

Alert

English High Court Clarifies Post-Settlement Treatment of Interest and Fees for Secondary Market Participants

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A recent High Court decision demonstrates one occasion where a secondary market buyer of bank debt may be required to pay its seller monies under a credit agreement after a settlement date has passed. This decision is important for European distressed debt market participants trading on Loan Market Association (“LMA”) documents, as it clarifies that a buyer’s payment obligations to a seller may continue after a transaction has closed, and it further highlights that pre-trade diligence should include a clear understanding of how and when interest, fees or any other repaid cash is allocated.

Background

Tael One Partners Ltd. (acting in its capacity as general partner of The Asian Entrepreneur Legacy One LP) (“Seller”) was an original lender of US\$32 million under a 24-month, US\$100 million syndicated credit agreement dated 16 April 2009 (as amended and restated on 26 Nov. 2009). The agreement provided for the borrower to pay interest at a rate of 11.25 percent p/a, accruing daily but payable three months in arrears, and a “Payment Premium” to be made alongside the repayment of the principal amount of the loan, varying between 17-20 percent depending on the circumstances surrounding the repayment.

On 14 Jan. 2010, the Seller transferred US\$11 million of its debt position to Morgan Stanley & Co. International PLC (“Buyer”). The trade was conducted on the basis of the LMA standard terms and conditions for par trade transactions (“ST&C”).¹ A pricing letter was executed with a schedule setting out amounts payable by the Buyer, including interest. The elected form of interest treatment was “Paid on Settlement Date,” and there was also no reference to the Payment Premium mentioned. The Buyer subsequently sold its position onwards to a third-party.

On 16 Dec. 2010, the borrower repaid the loan in full and paid the Payment Premium to all lenders of record. The Seller subsequently contacted the Buyer requesting the Seller to pay it the proportion of the Payment Premium relating to the US\$11 million traded debt which had accrued as of 14 Jan. 2010. This request was disputed by the Buyer.

¹ Effective 25 Jan. 2010, the LMA modified its documentation so that only one set of terms and conditions govern both “par” and “distressed” trade transactions. As this trade occurred prior to the modified documentation going live, the conditions referenced in this *Alert* are based on the old terms and conditions which are no longer in force. However, it should be noted that the LMA language set out in this *Alert* has not changed in form following such modification.

Analysis

The High Court focused on the agreed terms of trade between the Buyer and the Seller, which included interest being calculated on a Paid on Settlement Date basis. The relevant LMA ST&Cs documenting this form of interest treatment are Condition 11.3 and Condition 11.9:

- Condition 11.3(a) states that *“the Buyer shall pay to the Seller on the Settlement Date ... any interest or fees accrued up to but excluding the Settlement Date in respect of the Purchased Assets (other than (i) PIK Interest and (ii) the fees referred to in paragraph (b) of condition 11.9 ... which are payable after the Trade Date.”*
- Condition 11.9(a) states that *“any interest or fees ... which are payable under the Credit Agreement in respect of the Purchased Assets and which are expressed to accrue by reference to the lapse of time shall, to the extent that they accrue in respect of the period before (and not including) the Settlement Date, be for the account of the Seller and, to the extent they accrue in respect of the period after (and including) the Settlement Date, be for the account of the Buyer.”*

The Buyer argued that the Seller was not entitled to a proportion of the Payment Premium because the Payment Premium did not “accrue” either up to the settlement date (Condition 11.3(a)) or in respect of the period before the settlement date (Condition 11.9(a)). Counsel for the Buyer further argued that Conditions 11.3(a) and 11.9(a) should be read together and that Condition 11.9(a) simply defined what is capable of falling within Condition 11.3(a), helping parties identify what is to be paid on the settlement date of a bank debt transaction. The Buyer’s argument was based on the assumption that a secondary bank debt transaction is meant to be concluded by payment of the settlement amount on the settlement date, supporting the “clean break” of a transaction between old lender and new lender under a credit agreement.

The court did not accept the Buyer’s arguments, instead providing a distinction in the explicit wording under both Conditions 11.3(a) and 11.9(a), which resulted in a separate scope of application between both conditions. As condition 11.3(a) addresses *“fees accrued up to ... the Settlement Date,”* it must therefore deal with amounts which have accrued up to an identified point of time (i.e., the Settlement Date). Separately, condition 11.9(a) addresses *“fees ... to the extent they accrued in respect of the period before the Settlement Date,”* which must therefore account for amounts which accrue by reference to a period of time, not *at or by* a particular time. The court inferred from this distinction that Condition 11.9(a) addresses interest and fees which may only accrue at a later date but which accrue in respect of an earlier period (i.e., prior to settlement date). Any other interpretation of Condition 11.9(a) would make the condition redundant vis-à-vis Condition 11.3(a).

Decision

The court determined that Condition 11.9(a) covered the treatment of Payment Premium, as it addressed interest and fees which may only accrue at a later date, but had accrued in respect of an earlier period. While the court felt the Payment Premium could be categorized more as “interest” as opposed to a “fee” for the purposes of Condition 11.9, it accepted the Seller’s argument to treat it as a “fee,” and took the view that it was almost analogous to a commitment fee, where a borrower pays a lump sum to a lender for making an advance available. Consequently, the Buyer was required to pay the Seller the Payment Premium amount that had accrued in respect of the US\$11 million traded portion up to 14 Jan. 2010.

Significance

The findings of this High Court case demonstrate that settlement of a debt trade may not always signify the end of cash payments between the parties. While parties will try to reconcile amounts owed on the date of a bank debt transfer, there remain instances where future payments may still be required to be made, which debt trading parties should review as part of their pre-trade diligence.

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