A BORROWER’S GUIDE

SECOND EDITION

A BORROWER’S GUIDE TO THE ASIA PACIFIC LOAN MARKET ASSOCIATION SYNDICATED FACILITY AGREEMENT FOR INVESTMENT GRADE BORROWERS (SFA) (AND PROJECT FINANCING DOCUMENTATION)
Introduction

Venables Lawyers

Venables Lawyers is a premium boutique firm. Our senior lawyers all have top tier and international experience but come at a more reasonable cost than larger top tier firms. Our areas of expertise are:

- Corporate and project finance and treasury related issues;
- Projects, and particularly aspects of projects related to:
  - project output, such as off-take agreements, complex commodity derivatives and power purchase agreements; and
  - the allocation and management of credit risk;
- Complex litigation relevant to our core competencies; and
- Related corporate, regulatory and secretarial law.

The Second Edition

The response to the issue of the Guide in 2011 was very pleasing with many treasurers reporting that it is a useful resource. We were also pleased to be asked by the Association of Corporate Treasurers in London to publish a chapter in their Asian Handbook, based on this Guide.

In December of 2013 the APLMA issued an update (marked up to its 2009 version) of its Investment Grade Syndicated Facility Agreement. It seemed timely then to issue a new edition of this Guide. Our new comments on the APLMA documents are shown in mark up in this edition.

Changes in the APLMA documents reflect the import of clauses in the LMA documents designed to deal with Lehman Bros type circumstances and subsequent regulation by financial authorities. There are also provisions to pass on the cost of additional regulation and capital requirements. This is a response to Basel III regulation. This is one of the reasons corporates are looking to new markets like the ‘Term Loan B’ markets with Institutional investors, which have other benefits, especially in longer tenors. We suspect that as this and the effect of other new regulation continue, such as in Dodd Frank/EMIR, there will be even further non-bank markets opening up.

The 2013 SFA includes some new options, including to replace individual Lenders in the case of a Lender becoming a Defaulting Lender or an illegality, as well as if there increased costs claims. There is also some additional flexibility if there is a Change of Control. This greater flexibility in managing the membership of the syndicate in difficult circumstances is welcome.

We highlight the seemingly irreconcilable difference between the English and Australian law position on Material Adverse Effect. On the same points the Australian position favours the Lenders much more, perhaps continuing the reputation of Australia as a creditor friendly jurisdiction.

There is also some tightening of credit requirements, which is a bit surprising given the factors mentioned above. There are, however, some welcome rationalisation of administrative requirements.

No doubt with the more aggressive approach of private equity in debt markets, especially relating to distressed assets, there are new provisions relating to the acquisition of debt by related entities. We think the reaction by banks on this has gone a bit too far. Non-bank financiers may well be better at working out difficult situations without eroding value.
General

The APLMA documentation is based on the London Loan Markets Association Facility Documentation but adjusted for Australian conditions. The format of this Guide is in part dictated by copyright requirements.

We have looked at the SFA and also made reference to terms that appear in the project finance market. While project finance documentation is necessarily more complex, the investment grade provisions would typically also appear in any project financing document. As such, there is limited duplication. Project financing is also something of a proxy for credits that are less than investment grade.

We have not sought to comment on every clause in the SFA but have restricted ourselves to those that we wish to address.

Naturally what is appropriate for a financier to concede or a borrower to accept will depend on a range of matters such as the credit standing of the borrower and the general availability of credit. However, we feel it is important to say that the relationship between credit and financing terms is not linear. Our review of many financing documents has highlighted some interesting inconsistencies.

This Guide does not purport to address every issue that a borrower may wish to raise in optimising a financing arrangement with its financier. While care has been taken in preparing this document, it is not intended to be relied on and is general in nature. Borrowers should seek specific advice, which we are happy to provide.

Andrew Venables

June 2014
1. OBJECTIVES AND KEY ISSUES

1.1 Background to the SFA

This guide is aimed at assisting corporate treasurers and project financiers to negotiate the SFA and financing documents generally.

The SFA is based on (but is not the same as) the LMA Agreement.

The APLMA only admits bankers as members of its board1.

The front page of the LMA document carries a warning that it is only intended as a starting point for negotiations. The SFA does not carry that warning but the APLMA produces a separate guide which does say the SFA represents a sensible starting point only. Treasurers have reported that banks suggest that the SFA represents a market standard, although there now seems to be more awareness around this point. Given the constituency of the APLMA, the warning in the APLMA guide, the absence of approval by the FTA and the comments in this guide, treasurers may suggest to the contrary.

1.2 Transactions

The transactions for which the SFA is suitable are different to the transactions for which the LMA Agreement is suitable. The SFA is supported by APLMA for transactions where (with the LMA position in brackets):

(a) the Agent is based in Sydney or Melbourne (London);

(b) the Obligors are companies incorporated in Australia (companies incorporated in England and Wales and the transaction is syndicated in the Euromarkets);

(c) no security is provided (same) and the Company is of an investment grade rating;

(d) Australian Law is the Governing Law (English law).

The SFA is modified for these purposes as well as for the purpose of Australian funding arrangements, Australian tax issues and market differences.

1.3 Key issues to be considered

Without limiting our comments on certain specific provisions we think that Borrowers should especially focus on:

(a) any potentially ambiguous drafting: as is discussed in section 2, courts in Australia use phrases such as ‘Lenders may wear belt and braces’2. As between the circumstances of a particular business and bank finance documents the courts say they should be the ‘upholder of agreements’ so as to avoid paying the price ‘in terms of the cost of capital necessary as a consequence of uncertainties of the enforcement of agreements in their courts’. If a view is formed that, at least at the corporate level, there is a bias in favour of banks in interpreting finance documents and upholding securities

2 Pan Foods Company Importers and Distributors Pty Ltd v Australia and New Zealand Banking Group Limited (2000) 170 ALR 579. See our further discussion on this case from page 5.
then treasurers need to address ambiguities in their documents and eschew standard ‘one size fits all’ arrangements;

(b) group structuring issues;

(c) the financial covenants and in particular whether they are to be complied with ‘at all times’ or on ratio testing dates;

(d) Clause 22.3, the negative pledge and with Clause 22.4 relating to disposals of assets;

(e) especially if you have issued notes or bonds in the debt capital markets, the cross acceleration/cross default question;

(f) the definition of Material Adverse Effect, especially if there is an MAE Event of Default;

(g) the breadth of the indemnities, especially if the indemnity for mitigation is not removed;

(h) the constituency and ability of the bank syndicate to change along with voting arrangements (including the new Borrower Affiliate/disenfranchisement provisions);

(i) the change of control provision;

(j) the ability to change the SFA (refer discussion around ‘continuing’ and mechanics to obtain a waiver);

(k) payment of Break Costs;

(l) the inclusion of Fee Letters and the Arrangers inclusion in the SFA document;

(m) the scheme of information representations;

(n) the representation in respect of whether a Material Adverse Change has occurred at Clause 19.9(c);

(o) avoiding a continuous disclosure regime (see clause 19.10 for instance).
1.4 Definitions Used in this guide

Unless the context otherwise requires, capitalised terms in this guide (other than those defined below) have the meaning given to them in the Agreement (as defined below) or the meaning ascribed to them on first usage. In this guide, the singular includes the plural and vice versa.

**Agreement (or SFA)** means the APLMA Multicurrency Term and Revolving Syndicated Facility Agreement for investment grade Borrowers (Australian Branch) 2013.

**APLMA** means the Asia Pacific Loan Market Association.

**Borrower** has the meaning given to that term in the Agreement. In this guide, we have also used it as an umbrella term covering borrowing parties contemplating entry into the Agreement.

**FTA** means the Finance and Treasury Association.

**LMA** means the Loan Market Association (UK).

**LMA Agreement** means the LMA Investment Grade Facility Agreement.

2. PROCESS

As with any procurement process the key to a successful outcome is performing well on the basics: presenting the investment case in the best possible light, maintaining good relationships with a number of providers over an extended period, planning, maximising competitive tension, getting the right advice from lawyers and, where appropriate, investment banks, setting your objectives at the outset and objective review by parties not involved in the negotiation with relevant experience.
3. COMMENTARY ON THE SYNDICATED FACILITY AGREEMENT

PARTIES

The Parties include:

(1) the Company;

This is usually the lead company or finance company in the group. The reference is to ‘Company’ because the SFA provides for there to be more than one Borrower.

(2) certain Subsidiaries, listed as Original Borrowers;

(3) certain Subsidiaries listed as Guarantors;

(4) an Arranger, the mandated lead arranger(s);

Clause 27.3 provides that the Arranger has no obligations of any kind under or in connection with any Finance Document. In those circumstances we do not think they should be a party. It might, for instance, afford the Arranger the benefit of the default and indemnity provisions in respect of their fee arrangements. This might be disadvantageous in disputes over fees, which occur from time to time.

It is not clear what effect clause 27.3 would have on any public offer representations by the Arranger in clause 30. As such they would be better placed in the mandate letter to avoid confusion.

(5) the Original Lenders, which may come and go in accordance with or subject to the syndication provisions;

(6) the Agent of the Finance Parties, which includes the Arranger, the Agent and the Lenders.

The key point for Borrowers is which companies to include in the Borrowing Group and how to structure the Group’s affairs. In the context of project financings, especially for junior developers, it is important to start thinking about the financing early in the development. Key assets should be kept in a subsidiary so as to maximise capital raising flexibility. Some executives claim that a company need not go to the trouble because the company is a single project entity but, especially in the resources sector where farm-ins and sell-downs become necessary to raise capital, this is often not the case.
SECTION 1
INTERPRETATION

We generally discuss definitions in the context of the place they are used although as some are used in different contexts comments are relevant here. The following is not a complete list of the definitions as there are some on which we have no comments. We have paraphrased each definition.

1. DEFINITIONS AND INTERPRETATION

1.1 Definitions

An Affiliate is taken to be any Subsidiary or Holding Company of a person or and each ‘sister’ company of that ‘person’. The word ‘person’ works because it is defined in Clause 1.2(a)(v) to include a company.

This definition is primarily used in the context of the rights of the Lender but, importantly, is also used in the restrictions on the disposal of assets provision at Clause 22.3 (Negative Pledge). We have difficulty with those provisions generally for an investment grade Borrower but if they are to be included, this definition needs to be considered closely. It is a narrower concept than that of a related body corporate in the Corporations Act.

The Agent’s Spot Rate of Exchange means the Agent’s bid rate at around 11am for the relevant currency.

There is almost always a screen rate for any currency or interest rate. It is preferable to adopt that rate plus any spread the Agent proposes from the perspective of transparency and verification for audit purposes. The Agent’s rate for large corporate customers can be adopted as a fall back.

An Authorisation is broadly defined to include any consent, licence etc thing required by a government agency or any law, or, the passage of a period of time without a government agency taking action.

Some firms include the materiality qualifiers for Authorisations in the definitions rather than the place in which it is used. We prefer to set them out where the definition is used in order to ensure they are given proper consideration.

Authorised Officers are defined by notice in the case of an Obligor and by persons who have a particular title in the case of the Finance Parties.

Commonly we see a provision for a Finance Party to notify a particular ‘position’ that may not have one of the nominated titles.

BBR used to be identified by reference to a screen rate and failing that or if in the opinion of the Majority Lenders the screen rate does not reflect the Lenders’ cost of funding at the date of the Agreement, then the arithmetic mean of quotes of the Reference Banks. It is now determined by the Agent applying its opinion of the relevant Interest Period to screen rate. If there is no equivalent Period then the Interpolated period or if there is no Interpolated period the rate determined by quotes from 3 reference banks.

Previously we said:

‘The reference to the cost of funding in (b)(ii) is flawed in as much as it is based on the Lenders’ opinion. Repricing mechanisms for changes in market positions of a particular group of banks is not something the Borrower should face and if it is to be
incorporated at all it should have more checks and balances that solely the Lenders’ opinion.

If the problem is a Screen Rate for a particular period then it should be possible to determine a rate by linear interpolation or extrapolation. The Reference Banks should be the last resort.

It seems that the definition has moved in that direction, which is an improvement.

**Break Costs** are calculated by subtracting the amount of interest that the Lender could have received by placing the funds on deposit with a leading bank from the amount it should have been paid had the loan not been repaid early. It is said to be an amount payable in lieu of interest which would otherwise have been paid.

<table>
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<th>The general principles applicable to Break Costs should be that they are:</th>
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<td>(a) compensatory, but should not involve a profit element to the Finance Party or the Borrower,</td>
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<tr>
<td>(b) transparent and objectively determined; and</td>
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<td>(c) reciprocal.</td>
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This definition is inconsistent with each of those principles.

Some of the key issues are:

| (a) paragraph (a) involves a loss of profit concept as ‘the interest the bank should have received’ also includes its margin. It should exclude the margin; |
| (b) paragraph (b) introduces a subjective element in that, rather than referring to a screen rate it is the deposit amount that the particular Lender is able to achieve. Why there would also be the option of acquiring a bill is not clear to us; |
| (c) the word ‘exceeds’ between paragraphs (a) and (b) suggest that the Lender will not take into account or pass on any gains it makes as a result of the outcome. This is inconsistent with the position adopted under ISDA documentation for interest rate swaps where even a party in default, whether it is the Finance Party or the Borrower, has to pay marked to market amounts on termination. We provide an example of a ‘Break Gain’ definition from a current and publicly available project finance definition at Clause 11.5 (Break Costs); |
| (d) there is no requirement to demonstrate how the amount is arrived at; and |
| (e) the statement at the end of the definition is not consistent with the remainder of the definition. |
**Default** means an Event of Default in Clause 23 (Events of Default) and what would typically be referred to as a Potential Event of Default.

This term replaces the more usual 'Potential Event of Default' and combines it with Events of Default. It is a little unusual because it includes the Events of Default as well as potential defaults. We discuss the structure of drawing and rollover arrangements in Section 9. We think that a more normal Potential Event of Default and rate set arrangement would be in both the Finance Partners’ and the Borrowers’ interests.

As 'Lehman' provisions have now been incorporated we have deleted the following commentary. Since the Lehman collapse, the LMA Agreement has included provisions dealing with a ‘Defaulting Lender’. Broadly speaking, once a Lender becomes a Defaulting Lender, the Borrower can cancel any undrawn Commitment of the Lender and they can be assumed by a new or existing Lender selected by the Borrower.

There are many examples of banks that collapsed (Lehman) or went close to collapsing during the GFC that had operations in Australia. We therefore cannot see why this arrangement would not apply here. What is even more difficult, and is a particular Australian issue, is the closing of Australian Branches of foreign banks, which happens from time to time and sometimes happens in waves.

It would be a useful policy development if Borrowers could nominate banks as ‘Defaulting Lenders’ if they in substance close their branches. Such banks should presumably pick up any relevant costs.

**Distribution** means [#], (note, this does not appear in the SFA).

This definition is particularly important in project financings because the assets financed are ‘ringfenced’ and the price of non recourse to Sponsors is a limitation on their access to the cash of the project. Many firms take a different approach to defining what is a Distribution. While all are expansive if prepared by the Finance Parties’ lawyer, there are some issues for the Borrower to consider.

**Facility Office** means the office or offices [in Australia] of the Lender notified to the Agent.

If at any time it is proposed that a Lender will have an office outside of Australia it is important to closely consider the withholding tax provisions of this document.

In addition to withholding tax issues it is also important to consider whether the laws of the office of the relevant country may enable a bank to withdraw a Commitment or refuse to provide a drawdown, as is contemplated by Clause 8.1 (Illegality).

**Fee Letter** means the letter setting out the fees referred to in Clause 12 (Fees).

We do not see a role for Fee letters in this Agreement. It makes negotiations with Lenders difficult as the Lender may be able to rely on default rights in the event of a dispute.

A **Finance Document** is the Agreement, any Fee Letter, any Accession Letter and any other document the Agent and the Company agree is a Finance Document.

As outlined above, we generally prefer that Fee Letters not be included as Finance Documents.

