

Dealings with Lehman Brothers companies in administration

This briefing note has been prepared by The Loan Market Association and Clifford Chance LLP in response to those questions that have been most commonly asked by participants in the loan markets following the filing for Chapter 11 protection in the US by Lehman Brothers Holdings Inc and the filing for administration by certain of its English subsidiaries.

The situations addressed in this note are addressed only on the basis that the relevant contracting party within the Lehman Brothers group is one of the English companies that is in administration and that all relevant documentation is governed by English law. The Lehman Brothers group companies that are currently in administration (each a "**Lehman Admin Entity**") are as follows:

Lehman Brothers Holdings Plc

Lehman Brothers International Europe

Lehman Brothers Limited

LB UK RE Holdings Limited

This note provides general advice and does not address specific situations. It cannot be overstated that in relation to specific situations any advice should be based on a thorough understanding of the specific wording of all relevant documentation and all the relevant facts.

One other general point should also be noted, which is that English law does not recognise branches of financial institutions as being legal entities. So, if a person has contracted with a particular branch of a member of the Lehman Brothers group, that person's contractual counterparty is that member of the Lehman Brothers group and not the branch.

The situations addressed in this note are the following:

- payments due to be made by, or to, a Lehman Admin Entity under a syndicated facility;
- payments due to be made by the borrower to the lenders or by the lenders to the borrower under a syndicated facility when a Lehman Admin Entity is the agent;
- sub-participations made with Lehman Admin Entities; and
- transfers/assignments made with Lehman Admin Entities where the settlement date has yet to occur.

Payments to or by a Lehman Admin Entity as lender

New loans

With respect to prospective new loans, standard agency provisions (including those in the LMA recommended form) provide that, in circumstances where an amount is to be paid by the agent to another party (e.g. the borrower), the agent is not obliged to pay that sum unless it is satisfied that it has actually received that sum (e.g. from Lehman Admin Entity).

Key Issues

Payments made to/by Lehman as lender

Payments made where Lehman is agent

Sub-participations with Lehman

Transfer/assignments made with Lehman

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Effect on facility agreements

Assuming there are no express contractual termination provisions in the event of the insolvency/administration of a lender (and such a provision would be unusual), a facility agreement will not be affected by the administration of a Lehman Admin Entity. As a result, even though the administrators of a Lehman Admin Entity may decide not to honour that Lehman Admin Entity's obligations under a facility agreement, the relevant agent should notify the administrators of the details of the Lehman Admin Entity's participation in any new loan in accordance with the provisions of the facility agreement. If the Lehman Admin Entity does not comply with its funding obligations, this will constitute a breach of contract by the Lehman Admin Entity (giving the borrower the right to claim for damages and possibly the right to cease paying commitment commission).

Lenders' obligations severally

With regard to the effect on other lenders, it should be noted that standard terms provide that no lender is responsible for the obligations of any other lender.

Anticipatory failure to fund

If there is reason to believe that a Lehman Admin Entity will not be making future loans under a facility agreement, subject to there being sufficient undrawn facility amounts, a borrower may consider "grossing up" the amount requested in a drawdown notice to compensate for the Lehman Admin Entity's anticipated failure to fund.

Rollover loans

In the context of "rollover" loans, it should be noted that, while market practice tends to be that rollover loans are effected by way of book entry only (rather than actual movement of cash), most revolving facilities are, in fact, documented such that rollover loans involve, amongst other things, the repayment of the old loan and redrawing of a new loan in an amount equal to (or less than) the maturing one.

Absent any express provisions permitting rollover loans to be effected by way of netting, pursuant to the facility agreement:

- (i) notice of the proposed rollover loan and details of a Lehman Admin Entity's participation in it should be delivered to that Lehman Admin Entity; and
- (ii) the borrower is contractually obliged to repay the maturing loan in full since, pursuant to the documentation, any failure to do so would result in a payment default by the borrower. In most cases, a payment default acts as a drawstop to all new loans, including rollover loans. In compliance with the documentation, the agent should then repay the Lehman Admin Entity's portion of the maturing loan. If the administrators of the Lehman Admin Entity do not honour the Lehman Admin Entity's contractual obligation to fund its portion of the new/rollover loan, this would constitute a breach of contract by the Lehman Admin Entity (resulting in a right of the borrower to claim for damages against the Lehman Admin Entity and, in the circumstances, may also give the borrower the right to cease paying commitment commission).

