also continued to be the agent for the B1 lenders (including Torre) and the agent for itself as B2 lender.

In early 2007, the income stream from the property portfolio was lower than the expectations set out in the business plan. The Borrower approached RBS to discuss restructuring the payment structure. It appeared that the cashflow would be insufficient to meet all interest payments. Eventually, the Borrower submitted a new business plan and cashflow statement to RBS. These were recalibrated on the basis that the entirety of the B2 interest should be deferred and rolled up until maturity. These documents were reviewed by the senior and super senior lenders, however they were not presented to B1 lenders. RBS as the B2 lender agreed to the proposal and then approached the B1 lenders to request their consent. RBS explained that the amendments were necessary to allow the Borrower to have the flexibility to apply some cash surpluses towards capital expenditure on physical assets. Although the B1 lenders themselves gave their consent, RBS did not gain all the lenders' consents and so the attempt to restructure failed. Subsequently in 2008, the Borrower went into default and entered administrative receivership. The B1 lenders did not recover their loans and sued RBS for the value of their participations. The claims advanced by the claimants were in relation to three distinct matters: the Event of Default claim, the Business Plan claim and the Negligent Mistatement claim.

As part of the claims, the claimants submitted that an agent has additional general duties beyond those expressly set out in contract and those included the obligation to provide relevant information to the principal. They submitted that these additional obligations (a) arise as a matter of common law and (b) can be implied into the agreements.

With respect to (a) above, the Court did not accept this. Sales J found that common law does not impose on an agent a defined set of obligations that will apply unless the contract governing the agency relationship excludes them. If, as was the case here, the parties have entered into detailed commercial agreements, "*it is not plausible to suppose that they intended that some potential set of vague and unspecific duties might apply over and above those specified in the agreements themselves*".

With respect to (b) above, the judge analysed the case law relating to implied terms generally before making its conclusion. The case therefore provides useful guidance on this matter, as further explored below.

(i) The Event of Default Claim

The claimants claimed under various heads that RBS as agent for the B1 lenders had an obligation under the facilities agreement for the B1 lending (or junior mezzanine) tier (the **JM Facilities Agreement**) and the intercreditor deed to notify the B1 lenders of an event of default or the events which constituted an event of default.

In this respect, the claimants submitted that there had been an event of default as the Borrower had commenced negotiations with one of its creditors (RBS) with a view to rescheduling part of its indebtedness, which was one of the insolvency events of default specified in the JM Facilities Agreement. The claimants argued that there was therefore an implied obligation on RBS in its capacity as agent to notify the B1 lenders of that event of default and of the circumstances leading to it. The Court held that (assuming that there had been an event of default) there was no such implied term. It referred to existing case law suggesting that if a matter is dealt with elsewhere in the contract, it will be difficult to imply another term covering the same ground but going beyond that term. Sales J pointed out that with respect to passing on information about an event of default (that falls short of "formal" notice of an event of default by another party to the JM Facilities Agreement, which had not occurred in this instance as the agent had not received any such notice from another party to that agreement loan (i.e. an obligor)), the JM Facilities Agreement already included

express terms dealing with the provision of information that only imposed on the agent a *discretion* to pass on such information e.g. "*The Agent may disclose to any other Party any information it reasonably believes it has received as agent under this Agreement*". Further, the Court also held that an implied term imposing such an obligation rather than simply a discretion would also oblige the agent to use its own judgment to decide whether an event of default had in fact occurred: not always straight forward and not a mere mechanical or administrative duty of the type provided for under the JM Facility Agreement.

The claimants' next submission was that there was also an obligation under the intercreditor deed to notify the B1 lenders of the occurrence of an event of default.

However, although the Court found that an event of default had occurred in regards to the Borrower having approached RBS to negotiate a rescheduling of its debt[1], the claimants had still to establish that the agent had a duty to notify the B2 lenders of this event of default. The intercreditor deed stipulated: "*Each Agent shall promptly notify each other Agent on becoming aware of any Default. Any Creditor shall promptly on becoming aware of any Default notify its Agent*". The claimants claimed that RBS as agent for the B2 lenders became aware of the default and were obliged to notify itself of the default as agent for the B2 lenders and then came under the implied obligation to notify the B1 lenders. Alternatively, RBS in its capacity as B2 lender became aware of the default and was obliged to notify itself in its capacity as agent for the B2 lenders and then to notify itself in its capacity as agent for the B1 lenders, and then came under an implied obligation to inform the B1 lenders.