The **Finance Parties** are the Agent, the Arranger or a Lender.
The Arranger is included as a Finance Party. The risks associated with being an Arranger are different to those of a Lender and therefore we prefer the indemnities and representations to be given to the Arranger to be dealt with in their mandate or Fee Letter. We do not agree, as this Agreement proposes, that the Arranger fees should be set out in the Fee Letter for all Lenders. In our experience, there is usually no separate concept of Arranger and we would generally prefer that be the case here.

Financial Indebtedness is a very broad definition including:

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Many firm’s precedents have broad and inclusive introductory words to this definition which are capable of capturing even trade receivables. An example is:

‘means any present or future actual or contingent debt or other monetary liability …, including in respect of:’

The APLMA version is to be preferred.

This definition is used for the purpose of the Clause 22.3 (Negative Pledge) and 23.5 (Cross Default). It may also be used in some financial covenants.

Lenders use this clause to capture all kinds of indebtedness that may be or become owing. Its precise content and effect needs to be carefully considered to ensure that it does not unnecessarily restrict a Borrower’s ability to undertake its normal activities or unnecessarily trigger a cross-default. It should exclude debt between Obligors and any subordinated debt.

During the GFC this definition was used by banks closely examining their documents for defaults. In particular, the effect of derivatives on gearing ratios was an issue. Also contingent liabilities like guarantees (including ASIC Class Order Guarantees) could be captured if required. These are highlighted below.
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(a) moneys borrowed;

(b) bill facilities;

(c) debt under bonds, notes, debentures, loan stock or any similar instrument;

(d) any lease or hire purchase contract which is a finance or capital lease;

(e) receivables discounted (except if sold on a non-recourse basis);

(f) any redeemable preference shares;

(g) any arrangement having the commercial effect of a borrowing;

(h) deferred purchase price of more than 90 days;
(i) the marked to market value of any derivative;

The inclusion of derivatives may be a concern where the Agreement restricts the circumstances in which and/or the level of Financial Indebtedness that may be incurred by a Borrower.

The problem with this definition is that the inclusion of the marked to market value may not reflect the hedge’s effectiveness. In our view, Borrowers should seek an express carve-out of this provision where it is used subject to an overall cap on Financial Indebtedness (where one is selected in Clause 22.3, for example).

Borrowers need to take care that this does not work so as to form part of any gearing ratio (but derivatives may be taken into account in interest cover/DSCR ratios). Particular interest rate hedges will change in value but will be offset by the countervailing physical position because that is what they are intended to do.

(j) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, standby or documentary letter of credit or any other instrument issued by a bank or financial institution; and

Borrowers should make sure this does not create double counting.

(k) the amount of any liability in respect of any guarantee or indemnity for any of the items referred to in paragraphs (a) to (j) above.

For Investment Grade Borrowers, care needs to be taken with the particular circumstances of each Borrower and the usage generally of this definition. For instance, if there is a cross guarantee in place in a group, paragraph (k) can result in considerable double counting. Borrowers may wish to specifically exclude intra-Group debt from this definition. Also, if the ratios or interest charging provisions are not closely considered there can be interest charged on the amount letters of credit or artificially inflated gearing.

Financial Indebtedness and project finance

In the project finance context there will sometimes be an absolute prohibition on incurring Financial Indebtedness, other than Permitted Financial Indebtedness. There have been many types of carve-outs in Permitted Financial Indebtedness at a basic level including such matters as small equipment leases, Austraclear, swaps, working capital facilities, trade accounts etc, but also a number of more general schemes such as the following:

(a) any Subordinated Debt, which will generally have a form of Subordination Deed Poll appended;

(b) Refinancing of part or all of existing indebtedness. This can be particularly important to avoid having to renegotiate a whole facility when only some lenders do not wish to renew or when a bullet tranche is coming due for maturity. If it is not available then an entire facility may take on the terms of a Finance Party that is least inclined to continue. The Finance Parties will rightly be inclined to set some basic parameters for the effect of the new debt on ratios etc;

(c) Financial Indebtedness for which the Finance Parties are given a first right of refusal to provide and which will not cause certain ratios to be exceeded;

(d) an amount for a known requirement for capital expenditure, which will again be limited by its impact on current and projected ratios; and
If possible, it affords the Borrower more flexibility if it is able to satisfy its Finance Parties by accepting general gearing and debt service ratios in contrast to restrictions on the basis of form and amount.

**Group** means the Company and its Subsidiaries.

This is used in the definition of Material Adverse Effect (see page 16) in a number of warranties (see Clause 19.9 (No Misleading Information) 19.10 (Financial Statements)), Clause 22 (General Undertakings) and Clause 23.5 (Cross Default).

Given the significant consequences that can flow from this definition, it deserves close attention. As is discussed later in this Guide, where Borrowers are required to warrant particular matters on behalf of other members of the Group, it may be appropriate to qualify its effect by reference to a certain level of knowledge or the materiality of the matter being warranted.

‘Holding Company’ means, in relation to a company or corporation, any other company or corporation in respect of which it is a Subsidiary.

The LMA Agreement includes a definition of ‘Impaired Agent’ which, generally speaking, extends the notions relevant to the definition of ‘Defaulting Lender’ to the Agent. An inserted Clause 12 allows for the Majority Lenders to remove the Impaired Agent, after consultation with the Borrower and appoint a replacement Agent. This could be useful in Australia.

The **Information Memorandum** is the document in the form approved by the Company and at the Company’s request and on its behalf, was prepared in relation to ‘this’ transaction and distributed by the Arranger.

Given its use in the indemnities (see, for example, Clause 15), this is one of the most important definitions in this Guide.

It may well be a fiction that the Arranger prepared the Information Memorandum (IM) or that the Borrower approved it. It is likely that it was not prepared at the Borrower’s request. Many Borrowers prepare IMs themselves and give them to Finance Parties to review. Importantly, sometimes expert reports are reproduced or bound in with IMs. Those reports should be addressed to the Arranger (not the Borrower) and the relevant expert responsible for them. Whatever the process it is appropriate to set out exactly what did happen.

It is important to make sure that the Borrower is in fact comfortable with the document and that it is not changed or embellished by comment of the Finance Parties including when it is being distributed by the Arrangers. This is because such comments will be sheeted home to the Borrower either formally or informally.

Especially in the case of project financings, we have seen financial models, assumption books and associated IM dissected in the representations so as to layer who was responsible for what and how the information is represented. The Finance Parties are entitled to be told that the important information they are relying on is correct but we get anxious about representations around future events and forward looking statements.

There are two **Loan** facilities, Facility A Loan and Facility B Loan. Facility A is a term loan and Facility B a revolver.

The **Majority Lenders** are those with $66\frac{2}{3}\%$ of Loan outstandings or if there are none, $66\frac{2}{3}\%$ of the Lenders’ Commitments.
The concept of Majority Lenders has a few variations. Sometimes it is focussed on ‘Commitments’ and other times on ‘Outstandings’, as is the above definition. Both have competing qualities and issues.

In project financings the interest rate swaps are commonly tied together with the principal debt through a definition of ‘Exposure’ and regulation of enforcement rights of swap counterparties. The Exposure is sometimes taken into account in the definition of Majority Lenders. The Borrower needs to consider the dynamics of its bank group in determining its position on these matters.

The critical question of managing voting rights and the interaction between different bank groups is dealt with in cross-default. Further important aspects of managing a syndicate and voting arrangements between different syndicates is dealt with in the Agency sections. In some cases, Borrowers are able to exclude or (preferably include as a positive vote) the vote of Finance Parties that do not respond within a certain period. An option along these lines is included in the 2013 SFA.

['Material Adverse Effect' means a material adverse effect on the ability of an Obligor to perform its obligations under the Finance Documents, on the remedies or rights of the Finance Parties or on the financial condition or business of an Obligor.]

OR

['Material Adverse Effect' means a material adverse effect on:

(a) the business, operation, property, condition (financial or otherwise) or prospects of the Group taken as a whole;

(b) the ability of [an Obligor]/[the Obligors (taken as a whole)] to perform [its]/[their] obligations under the Finance Documents; or

(c) the validity or enforceability of the whole or any material part of any Finance Document or any material rights or remedies of any Finance Party under the Finance Documents.]

This is one of the most important and most often discussed definitions in the Guide. It is used at least in Clause 19.8 (No Default), Clause 19.12 (No Proceedings Pending or Threatened), Clause 20.4 (Information: Miscellaneous) and (potentially) 23.13 (Material Adverse Change).

Enforceability of Finance Documents

Some Borrowers express the view that there are many clauses that deal with the validity and enforceability of Finance Documents and that it seems duplicative to be dealt with again here. In our view, it is common for people to look at the definition where it is used and assume it relates to the position of the Borrower, not the efficacy of the Finance Documents.

Finance Parties have numerous rights relating to the enforcement of the Finance Documents. Certainly the first option above is too broad but even under the second option, if a judgment is handed down that, for instance, makes it easier for Borrowers generally to get an injunction to restrain enforcement in circumstances that will be unlikely to apply to a particular Borrower, does that mean the Borrower is in default? On a plain reading of the words in (c) taking into account the ‘belt and braces’ rule of construction above it would. There are bases for suggesting that managing the enforceability of Finance Documents is part of the Finance Parties day to day business and a risk best left with them. It is only when there is an actual problem that cannot be remedied that the Borrower should become involved and only then when it has had a chance to remedy or substantially remedy.
**Ability to Perform**

The first definition refers only to the ability of an Obligor to perform. If the Borrower is the Holding Company and is entitled to dividends from all its subsidiaries, there may be an argument to exclude ‘taken as a whole’ but we think it preferable to include it anyway. In the more normal circumstance where the Borrower is a finance company subsidiary then this is plainly necessary because its access to cash is commonly dependant on the Group and viewed in isolation its prospects may be severely affected by something which is not a concern for the Group.

In the first definition the performance criteria are related to each Obligor and its ‘financial condition or its business’, but in the second it relates to the Group business, operation, property, condition (financial or otherwise) or prospects ‘taken as a whole’. We do not appreciate the rationale for the difference. Perhaps the draftsperson thinks that the quid pro quo for the ‘taken as a whole’ is a broader range of enquiry for the Finance Parties.

We consider ‘taken as a whole’ to be the logical response.

As regards performance, we generally think that the MAE should not be a cure all or for the more specific performance clauses, so we like to add:

‘but does not include any material adverse effect that arises from or in connection with any event or effect which would otherwise of itself constitute an Event of Default’.

As an aside, this makes waiver letters easier to write.

With those qualifications we therefore prefer the first definition.

We also think that the performance question in the first definition should be relevant to the ‘material financial obligations under the Finance Documents’. Non material and non financial obligations have their own remedies and commonly grace periods and carve-outs. As this document provides for a stand alone MAE default there is considerable risk that a definition that relates to non-material or non-financial obligations will cut across those grace period and specific provisions.

The breadth of the references to business, operation, property, etc in the second definition is also problematic. We give an example of that in the next paragraph.

**Value of Security**

Usually if a finance document addresses the value of a security or the assets of an Obligor it will do so through detailed loan to valuation ratios where the parties agree how and when assets will be valued or through gearing ratios which give the Borrower opportunity to remedy any fall in asset values through capital raisings, etc. We suggest that defaults based on the value of assets require close consideration, should only be tested periodically and should not be left to general provisions such as the MAE clause. We note the APLMA document does not expressly refer to the value of assets but the reference to prospects or ‘property’ could so relate.

**Lesser matters**

We sometimes exclude matters that have otherwise been consented to by the Agent as this assists administration.

If, as will often be the case in a project financing (and the SFA), the Financing Documents include insurance provisions, then consideration should also be given to recognising the availability of insurance in the MAE clause.
Setting out the meaning of ‘material’

While agreeing to a broadly drafted clause may help avoid the time and expense inherent in haggling over low-probability contingencies, parties should be aware they are essentially asking the court to ‘gap fill’.

Borrowers should specifically consider whether they are in a position to exclude some external eventualities. That is, are they in a position to exclude developments external to the business that affect the business? This may include factors affecting related entities that are not a party to the transaction. It is to be noted that the limited judicial guidance we have in this area indicates that unless such exclusions are expressly written into the clause, they will be included within its scope. The Court took this view on the basis that the option to exclude was available to the parties and they elected not to exercise it.

There are many examples of such exclusions. For instance, in transactions involving companies operating in the National Electricity Market we have excluded a change in the price of electricity or the definition of Voll (market price cap).

Some cases

Material in whose eyes?

It has been noted by a number of commentators that one key element of Material Adverse Effect/Change provisions which is left undefined is the definition of materiality itself.

Parties to these transactions generally adopt one of two options:

(a) events of default may be predicated upon a lender’s state of mind which typically takes the form of including, ‘which, in the opinion of the Lender, will have a material adverse effect’; or

(b) one that is defined in purely objective terms: ‘if a material adverse change occurs.’

For obvious reasons, we consider a formulation defined in purely objective terms to be more advantageous to a borrower. In Pan Foods Co Importers & Distributors Pty Ltd v Australia and New Zealand Banking Group Ltd the High Court of Australia considered the effect of the activation of a material adverse change clause predicated upon the lender’s state of mind.

In particular, the case focussed on whether the basis upon which such an opinion was founded needed to be expressly communicated to the Borrower.

The High Court held that it was sufficient that the basis for the lender coming to such a conclusion was implicit in the activation of the clause. The Privy Council took a different view in the BVI case of Cukorova v. Alfa when it held that the court needed to be convinced on the basis of admissible evidence that the lender did in fact form the requisite opinion, and that the opinion was both rational and honest. In that case there was such evidence according to the Board (although not the primary judge).

As we outlined in some detail in the first edition of the guide the Pan Foods case represents an judicial attitude that is supportive of a ‘belts and braces’ outcome for banks and warns of a potential flight of capital from Australia if courts are not ‘upholders of [loan] agreements’.

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3 IBP, Inc v Tyson Foods, Inc Shareholders Litigation 789 A 2d 14 (Del Ch, 15 June 2001), a decision of the Delaware Court of Chancery.

We also prefer the approach of the English High Court in Grupo Hotelero Urvasco S.A. v Carey Value Added S.L. [2013] EWHC 1039, in which the court considered a relatively simple form of an MAE clause. It said that in order to be material the event or change needed to significantly affect the borrower’s ability to perform its obligations under the loan documents and particularly its payment obligations. The court supported the view that the change would need to be of a type that, had it been known at the time of the loan, would have caused the bank not to lend or to lend on significantly more onerous terms. The decision canvasses a number of other useful concepts such as pre-existing conditions, awareness of the bank and the need for the change to be more than merely temporary.

It seems the Australian position is towards the opposite end of the spectrum to the English position and we are not aware of an urgent flight of capital from England as a result. This is not inconsistent with Australia’s reputation as a creditor friendly jurisdiction.

The upshot of the Australian approach is that Borrowers in Australia may wish to resist a potential Material Adverse Effect/Change clause that is predicated on the opinion of the Lender.

Holding the Lender to their Obligations

In Genesco Inc. v Finish Line Inc at a well drafted MAE clause was able to hold the Lender to their obligations under a deal in circumstances which would otherwise have constituted a MAE.

Genesco and Finish line, both retailers in the shoe industry, entered into a merger agreement in June 2007 whereby Finish Line agreed to acquire Genesco for $1.5 billion in cash. Finish Line planned to fund the highly leveraged transaction with funds borrowed from UBS A.G. The agreement contained a relatively standard MAE definition. The definition included a ‘carve-out’ that excluded from the definition of MAE a change in ‘general economic conditions’, unless such changes adversely harmed Genesco ‘in a materially disproportionate manner’.

A few weeks after the agreement was executed, Genesco suffered a significant loss in earnings - the worst in 10 years. At the same time, the full effect of the credit crisis was being felt by the banks and UBS admitted in its court filings that funding the Genesco deal would result in a huge loss for UBS.

As a result, UBS and Finish Line pressured Genesco to renegotiate a lower price for the deal. Genesco refused and sued Finish Line seeking specific performance.

Finish Line argued that an MAE had occurred and it was not obliged to complete the deal.

The court held that although the conditions suffered by Genesco were sufficiently bad to constitute an MAE, these problems were attributable to general economic conditions and Genesco had not suffered disproportionately to its peers in the same industry. As a result, these events fell within the broad reading of the ‘general economic conditions’ carve-out and were excluded from events that constituted an MAE.