Alternatively, if the borrower is concerned that a Lehman Admin Entity will not fund future loans, it would be possible for loans to be "rolled over" as follows:

- (a) the borrower deposits with the agent an amount sufficient to repay the Lehman Admin Entity's participation in the maturing loan (the "**Deposit**");
- (b) the borrower pays to the agent an amount equal to the participations of all the other lenders in the maturing loan and the agent pays the same to those lenders in accordance with the relevant facility agreement;
- (c) the agent makes the full amount of the new advance available to the borrower;
- (d) following notification from the agent of its obligation to fund its portion of the new loan, the Lehman Admin Entity fails to fund;
- (e) the agent demands payment of the Lehman Admin Entity's participation in the new loan from the Lehman Admin Entity in accordance with the relevant facility agreement;
- (f) the borrower instructs the agent to apply the Deposit in repayment of the Lehman Admin Entity's participation in the maturing loan (creating a payment obligation from the agent to the Lehman Admin Entity); and
- (g) the agent sets off its payment obligation to the Lehman Admin Entity against its unsatisfied claim against the Lehman Admin Entity.

Please note that this approach assumes contractual set-off rights in the facility documentation permitting the agent to set off amounts owed to it as agent by a lender against amounts the agent owes to that lender. The LMA recommended forms of facility agreements contain such set-off rights.

In circumstances where the relevant documentation permits loans to be "rolled over" by means of netting, the above requirements for full repayment by the borrower and a new advance by the lenders do not apply.

For practical reasons where, notwithstanding the documentation, rollover loans have in the past always been effected by means of a netting arrangement, the agent may wish to consider continuing to do so on the basis that such past practice constitutes an established course of dealing that amounts to an agreement supplemental to the main facility documentation. In these circumstances it may still be prudent to get authorisation from the syndicate to effect rollovers by book entry only. In practical terms, one approach to this could be to specify to the lenders when the details of their participations in a rollover loan are circulated, that in accordance with usual practice the agent intends to effect the rollover by way of account entries rather than the physical movement of cash and requesting the lenders to notify the agent that this is acceptable. Alternatively, an agent may take the view that it only needs to flag this with the Lehman Admin Entity. Ideally, the agent would get positive confirmation from the lenders that this is acceptable and amend the facility agreement accordingly (but again an agent may decide to try to get positive confirmation from the Lehman Admin Entity only).

Issuing Banks

In relation to a fronted bank guarantee (an "L/C") issued by one bank (the "Issuing Bank") on behalf of the lenders, if the Issuing Bank is required to pay a claim made by a beneficiary under the L/C, it has a direct claim against the borrower that requested the issue of the L/C (in addition to a separate indemnity from the lenders) under the facility agreement in accordance with the relevant indemnity provisions. It should be noted that the indemnity obligations of the lenders are several obligations and, therefore, a lender will not be liable to "cover" any amount not paid by the Lehman Admin Entity.

If the borrower fails to pay under such indemnity provisions, this will ordinarily constitute a payment default under the relevant facility agreement giving rise to the usual potential sanction, i.e. acceleration. In addition, the Issuing Bank would have a direct enforceable claim for the unpaid amount against the borrower.

Payments for Lehman

Some agents have queried what they should do with payments received from a borrower for the account of a Lehman Admin Entity as lender. The standard position in relation to such payments made to the agent, is that the agent should make the relevant funds available to the party entitled to receive payment. In the absence of instructions to the contrary from the administrator, the agent should continue to pay monies to the Lehman Admin Entity to its account on the agent's records. If that account is no longer operational, payment should be made to an escrow account established for this purpose.

