

## SYMPOSIUM ON REMEDIES ON DEFAULT

Comment by

PHILIP WOOD

Allen & Overy  
Solicitors, London

One is presented here with a situation where although the last accounts were fine the group is now in an extremely serious situation. The first thing the banks don't do, is they don't accelerate, because that will spark off a cross default which will bring in the holders of the Eurobonds, who have got a cross default clause but not a negative pledge and therefore will be able to get some security. However, if there are any defaults by an acceleration they would have to bring them in too.

The second thing which one has to do is to issue a no waiver letter, which says that notwithstanding that the banks are not taking any action, that is not to be taken to be a waiver, thereby obliterating the events of default.

Now the choices at this stage are either liquidate or appoint a receiver or do a support operation. The advantages of a support operation are: no break up values, no surrender of control to the liquidator, it is quicker, less expensive, no complex multiple bankruptcy in several countries, security, possibility of some convertibles if the situation is bad but could improve, interest continues, it is not guillotined, and if foreign currency debts exist, they are not converted into local currency.

The disadvantage is new money. Is it good money after bad? First, new money will be required to keep the thing going and to avoid fraudulent trading. Secondly, we can't disclaim onerous contracts which may be bringing the group down which you can do on a liquidation. Thirdly, the disadvantage of a support operation is you can't free the creditor who doesn't come in. And fourthly, if the unions don't co-operate, then receivership or liquidation may be the only solution.

Now, the banks decide to go in for a support operation and they set up a steering committee, which is composed of the two or three main banks involved in this group. The risks for this steering committee are first they must not act as agent of the banks because that will bring in fiduciary duties. They must establish themselves purely as a liaison between the debtor companies and the rest of the banking community.

Secondly, if they acquire any inside information about the group, which they are bound to do, they must make sure that it is disclosed to the rest of the pack.

Thirdly, they must not make any secret deals. If you want to see what happens to a creditor who makes a secret deal in a composition, look at Re EAB 1902. Then there is the possibility of any Hedley-Byrne or s 52 problems in sending round an information package to the other banks.

Finally, the steering committee wants to be beware of the tort of procuring a breach of contractual relations such as taking security in breach of somebody else's negative pledge, encouraging a disposal of assets which may breach somebody's asset disposal clause or encouraging the debtor not to pay its debts in breach of other loan agreements.

So the creditors decide, the banks decide, to do a support agreement. The main feature of a support agreement is it is a sort of mini liquidation done by agreement. First, the creditors agree not to accelerate for an agreed period, say a year. They agree to maintain their exposure, ie what they agree to lend, not their outstandings. So that if you have got an overdraft bank whose outstandings are say 5 million and it had a line of 10, then it would be expected to maintain that line at 10, not at 5. It is a matter of negotiation. Letters of credit and bonding facilities will usually be converted into loans on utilization and subject to this exposure rule.

The new money will be syndicated, the overdraft will continue to be provided by one of the banks only, because it is too difficult to syndicate an overdraft and the other banks will come in by indemnifying the bank which is providing the overdraft.

The advantages of this support agreement are first there is equality between all of the creditors, they get the same financial terms, the same documentary terms. Secondly, you can have majority control of accelerations which stops the unilateral action. And thirdly, you can have a loss sharing agreement. Now this always, in my experience, is the thing which takes the most time to negotiate.

The problem is that if you have a large group with many creditors, some of the banks are in a much better position than the others, or would be on a liquidation. Those banks which have lent to the operating company have got a direct bite on the assets whereas the banks which have lent just to the holding company don't have a bite - they are a subordinated credit. And so those banks which have got loans to the operating company are going to want to be taken out first. Hence the last sharing agreement - an agreement between the banks, which will want the first bite out of any proceeds.

Normally, new money as well is treated as coming out first. Some banks who have short-term credits may also be able to negotiate their position but it's last in, first out, because their money is short - it wasn't medium term money therefore they should come out first. Now this loss sharing agreement is an agreement

between the banks - the borrower is not a party to it - and it says that after an acceleration, the proceeds which are received by the banks will be pooled, notionally pooled, by an account maintained by the agent and then, when the liquidation is over, the banks will account to each other in accordance with this steering arrangement. First of all the banks which have provided new money get paid, then the banks which have got their special positions (because they are lending to subsidiaries) get paid and so on, down through the steering structure.

An important thing about steering, ie about the loss share agreement, is that the banks' risks are calculated according to exposures, not their outstandings. So if for example a bank has an overdraft of 10 million, it is on the actual acceleration. It has only got 5 million outstanding and it has got to put 5 million into the pool to share with the other banks and to be appropriated according to the steering arrangements.