This highlights the value to the Borrower of negotiating appropriate carve-outs from any MAE clause that is part of an agreement.
A **Repeating Representation** is one that is deemed to be repeated for the purposes of Clause 4.2 (Further Conditions Precedent means each of the representations set out in Clauses 19.,[ 19., ] and 19.[ ]).

This is a matter of considerable importance. The starting point is to not repeat all the representations that have spent their usefulness on their first repetition, such as the validity of Finance Documents. Second, for listed entities in particular but all Borrowers, it is important to avoid setting up a ‘continuous disclosure’ regime, which may require more disclosure or trigger disclosure to share market regulators. Third, there are some questions of risk allocation that properly reside with the Finance Parties. For instance, in the context of a project financing it would be inappropriate to represent more than once that the financial model is accurate.

**Screen Rates** are determined by reference to various Telerate or Reuters pages. There is also a repetition of the protection afforded to the Lenders in the event, in their opinion, the Screen Rate does not reflect their cost of funds then an alternate page or service will apply if the Majority Lenders so specify.

*We would add ‘reasonable’ before opinion and change ‘appropriate’ to ‘corresponding’ so as to reduce the possibility that the Finance Parties might achieve a windfall gain.*

Our comments about the appropriateness of the application of the Lender’s opinion test under the definition of BBR also apply to switching the Screen Rate page or provider.

**Security** is defined to mean a mortgage, charge, pledge, lien or other security interest and similar interests.

*The reference to ‘obligation’ should be to Financial Indebtedness as that is the aim of the definition.*

To avoid double-counting we like to exclude letters of credit and bank guarantees. *Failing this, Borrowers may find themselves in default because a contracting party has called on a bank guarantee even though the party is in dispute.*

**Subsidiary** there are 2 cumulative options for defining a Subsidiary either per Division 6 of the Corporations Act 2001 or a combination of the Corporations Act and ‘current accounting practice’.

*Borrowers need to think closely about the definition of Subsidiary that is employed as it is incorporated in the definition of Group (see page 13) and thus determines which entities are caught by the representations, warranties, covenants and Events of Default. We are not sure why the defined term GAAP is not used instead of ‘current accounting practice’.*

**A Tax** is broadly defined to include any tax, levy, impost, duty or other charge or withholding of a similar nature (including any penalty or interest payable).

*We suggest that there should be an express exclusion of tax on the income of the Finance Parties. There are also a range of circumstances where a Finance Party should not be able to claim a tax reimbursement, such as when they have failed to comply with a regulatory requirement.*

*We generally take the view that any penalties payable should be qualified by the extent to which such penalty or interest payable is caused or contributed to by the Lender.*

*We would usually expect to see the exclusion of ‘Contested Tax’. A provision such as this covers Tax payable by an Obligor where they are contesting their liability to pay a particular Tax .*
Other possible carve-outs include:

(a) Australian Withholding Tax;
(b) tax on the income of the Facility;
(c) tax that arises from the Indemnified Party being a resident of a particular jurisdiction because of the Financing documents; and
(d) tax that arises because the Finance Party fails to comply with a certification, identification, or other reporting or similar requirement.

1.2 Construction

(a) In this clause the meanings of the following words are clarified (or generally broadened):

   (ii) assets;

   We suggest that all accounting terms be defined by reference to GAAP. We do not think assets should be singled out for special treatment. Because this definition does not identify whose asset it is referring to and also because of some unusual arguments made by a financial institution, we have previously had to expressly exclude liabilities from it.

   (v) indebtedness includes any obligation for the payment or repayment of money;

   This potentially cuts across the carve-outs and limitations applicable to Financial Indebtedness and should be deleted.

   (vii) a regulation is broadened to include any regulation, rule, official directive, request or guideline (whether or not having the force of law) and if not having the force of law, with which responsible entities in the position of the relevant Party would normally comply;

   While the reference to matters which do not have the force of law may be considered reasonable on a facility by facility basis, the inclusion in standard documents by an industry association highlights the ability of the banks to effect outcomes under this document through their association.

   (viii) the words ‘including’, ‘for example’ or ‘such as’ do not limit the meaning of the words to which the example relates to that example or examples of a similar kind;

   One of the canons of construction applied by courts in attempting to work out what parties mean in a document is called the ejusdem generis rule. It means that where several words come before a general word, usually a list of examples or circumstances, the general word is restricted to the meaning of the preceding words. The result is the general word does not expand the beyond the subjects or classes of the preceding words.

   For instance, where an exclusion clause in an insurance contract states that liability will be excluded by damage caused by ‘acts of god, flood, fire or otherwise’, the term ‘otherwise’ relates only to damage of the same class as the preceding words. Thus the
clause would not exclude liability for damage caused by riots, but may do for damage caused by earthquakes.

The effect of this rule of interpretation is usually avoided by use of the words, ‘without limitation’.

(i) A Default (other than an Event of Default) is ‘continuing’ if it has not been remedied to the [reasonable] satisfaction of the Agent (acting on the instructions of the Majority Lenders) or waived in writing and an Event of Default is ‘continuing’ if it has not been [remedied to the [reasonable] satisfaction of the Agent (acting on the instructions of the Majority Lenders) or waived in writing]/[waived in writing].

For the purposes of financial reporting and disclosure generally it should not be necessary to seek approval from, or give the Agent authority to, decide whether a default has been remedied. That should be an objective analysis. For example, even where the word ‘reasonable’ is included above, if the Agent takes an erroneous but not outrageous view of an accounting standard that puts a financial ratio into breach, the Borrower must notify the Agent of the breach and may not be able to repeat representations or draw down funds etc.

Subject to our comments above, it is important that Borrowers include in the definition that Event of Default is ‘continuing unless it has been remedied or waived’ (the first option). This is important to prevent Borrowers finding themselves in a situation where they may have remedied an Event of Default, but such remedy does not prevent an Agent enforcing the consequences of a continuing Event of Default due to the fact that it has not been waived. An example of this is Clause 4.2 (Further Conditions Precedent) which provides that further advances may be conditional on the absence of a continuing Event of Default.

Other Provisions

Listing Rules

We have seen a post GFC clause, which says that a listing rule will be regarded as a law (including for unlisted companies). We do not like this at all for a number of reasons. If care is not taken over any undertaking to comply with all laws, such as Clause 19.5 of the SFA, then that provision could require an Obligor to have to comply with a law that it would not otherwise have to.

There is also a lot of room for judgement and analysis in the application of the listing rules. If, for example, the bank were to take a different view of whether a particular event is likely to have a material effect on the value of the Borrower’s securities then that could cause considerable inconvenience for an unlisted let alone a listed Borrower. Directors would feel uncomfortable if a facility is terminated for breach of continuous disclosure rules when the relevant matter had not been disclosed.

Non-Recourse Clause

Most project financings will include a non-recourse clause because this is an essential feature of the arrangement from the Sponsors’ perspective and the reason why additional margins are paid, etc. The following is an example clause. Its precise content will depend on each particular transaction. This is because the relevant circumstances of the action that Finance Parties will take to have recourse to the Sponsor will vary depending on the circumstances. We would not expect to see this in a corporate document such as the SFA.

Non Recourse
The parties acknowledge and agree that, despite anything to the contrary in any of the Finance Documents:

(a) no Indemnified Party will have any recourse to any Associate of the Borrower, or any of their shareholders, officers or other controlling persons, employees, agents or advisers (each a ‘Non Recourse Party’) in respect of any amount owing to the Indemnified Party under or in respect of the Financing Documents or in respect of the Secured Money or transaction relating thereto, other than pursuant to an agreement to which the Non Recourse Party is a party;

(b) a Non Recourse Party is not personally liable for the performance of any obligations contained in any Finance Document or for any representations or warranties contained in or given in relation to the Finance Documents except those obligations and representations and warranties which it expressly assumes in writing;

(c) for the purpose of paragraph (a), ‘recourse’ includes:

(i) issuing a demand, bringing proceedings or taking any action to obtain a judgment, enforcing any judgment obtained against a Non Recourse Party or the assets of a Non Recourse Party;

(ii) bringing any proceedings for the bankruptcy winding-up or liquidation (or analogous proceedings) of a Non Recourse Party;

(iii) proving in any winding-up (or analogous proceeding) of the Non Recourse Party; or

(iv) appointing a receiver, receiver and manager, administrator (as defined in the Corporations Law), or other controller to a Non Recourse Party; and

(e) each Indemnified Party expressly waives (and irrevocably direct the Agent to waive) any Power or right which it or the Agent might otherwise have, to do anything prohibited by paragraph (a) to the extent to which that Power or right is inconsistent with this Clause [insert] but provided that while this Clause [insert] limits the recourse of an Indemnified Party in accordance with its terms it will not affect the manner of exercise by any Indemnified Party of any Power or right available to any Indemnified Party under any of the Financing Documents against an Obligor.
SECTION 2
THE FACILITIES

2. THE FACILITIES

2.1 The Facilities

The standard facilities include a term loan and a revolver. These can be modified.

2.2 Increase

An option for a new mechanism has been included to allow for commitments that have been cancelled because a Lender has become a Defaulting Lender or an Illegality has been claimed to be replaced. The mechanism is useful because it allows the Borrower to select the new lenders from within the existing syndicate or otherwise. This allows the Company to repair a Facility without having to go to the trouble and expense of a new Facility.

It would be even more useful if this concept could be extended to replacing Lenders while the Borrower is not in default or on annual review basis so that the syndicate can be managed more efficiently.

In addition a new option has been provided for in the Change of Control provision for Lenders to be repaid individually rather than all commitments being terminated. But this may be impractical if it leaves the facility smaller than it was. It would be useful if Lenders that were uncomfortable with a new owner could also be replaced rather than have to go to the expense of a new Facility. Presumably the Lenders that are continuing post the Change of Control continue to be comfortable with the credit and the debt size?

2.2.3 Finance Parties' rights and obligations

No Finance Party is responsible for the performance of the other Finance Parties. Each can also separately enforce their rights.

Although reasonably remote, Borrowers may want an option to take none of the money if one or more Finance Parties fails to perform its obligation. It may be, for instance, in an M&A transaction that a smaller amount may cause the whole transaction to fail. In those circumstances, the Borrower will not want to trigger the payment of fees to the remaining Finance Parties.

3. PURPOSE

3.1 Purpose

Subject to Clause 3.2, Borrowers should be careful not to draw this too narrowly, particularly in the context of Facility B amounts which may be used as working capital. There is a line of cases starting with Barclays Bank Ltd v Quistclose Investments Ltd\(^6\) that generally stand for the proposition that: if money is given for a purpose then it can only be used for that purpose and if the purpose fails, a constructive trust arises in respect of the money in favour of the Lender. This means that, in some circumstances, where the purpose of the loan cannot be fulfilled, the moneys advanced under the loan agreement will be held by the Borrower in favour of the Lender and do not form part of the Borrower's assets. This is the case even where the money borrowed was for the purpose of repaying other Lenders. In such circumstances, the Lender advancing the monies (for a specific purpose) will have a

\(^6\) [1970] AC 567.
greater entitlement to those funds in the event that the purpose is frustrated than will any other creditor, regardless of the nature of their security.

Such a trust will not arise simply because funds are advanced for a particular purpose. It is common commercial practice for Lenders to inquire into the purpose of a loan to decide whether it constitutes a worthwhile investment.\(^7\) Other reasons for a Lender inquiring into the purposes of a loan include determining issues such as the legality of the purpose (see our related discussion on the anti-money laundering regime at Clause 20.6). Whether a trust of the type outlined above arises depends on the intention of the parties.\(^6\) The question in each situation is whether the parties intended for the money to be at the free disposal of the recipient.\(^9\) This has recently been supplemented by a decision of the WA Supreme Court\(^10\) in which the Court stated the issue in these terms: ‘Is it intended that the monies not become part of the general assets of the company and be used only for a particular purpose?’ The Court was of the view that for such a trust to arise, it was just as important for the relevant funds to be kept separate (eg. in a specific account or in escrow) from the general assets of the company as it was to express them to be used for a particular purpose. It is not yet clear whether this decision will be followed in other Australian jurisdictions.

Borrowers should also be careful to ensure that the purpose does not breach private legal requirements. This may especially be the case where a Borrower is entering into a transaction in its capacity as trustee. The Borrower must ensure that it is enabled by its trust deed to enter into such a transaction.

As Borrowers often enter into these transactions as part of a corporate group, they also need to be careful to ensure that the purpose of the loan corresponds, complies with, and does not engage the related-party transaction rules set down in the Corporations Act.

3.2 Monitoring

4. CONDITIONS OF UTILISATION

4.1 Initial conditions precedent

The conditions precedent to first drawing are set out in Part I of Schedule 2 (Conditions precedent). They must be in a form and substance satisfactory to the Agent and there is an option for some of the CPs to be signed off by the Majority Lenders or on advice of counsel.

Borrowers may wish to seek that the clause be amended to read: ‘in form and substance to the reasonable satisfaction of the Agent.’ It is common for there to be minor issues with CPs. In limited circumstances, such as public company takeovers or privatisations, Borrowers can seek to add further limitations to the rights of an Agent to reject conditions precedent, although the more productive activity in these circumstances is to have a team dedicated to achieving the conditions precedent and spending significant time transferring as many conditions precedent to conditions subsequent or undertakings.

One solution in the context of a project financing is to provide recourse to a Sponsor for the consequences, measured in losses and damages, for certain conditions

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\(^7\) For a discussion on this point in the context of a Quistclose trust, see the famous Judgment of Millett LJ in Twinsectra Ltd v Yardley [2002] UKHL 12 at [73].

\(^8\) In addition to the terms of the agreement factors from which such an intent can be inferred include parties’ language, conduct, the nature of their transaction and the circumstances surrounding their relationship. See Walker v Corboy (1990) 19 NSWLR 382.

\(^9\) See In re Goldcorp Exchange Ltd [1995] 1 AC 74 at 100 per Mustill LJ.

\(^10\) Compass Resources Ltd v Sherman [2010] WASC 41 at 67 per Beech J.
precedent not being met so as to encourage the Finance Parties to waive or defer conditions precedent.

4.2 Further conditions precedent

(a) In addition to the initial conditions precedent there is an option in the Agreement to elect either that in the case of a rollover no Event of Default or no Default is subsisting and in the case of new money, no Default is subsisting. Also the Repeating Representations must be correct in all Material respects.

(b) Similarly there are conditions to switching currencies.

This provision provides another important impetus for Borrowers to limit the Repeating Representations.

4.3 Conditions relating to Optional Currencies

This provision sets out three key elements for drawing on optional currencies under this agreement. The currency listed must be:

(a) listed at the outset; or
(b) approved by all (not just majority) lenders; and
(c) be readily and freely available.

4.4 Maximum number of Loans

Rollovers do not create the administrative burden that they once did.
SECTION 3
UTILISATION

5. UTILISATION

6. OPTIONAL CURRENCIES
SECTION 4
REPAYMENT, PREPAYMENT AND CANCELLATION

7. REPAYMENT

7.1 Repayment of Facility A Loans

7.2 Repayment of Facility B Loans

Facility B Loans must be repaid at the end of each interest period.

There is no need to actually repay and redraw an amount that will continue to be outstanding. But for the concept of a 'Rollover Loan' in Clause 4.2 this brings the Potential Event of Default draw stop arrangements into play and effectively elevates Potential Events of Default to Events of Defaults through repetition of the representations. To avoid this it is important the first option in Clause 4.2 should apply.

Our comments on this at Clause 19.7 are also relevant. Borrowers need to have a clear view on what repetition regimes are possible and appropriate.

7.3 Term out of Defaulting Finance Party’s Facility B Loans

There is provision for the term out of the Facility B Loan of a Defaulting Finance Party. The 'Lehman' clauses are set out below.

7.4 Reduction of Facility B

8. PREPAYMENT AND CANCELLATION

8.1 Illegality

If it becomes unlawful or impossible for a Lender to perform any of its obligations as contemplated by the Agreement or to fund or maintain any Loan:

(a) that Lender must tell the Agent;

It is arguable that the ability to give this notice means it is the Lender who decides what the effect of the law is. This should remain an objective process where the Borrower is given the opportunity to object.

