Feature

KEY POINTS

- Agent banks are in a unique position to monitor a borrower's financial health, particularly where the usual covenant breaches do not act as a trigger warning, as in cov-lite loans.
- *Torre Asset Funding Limited v RBS* [2013] EWHC 2670 when read with more recent case law on contractual discretions, duties of care and exclusion clauses shows that an agent's duties may be more extensive than the narrow construction given in *Torre*.
- In the current environment, a syndicate would be well-advised to consider whether it is worth paying a higher agency fee to the agent bank for removing or modifying the non-fiduciary clause so that the agent bank owes fiduciary duties to them.

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Agent banks' duties in the era of cov-lite loans and infinite liquidity

In this article Lisa Lacob considers whether the current cov-lite environment changes the analysis on the extent of agent banks' duties, particularly where action or inaction may favour one side.

INTRODUCTION

The role of a bank charged with acting as the agent for a loan syndicate, and therefore responsible for the day-to-day running of the loan, is referred to in the LMA's standard loan documentation as "solely mechanical and administrative in nature"; not a description which is suggestive of headline-grabbing news. The litigation surrounding Citigroup's accidental overpayment of US$900m to creditors of Revlon has, however, brought the role of agent banks starkly into the spotlight. The extent of the agent bank's duties is also of particular interest in an era where traditional borrower covenants are often relaxed or removed altogether (so-called "cov-lite" loans) and where low yields have shifted the balance of power to corporate borrowers. The question posed in this lending environment is: do agent banks' duties extend to the provision to the syndicate of information about the borrower which might suggest that it is in financial difficulty or that the borrower is otherwise acting, or proposing to act, in a way which may concern the lenders?

THE COSTLY MISTAKE

Few will have missed the simple but startling facts of the Citigroup case: In August 2020, when Citigroup discovered that an "operational mistake" had led it to accidentally transfer US$900m to various hedge fund lenders, it promptly asked the recipients to return its money. While certain of the lenders complied with that request, others, including Brigade Capital, did not immediately return the overpayment. If that seems a mercenary stance, the broader context explains the refusal to refund Citigroup's money. Earlier in the year, as the coronavirus crisis unfolded, Revlon did not have enough support from its existing creditors to take on new debt and it therefore borrowed funds of c.$850m from Jefferies Finance LLC. The Jefferies facility was paid off days later, but the deal temporarily increased the number of creditors who could vote in favour of acquiring new debt, which reduced the value of the existing hedge funds' loans. A claim was brought in the US courts by Brigade and others against Revlon, Jeffries and Citigroup alleging that the new lending sanctioned by Citigroup "served no legitimate business purpose; rather, they were created solely to manipulate and gerrymander voting". In those circumstances, Brigade must have felt that the accidental overpayment was divine recompose for Citibank's actions.

That lawsuit has now settled (as have the claims by Citigroup against various creditors for the return of the mistaken overpayments), but the allegations made by the hedge funds against Citigroup showed that, far from simply facilitating payments between borrowers and lenders, an agents' action, or inaction, may favour one side. It was not the first time Citibank's role as agent bank had been in the news; in 2018 PetSmart sued Citigroup for its failure to release collateral in relation to US$4bn of loans. In that case, the criticism of the agent's conduct therefore came from the borrower side. That litigation was also eventually settled, but agent banks may well wonder whether the role is quite as "neutral" as it once seemed.

THE AGENT'S DUTIES: LEGAL PRINCIPLES

An agent banks' responsibilities include inspecting and certifying the conditions precedent to drawdown of the loan, calculating relevant interest rates, communicating payment amounts to all parties, remitting payments and taking appropriate action when a loan is in default. As such, the agent acts as a single point of contact for the borrower and should smooth communications on both sides.

The leading English law authority on agent bank's duties remains the decision of Sales J in *Torre Asset Funding Limited v RBS* [2013] EWHC 2670. *Torre* is often cited as authority for the proposition that an agent's banks responsibilities are circumscribed by the transaction documents (usually in LMA standard form) and should be construed very narrowly. On a closer analysis, however, this case (particularly when read with more recent case law on contractual discretions, duties of care and exclusion clauses) shows that an agent's duties may be more extensive than suggested above, and that there is at least some prospect of an agent's duties giving rise to contractual and tortious liabilities to the syndicate.

In short, this case concerned a leveraged financing structure in relation to a commercial property portfolio. The structure included various senior lending layers and Junior Mezzanine B1 and B2 loan layers. RBS, the agent for the B1 and B2 lenders, was also a B2 lender. The devaluation of the borrower's commercial property portfolio following the 2008 financial crisis meant that the level of eventual recovery from the sale of properties left the Junior Mezzanine with nothing. The claimants, who were participants in the B1 loans, sought to recover their losses from RBS as agent bank on the basis that it had failed

to disclose information which would have revealed the borrower's financial difficulties and had also made misrepresentations when seeking consent to defer the payment of interest on the lending. The claimants argued that, had they had the correct information, they would have sold their participations at an early stage.