Payments where a Lehman Admin Entity is agent

Should the administrator of a Lehman Admin Entity confirm that it is to continue in its role as agent, then all parties will need to be satisfied that any funds sent to the agent will be "ring-fenced" for the benefit of the relevant parties. While it is possible that a court would construe that the agent is holding monies received by it on trust for the relevant parties, it is still likely to be undesirable to the other parties that the Lehman Admin Entity continue in its agency role (and that payments continue to be made to it in this capacity).¹

Facility agreements typically include provisions that enable an agent to resign and permit the majority lenders to appoint a successor. It is less common, however, for the lenders to have the right to replace an agent if it does not choose to resign. If an agent is to be replaced other than in accordance with the provisions of the relevant facility agreement, majority lender consent and the consent of the agent would usually be required. As replacement of the agent is likely to be a time-consuming process, it would be advisable for payments from the borrower to be made direct to the individual lenders, pending appointment of the new agent. While this may be contrary to the documentation, there is likely to be little (if any) loss to the Lehman Admin Entity, as agent, in respect of which it could assert a claim.

In very large syndicates the borrower may well not be able to identify all of its lenders to whom it should be making payment. In such circumstances the borrower should take legal advice on the options available to it.

Sub-participations with a Lehman Admin Entity

Sub-participations fall into two types: funded participations and risk participations. A Lehman Admin Entity may be the grantor (the "Grantor") of a participation or the person to whom it is granted (the "Participant").

¹ Lehman Commercial Paper, Inc. has notified lenders in respect of which it acts as agent under certain credit agreements to strictly adhere to the funding provisions set out in those credit agreements. It has stated that payments received by it as agent from the borrower will be forwarded to the relevant lenders accordingly.

In relation to any sub-participation, the principal relationship between the Grantor and the Participant is that of a debtor and creditor, even where it is not expressly stated as such. The Participant has no proprietary claim to the payments (e.g. interest and/or principal) made on the underlying loan by the relevant borrower to the Grantor - it cannot successfully argue that the payment belongs to, or is held in trust for, the Participant. It simply has a contractual claim on the Grantor to the matching payment that the Grantor has agreed to make to the Participant. So, in the event that the Grantor of a participation (whether funded or risk) is a Lehman Admin Entity, if the borrower of the underlying loan makes a payment to that Lehman Admin Entity, the Participant should not expect to receive the matching payment and its only remedy will be to claim for breach of contract against that Lehman Admin Entity.

In relation to risk participations and funded participations where the Participant is required to make further payments to the Grantor (i.e. to meet future drawdown requests) and which are made with a Lehman Admin Entity as Grantor, if the Participant is required to make a payment to the Lehman Admin Entity specific legal advice should be sought in relation to the making of the payment.

Turning to participations where a Lehman Admin Entity is the Participant, the Grantor should expect not to receive payments from the Lehman Admin Entity. As for payments which the Grantor is due to make to the Lehman Admin Entity, the Grantor should ascertain (taking such advice as it deems necessary) whether it is possible for it to set off that payment against amounts owed to it by that Lehman Admin Entity in respect of other transactions. In the absence of the ability to make such a set-off, the Grantor will be obliged to make the payment to the Lehman Admin Entity. It may be possible, in certain circumstances, for the Grantor of a risk participation to terminate the participation but this will depend upon the facts.

Transfers/Assignments with Lehman Admin Entities

In relation to a transfer or an assignment of a loan made with a Lehman Admin Entity where the settlement date has yet to occur, the position is relatively straightforward.

If the transferor/assignor is a Lehman Admin Entity, the transferee/assignee will, subject to its ability to make a valid set-off as set out above, be obliged to make the payment on the settlement date.

On the other hand, if the transferee/assignee is a Lehman Admin Entity the transferor/assignor should not expect to receive the relevant payment on the settlement date. Assuming the Lehman Admin Entity does not make the payment on the settlement date, the transferor/assignor can claim against the Lehman Admin Entity for breach of contract. However, in that situation it would have a duty to mitigate its loss which could involve it actively trying to sell the underlying asset. In any event, whether or not it makes a claim for breach of contract, the transferor/assignor will be free to sell the asset.

This note addresses only the issues in respect of which participants in the loan markets have most commonly been concerned following the filing for Chapter 11 protection by Lehman Brothers Holdings Inc. The administrators of the Lehman Admin Entities have helpfully provided telephone hotlines for questions about the administrations and the numbers for those are set out at the end of this note.

Again, we would emphasise that this note only provides general guidance and no reliance should be placed on it in relation to specific situations.

The Loan Market Association

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Administration telephone hotline numbers:

+44 (0)20 7102 0372

+44 (0)20 7102 6759

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