(b) the Lender’s Commitment of that Lender will be immediately cancelled upon the Agent notifying the Company; and

(c) each Borrower must repay outstanding loans to that Lender's participation in each Loan made to that Borrower on either the latter of the end of the current Interest Period and 30 days after the Agent has notified the Company or when the Agent says so.

Commonly, while future draw downs can be prevented, actual repayment will only be required if the law requires the amount to be repaid. It should only be required to be prepaid if the advance constitutes a breach AND the repayment will cure the breach of the law.

We are satisfied with the sentiment of this sub-paragraph however the drafting requires attention - what if there is no express grace period referred to in the legislation? It would be better to say the latest date required by a new or changed law.
Also, the relevant Lender should be required to use its best endeavours to replace the Loan in a way or through an office that is legal. Sometimes the relevant Lender is required to give assistance to find another Lender.

8.2 Change of control

In summary, if a certain person ceases to control or alternatively a person holds more than [100]% then the Company must notify the Agent and if the Majority Lenders so require then the Facilities must be repaid. Control is defined in s 608 of the Corporations Act.

A useful option has been added for Lenders to terminate Commitment on a Lender by Lender basis rather than just having all Commitments terminated if the Majority Lenders so require. This is brought over from the LMA documents and as it was something we commented on previously, we have now deleted that commentary.

This clause, as drafted, allows the Majority Lenders to cancel the Facilities and require repayment if control of the Company changes after the SFA has been executed. This approach is to be preferred to the inclusion of Change of Control as an Event of Default, especially if the Borrower is attempting to manage cross-defaults. As control is in the hands of its shareholders it is not a default by the Company if the shareholder wishes to divest.

It is important for the Company to negotiate some key aspects of this clause. Some of the matters for consideration are:

- paragraph (a) contemplates the selection of triggers for the operation of the remainder of the clause - that is, whether change of control should be linked to a particular person or entity or to a new person acquiring control. The Company’s preference will depend very much upon its particular Group/loan structure.

- It is preferable to have a combination of the two suggestions. While it is usually pretty clear when a person sells their shares, it can be a problem at the margin because the definition of control is vague. Section 608(4) provides that a person is in control if they have the capacity to determine the outcome of decisions about the body corporate’s, financial and operating policies. By definition, that could be more than one person. It could be a person that is not even a shareholder. It does not mean that the person need actually exercise that power.

- The second option is unsatisfactory because it contemplates that at the date of the document no-one is in control, which is often not the case.

(b) whether, in these circumstances, all outstanding Loans, interest and other amounts will be repaid and all Facilities cancelled, or whether it should be confined to the Lenders wishing to exit upon the conditions set down in paragraph (a) is an important issue for consideration. The LMA provides two versions here:

(i) the APLMA option; and

(ii) each Lender, within a limited period, has the right to require the Agent to cancel its particular Commitment and declare the monies owing to it due and payable within a particular notice period.

The second option could be in the APLMA version, although generally we prefer the APLMA version.
A key consideration in the negotiation and drafting of this clause is the notice period. The Company needs to ensure that the notice period allows sufficient time to arrange replacement Facilities.

There are company specific variations and carve-outs to these arrangements, for example:

(a) a Change of Control will only apply if there is a downgrade in the credit rating/standing of the Borrower (as is the case in the ‘Credit Event Upon Merger’ in the ISDA Master Agreement);

(b) where there is more than one key owner, one or more of those owners cease to own a certain percentage of shares; and

(c) allowances for intergroup restructures and transfers where ultimate control does not change.

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<tr>
<th>8.3</th>
<th>Review Event</th>
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A new Review Event is included as an alternate to clause 8.2. This is the same as the old Change of Control without the option for Lenders to cancel on a Lender by Lender basis, except that a longer period to repay the outstanding amounts is contemplated.

It would have been reasonably simple to incorporate this option within the Change of Control provision.

<table>
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<tr>
<th>8.4.4</th>
<th>Voluntary cancellation</th>
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The Company may cancel the whole or any of an Available Facility after a specified period of notice.

We would like to see that a very strong Company would have the right to selectively apply this clause if its relationship with a particular Lender has deteriorated. We cannot say this is common.

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<tr>
<th>8.4.5</th>
<th>Voluntary Prepayment of Facility A Loans</th>
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Borrowers should note that where a prepayment is not made on a day other than the last day of an Interest Period, the Break Costs provisions in Clause 11.5 will apply.

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<tr>
<th>8.6</th>
<th>Voluntary Prepayment of Facility B Loans</th>
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This clause allows the Borrower (but not the Company) to cancel the Commitment of and prepay any Lender that makes a claim for Tax Gross up (Clause 13.2), Tax indemnity (13.3) and Increased Costs (14.1).

The LMA Market Provisions used in the LMA Agreement also provide for this clause to be activated where a Lender becomes a Defaulting Lender.

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<tr>
<th>8.7</th>
<th>Right of replacement or repayment and cancellation in relation to a single Lender</th>
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Previously if a Lender claimed gross up or increased costs the only option was to repay and cancel the Lender’s Commitment, making the Facility smaller. Now the Company may require the Lender to transfer its rights and obligations to an incoming Lender.

This may be more efficient from the Company’s perspective and will maintain the size of the Facility. It is a useful development.
8.8 Rights of cancellation in relation to a Defaulting Finance Party

A Defaulting Finance Party is, in summary, a Finance Party (which is not a Borrower Affiliate) that has failed to make a payment due, has repudiated the Finance Documents or is insolvent, being wound up or is in administration/liquidation.

The Borrower may terminate the Commitment of a Defaulting Finance Party and its Facility B Loan outstandings will be termed out under clause 7.3.

These are the Lehman provisions that seek to minimise disruption to the Borrower in the event of a Lender Default. With the return of more foreign banks to the Australian market these provisions are welcome.

It is worth noting though that the banks have used a much narrower definition of insolvency for themselves compared to the provisions applicable to the Group in Clauses 23.6 and Clauses 23.7. There may be some negotiating leverage in this.

8.58.9 Restrictions

8.68.10 Mandatory Prepayment

[1]

This is more often an option in project financings. Depending on the transaction, this provision may contain clauses dealing with payments made in respect of costs incurred as a result of termination of a Project Deed and other Transaction Documents.
SECTION 5
COSTS OF UTILISATION

9. INTEREST
9.1 Calculation of Interest
9.2 Payment of interest
9.3 Default interest

The Interest Periods for the overdue amounts are expressed to be set by the Agent (acting reasonably). It should not be difficult for Finance Parties to agree that this will not be more regular than monthly.

Paragraph (b) applies where the loan has been accelerated. It provides that the interest rate applicable to the Loan after acceleration will be the previous rate for the given Interest Period plus 2%. Accordingly, the first Interest Period for the defaulted upon amount is the remainder of the current Interest Period.

9.4 Notification of rates of interest

10. INTEREST PERIODS
10.1 Selection of Interest Periods

Some Borrowers prefer to align their Interest Periods with their hedging arrangements.

10.2 Changes to Interest Periods
10.3 Non-Business Days
10.4 Consolidation and division of Facility A Loans

11. CHANGES TO THE CALCULATION OF INTEREST
11.1 Absence of quotations
11.2 Market disruption

If the Agent determines that a Market Disruption Event is occurring then the interest rate is the Margin plus what the affected lender says is its cost of funds from whatever source it selects. So long as it acts in good faith, the Lender’s rate is binding and conclusive.

In summary, a Market Disruption Event occurs where:

(a) the designated Screen Rate and only one (or none) of the Reference Banks provide a quotation; or

(b) Lenders responsible for more than a specified percentage of the Loan say their cost of obtaining matched funding would be higher than the designated rate.

The effect of this occurring is that the rate of interest payable to each Affected Lender will be the Margin plus the Affected Lender’s actual cost of funding.

Given that the interbank markets are liquid and considering the processes for establishing screen rates are proper in Australia, we think there is no basis for
allowing an increase in price to a limited number of Lenders in a syndicated loan. At a minimum, there should be at least a significant proportion of Finance Parties affected, if not a majority. We note with interest the following extract from comments by the UK Association of Corporate Treasurers on the potential invocation of Market Disruption Events.

'It seems … that in the current market conditions the data being provided by banks for the purposes of calculating the displayed screen rates for LIBOR and EURIBOR is not in all cases reflecting the true cost of funds. If this is correct, it means that banks are not providing good information and, as a result, they are triggering a situation in which the Market Disruption clause is likely to be invoked, thus enabling banks to abandon the transparent system of displayed screen rates and instead to charge borrowers interest rates based on the individual cost of funds of each bank. This is a highly opaque and cumbersome way to calculate interest on major loans.

If banks are not making proper inputs the British Bankers Association/the European Banking Federation (www.fbe.be) and ACI-The Financial Markets Association (www.aciforex.com) should take the matter up with the affected banks. The ACT believes that it is essential that the reason for the screen rates not being reflective of market rates is investigated before banks seek to use these circumstances as a reason for abandoning the established method of charging LIBOR- or EURIBOR-based interest'.

The experience of the past few years suggest that it is not enough that the Banks be subject to sanction by government and nor is it good enough that the banks not directly involved get the added cash without having to pay the sanction. There ought to be a requirement of contracting in good faith expressly provided for in connection with these matters and a claw back if there is a failure of the type we have experienced. Common market acceptance of such a provision would be a much better driver to ensure proper behaviour than relying on our regulators. It would make it the banks’ business to ensure that these things are done properly or face wide clawback claims.

11.3 Alternative basis of interest or funding

11.4 Agent’s role and confidentiality

11.5 Break Costs

See our comments on Break Costs on page 9. There we reiterate some of our issues with the definition of Break Costs including:

• the inclusion of Margin within the definition;

• the subjective elements of the definition;

• the lack of a requirement for the Lender to pass on any gains it makes as a result of the outcome; and

• the lack of a requirement to account for how the amount is arrived at.

The following is a definition of Break Gain that may be used if required.

Break Gain means any benefit or gain received because of the liquidation or re-employment of deposits or other funds acquired or contracted for by the Lenders to fund or maintain any Loan or amount or because of the termination or reversing of any

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agreement or arrangement entered into by the Lenders to fix, hedge or limit their effective cost of funding or maintaining any Loan or amount.

12. FEES

The settling of fees should be the subject of competitive tension or if not the Arranger should at least be asked to present a range of recent comparable pricings. Borrowers should note the interaction of fees and GST which is dealt with in Clause 13.6 (Indirect Tax).

12.1 Commitment fee

12.2 Arrangement fee

This clause should be deleted. The obligation arises under the Fee Letter. Borrowers should note the interaction of fees and GST which is dealt with in Clause 13.6 (Indirect Tax).

12.3 [Establishment Fee]

12.4 Agent’s fee

12.5 Line Fee
SECTION 6
ADDITIONAL PAYMENT OBLIGATIONS

13. TAX GROSS UP AND INDEMNITIES

13.1 Definitions

13.2 Tax gross-up

Tax

*We refer you to our comments made in relation to the definition of Tax on page 12.*

13.3 Tax Indemnity

13.4 Tax Credit

*No amount should be payable under this clause if it is in respect of an Excluded Tax or in respect of any withholding tax when the relevant Finance Party has made a misrepresentation under Clause 29 (Public Offer). In addition, there is sometimes a carve-out for penalties incurred through no fault of the Borrower.*

13.5 Stamp duties and Taxes

13.6 Indirect Tax

14. INCREASED COSTS

These provisions constitute a regime providing that a Borrower should indemnify a Lender where they incur a cost or suffer a loss or a reduced return in relation to the Facilities arising from changes in the regulatory environment.

*The increased cost provisions have been expanded to expressly include Basel III.*

**Post-GFC, the issue of greatest concern is the Basel III prudential standards released late last year. Australia participated as a committee member for the first time.**

**Basel III sets down a range of minimum standards in relation to capital and liquidity.**

**A number of these are to be phased in over the next decade.**

**On one view, the cost for compliance with Basel III is unlikely to be as high for Australian banks vis-à-vis different jurisdictions. Nonetheless, the implementation of the Basel III framework will not be without cost and it goes without saying that Banks will pass this cost on to their customers. In addition, syndicated facilities may involve cross-jurisdictional engagement with a range of financial institutions upon which the new requirements may weigh more heavily.**

**As Basel III has been around for some time lenders should for the most part, have been able to cost its consequences. There should be a sunset date on claims for any specific form of known regulation.**

14.1 Increased costs

*At best, the Agent should be entitled to submit an invoice which will contribute *prima facie* evidence that the amount is payable.*

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12 For elucidation on this point, see Malcolm Edsey, RBA Assistant Governor (Financial System), *Basel III and Beyond*, Speech given at Basel III Conference, Sydney, 24 March 2011.

13 For example, the new minimum for risk-weighted assets of 4.5% will be fully implemented by 1 January 2015.
We have concerns with the wording of paragraph (a)(i) which captures a change in the 'interpretation or application of' laws and regulations. In our view this is too broad and could conceivably encompass a new legal opinion developed internally. This should be qualified by reference to an official change of position so the amended clause reads:

(i) the introduction of or any change in any law or regulation; or

(ii) any change in the interpretation or application of any law or regulation by any Government Agency.

<table>
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<tr>
<th>14.2 Increased cost claims</th>
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<tr>
<td>The certificate confirming the amount of Increased Costs as identified in paragraph (b) should contain the calculation as well as the amount.</td>
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<th>14.3 Exceptions</th>
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<tr>
<td>In our view, the breadth of paragraph (c) should be expanded to include costs attributable to the gross negligence or wilful misconduct of the relevant Finance Party.</td>
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<tr>
<td>Other exclusions should include:</td>
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<tr>
<td>(a) where the Borrower disagrees with the basis of calculation. It will be the case that there will be an element of discretion in how the Finance Parties allocate a cost among their customers;</td>
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<tr>
<td>(b) if the basis for the cost is already known at the time of entry into the SFA or the prospect was known and it was reasonably certain it would occur;</td>
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<tr>
<td>(c) if more than 60 to 90 days elapsed since the Finance Party became aware of the cost;</td>
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<tr>
<td>(d) if the cost (say cost of capital) is already compensated for by an increase in the Base Rate or some other mechanism. That is, there should be no windfall gain; and/or</td>
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<td>(e) if it arises from a change in a Finance Party’s Lending Office or as the result of a novation or assignment.</td>
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<th>15. OTHER INDEMNITIES</th>
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<tr>
<td>Clause 15.3(h) has been expanded to include an indemnity for the Agent for taking security under clause 27.7(b) &amp; (c), which relates to requiring Security prior to exercising its discretion.</td>
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<tr>
<td>Borrowers should not enter into indemnities lightly. In addition to this Clause 15, this Agreement contains a large number of provisions under which various Borrowing parties such as the Company or the Guarantors (here, the Indemnifier) are required to indemnify a Lender, be it the Finance Parties in general or the Agent specifically (here, the Indemnifiee) (see, for example Clauses 13.3 (Tax Credit) and 18 (Guarantee and Indemnity)).</td>
</tr>
<tr>
<td>Broadly speaking, the indemnities provide a simplified mechanism whereby an Indemnifiee can be compensated by the Indemnifier regardless of whether the loss was caused by them or a third party. Indemnities differ significantly from damages which, in the absence of the indemnities, would be the Indemnifiee’s remedy. Damages differ from indemnities in that the damaged party is limited to bringing an</td>
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action against the party that actually caused the damage and is under an obligation to mitigate the damage. An action for damages is also potentially more defensible.

Pursuant to the indemnities, an Indemnifiee generally does not have to prove any actual damage. Procedurally they generally invoice the Indemnifier for whatever costs they incur. Indemnities generally cannot be defended and the only option available for an aggrieved Indemnifier is to attack the indemnity itself. Indeed, the Agreement absolves the Indemnifiees of having to mitigate their losses and in fact provides an indemnity for losses incurred as a result of mitigation (see Clause 16).

Though some indemnities will necessarily be non-negotiable, in general we advise that Borrowers should seek to limit the indemnities they provide to matters within their control.

