

FINANCE AND BANKING ALERT

IN THIS ISSUE

LENDER CONSENT: PRIORITY, SUBORDINATION AND MANDATORY PREPAYMENTS

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In syndicated loans, what lender consent level is required to re-order the mandatory prepayment ranking? Is it the consent of lenders holding two-thirds of the loan value or must all lenders consent? Do the principles of priority and subordination apply to mandatory prepayments? If the transaction is governed by a senior facilities agreement (SFA) and an inter-creditor agreement (IC), the answer lies in the interpretation ascribed to the relevant provisions.

This is an approximation of the legal issues that came before the English courts in 2013. In *Bank of New York Mellon (London Branch) v Truvo N.V and others* [2013] EWHC 136 (Comm) QBD, the court interpreted the SFA and IC to answer these questions. The agreements were based on the LMA standard form. We focus on selected aspects of this judgment, and its relevance to syndicated loans in South Africa.

Truvo, a publisher of printed directories, experienced serious financial difficulties because of online search engine competition. It filed for voluntary Chapter 11 bankruptcy under Title 11 of the US Bankruptcy Code in the US Bankruptcy Court, Southern District of New York. Later, a restructuring plan was agreed with Truvo's creditors to enable it to exit the bankruptcy proceedings. The plan consisted of an internal group restructure

coupled with releasing existing debt which was swapped with new, lower value debt. The claimant was the agent and security agent, and the second and third defendants were both senior lenders and first and second *lien* debt holders respectively.

In clause 11 of the SFA, all proceeds from disposals, flotations, insurance, US tax payments and 75% of excess cash-flow for any financial year had to be prepaid in a stipulated payment order. The consent of lenders holding 66²/₃ of the loan was required to amend or waive a finance document term and of all lenders were required to amend the order of priority or subordination under the IC.

Anticipating breaches to the financial covenants, Truvo negotiated a limitation of the lenders enforcement rights with some lenders and requested the facility agent acting for the majority lenders to consent thereto. The amendment reversed the mandatory proceeds payment order, allegedly to the detriment of the second *lien* holders. Lenders holding 80.15% of the loan value consented.

The court held that generally, the terms priority and subordination were used to rank payment amongst creditors where there was a shortfall in the debtor's assets required to meet its liabilities, that is, where the debtor was insolvent; and

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In South African law, subordination postpones or puts in abeyance, the creditor's claim, rendering its cause of action incomplete until the condition in the subordination agreement is achieved.

it was possible that such terms might also be used to rank payment where the debtor was solvent. In South African law, subordination postpones or puts in abeyance, the creditor's claim, rendering its cause of action incomplete until the condition in the subordination agreement is achieved.

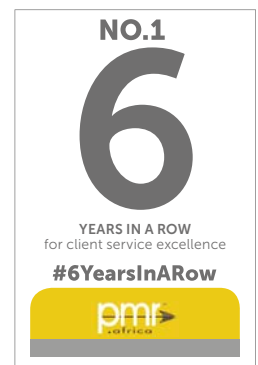
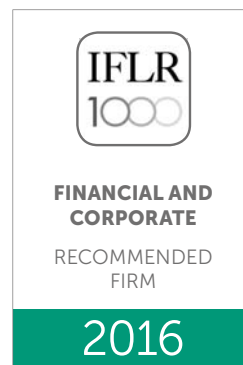
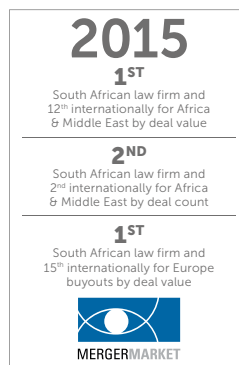
The court further held that:

- (i) the third defendant's construction that the consent request signed by the majority lenders did not have the effect of amending nor changing '... the order of priority or subordination under the ICA within the meaning of ... the SFA and there is nothing in the ICA ... which would justify a contrary conclusion.' was correct;
- (ii) the consent of all lenders was not required; and

- (iii) the consent of the majority lenders and Truvo to the amendment was sufficient to constitute an effective and valid amendment.

It is submitted that there are two important lessons which ought to be applied in South African law. First, the terms priority and subordination, although used to rank payments to creditors on insolvency, need not be restricted to this. Such principles can also be used to rank payment to creditors in a mandatory prepayment scenario where the debtor is solvent. Second, the parties to the loan ought to stipulate in the loan documentation if priority and subordination apply to the mandatory prepayment provisions and the level of lender consent required to alter the mandatory prepayment ranking.

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