The Court rejected this argument and held that the obligations to notify the B1 lenders under the intercreditor deed were not triggered because RBS did not know that the Borrower's request to defer the interest constituted an event of default. For the obligations to be triggered, the agent or creditor would have to be aware not just of the event or circumstance giving rise to the event of default, but also "*that it qualifies (or would qualify) as an Event of Default*" under the relevant credit facilities agreement. Even had the B1 agent received notice of the event of default from the B2 agent or a B2 lender, the Court found that there was no implied term to pass on that information to the B1 lenders. Again, Sales J pointed to other clauses that dealt with the provision of information to the lenders and which conferred on the agent only a discretion (rather than an obligation) to disclose certain information. Where the matter was already covered, it would not be appropriate to imply another term going beyond the existing terms in the agreement.

(ii) The Business Plan Claim

The claimants additionally claimed that RBS as agent should have treated the business plan and cashflow statement in October 2007 as constituting the Borrower's annual budget for the purpose of the JM Facilities Agreement and therefore forwarded these to the B1 lenders pursuant to the terms of that agreement, which defined the annual budget as a budget "*prepared by the Borrower and approved by the Agent*". The Court held that the Borrower had not submitted the documents as the annual budget and had not asked the agent for approval. The agent had therefore not acted in breach of duty by failing to pass these on to the B1 lenders.

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[1] Applying the test set out in a previous case (*Grupo Hotelero Urvasco S.A. V Carey Value Added S.L.* [2013] EWHC 1039 (Comm)) regarding the meaning of "*negotiations for rescheduling*", Sales J held that the negotiations constituted an event of default because they happened "*by reason of actual or anticipated financial difficulties*".

Interestingly the Court also held that the agent was under no obligation, express or implied, to chase the Borrower to ensure that it provided a proposed annual budget. That would have been an obligation well in excess of the "*solely mechanical and administrative*" nature of the duties which the parties intended should rest on the agent pursuant to the terms of the JM Facilities Agreement. Further, the Court noted that the agent was not under any implied duty to inform the B1 lenders of any failure by the Borrower to provide the annual budget and nor was it under an implied obligation to consider from time to time on its own initiative what additional financial information should be sought from the Borrower regarding its financial condition.

The claimants' claims with respect to implying terms into the JM Facilities Agreement with respect to the Business Plan claim failed for the same reasons as those in relation to implied terms relied on for the purposes of the Event of Default claim.

(iii) The Negligent Misstatement Claim

RBS made negligent misstatements to the B1 lenders regarding the reason why RBS was at that stage seeking their consent to the deferral and roll up of interest due to be paid on the B2 loan held by RBS.

In 2007 and 2008 when RBS (in its capacity as B2 lender) provided an explanation as to why the B1 lenders' consent was sought for the B2 interest to be deferred to maturity, it did so with a view to inducing the B1 lenders to grant their consent. The Court therefore held that RBS in its capacity as B2 lender had assumed responsibility to the B1 lenders to take reasonable care as to the accuracy of that explanation. RBS had breached that duty of care as it had given a materially inaccurate and misleading account of the reason for the request to defer the B2 interest. RBS had asserted that the rational was to enable the Borrower to retain cash to spend more on capital expenditure so as to improve the portfolio rather than the Borrower's expected inability to pay the B2 interest.

Nevertheless, the Court held that the Negligent Misstatement claim failed by reason of the limits upon the scope of the duty of care. RBS only assumed an obligation to exercise reasonable care to protect the claimants against such loss as they might suffer by reason of giving their consent to deferring the B2 interest. RBS did not volunteer the explanation to the B1 lenders so that they could carry out a wider review of their investment. Since the proposal to defer the interest did not come into effect, the Court therefore held that the claimants suffered no relevant loss.