15.1 Currency indemnity

15.2 Other indemnities

The Company indemnifies for loss (including legal fees) incurred as a result of:

(a) the occurrence of any [Event of] Default;

(b) the Information Memorandum or any other information;

(c) any enquiries or investigations;

(d) a failure by an Obligor to pay any amount on time;

(e) funding, or making arrangements to fund, its participation;

(f) a Loan (or part of a Loan) not being prepaid in accordance with a notice of prepayment given by a Borrower or the Company; or

(g) an amount payable by a Finance Party to the Agent (for instance see Clause 26.10 (Lenders’ indemnity to the Agent)).

In relation to paragraph (b), we are concerned that this indemnity extends to cover allegations that the Information Memorandum is misleading or deceptive in any respect. In our view, there should be a carve-out for circumstances in which a Lender or its related entity makes such an allegation which subsequently turns out to be unsubstantiated. In any case, the inclusion of a reference to an Information Memorandum is far from universal in the general indemnities.

In addition to the above, these indemnities should be qualified by reference to the direct results of the events specified.

• Paragraph (c) should be a limited to ensure it’s not a general enquiry against the Finance Party or an action brought by an Obligor.

• Paragraph (g) should be deleted. There may be many reasons why the Obligors should not pay in these circumstances. If that is not agreed then there needs to be limits to the indemnity under clause 26.10.

15.3 Indemnity to the Agent

The Company also indemnifies the Agent against any losses as a result of:

(a) investigating Defaults; or
(b) foreign exchange contracts for the purposes of Clause 6 (Optional Currencies); or

(c) acting or relying on any notice, request or instruction which it reasonably believes to be genuine, correct and appropriately authorised.

Paragraph (c) should be restricted to costs incurred where the Agent acted on the basis of a notice, request or instruction which subsequently turned out not to be genuine, correct and appropriately authorised.

16. MITIGATION BY THE FINANCE PARTIES

16.1 Mitigation

16.2 Indemnity and limitation of liability

The Company indemnifies each Finance Party for its costs in mitigating its loss under Clause 16.1 (Mitigation). A Finance Party does not have to mitigate if, in its opinion that might be prejudicial to it.

There is a good argument that the Finance Parties should mitigate to a certain extent without requiring an indemnity at this level. Without the overarching indemnity they would be required to mitigate in order to claim damages. If the Finance Parties think that they should be compensated before taking steps to mitigate (say by changing their funding office) then they can always ask at the time so that the Company consider the matter properly before taking action without consultation and submitting an indemnity claim.

17. COSTS AND EXPENSES

In relation to each of the provisions below, it appears reasonable to us that any demand for payment should be supported by appropriate documentary evidence of the right to the amount claimed.

17.1 Transaction expenses

The Company pays the Agent and the Arranger’s costs associated with the negotiation, preparation, printing, execution and syndication of the SFA and each connected document and any later Finance Document.

A key point in the negotiation is for Borrowers to have a say in the appointment of and cost arrangements for the Finance Parties’ lawyers. Borrowers may wish to introduce a time limit for payment (e.g. 14 days) as payment on demand appears to be an unnecessarily severe requirement especially given the succeeding provision(s).

17.2 Amendment and other costs

17.3 Enforcement costs

The Company must pay for any enforcement or preservation costs either on demand or within three Business Days.

Borrowers should take careful note that this clause, as drafted, means, for instance, that the Borrower must compensate the Finance Parties for all costs. This likely includes internal costs of a wide variety of claims, including disputes among themselves.
SECTION 7
GUARANTEE

18. GUARANTEE UNDERTAKING AND INDEMNITY

This clause sets out in detail the guarantees to be given pursuant to this Agreement. As such, it is only of use where each of the guarantors under this Agreement is giving precisely the same guarantee. The effect of this clause is to overlay each individual security held by the Lenders in respect to the Facilities with a global, interlocking guarantee. Please refer to our comments on securities in Schedule 1.
The consequences of a misrepresentation are:

(a) if any of these representations is or proves to be incorrect or misleading in any material respect when it is made or deemed to be made, that will constitute an Event of Default; and

(b) damages arising from reliance on the misrepresentation that are not covered by the indemnity at Clause 15 may be claimable.

Borrowers therefore need to ensure they have the requisite systems in place to ensure ongoing compliance with these representations.

One matter for negotiation from the outset is to whom these provisions should apply to - i.e. each Obligor, all members of a particular group or potentially ‘Material Companies or Persons’.

Other potential limitations are materiality qualifications and qualifying the scope of particular representations by reference to the knowledge of the particular representor in question.

19. REPRESENTATIONS

Borrowers may wish to exclude certain representations from the definition of Repeating Representations. Please see the discussion at the definition of Repeating Representations.

19.1 Status

This has two limbs, the first provides that each Obligor says it is a Company and is duly incorporated, the second says it has the power to own its assets and carry on its business.

Paragraph (b) is not universally required in Australia by Finance Parties in modern finance documents (including project finance documents). It may be that it reflects the European origins of the LMA Agreement. Statements relating to power are usually confined to the Obligor’s ability to enter into the Finance Documents and statements about assets are usually confined to a statement in secured transactions that its assets are not held on trust for others. In project financings there will generally be a statement that material authorisations (as a defined term) are held. In addition, financiers will usually seek assurance on this via the Conditions Precedent.

If paragraph (b) cannot be excluded it is possible to raise a number of issues about it: is it intended to include planning permits, what if the Obligor has not perfected all the licences, what if the relevant activity is not central to the business etc?

19.2 Binding obligations

Each Finance Document is legal, valid, binding and enforceable.

This representation is given by each Obligor in relation to its own obligations.

If this is a Repeating Representation, Obligors should be aware that it carries some risk on the basis that the legal opinion the representation relies on will be expressed to be accurate on the day on which it is given. Accordingly, a change in law may render the clause inaccurate. Obligors may therefore wish to qualify the clause by reference to the date on which the legal opinion is given or avoid repetition.
19.3 **Non-conflict with other obligations**

The finance documents do not conflict with (a) any law, (b) its, or any of its Subsidiaries’ constitutional documents; or (c) any agreement or instrument binding on it.

An option has been added to para (c) that requires the Obligors to also say that in addition to not conflicting with any agreement or instrument, the entry into and performance of the Finance Documents do not cause a default or termination event.

While it is appropriate that the Finance Parties have a statement that their Finance Documents are not in conflict with any law, the final paragraph is unnecessary and too broad. If there are agreements that are particularly important to the business or central to the transaction then they should be identified. Even in that context, a key consideration should be whether the relevant agreement can be replaced or not. The addition of the reference to default or termination event probably doesn’t add much because to cause a default the documents would likely be in conflict anyway. As we were already concerned with the breadth of this clause this amendment makes that concern greater.

It is not uncommon to see a ‘Material Adverse Effect’ qualifier in respect of paragraph (c) as well. We notice that in the No Default representation, which also deals with the relationship between the Finance Documents and other documents, the Finance Parties are prepared to agree to a reference to Material Adverse Effect.

We also have concerns about the use of the term ‘constitutional documents’. This is not a term of art and in our view should be defined to avoid inadvertent breach.

19.4 **Power and authority**

19.5 **Authorisations**

All Authorisations needed for the Finance Documents and for its business are in place. There have been amendments to paragraph (b) to provide that all Authorisations are in place to make the Finance Documents enforceable both in the Obligors’ home jurisdiction but also under the governing law of the Agreement. There are new carve outs relating to Authorisations specifically referred to in opinions given to the Agent and those contemplated by the conditions precedent.

In the context of an Investment Grade Credit we think that paragraph (c) is not warranted as that is a matter for management and if there were a specific Authorisation which is central to the business, that could be dealt with. In the project financing context there will be a regime dealing with Material Authorisations. Please also see our comments at Clause 19.3 above.

We think the new references to enforceability largely repeat paragraph (a) and the reference to the governing law of the document is unusual and not necessary in Australia.

Both the new carve outs are sensible. Limiting the Authorisations to those specifically referred to in opinions is probably reasonable given otherwise it would pick up all the language used by lawyers to limit their liability to the Banks.

19.6 **Governing law and enforcement**

The choice of law referred to in Clause 26 (Governing law)- and judgments obtained pursuant to the Governing law will be recognised.

This will not be necessary for an Australian Borrower if the applicable law is Australian. In general we do not agree with leaving seemingly innocuous provisions
that are unnecessary in documents because they may be used to do work that was not intended.

19.7 No stamp taxes

This is a somewhat unusual clause in Australia for an unsecured investment grade transaction, especially as it duplicates the ‘binding obligations’ representation. If it is to remain, the Borrower should use it as an opportunity to get the benefit of the right to repair any deficiency on a ‘no harm no foul’ basis for both this and the binding obligations clause. That is best done by merging the two representations. If the Obligors can achieve that outcome in this context it can also form the basis for an argument about the wider application of a ‘no harm no foul’ regime, for instance in respect of the Authorisations representation.

We note that the ‘filing’ aspect of this has been deleted possibly because it duplicates Clause 19.5, as we suggested previously.

It should not be a Repeating Representation.

19.8 No default

There is no Event of Default and no Obligor is in breach of any other agreement or instrument.

Paragraph (a)

Sometimes Borrowers qualify this representation by reference to their ‘knowledge and belief’.

If existing defaults are ‘continuing’ because they have merely been remedied without the Agent expressing its satisfaction or waived in writing, on repetition this will create another Default. Please see our discussions on ‘continuing’ at Clause 1.2.

Paragraph (b)

Paragraph (b) is intended to reassure the Lenders that none of the Obligors is in default in any agreement is a party to where that default might have a Material Adverse Effect.

The effect of this provision is to bring within the purview of Material Adverse Effect all of the external relationships of the Obligors and so is wide in scope.

In light of Clauses 19.12 (No Proceedings Pending or Threatened) and clause 23.5 (Cross Default), we think this is unsatisfactory and is effectively an MAE default (which we comment on below).

We suggest it is not a common position for any investment grade credit and in a project finance, there will be a more tailored Material Documents regime.

Please also see our comments on page 16 regarding Material Adverse Effect.

19.9 No misleading information

(a) Any factual information provided for the purposes of the Information Memorandum was true and accurate in all material respects as at the date it was provided or as at the date (if any) at which it is stated.

(b) Any financial projections are based on recent historical information and reasonable assumptions.
(c) The relevant information is not untrue or misleading by omission or commission in any material respect.

It is recommended that close consideration be given to these representations. They ought not be included as Repeating Representations.

Paragraph (a) is broader in scope than its purpose should dictate and should be limited to the information contained in the Information Memorandum. The option to incorporate factual information ‘provided in writing in connection with the Finance Documents…’ should be resisted on the basis that it potentially covers all pre-contractual negotiations regardless of qualifications that may be contained within them.

Particularly in project financing models and financial forecasts referred to in paragraph (b) are important. They are often a collaborative effort. It is important that Borrowers sign up for no more than they have done. We think that paragraph (b) above is inappropriate as, if the financial projections turn out to be incorrect, it will be because an assumption was wrong and with the benefit of hindsight it will be too easy to argue it was not reasonable. On the contrary, and commonly, we include express statements that forecasts are not statements of fact and there is no representation that any forecast will be met. The representation should be limited by that statement.

Paragraph (c) requires that Borrowers identify if certain information is untrue or misleading in a material respect. We prefer to clarify the position and make this more objective by replacing ‘results in the information …’ with ‘which would cause a reasonable person in the position of the Finance Parties to not provide the Facility’ or ‘materially and adversely affect the decision of a reasonable person in the position of the Finance Parties considering whether to provide financial accommodation to the Obligors’.

19.10 Financial statements

Its financial statements are prepared in accordance with GAAP, and give a true and fair view. There is an option to provide that there has been no Material Adverse Effect since the latest accounts.

Paragraphs (a) and (b) of this representation duplicates the ‘No misleading information representation’ above.

Paragraph (c) is the most important and in the Investment Grade credit context is unsatisfactory. It is not universal in the corporate, private equity or project finance context. We would suggest it be resisted especially by listed entities given it requires an assessment of financial reports on dates that do not coincide with reporting dates and potentially creates a great deal of administration. It may also set up a ‘continuous disclosure regime’. It should not be a Repeating Representation.

19.11 Pari passu ranking

19.12 No proceedings pending or threatened

There is no litigation which might reasonably be expected to have a Material Adverse Effect.

We prefer to have a $ based materiality threshold as well as the Material Adverse Effect qualifier so as to remove at least some argument about what is material at the relevant time.

We suggest that in a document as serious as a Finance Document the word ‘might’ is not appropriate and the proper word is ‘would’.
In circumstances where about only 1% of cases that are started ever get to trial and a potential for litigation to drag on for many years we would like to see that the completion of discovery process or the commencement of the trial is the appropriate point for the financiers to have a default right. It should also exclude matters commonly dealt with in mediation/conciliation such as employment issues. Naturally the Finance Parties should be made aware of the proceedings from their commencement and informed of developments if they require. In some cases litigation is part and parcel of the business (for example, the Construction Industry) and this should be taken into account. Whether or not the representation has a MAE qualification it should carve out actions which are frivolous or vexatious as those usually are accompanied by large demands. Borrowers should seek to refer to the reasonably likely outcome of the litigation rather than the worst case scenario.

19.13 Trustee

No Obligor is a trustee.

Where a Borrower is entering into the transaction as a trustee, the Finance Parties will likely require further Representations and Warranties to be entered into by that entity. This representation should be limited to express trusts over any material part of its assets as some trusts arise by operation of law.

19.14 Authorised Signatures

We are not aware of only one any major firm that has this in their precedent in Australia. We are not certain how it would assist?

19.15 Tax Consolidation

No Obligor is a member of a Tax Consolidated Group.

This is highly transaction-dependent and is simply designed to give notice as to whether the Obligors are members of a tax consolidated group and whether one of the Obligors is the head company.

The issue is that entities in a consolidated group can be liable for the unpaid tax of their related entities. This form of the representation can only be the starting point given some groups will have their consolidation arrangements organised differently. In a project financing the Finance Parties would be rightly concerned if their 'ring fenced' borrower was responsible for the tax obligations of a member of the group involved in activities unrelated to the project being financed. However the representation may be inappropriate in a corporate group with a cross guarantee in favour of the Finance Parties and which they view on a group basis.

19.16 Other

[ ]

19.17 Repetition

The Repeating Representations are repeated on each date of each Utilisation Request and the first day of each Interest Period and the date any new Obligor is added.

Please see our discussion of this issue in the preamble to Clause 19 and the definition of Repeating Representations. If progress cannot be made on reducing the Repeating Representation then it can be useful to make a further list that are repeated with each Utilisation Request and a shorter list on interest payment dates.
Please see our comments on Clauses 4.2 and 7.2 as the repetition regime is important. There are facilities where representations are only repeated where fresh money is being drawn. The other extreme is periodically and when fresh money is being drawn. As there can be multiple Loans under the SFA this clause goes even further and could have representations being repeated more than that. We think this is a significant issue in the structure of this document. We think the irregularity may be the bigger issue than the frequency because Borrowers cannot plan properly how to deal with relevant circumstances.

20. INFORMATION UNDERTAKINGS

The undertakings in this Clause 20 are in force while any amount is outstanding under the Finance Documents or any Commitment is in force.

20.1 Financial Statements

The Company is to provide audited consolidated financial statements for itself and separate audited financial statements for each Obligor as soon as they are available and in any event within 120 days of the end of each financial year. Unaudited financial statements are to be provided within 90 days of each financial half year.

For listed entities it will be appropriate to align the timing of delivery of Financial Statements with announcements to the relevant exchange and for unlisted entities with the requirements under the Corporations Act or whatever is reasonable. In our experience, Finance Parties are generally happy to fall in line with the custom of the Borrower, especially in the case of companies owned by non-Australian entities where layers of approval sometimes delay final delivery of accounts.

The change to only requiring consolidated statements is welcome.

20.2 Compliance Certificate

Compliance Certificates, with reasonable detail, are to be delivered with the Financial Statements. They are to be signed by two directors and audited.

It would be unusual in Australia to have two directors of an investment grade listed entity sign a compliance certificate. Usually the requirement would be for the certificate to be signed by an Authorised Officer. That would be the common outcome in a project financing as well.

