**Loan Agreement provisions –**

**Lender's options following Events of Default**

This element explains what steps/options are available to a lender when the borrower triggers an event of default.

Note: Unless otherwise specified, clause references throughout this element are to the LMA Agreement. You are **not** required to read the clauses in the LMA Agreement in full, only to broadly familiarise yourself with them.

**What are a lender’s options following an EoD?**

**Acceleration (clause 29.20):** This clause provides a lender with the following remedies:

i) Cancel its obligations to make any further loans to a borrower (this will be relevant where there are numerous tranches of a loan or if the loan is a revolving credit facility; see clause 29.20(a)(i).

ii) Demanding immediate repayment of some or all of its outstanding loans including any outstanding interest and fees; see clause 29.20(a)(ii). This is what is meant in practice by ‘accelerating’ a loan.

iii) Place all of the remaining outstanding loans on demand meaning that these will now be payable on demand; see clause 29.20(a)(iii).

**‘Drawstop’ (clause 4.2):** If a lender is obliged under the loan agreement to lend further money to the borrower, it can also call a **drawstop.** This will be a temporary measure taken by the lender until the EoD is rectified. Under a drawstop, a lender **suspends** further tranches of the loan being drawn down until the relevant situation is rectified. This is different to cancellation of a loan; cancellation is permanent whereas a drawstop is temporary.

**Enforcement of security**

By the Lender or (in a syndicated deal) by the Security Agent/Security Trustee under the terms of the relevant security document.

**The Agent's role in a 'Default' situation**

In a syndicated loan, the agent has duties (clauses 33.3(e) and (f) of the LMA Agreement) to notify the syndicate lenders promptly if it receives a notice of a Default under the loan and also to notify the syndicate lenders promptly if it is aware of any non-payment under the loan (remember non-payment is an EoD).

Under clause 29.20 of the LMA Agreement, in an EoD situation the agent has the **power** to exercise any of the remedies under the ‘Acceleration’ provisions of the EoD clause and the **obligation** to do so if instructed by the '**Majority Lenders**'. (See Workshop 1 element 2).

The borrower will be keen to ensure the Agent can only exercise the remedies under the 'Acceleration' clause in respect of an EoD 'which is continuing'.

See EniBank Precedent Loan Agreement for definition of 'Default'.

**Potential event of default**

**A potential EoD is a situation which would be an EoD but for the fact:**

• the EoD has a contractual grace period which the borrower is currently in; or

• the EoD clause requires the giving of a notice or making of a determination which has not happened yet.

**In the EniBank Precedent loan Agreement (which reflects the LMA position) the term ‘Default’ includes:**

• **an EoD; and**

• **a potential EoD** (“… any event or circumstance specified in clause 23 (Events of Default) which would (with the expiry of a grace period, the giving of notice, the making of any determination under the Finance Documents or any combination of any of the foregoing) be an EoD”).

**The term ‘Event of Default’ means only an EoD. There is no separate definition of a potential EoD.**

**Example (see also diagram at the end of the example)**

On 1 December the borrower signs a term loan agreement with Lender X.

On 2 March a winding-up petition is served upon the borrower by a creditor who is only owed £1,000. This would fall under the ‘Insolvency proceedings’ EoD which in this loan agreement contains a carve-out allowing the borrower a 14-day grace period in which to discharge frivolous or vexatious proceedings. So, on 2 March this situation is only a potential EoD as the 14-day grace period starts running.

The borrower is due to send a utilisation request on 5 March to draw down further funds on 8 March. Both of these would occur during the 14-day grace period.

During the grace period, while there is only a ‘**potential event of default**’, Lender X *cannot* call an EoD and *cannot* use its remedies under the ‘Acceleration’ provisions of the EoD clause.

However, under clause 4.2(a), Lender X *can* exercise a drawstop of the term loan (i.e. suspend lending any further tranches) if a ‘Default’ is continuing (as explained above, ‘Default’ in the LMA includes both an EoD and a potential EoD). So for our term loan above, during the grace period while the potential EoD is continuing, the borrower cannot draw down further funds. N.B. you will see in clause 4.2 that if the loan is a rollover loan (which occurs only in RCF’s), drawstop can only be exercised if there is an actual EoD.

If the borrower rectifies the situation by quashing the petition within the grace period, then the *potential* event of default never becomes an EoD (and the drawstop would be lifted).

**Potential event of default (example)**

[Diagram Timeline]

1 December - Loan Agreement signed

2 March - 'vexatious' insolvency proceedings brought against borrower. 14-day grace period begins.

5 March – utilisation request due to be sent. Representations deemed repeated

Note that in this situation, submitting the utilisation request is likely to be within the borrower's control. However, the same problem would arise if 5 March were to be the first day of an interest period.

**Potential event of default**

A problem can arise for the borrower however (in both term loans and RCF’s) if it is deemed to repeat its representations while it is in a potential EoD situation. As previously discussed, in most loan facilities the borrower will be deemed to repeat representations on the date of each utilisation request and the first day of each interest period under clause.

One of the representations the lender will require the borrower to repeat is the representation that there is no EoD. However, the lender may also try to get the borrower to repeat a representation that there is no **potential**EoD i.e. using the LMA definitions, the lender may ask the borrower to repeat a representation that there is no ‘Default’.

**A borrower should never agree to repeat a representation that there is no ‘Default’ or should amend the representation so it refers only to an EoD** i.e. using the LMA definitions, the representation would refer to there being no ‘Event of Default’ instead of no ‘Default’. **Why?**

Using the scenario above, imagine that the loan agreement contains a representation that there is no **Default**. As we have seen, the issuing of a utilisation request to the lender will trigger deemed repetition of the representation.

On 5 March with their repeated representation that there is no **Default** the borrower would be representing both that there is no EoD (which is true as it is in the grace period for the insolvency proceedings) *and* no potential event of default (which is incorrect because the grace period has started).

So on 5 March, the borrower would be making a**misrepresentation**, and this would trigger the misrepresentation EoD. The misrepresentation EoD would entitle Lender X to accelerate the loan if it chose to (even though the potential EoD for insolvency proceedings may never become an actual EoD if the proceedings are dismissed within the grace period).

**Summary**

• A lender’s possible courses of action following an EoD include cancelling its obligation to make further loans, requiring immediate repayment of outstanding loans plus any accrued interest and fees, and placing outstanding loans on demand. This is known as 'Acceleration'.

• In a syndicated loan, the agent has certain duties on occurrence of a 'Default'. The 'Majority Lenders', will usually be consulted before the agent takes any action to accelerate the loan.

• It is important to appreciate the distinction between events of default, potential events of default and the term 'Default' in a loan agreement.