Sales J agreed with the claimants that an event of default had occurred in 2007 when the borrower had provided information to RBS which indicated that it would be unable to pay interest due on the B2 loan and asked for a deferment of that interest. (The events of default in the Junior Mezzanine Facility Agreement (JMFA) included that the borrower "by reason of actual or anticipated financial difficulties, commences negotiations with one or more of its creditors with a view to rescheduling any of its indebtedness"). The judge refused, however, to imply a term in the Facility Agreement placing an obligation on the agent to disclose the occurrence of an event of default to the lenders on the basis that, where there is complex documentation defining the parties' contractual rights and obligations, it is neither necessary nor appropriate to imply additional terms into those documents. It was noted, however, that RBS had an express *discretion* to pass information it received to lenders and that, if the agent has a discretion, it must exercise that discretion in good faith and in a manner that is not arbitrary, perverse or irrational (in accordance with the well-known principles stated by the Court of Appeal in *Socimer International Bank Ltd v Standard Bank London Ltd*) [2008] EWCA Civ 116). The same reasoning was applied in relation to the argument that RBS had an implied obligation to pass to the lenders all financial information received about the borrower.

Since *Torre*, a number of authorities have refined the principles which apply to the exercise of a contractual discretion. While much of that case law demonstrates that, at least in certain commercial contexts, the circumstances in which a party can exercise the discretion in question without falling foul of the *Socimer* test are very limited (for example, the valuation of illiquid securities in difficult market conditions without reliable pricing information: *Lehman Brothers International (Europe) (in administration) v ExxonMobil Financial Services B.V.* [2016] EWHC 2699 (Comm)), the tide has not been all one way. Notably, in *Braganza v BP Shipping Limited* [2015] UKSC 17, the Supreme Court scrutinised not only the outcome of a party's exercise of a contractual discretion, but also the *process* by which it exercised the discretion. *Braganza* expressly left open the question of the extent to which the court's review of the decision-making process would apply in all contractual contexts, particularly commercial contracts, stressing the importance of the employment context of *Braganza* itself. For example, in *Lehman v ExxonMobil* (above) the Commercial Court decided that it was not appropriate to review the decision-making process in the context of a US$250m repo financing extended by an oil major to an international investment bank. On the *Torre* facts, however, examining the agent's decision-making process may well have been appropriate. As the commercial rationale for an agent providing financial information about a borrower to the syndicate is obvious and the task itself should pose no difficulty for the agent, it would be surprising if an agent in possession of information indicating that a borrower was unable to pay interest due to the creditors in the short term could simply exercise a discretion to withhold that information without at least considering what impact it might have on the lenders' decision to, for example, allow a general restructuring of the debt.

Torre also remains of assistance to syndicates in relation to agents who do choose to pass on information but do so carelessly or in a misleading fashion. RBS (in its capacity as B2's lender) had sought consent from all the lenders to the deferment of interest. The email seeking this consent had suggested the reason for the deferment of interest was to allow the borrower to use funds to improve its properties, rather than because it could not make the payment. The court held that RBS had breached its tortious duty of care to ensure that it provided accurate information to the B1 lenders, however it also held (applying the test in *Caparo Industries Plc v Dickman* [1990] 2 A.C. 605 and *South Australia Asset Management Corp v York Montague Ltd* [1997] A.C. 191) that the losses claimed did not fall within the bank's duty of care as the misleading information was not provided for the purpose of the B1 lenders deciding whether or not to sell their participation. As a matter of legal principle, however, this case shows that the provision of incorrect or misleading information by an agent to the syndicate may well found a good claim in tort. After all, one of the core functions of the agent is to act as a conduit between the borrower and the syndicate and to provide information which will enable lenders to consider how to exercise their right under their facility agreements. At the very least, that role must be performed with due care.

Where, however, the syndicate alleges that a borrower was acting improperly and that the agent failed to pass on relevant information about the borrower's conduct or dealings to it (rather than disclosed information which was false or misleading), there will be no positive mis-statement on which to found a claim for misrepresentation or breach of duty. How then is the agent to be held accountable for its omission? The decision of the Supreme Court, New York County in *Harbinger Capital Partners Master Fund I, Ltd. v Wachovia Capital Mkts., LLC* 27 Misc 3d 1236(A) (10 May 2010) is instructive in this regard.

This action arose out of a very substantial fraud allegedly orchestrated by Le Nature's Inc., a beverage company based in Pennsylvania, which involved massive revenue inflation, and false profit reports. The plaintiffs were members of a lending syndicate and the defendant, Wachovia, acted as administrative agent. The plaintiffs alleged that Wachovia knew about Le Nature's' improper practices and precarious financial position yet chose to press forward with the loan and its syndication to advance its own agenda. In particular, the plaintiffs alleged that Wachovia knew – but did not disclose to the lenders – that Le Nature's had regularly been unable to make timely interest payments, a matter peculiarly within its knowledge as agent bank. In order to allege fraudulent concealment, the plaintiffs had to prove a "special relationship" between the parties. Under the special relationship doctrine, a duty to disclose arises where one

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party's superior knowledge of essential facts gives rise to a duty of disclosure (*P.T. Bank Cent. Asia, NY Branch v ABN AMRO Bank* N.V., 301 AD2d 373, 378 (1st Dep't 2003); see also *Swersky v Dreyer & Traub*, 219 AD2d 321, 328-329 (1st Dep't 1996)). This doctrine is therefore analogous to alleging a fiduciary relationship under English law. The plaintiffs argued that this special relationship existed because Wachovia had crucial information not readily available to the plaintiffs and because it served not only as Le Nature's' financial advisor, but also as the lenders' long-time trusted counterparty. The court refused Wachovia's application to determine this aspect of the claim summarily.