Compliance certificates are not universally audited - especially so in the case of half-yearly accounts. The key issue for the Lenders here is usually the definition of Financial Indebtedness. If the definition of Financial Indebtedness is aligned with GAAP there is even less need for separate auditor sign off. It is likely that in most cases the difference between GAAP and Financial Indebtedness would be minimal or even favour the Lenders. Borrowers have reported that getting the bank to sign necessary releases from auditors in connection with their sign off can be problematic.

20.3 Requirements as to Financial Statements

Financial Statements must be a) certified as fairly representing the financial condition; b) be prepared in accordance with GAAP or there is an election for them to be prepared in accordance with GAAP as at the date of the Original Financial Statements, except as notified to the Agent (with auditor sign off).
We do not think that there is any room for directors taking personal risk on this sign off and it should be made clear that they are not doing so.¹

Most Borrowers, in our experience, prefer to provide Financial Statements in accordance with GAAP so as not to have to prepare two sets.

The key issue is to maintain the status quo for the Borrower and the Finance Parties of the meaning of any financial ratios. There are many such clauses which commonly provide that the parties will negotiate and until such time as the matter is agreed the Borrower will prepare ratio certificates in accordance with historical GAAP as is reflected in Clause 21.2 of the SFA.

20.4 Information: miscellaneous

The Company is to provide a) copies of all documents forwarded to its shareholders or creditors generally; b) details of any litigation which might have a Material Adverse Effect if adversely determined; c) any other information about the Group as any Finance Party (through the Agent) may require. Changes in authorised signatories are also to be provided.

Provision has been made for reporting of anything which has a Material Adverse Effect.

In relation to paragraph (b), Borrowers may wish to raise the threshold required for notification so it is consistent with that expressed in relation to Clause 19.12 on page 41. We view the addition of MAE here as potentially serious. MAE is not necessarily a Default under this Agreement. The obligation to notify can mean that MAE is a Default because if it is not reported then the MAE effectively becomes a Default which is potentially not capable of remedy. This creates a burdensome compliance regime and perhaps some difficult calls to be made as to what constitutes an MAE.

Consistent with the general issue of public and private information (see page 43) listed Borrowers may seek to limit the material which can be requested to publicly available information. We see no great cost impost in complying with this.

Following the same order as the paragraphs above:

a) this is a bit unusual and it is not hard to identify why. If the company is a public company its shareholder documents will be available through the ASX website so there doesn’t seem to be much point. If the company is private it is easy to envision circumstances where the shareholders will want to communicate about possibilities and projects without sharing them with the Finance Parties;

b) our comments on the equivalent representation apply equally here. Even if the Finance Parties are informed earlier in the process then there should be no possibility of a Default.

20.5 Notification of default

We have considerable difficulty with the requirement to notify a Default, as opposed to an Event of Default. Defaults, or potential defaults should only come into play to stop drawdowns. Being required to notify every potential default creates a self-fulfilling prophecy because the failure to notify is a default itself. Therefore (potential) Defaults will become Events of Default unless notified. This affects grace periods generally and may cause an event or circumstance to become an Event of Default when this need not have been the case.

¹ See, for example, the decision of the Federal Court in Australian Securities and Investments Commission v Healey [2011] FCA 717.
It also creates problems in drafting waivers. The parties may agree that an Event of Default should be waived but fail to address a notice breach connected with the Event of Default when it was a mere (potential) Default.

20.6 ‘Know your Customer’ checks

Know Your Customer (KYC) - in the financial sense - describes the process by which Lenders check the identity, background and other aspects of the source of wealth of the Borrower.

It is important that Borrowers are aware of the precise requirements set down under the KYC regime. KYC is a policy introduced by the Anti-Money Laundering/Counter Terrorism Financing Act 2006 (Cth) (here, the Act). It requires certain businesses to implement procedures to ensure they can effectively identify, verify and monitor their customers and the financial transactions they engage in. This is known under the Act as ‘customer verification procedures’.

Lenders come under the definition of an entity providing a ‘designated service’ and thus come within the purview of the Act. Borrowers are covered within the definition of customers.

Minimum Requirements under the Act

The Anti-Money Laundering and Counter-Terrorism Financial Rules Instrument 2007 (No. 1) (Cth) set out minimum requirements for reporting entities in relation to customer verification procedures. These requirements vary depending on whether the Borrower is an individual, company, trust or other such structure.

Below is an example of the KYC minimum requirements for lenders where the borrower is a company. Each Lender’s customer identification procedures must include a means to collect, as a minimum, the following information:

(a) the full name of the company as registered by ASIC;
(b) the full address of the company’s registered office;
(c) the full address of the company’s principal place of business, if any;
(d) the ACN issued to the company
(e) whether the company is registered by ASIC as a proprietary or public company;
(f) if the company is registered as a proprietary company, the name of each director of the company; and
(g) the name and address of each beneficial owner (if any) of a proprietary or private company.

In addition to this lenders are also required to have ‘risk based systems’ in place to determine whether further KYC information is required for certain borrowers.

Further requirements exist for foreign companies as well as trusts (including identifying the names of beneficiaries), partnerships and other business structures.

Suggestion

Borrowers may be requested to provide information which they cannot provide, such as the beneficial ownership of shares owned by a trust entity, for example. In the event that compliance with a request is impossible, this should trigger the operation of
the illegality provision (Clause 8.1) and the consequences agreed to pursuant to that clause, rather than it constituting a breach of the Agreement.

## 21. FINANCIAL COVENANTS

These provisions are largely left blank as any financial covenants must be tailored to the precise circumstances of the Borrower and the transaction.

However, the APLMA Asian documents do have separate suggested ratios which are based on the LMA ratios. The covenants we comment on below are those provided in template form as part of the suite of Asian documents available on the APLMA website.

Borrowers are often concerned with the possibility that financial ratios will need to be complied with at all times. Paragraph (b), combined with the wording at 23.2 (Financial covenants) can set up that result depending on what the ratio wording is. Certainly some if not all of the APLMA Asian covenants need to be complied with at all times. Few businesses run their accounting function in a way that can comply with this and for many businesses it would not make sense because their cash flow is irregular or seasonal. As the Agent can ask the directors to certify the absence of a Default at any time, this can indeed be problematic.

As users of this guide will be aware, financial covenants provide a mechanism whereby the Lender can assess the ability of a Borrower to repay and effectively pre-empt any issues that arise. The financial covenants achieve this by creating a series of trigger points which, if breached, create an opportunity for Lenders to take remedial action and, if necessary, treat the non-compliance with the financial covenants as an Event of Default - see clause 23.2 (Financial covenants).

The key issues to consider when considering a financial covenant package are:

1. **make sure you are making consistent comparisons:** an interest cover ratio based on EBIT is different to one based on EBITDA or adjusted EBITDA;

2. **have regard to how the ratios interact with each other and the rest of the covenant package.** In the project finance context it is preferable to adjust excess cash flow definitions to assist with DSCR outcomes and distribution capabilities but it may also cause cash sweeps to increase. **There is no point having a gearing ratio if you have a Permitted Financial Indebtedness regime;**

3. **there are some reasonably obvious points to consider on the face of the ratios but these can be misleadingly simple compared to the variability in the definitions;**

4. **when setting ratio levels there is sometimes a counterintuitive inclination to start with the projected level of performance rather than market.** As a result the more optimistic or better placed borrowers end up with less headroom, which is something that no borrower can have too much of. Borrowers should ask for comparables and check those with as many independent sources as possible, including their lawyers and accountants if they are able to assist.

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**Definitions**

As noted above, the devil is very much in the detail the definitions that underpin the various Financial covenants. Parties will select the definitions that are appropriate to their understanding of the transaction. Accordingly, we direct most of our analysis toward those definitions.
**Single/Consolidated Borrower(s)**

Please note, for ease of drafting we have restricted our comments to the provisions dealing with a single Borrower. In regards to the ‘Consolidated’ Financial Covenants, it will be important that the definitions chosen are appropriate for their usage. For example, in some Agreements we have seen, the definition of EBITDA may be used on a consolidated basis (dealing with the entire Group) as well as for an individual entity within that group. In such circumstances it will be important that the drafting reflects this distinction.

Please also refer to our comments in clause 20.3 (Requirements as to Financial Statements) and the impact of changes in GAAP from time to time.

A significant omission from the APLMA package set out below is any kind of equity cure rights. Such equity can be sourced from sponsors and shareholders in private markets and from rights issues in public markets. If additional equity is contributed then the relevant ratio will be recalculated for the Relevant Period. There may be a limit to the number of times that this right can be exercised.

### 21.1 Financial condition

The Borrower shall ensure that:

(a) **Gearing**

*Borrowers should prefer the selection of Total Net Debt as it deducts the aggregate amount of Cash and Cash Equivalent Investments held by the Borrower at any given time. This has a significant flow-on effect on the operation of this ratio and in addition failure to net off cash can add a lot of unnecessary administration to manage ratios.*

The second most discussed issue in this is why intangible assets are excluded. For some businesses failure to include intangibles means this definition cannot really be used in this form. The most common areas of discussion revolve around deferred tax assets as well as goodwill on business amalgamations, especially where the acquisition is the subject of the financing.

Another issue with this ratio is that some Lenders will want a separate covenant dealing with the absolute level of shareholders funds (see paragraph (c) below). If the ratio is based on debt to assets that is more appropriate but not necessarily so if it is based on net worth as the ratio above is.

We are concerned that this definition refers to Total [Net] Debt/Total Liabilities ‘at any time’.

(b) **Interest Cover**


(c) **Minimum Tangible Net Worth**

*We reiterate our comments above - that Borrowers should resist the inclusion of the wording ‘at any time’ on the basis that is does not accord with their regular accounting practice.*

*Please see our comments on the definition of Tangible Net Worth below.*
21.2 Financial testing

The financial covenants set out in Clause [ ] (Financial condition) shall be tested by reference to the financial statements and Compliance Certificates delivered pursuant to Clause [ ] (Compliance Certificate) in respect of the Relevant Period.

The requirements of the Financial Statements are covered in the Agreement by Clauses 20.1 (Financial Statements) and 20.2 (Compliance Certificates). In general, those clauses provide for audited versions of the relevant Financial Statements to be supplied to the Lender at the end of each financial year and (non-audited versions at each half-financial year). Clause 20.2 provides that these be accompanied by a Compliance Certificate.

Without more, it is unlikely that this clause will override any requirement that ratios be satisfied at any time.

21.3 Financial definitions

In this Clause [ ]:

(a) Gearing

‘Borrowings’ means, at any time, the outstanding principal, capital or nominal amount and any fixed or minimum premium payable on prepayment or redemption of any indebtedness for or in respect of Financial Indebtedness (other than in respect of paragraph (g) of that definition [for which the marked to market value shall be used]) and any amount raised by the issue of redeemable shares which are redeemable before the [insert final repayment date of Facilities];

This definition is directly relevant to the definition of Total [Net] Debt and [Net] Finance Charges.

We do not agree to the inclusion of prepayment premium as such amounts will usually never be paid.

The definition directly invokes the definition of Financial Indebtedness in the Agreement (we refer to our comments on this at page 14).

Of particular note here is that this definition explicitly contemplates the valuation of derivative transactions at their marked to market value (note: the paragraph (g) referred to in the Asian documents is the equivalent of paragraph (i) of the definition of Financial Indebtedness used in the Agreement.) For reasons similar to the comments we made in relation to Financial Indebtedness, the inclusion of derivatives in this definition can have significant consequences. It may also introduce an level of volatility in the value of the ratio which does not accurately reflect the health of the business.

Note that, in practice, financial covenants are tested by reference to the financial information available to the lenders and therefore usually tested on the dates when financial statements are drawn up and delivered in accordance with the information covenants of the facility agreement.
In terms of drafting, where it is agreed that derivatives should not form part of this definition, Borrowers should seek to specifically exclude them (as opposed to merely deleting any reference) from the definition. This is so they are not caught by paragraph (g) of the definition of Financial Indebtedness (a catch-all).

There may be many other exclusions such as mezzanine, subordinated or shareholder debt, intercompany debt, guarantees and indemnities imported by paragraph (j) or (k) of the definition of Financial Indebtedness.

‘Total [Net] Debt’ means at any time the aggregate amount of all obligations of the Borrower for or in respect of Borrowings [but deducting the aggregate amount of freely available Cash and Cash Equivalent Investments held by the Borrower at such time,] and so that no amount shall be included or excluded more than once;

This definition invokes the definition of Borrowings and therefore Financial Indebtedness.

Given its use in the Gearing Ratio, it will clearly be beneficial for a Borrower to seek to adopt the use of the term ‘Net’. The effect of this is that the definitions of Cash and Cash Equivalent Investments come into operation.

We think the use of the words ‘freely available’ introduce unnecessary complexity into the definition and should be deleted.

‘Total Liabilities’ means at any time the aggregate of all indebtedness which would be treated as a liability of the Borrower in accordance with GAAP including any amount raised by the issuance of redeemable shares which are redeemable before the [insert final repayment date of Facilities] [but excluding redeemable shares redeemable solely at the option of the Borrower].

(b) Interest Cover

‘EBIT’ means, for any Relevant Period, the operating profits of the Borrower before taxation for that Relevant Period:

(A) before deducting any [Net] Finance Charges;

(B) before taking into account any items treated as exceptional or extraordinary items,

in each case, to the extent deducted or taken into account, as the case may be, for the purposes of determining the profits of the Borrower from ordinary activities before taxation.

EBITDA is the more common measure used in finance agreements.

It is important for Borrowers to assess the relationship between the definition of Tax selected in Clause 1 (see page 18) and the operation of this provision. We note that this clause uses the term ‘tax’ (uncapitalised and thus undefined) however, for the sake of clarity and control, Borrowers (and indeed, Lenders) may wish to define its operation in this context.

‘EBITDA’ means, for any Relevant Period, EBIT for that Relevant Period before deducting any amount attributable to amortisation of goodwill or depreciation of tangible assets.
EBIT and EBITDA can be adjusted for many things including non-cash losses from impairments or asset sales. There may be one off events in the business to be adjusted.

A significant issue in acquisition related transactions can be when and how the EBIT[DA] of the target (or disposal) is accounted for, especially if the target is acquired in the middle of a period.

It is also important to consider whether any EBIT is being 'lost' in the consolidated context, say from joint venture arrangements or minority interests.

Finally, in some cases equity cure amounts are included as revenue or EBIT, although that is not commonly the Lender’s preferred approach.

‘[Net] Finance Charges’ means interest, commission, fees, discounts, prepayment penalties or premiums and other finance payments in respect of:

(i) including the interest element of leasing and hire purchase payments;

(ii) including any amounts paid, payable or accrued by the Borrower to counterparties under any interest rate hedging instrument;

(iii) deducting any amounts paid, payable or accrued by counterparties to the Borrower under any interest rate hedging instrument; and

(iv) deducting any interest paid, payable to or accrued to the benefit of the Borrower on any deposit or bank account;

It is important to exclude non-recurring fees and for the same reason there is a good argument that pre-payment penalties should be excluded.

Sometimes in project financing arrangements principal repayments will be included in financing costs. It is necessary to exclude unscheduled or mandatory prepayments. Also, in any context, mezzanine, subordinated or shareholder debt interest and repayments will need to be excluded.

With regard to footnote 2, we suggest the most logical response is to refer to cash.

(c) Tangible Net Worth

‘Tangible Net Worth’ means paid up or ordinary share capital of the Borrower and reserves of the Borrower, including any amount credited to the share premium account,

but deducting:

(i) any debit balance on the profit and loss;

(ii) any amount shown in respect of goodwill or other intangible assets;

Please refer to our comments about intangible assets above.

(iii) any provision for deferred taxation;
(iv) any upward revaluation of assets made at any time after [insert date of base financials]; and

It may be problematic if upward revisions are excluded but downward revisions are not, depending on the nature of the business. There is an argument that, whether or not they are included, the outcome should be reciprocal.

(v) any amount in respect of any dividend or distribution declared but not paid,

It almost goes without saying that the definition adopted here must adequately reflect the nature of the transaction and the structure of the Borrower.