(iv) Scope of Exclusion Clauses

The JM Facilities Agreement also contained a number of customary exclusion of liability clauses, upon which RBS placed reliance in the event that the Court were to find it liable for any of the claims brought by Torre. Specifically, the exclusion of liability clause provided that the agent "*will not be liable for any action taken by it under or in connection with any Finance Document unless directly caused by its gross negligence or wilful misconduct.*" Torre contended that this provision only applied as an exclusion clause in relation to "*any action*" taken by the agent and so did not cover any omission by the agent or failure to act, therefore providing no defence in relation to the Event of Default claim and the Business Plan claim. The Court disagreed and held that "*any action*" included any omission to act. Torre also contended that the clause only provided an exemption in relation to action taken by an agent in its capacity as such (and therefore did not assist RBS in respect of the Event of Default claim and the Business Plan claim which both alleged that RBS had failed to act when it was obliged to do so in its other capacities). The Court agreed. In this case the agent was the same legal person as the B2 lender, however, the exclusion clause did not apply to cover the actions of RBS in its capacity as a B2 lender when it sought consent to the deferral of B2 interest.

On its interpretation of the exclusion clause, the Court held that "*even if the Claimants made out the basic elements of their case for the Event of Default claim and the Business Plan claim, they would have failed to establish liability on the part of RBS by reason of this provision*". The Court's rational was simple: although in retrospect the agent at times may not have considered whether the events that unfolded in this transaction gave rise to an obligation on their part to act (setting aside whether in fact such an obligation was triggered in this case), this did not equate to gross negligence or wilful misconduct on the part of the agent. As Sales J observed "*There was no "serious disregard of or indifference to an obvious risk" to others, including the Claimants, on the part of the [agent]".*

Comment

Torre v *RBS* is informative for its confirmation that the scope and nature of the agent's duties are shaped by the terms of, and the language used in, the finance documents. Courts will not generally imply additional obligations into the contract, particularly in respect of "*complex, interlocked, financial transactional documents*" between sophisticated parties.

For lenders, the case highlights that if they cannot expect the duties of their agent to extend beyond those explicitly set out in the credit agreement, then consideration should be given to whether these duties are sufficiently exhaustive and/or explicit. Likewise, where the agent has been delegated a discretion to act, lenders might want to reconsider the basis on which such a discretion should be exercised (and whether in fact the Socimer principle sufficiently protects their interests in this respect). On this point, is it sufficient from a lender's perspective that an agent simply acts "*in good faith, without capriciousness and rationally*" (as Sales J summarised the Socimer principle in *Torre* v *RBS*), or should the agent be obliged to exercise such a discretion in the best interest of the lenders?

Conversely, for agents, the case supports the view that their role is mechanical and administrative in nature and, importantly, that the scope of and obligations connected to such role are as set out within the terms of the credit agreement (or other finance document) that appoints them to that role. From a liability perspective, it is difficult to see agents entertaining any attempts to modify their duties and/or liabilities to lenders that would represent a departure from this principle.

The case also highlights some of the issues that can arise where an agent acts in more than one capacity in a transaction. *Torre* v *RBS* was perhaps unusual because the RBS team in this instance acted as both a lender and as an agent for different lending tiers, whereas typically an institution would have its own dedicated agency team to fulfil the agency role. Consequently, here RBS received information that it would not necessarily have received had it not also been a lender (and agent) in another lending tier. The potential issue in such a scenario may be less one of a conflict of interest, rather than one of a conflict of institutional priority but regardless has undoubtedly been the reason behind a movement for lenders, especially non-bank lenders, to require their own "independent" agent in connection with new money transactions or transactions entering a refinancing (and, conversely, a desire by incumbent bank agents to exit their positions where institutionally they have multiple roles and/or exposure so as to avoid any potential liability risk).

Finally, the claimants did not rely on any claim relating to the improper use of an express discretion, so this angle was not fully explored by the Court. However, going forward, in light of the difficulty in implying additional obligations on the agent into the finance documents, this might provide a more compelling basis for claims related to the actions of, or the failure to act by an agent.

If you would like to learn more about the issues in this alert, please contact your usual Ropes & Gray attorney, or any of the attorneys listed below.

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