In other jurisdictions, courts have been quick to recognise that agent banks owe fiduciary duties to the syndicate. For example, in *NZI Securities Limited v Bank of New Zealand* (High Court Auckland, 11 February 1992) the court noted that:

> "Much argument was avoided by [counsel] having conceded very properly in my view, that [the agent bank] was in a fiduciary relationship to the plaintiffs in respect of its function as a member of and agent for the syndicate."

In *Chemical Bank; National Westminster Bank USA v Security Pacific National Bank* 20 F.3d 375 (9th Cir. 1994) (Appeal from the United States District Court for the Northern District of California) the court held that Security Pacific, the agent for three banks, owed a fiduciary duty to the lenders simply by reason of being unequivocally identified in the documentation as the agent bank, on the basis that "the very meaning of being an agent is assuming fiduciary duties to one's principal". Security Pacific was nonetheless able to avoid liability for breach of its fiduciary duties as the facility agreement excluded liability "except for their own gross negligence or wilful misconduct".

As far as English law goes, there is a dearth of authority on the fiduciary duties owed by agent banks to the syndicate. In *UBAF Ltd v European American Banking Corporation* [1984] 1 QB 713, UBAF alleged that EABC, who acted both as lead arranger and agent bank, had misrepresented to the syndicate that the borrower was "a sound and profitable group". UBAF pleaded three separate causes of action: (i) deceit, on the basis that the representations alleged were known to EABC; (ii) misrepresentations under s 2(1) of the Misrepresentation Act 1967; and (iii) breach of a duty of care. The court held that:

> "… quite clearly the defendants were acting in a fiduciary capacity for all the other participants. It was the defendants who received the plaintiffs' money and it was the defendants who arranged for and held, on behalf of all the participants, the collateral security for the loan. If, therefore, it was within the defendants' knowledge at any time whilst they were carrying out their fiduciary duties that the security was, as the plaintiffs allege, inadequate, it must, we think, clearly have been their duty to inform the participants of that fact and their continued failure to do so would constitute a continuing breach of their fiduciary duty."

It is unfortunate that the court, however, failed to distinguish clearly between EABC's role as lead arranger and as agent bank when considering the scope of its duties.

In *Torre*, the fiduciary duty argument received short shrift. Clause 26.4 of the JMFA expressly stated that "nothing in this Agreement constitutes the Agent, the Security Trustee or the Arranger as a trustee or fiduciary of any other person" and, in line with the general conclusion that RBS's duties extended only to what could be found in the JMFA, the court quickly concluded that RBS owed no fiduciary duties to the syndicate. There appears to have been no real debate around the vexed question of whether it is in fact possible to contract out of the traditional principal-agent fiduciary relationship.

That question aside, in the current environment, a syndicate would be well-advised to consider whether it is worth paying a higher agency fee for removing or modifying this sort of principal-agent clause. If the syndicate's agent is an agent properly so-called, there is every reason to expect that it would put the interests of the syndicate above its own when making decisions about passing on information received from the borrower. Preserving the principal-agent fiduciary relationship seems apposite in this context.

Finally, in *Torre* the court held that even if RBS had had a duty to pass on financial information to the lenders, the contractual exclusion ("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") would have applied as "actions taken by it" would include a failure to act. It is beyond the scope of this article to canvass the case law on the construction of exclusion clauses since then, but suffice to say that courts have recently demonstrated a willingness to construe exclusion clauses narrowly (for example, *Primus International Holding Co v Triumph Controls – UK Limited* [2020] EWCA Civ 1228).

CONCLUSION

It is fair to say that there have been no direct inroads into the *Torre* decision since 2013. In the current lending environment, however, agent banks are in a unique position to monitor a borrowers' financial health, particularly where the usual covenant breaches do not act as a trigger warning. Syndicates negotiating loan documentation would do well to consider whether exemption clauses narrowing agents' duties deprive even the minimum duties to exercise discretions properly and to act with due care of any real force. ■

Further Reading:

- Syndicating in one's own interest: the scope of the duties of a lead arranger during syndication which is also an underwriter or lender (2019) 6 JIBFL 383.
- Post boxes or decision makers? Facility agents, questions of judgment and *Torre Assets* (2014) 1 JIBFL 27.
- LexisPSL: Banking & Finance: Practice Note: The facility agent.