(d) Liquidity

‘Current Assets’

In relation to paragraph (c) the reference to Hong Kong should be deleted and any reference to ‘generally accepted accounting standards’ replaced with GAAP (as defined in the Agreement.)

‘Current Liabilities’ in accordance with generally accepted accounting standards in Hong Kong (as used in the Borrower's then most recent audited annual financial statements), be considered as a current liability.

As above, the reference to Hong Kong should be deleted and any reference to ‘generally accepted accounting standards replaced with GAAP.

21.4 Other Definitions

‘Cash’ means, at any time, cash at bank repayable on demand which is freely available.

This is a narrow definition of Cash and there are many agreements that includes notes and instruments issued by government authorities, certificates of deposits, bill, commercial paper and other corporate debt securities that are rated A1 or P1 or better. However in this context it is only used in the definition of Net Debt and in combination with the definition of Cash Equivalent Investments.

‘Cash Equivalent Investments’ means investments that are short term investments (excluding equity investments) which are readily convertible into cash without incurring any significant premium or penalty.

Cash and Cash Equivalent Investments are relevant to the definition of Total [Net] Debt and thus a fundamental component of the Gearing ratio.

Many Borrowers (and Lenders) prefer to be more precise what cash equivalents are. For instance, what rating must corporate bonds achieve?

21.5 ‘Relevant Period’ means [each period of twelve months ending on the last day of the Borrower's financial year and each period of six months ending on the last day of the first half of the Borrower's financial year][Accounting policy]

This clause appears as 21.2 in the SFA but has been moved as a result of the insertion of the Financial Covenants above.
22. GENERAL UNDERTAKINGS

The undertakings in Clause 22 remain in force from the date of this Agreement for so long as any amount is outstanding under the Finance Documents or any Commitment is in force.

The Undertakings in this clause are in a basic form. Particularly with regard to Clause 22.3 (Negative pledge), Borrowers should resist requirements that unnecessarily restrict their freedom to act and are not reasonably required for the Lender within the context of the particular transaction.

Generally speaking, key areas of focus include:

(a) which particular Obligors and members of the group are caught by specific undertakings;

(b) qualifications, such as materiality permitting transactions up to a defined monetary limit, within any of the undertakings; and

(c) any specific exclusions from the scope of the undertakings.

22.1 Authorisations

Obligors must obtain authorisations necessary for a) the maintenance of Finance Documents; b) its business. This clause includes an optional Material Adverse Effect qualifier.

We have two main issues with this clause:

(a) it repeats the content of the representation at Clause 19.5 (Authorisations) but in an inconsistent way. It is embarrassing for a CFO to have to report that there is no problem with a Representation but that the Borrower is in breach of an equivalent Undertaking. Whatever the agreed outcome the clauses should be consistent and if they are consistent it is only necessary to have the Representation. Sometimes in negotiations we have to go through the process of achieving the first with a view to achieving the second;

(b) please refer to our comments on the Representation at Clause 19.5.

22.2 Compliance with laws

Obligors must comply in all respects with all laws where failure to do so would impair its ability to perform its obligations under the Finance Documents.

On the whole this is in fair form. However, it is not uncommon to refer to material laws and material compliance and material obligations or, preferably, payment obligations. The 'materially impair' formulation is another way of saying that the non compliance will not have a Material Adverse Effect and we think that conformity would be helpful. That qualifier is deployed in project financings as well.

We have also seen a carve out for circumstances where the compliance is being contested by appropriate proceedings. In project financings it may also be qualified by reference to a concept of ‘Good Operating Practice’.

22.3 Negative pledge

This is a long clause because it has a blanket prohibition on providing Security which is supplemented by adding restrictions on ‘quasi-securities’. This involves disposals of
certain types of assets like receivables and set off arrangements. Certain types of transactions are then permitted.

There is a natural and inherent tension between the Finance Parties’ legitimate interest and reasonable expectation that the pool of assets supporting the Facilities is to be protected and the Borrowers’ interest in being able to trade and carry on business on a regular basis.

**Paragraph (a)**

Paragraph (a) is broadly drafted and contemplates security granted beyond that granted in respect of loan facilities. Accordingly, it also covers security granted in favour of trade creditors for example. It also refers to allowing a Security to subsist, which means that the security may come into effect without the Borrower taking any action, such as by the operation of law. This is a particularly important issue given the introduction of the PPSA (see our discussion from page 83).

**Paragraph (b)**

This paragraph adds certain ‘quasi - securities’ to the equation (such as set offs).

**Sub-paragraph (i)**

Sub-paragraph (i) restricts a range of intra-group transactions and activities and may be inappropriate for certain corporate structures. In addition, if the transaction is between Obligors and the Finance Party has a guarantee from both, there is no value ‘leakage’, we don’t see what the problem is.

**Sub-paragraphs (iii) & (iv) - ROT Arrangements**

In the scheme of Clause 22.3, retention of title (ROT) arrangements are not covered by the general prohibition under paragraph 22.3(a) because they remain assets of the supplier. As a result paragraph (b) deals with ROT transactions, specifically prohibiting them where entered into primarily as a method of raising or securing Financial Indebtedness or financing the acquisition of an asset. Accordingly, ROT arrangements entered into for other reasons may not be covered by this prohibition. Given the breadth of the definition of Financial Indebtedness (we note our comments in this regard on page 11), the situation remains somewhat murky. Accordingly, where Borrowers are subject to ROT arrangements in their operations, they should opt to include optional sub-paragraph (c) (v) or (vi) as an express carve-out.

**Paragraph (c)**

Paragraph (c) expressly carves out a range of matters from the operation of Paragraphs (a) and (b). It therefore provides for express limits on the general prohibition on creating or permitting the subsistence of certain Securities. Borrowers should note the key importance of this clause. We make the following comments in relation to certain sub-paragraphs:

**Sub-paragraph (i)**

Borrowers should consider whether the terms of Schedule 9 should be directed toward precise securities as listed in that Schedule, or perhaps are better described by form.

**Sub-paragraph (ii)**

When drafting this clause, Borrowers should review their precise arrangements to ensure that it is broad enough to cover their particular situation. They should include express carve-outs relevant to their cash-management arrangements. We are not sure that this is satisfactory to deal with ISDA netting unless it is with a bank the
Borrower has a wider relationship with. It may be the Lenders are ‘encouraging’ the Borrower to do hedges with the Lenders (only)?

Sub-paragraph (iii)

New language has been included which more broadly addresses hedging and transactional banking. It is a useful addition although the carve out at the end relating to Security pursuant to a credit support arrangement is unnecessary because any Security given under such an arrangement would be caught by clause 22.3 (a). Signing an ISDA with a credit annexe is not, without more, a Security.

Sub-paragraph (v) and (vi)

This provision deals with Security granted over assets acquired after the signing of the Agreement. It is quite narrow as it contains a number of key restrictions.

Sub-paragraph (v) is on similar terms but is directed to the assets of a company which becomes a member of the Group.

See our comments on paragraph (c) (Retention of Title) above.

Sub-paragraph (viii)

We do not think in an Investment Grade context that it ought to be necessary to put aside cash in order to contest an ROT claim.

Sub-paragraph (ix)

This provision is an important carve-out permitting the Borrower to create Security not permitted under preceding sub-paragraphs, up to a specified level of aggregate indebtedness.

Borrowers will have to decide whether it is in their best interests to have the ceiling set as a fixed amount or as the higher of a fixed amount, a percentage of assets or a ratio.

Sub-paragraph (xi)

A new exclusion applies to leases of goods, which is useful.

Drafting Note - Permitted Security Interest

Some agreements of this type label each of the carve outs under Paragraph (c) as a ‘Permitted Security Interest’ and list them in the definitions section of the SFA. This may be beneficial if dealings incidental to the above are to be permitted elsewhere in the Agreement (for example, under Clause 22.4 below).

22.4 Disposals

Obligors are not allowed to dispose of any asset, voluntary or not. There are limited exceptions for assets made in the ordinary course of trading, in exchange for other assets of the same quality type and value and a threshold to be agreed.

Paragraph (a)

This is a very broad prohibition on disposal of assets. The action in this clause takes place in paragraph (b). We think it is overly intrusive for an investment grade credit.

It duplicates the expropriation default at Clause 22.8 and so is inconsistent with the carve-outs in that clause.
**Paragraph (b)**

This clause sets out the exceptions to the broad prohibition in paragraph (a). We make the following comments on each sub-paragraph:

**Sub-paragraph (i)**

The scope of this clause is limited to disposals made in the ordinary course of trading. In our view, Borrowers should to expand this to read ‘in the ordinary course of business’, being a wider concept.

**Sub-paragraphs (ii) and (iii)**

These provisions deal with exchange of comparable or superior assets or the disposal of worn-out or obsolete assets. Their inclusion is desirable from a Borrower’s perspective but it may not be commonly used by Borrowers.

**Sub-paragraph (iv)**

This provision contemplates the inclusion of further, more bespoke, provisions as contemplated by the parties in the context of the transaction. Some of the exceptions regularly negotiated include:

(a) disposals made ‘for fair value on arm’s length terms’. Varying the wording in sub-paragraph (i) (see above) may negate the need for such a provision. Nonetheless, we recommend the inclusion excepting the disposal;

(b) made pursuant to a ‘Permitted Security Interest’ (see the discussion of Permitted Security Interest on page 54). This will likely be subject to any priority arrangement required by the Lenders or the Agent;

(c) Borrowers may also wish to except disposals made pursuant to arrangements made prior to signing;

(d) assets no longer required for the core business; and

(e) where the proceeds are used to repay debt.

**Sub-paragraph (v)**

This provision permits disposals other than those specifically covered up to a certain value each year (or other such period selected). In order to avoid arbitrary restrictions on dates, Borrowers may wish to request that unused amounts in this cap be carried forward from year to year (or any such other period as is agreed.)

22.5 **Merger**

Mergers, amalgamations and corporate reconstructions generally are prohibited.

If the assets and business of the group are staying within the ‘Guarantee’ net of the Finance Parties we suggest this be resisted. In some circumstances, as long as the credit quality of the merged group is maintained and the obligations under the Finance Documents properly assumed, a merger may be permissible. Although, in general, Finance Parties have a problem with changes in ultimate control. Please also see our comments on Change of Control (Clause 8.2).

The corporate reconstruction reference potentially duplicates some of the insolvency defaults so some carve outs may apply here as well.
22.6 **Change of business**

There must be no substantive change in the general nature of the business carried on by the obligors.

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This can be limited to the 'core business' and Borrower specific covenants introduced.

22.7 **[Insurance]**

*We would expect a more extensive provision in a project financing and some investment grade Borrowers would argue that this is a matter for management not the Finance Parties.*

22.8 **Environmental**

[]

22.9 **Guarantor coverage**

New requirements to maintain a certain percentage of the value of the Group are Guarantors. No suggestion is made as to what the basis of measurement of value but presumably assets or equity will be logical.

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Typically a Lender’s starting point will be to require all group entities will be Guarantors so to the extent this contemplates a lesser percentage and corporate flexibility it is welcome. No doubt this will be negotiated in the context of the Gearing ratio and whether or not those non-Obligor subsidiaries debts are guaranteed.

22.10 **[Other Non-Obligor external debt]**

As an alternative to a guarantor coverage arrangement, two new options which are very similar in effect, are included which limit the amount of debt non Obligors can have outstanding.

22.11 **[Other]**

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**22.12 [PPSA policy and steps]**

This paragraph requires each Obligor to implement procedures to identify and register PPSA interests.

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There is an increasing compliance burden for most corporates across a range of legislation. That they have chosen to single out the PPSA is only understandable because the SFA is drafted by finance lawyers. As is acknowledged, this would only be appropriate for a very limited number of businesses.

23. **EVENTS OF DEFAULT**

23.1 **Non-payment**

Failure to pay is an immediate breach unless it’s the result of a technical error in which case a grace period is provided for.

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There are multiple variations on the theme for payment defaults with a grace period of about three days. We suggest three days or, if the non payment is the result of technical failure, within three days of correction of the failure. This provision is unusual in that the grace period is only triggered after a technical error. The LMA Agreement provides for the option we recommend (three days flat) and also refers to
23.2 Financial covenants

It is a breach if any requirement of Clause 21 (FINANCIAL COVENANTS) is not satisfied.

This should only apply on the ratio testing date. This drafting may mean Borrowers must be in compliance at all times (see our discussion at Clause 21 (Financial Covenants) which is problematic.

In many cases, and especially project financings, there will be cure rights in respect of ratios. For instance if equity is contributed a DSCR calculation will be ‘re-run’ on the assumption that debt was being prepaid at the beginning of the period rather than the end. Sometimes Borrowers will agree that the equity contribution should be counted in a different way, such as revenue or EBIT.

23.3 Other obligations

Any other obligation is not complied with. Except in relation to payment defaults and financial ratios, a grace period is provided for.

Commonly there will be a grace period in which to remedy the default. There are multiple variables in how these grace periods operate including:

(a) when they commence, which may be from when the breach occurs, when it is discovered by the Borrower or when the Agent writes requiring rectification;

(b) whether the breach is capable of remedy or not;

(c) whether the Borrower or the relevant Obligor is diligently pursuing a remedy; or

(d) what the obligation is, so for instance a breach of the Negative Pledge may have a shorter grace period than a breach of a lesser provision.

23.4 Misrepresentation

Any misrepresentation in a Finance Document or any other document delivered under the finance documents (such as a compliance certificate) is a breach.

It is common for this default to apply only to representations in the Finance Documents (not any other document). We think this is very important for both the Lenders and the Obligors so as to encourage full and frank dialogue at all times. Otherwise lawyers will be needed at all bank meetings!

Our comments on the undertakings grace period regime apply equally here. It is often the case that there is a difference between the remedy and grace period regime as between the undertakings and the representations. Most Borrowers consider that whatever regime is agreed it is logical that the regime applied to the representations is the same as the one for the undertakings.

23.5 Cross default

It is a breach of this agreement if there is a payment default (rather than an acceleration) under any other Financial Indebtedness or any other Financial Indebtedness is accelerated.
There is a significant and important difference between cross acceleration and cross default. If cross acceleration applies, the Finance Parties are only entitled to call in their debts if another lender has demanded repayment or 'accelerated' their debt. In cross default, the Finance Parties can call in their debts as soon as a default occurs under another facility, even if the other lender waives the breach.

It is of key strategic importance in dealing with more than one group of financiers in a default situation. In circumstances where a default would not ordinarily be terminal, cross default may cause it to become terminal because one group of lenders will have access to a default that they would not otherwise have.

It is far easier in those circumstances to negotiate with one group of banks or bondholders than several. They will all become quickly aware of the default in one facility because the failure to notify of the cross default may become a default in itself and the Borrower will create problems for itself if it does not provide full details.

Naturally in a constructive borrowing relationship it is appropriate to keep the financiers informed but how that is managed and how information is disseminated can be crucial.

Paragraph (b) of this clause reflects a cross acceleration arrangement and is really all that is needed. Paragraph (a), by contrast, is a limited type of cross default which applies only to payment defaults. This should be avoided because it effectively removes the benefit of any indulgence that you may negotiate with the original financier. It is even more problematic if the original Lender is aware that the Borrower has cross default in its other finance documents in terms of trying to negotiate with them.

If a Borrower has a bona fide dispute with a Lender about when and how an amount should be paid - and these do arise - cross default can put it in a very precarious position to negotiate from.

Paragraph (c) is even more problematic. There may be many reasons a creditor may terminate a commitment, it may be the creditor’s problem, it may be that there was a condition precedent expressed as an undertaking that a particular creditor took a conservative view of. These are matters that the Borrower should manage on its own without having to involve the Finance Parties.

Paragraph (d) reflects the traditional cross default where the mere entitlement to accelerate by another lender creates the default in the SFA.

Paragraph (e) establishes a threshold amount.

In his book ‘Mastering the ISDA Master Agreements’ (1992 and 2002) at page 425 Paul Harding comes at these matters from a different perspective to us. He says:

'I think cross acceleration is a misnomer. It does not speed things up; it slows them down.

I believe such downgrade [to cross acceleration] requests should only be considered favourably if cross acceleration is already in a loan agreement they have with you [being the bank] and the ISDA Master Agreement is closely linked to its terms or if your counterparty gives you written confirmation that cross acceleration applies to all its agreements and will do so in the future. If they give cross acceleration to anyone they must give it to you'.
A few points arise from this analysis. First, it was not the intention of a cross acceleration clause to speed things up. Second, it is our experience that Finance Parties will often be as pre-occupied with what others have as they are with their own position or requirements, which is sometimes logical.

It would be inappropriate to say that a Borrower will never give cross default to anyone because markets change and it may need to in the future, even if its credit does not change. Having to go back to each lender at a time when a Borrower is trying to finalise a new facility could prove very problematic and reopen a whole series of negotiations for little gain for the Finance Parties or the Borrower.

At clause 1.2 of this Guide we set out a typical non-recourse clause that is commonly included in the facility agreement for a project financing. This clause can be useful in ensuring that there are no cross default implications for a sponsor in a project vehicle. Corporates that commonly use project financing should be careful to ensure they do not indirectly defeat the intention to isolate themselves from a project by allowing it to trigger a cross default in their corporate facilities. If it does and the financiers are common the non-recourse nature of the project debt may be short lived.

23.6 Insolvency

It is a default if an Obligor is unable to pay its debts or if there is a moratorium in respect of any of its indebtedness.

A new sub-paragraph (b) has been added which provides that the Group is taken to be insolvent if any member has more liabilities than assets, including contingent and prospective assets.

The optional formulation changes this clause from a traditional insolvency clause, designed to apply in the event of an actual insolvency to a forward looking test. As there is potential for significant differences of opinion as to what type of discussions might fall within the clause it is best to either resist it or to quantify the seriousness of the discussion.

It may well be appropriate to have a balance sheet test in certain jurisdictions but Australia is not one of them and this is not the test. It should obviously be viewed on a consolidated basis and some contingent liabilities may never be realised or may be volatile in nature. For instance electricity hedges in Victoria change in value greatly on a spot mark to market basis. We would delete sub-paragraph (b).

23.7 Insolvency proceedings

If any step is taken in connection with a number of proceedings such as composition, assignment, winding up etc it is a breach.

If the Borrower has subordinated debt where 'lock up' is expressly contemplated then this needs to be provided for in reference to the 'suspension of payments'.

The Finance Parties should have rights in respect of formal insolvency proceedings although the rights arise in this clause as soon as an application is made, which may be premature. The opening words are very broad. Take, for instance, an application by a Borrower itself for an injunction to stop some step being taken. That is capable of falling within those words and might defeat the injunction application by giving the Lender a Default. We think that would be an unsatisfactory outcome.

Carve outs may include a grace period for winding up applications during which they may be stayed or dismissed.
23.8 Creditors’ process

This refers to expropriation, attachment, sequestration, distress or execution.

This inappropriately incorporates two separate concepts, the first being expropriation and the second being legal steps to realise assets for creditors. In respect of the latter, we sometimes see a threshold amount of assets to which a controller can be appointed. There may also be a reference to certain key assets.

Expropriation is usually a concept confined to project finance documents because of their project-specific nature. In a corporate financing it is unusual and leaves the Borrower open to default for minor things like resumption of an insignificant piece of land at an insignificant site by a council.

In the project financing setting an expropriation or compulsory acquisition then no default will subsist in a variety of circumstances, including where there is adequate insurance or compensation or a Material Adverse Effect qualifier.

23.9 Ownership of the Obligors

An Obligor ceases to be a Subsidiary of the Company.

Many facility agreements will have carve outs for disposals of Subsidiaries. If they do the guarantee clause needs to provide for their automatic release where they are also Guarantors.

In some circumstances it will be a matter for management to determine in which entities the business should be operated and some argue that so long as gearing ratios are being maintained there is no real need for this clause.

It is also necessary to be careful that this aligns with the change in control provisions in Clause 8.2 as sometimes inconsistency can arise with the exceptions to the change of control clause defeated by an ‘indirect’ technical disposal of a Subsidiary.

23.10 Unlawfulness

It is unlawful for an Obligor to perform any of its obligations under the Finance Documents.

In circumstances where that unlawfulness corresponds to an illegality or otherwise relates to the Finance Parties it is appropriate to apply the carve-outs to the Illegality provisions. It will also be useful to consider, where it only applies to one Finance Party to deem that Lender to be a Defaulting Lender so the Borrower can engage the exit and control mechanisms which should be available in that context.

23.11 Repudiation

An Obligor repudiates or evinces an intention to repudiate a Finance Document.

We have little fear of contradiction in saying that this is an unusual clause for an Australian finance document. Given the protection afforded by the other defaults and undertakings we do not see that it adds much to the general key of repudiation. This is another reason not to include fee letters as a Finance Document. If there had been a financing involved (rather than a takeover defence) the circumstances of JP Morgan v Consolidated Minerals where JP Morgan claimed more than $50 million and Consolidated Minerals paid only $20 million, might have turned out differently. It is [2011] NSWCA3
23.12 Vitiation of Finance Documents

This duplicates the representations on this issue. It would be common to see remedy provisions in respect of this which give time for the relevant document to be restored or substantially replaced.

This is not in the LMA Agreement. We suggest it is unnecessary.

23.13 Material adverse change

[ ].

*In our view, an MAC default is not appropriate in the investment grade context but is in the project finance context. In any event, as a matter of form, the definition in this document is Material Adverse Effect not Material adverse change.*

23.14 Environmental

[ ].

*This is not in the LMA Agreement*

23.15 [Other]

[ ].

23.16 Consequences of an Event of Default

*If one considers the circumstances around the Pan Foods discussed in the Material Adverse Effect definition of this guide it would seem to be important to ask the Agent to include in its notice of default what the breach is. Banks would commonly do this anyway.*

*It is important the [#] around ‘which is continuing’ are deleted.*

*Sometimes a Borrower will be given a further period of up to five Business days to pay a demand before the Agent can take enforcement action. This is a bit unusual as grace periods are generally tailored to the relevant default. Occasionally a sponsor or shareholder will also be given a period to accept responsibility for the amount not paid so as to cure the default.*

*In project financings where there is a bullet repayment, the Finance Parties will sometimes agree that the Obligors will not be in default if they are diligently pursuing a refinancing for a period after the due date for repayment. However, during that period default interest will apply in respect of that Tranche.*

Waterfalls and Reserve Accounts

*In almost all project financings there will be a scheme of waterfalls and reserve accounts.*

*Reserve accounts are useful and can work to increase the amount of leverage on a project. Our only comment on them is that it seems unnecessary to create different accounts instead of one account into which amounts must be put for different reasons*
(debt service, capex etc). Also, if it is possible that cash may be locked up in those accounts for any period of time so it is advisable to include a concept of an Authorised Investment so treasurers can improve their returns on those amounts.

A waterfall usually involves a clause which provides that certain amounts must be paid in priority to others. We find them a bit curious and probably unenforceable in the light of current director’s duties. We do not know many businesses that receive all their accounts in a quarter and then pay them in a predetermined order assuming they have sufficient money. Trade accounts are received and paid continuously, financing amounts are paid when they are due for fear of acceleration etc.

The remedy for a breach of a waterfall undertaking can only ever be default under the Financing Documents whereas some seem to have the view that it somehow sets up some sort of priority. At various points some highly leveraged projects have asserted that this is the case so as to make their unsecured hedge counterparties feel more comfortable about their credit risk. In the scheme of insolvency laws, priorities and preferences this cannot influence the outcome. In assessing what is to be paid when, an officer is far more likely to focus on their duties and liability for insolvent trading than the waterfall and in fact the consequences of breaching the waterfall can complicate the position of the officer.

Still there is often a very detailed discussion about waterfalls which means there are some very different outcomes in an area where one would have thought there is more conformity.
SECTION 9
CHANGES TO PARTIES

24. CHANGES TO THE LENDERS

It is important for Borrowers to be aware of the circumstances and pre-requisites whereby a Lender may assign its rights or novate its rights and obligations under the SFA so it can manage who its Lenders are.

24.1 Assignments and transfers by the Lenders

Borrowers may wish to exclude certain specified persons from being transferees, or may wish to exclude a certain class. This may especially be the case where it is conceivable that the Borrowers’ competitors could come within the scope of assignees.

Generally we would expect to see a correlation between the scope of potential New Lenders and the rights of a Borrower to veto the transaction. That is, the broader the scope of potential New Lenders, the broader the rights of the Borrower to veto the transfer, and vice-versa.

Generally there are four main methods by which Borrowers may seek to control assignments and transfers. These include:

(a) by making any transfer or assignment subject to the Borrower’s consent which shall not be unreasonably withheld or delayed;

(b) by making any transfer or assignment subject to the Borrowers consent except where the relevant Commitment being transferred is less than a specified limit;

(c) by making any transfer or assignment subject to the Borrower’s consent but providing for a carve out covering specific circumstances where a Lender may make a transfer or assignment without requiring such consent. This usually covers transfers to related parties or where an Event of Default subsists; or

(d) a combination of each of the above.

We prefer a regime whereby any purported transfer is to be subject to the Borrower’s consent which shall not be unreasonably withheld or delayed. This should be the starting point and any associated carve outs or limits should flow from this. Even in the case of transfers not requiring the consent of the Borrower, strict notice provisions should be insisted on.

There are a number of collateral issues associated with imposing strict parameters within which Borrowers may transfer their rights and obligations. A Lender who is prevented from transferring may be more likely to enter into sub-participation arrangements. We note that this clause does not prohibit sub-participation (or credit derivatives). Accordingly, Lenders may be able to transfer some of their risks and rights in a non-transparent manner. Indeed, as the existence of the sub-participation is often confidential, Borrowers are often unaware that the arrangement exists.

This is a concern for Borrowers as sub-participants often obtain consultation rights which is code for an ability to exercise substantial influence on a Lender from behind-the-scenes. This influence usually becomes problematic in circumstances where a Borrower may need an alteration of the facility or is seeking the waiver and negotiations in this regard are affected by an unseen third-party’s priorities. In some circumstances the sub-participation arrangement may provide that, a sub-participant may actually become a Lender. Given the proliferation of sub-participation
arrangements, it may be impractical to prevent them entirely. In any event, they can provide benefits such as improved pricing and liquidity. In our view, the better approach is to agree on some controls for their operation such as requiring that entering into such arrangements is permissible provided that a Lender remains a Lender and the Borrower is kept appraised of any such developments.

24.2 Conditions of assignment or transfer

Lenders will point out that in some transactions it will not be appropriate for them to have to obtain Borrower consent. In these circumstances it is important for Borrowers to identify other mechanisms in the SFA through which they can ensure their interests are not compromised by the transfer. This will include narrowing the scope of potential transferees in Clause 23.2.

Case Study - Transfer/ Novation where consent of Borrower not required.

In Leveraged Equities v Goodridge\[18\] the Full Court of the Federal Court considered the effectiveness of a pre-authorised novation clause in the context of a margin loan.

Facts

In March 2003, Mr Goodridge, a Sydney Barrister entered into a Margin Loan Agreement, the Loan and Security Agreement (LSA) with Macquarie. In a complex transaction, that loan was onsold as part of $1.5b deal to Leveraged Equities (LE).

Following the dip in the market due to the GFC, in February 2009, LE made a series of margin calls on Goodridge and eventually sold the securities underlying the margin loan.

Goodridge sued and asked the Court to consider whether the actions taken by LE to make the margin calls and enforce the security were valid. This involved two specific sub-questions which were described by the Court as the Margin Call Case and the Transaction Case:

• The Margin Call case dealt with Leveraged Equities’ manner of making the margin call on Goodridge.

• The Transaction case dealt with whether Macquarie was authorised to novate and/or assign its rights and powers under the Agreement to a third party.

Margin Call Case

The Court held, in relation to the Margin Call Case, that as a matter of construction, the actions taken by LE in making the margin call and subsequently selling the underlying security were valid. This aspect of the case turned on the precise facts of the case and the terms of the contract in question.

Transaction Case

The Court examined whether the purported novation/assignment was effective to transfer the rights which LE had purported to exercise in making the margin call.

Novation

At first instance, Justice Rares found the purported prospective consent granted by the borrower to any novation was ineffective on the basis that it was ‘impossible’ for one party to a contract to pre-authorise a unilaterally executed novation. The Full

\[18\] [2011] FCAFC 3
Court overturned this approach and held that it was possible for a party to prospectively authorise the other party to unilaterally novate its rights and obligations under an agreement to a third party.

The Court held that a clause purporting to authorise a unilateral novation must contain the following key requirements:

• what the party is authorised to do (i.e. to ‘novate’);
• who has the right to take the action (i.e. the ‘Lender’);
• to whom (e.g. another bank or financial institution).

Assignment

The decision of the Full Court in relation to the issue of assignment of rights was more nuanced and more factually and contractually dependent. In upholding the assignment of rights from Macquarie to LE, the Court made the following key propositions:

• The benefit of contractual rights cannot be assigned where the corresponding obligation is so closely linked to the person to whom it is owed that the court should imply an intention that the benefit cannot be assigned. However, this was not one of those instances.

• Goodridge contended that the purported assignment created an unworkable situation whereby Macquarie retained an obligation to lend further funds while LE held the rights to give notice of a margin call and enforce the underlying security. The Court had the view that the situation was unusual, but nonetheless workable under which Macquarie bore the ultimate financial responsibility of providing further advances to the borrower. In this, they reiterated the approach taken in Pan Foods: i.e. that lenders may wear ‘both belt and braces’.

The case therefore stands for the proposition that any authorisation to act unilaterally in assigning rights or novating obligations must be expressly set out. Regard will also be had to the precise nature of the relationship between the parties to ascertain the precise nature of the rights being assigned.

24.3 Assignment or transfer fee

24.4 Limitation of responsibility of Existing Lenders

In general the process described under this clause is basically mechanical and emphasis in negotiations should be placed on Clauses 21 (Financial Covenants) and 23.2 (FINANCIAL COVENANTS).

24.5 Procedure for transfer

24.6 Disclosure of information

This provision empowers any Lender to disclose a wide variety of information to a wide range of parties and as such may be problematic in its current form. Depending on the nature of the Borrowers’ business, they may want insist on the optional inclusion of the requirement to enter into confidentiality agreements. However, in our view, this may serve to simply shift the emphasis from the parties to whom a transfer is made to the terms of the confidentiality agreement. We suggest that the focus should therefore remain on the scope of permitted transferees and any rights a borrower may have to veto a transfer under Clause 24.1 (Non-payment) has thankfully
been deleted and a confidentiality clause included (see Clause 39) which is discussed below.

24.7 Transfer Certificate to Company

24.8 Security over Lenders’ rights

This paragraph permits the Lenders to give security over their rights in the agreement.

While necessary in modern finance the protections in (i) and (ii) requiring the Lender to remain the Lender of record and ensuring no additional cost or remedy are of little value when the original Lender has no ‘skin in the game’. This is more reason for the Obligors to advance positions that enable them to manage the syndicate more effectively and flexibly.

At a minimum the Obligors ought to be made aware of the grant of any such security.

25. RESTRICTIONS ON DEBT TRANSACTIONS

This section has had a major overhaul to react to the advent of greater participation by non-bank lenders in the syndicated market. We have some difficulty understanding why a Company would accept these provisions in their present form, especially as it applies to Borrower Affiliates. If an entity puts its money on the table then it should be entitled to the rights of other Lenders. If other Lenders do not like the motivations of Lenders that are Syndicate members they can sell their participation. If they are unable to sell their participation because the credit has turned bad or are not inclined to at the price available then that is a consequence of the poor initial decision.

25.1 Prohibition on Debt Purchase Transactions entered into by [the Group/Borrower Affiliate]

This clause prohibits the Company, directly or indirectly, through either the Group or wider concept of Borrower Affiliate, hold any of the Loan.

25.2 Disenfranchisement on Debt Purchase Transactions entered into by Borrower Affiliates

This clause will only have room for operation if the provisions of clause 25.1 are limited to the Group. It provides that if a Borrower Affiliate does hold or beneficially hold any participation in a Loan it will have no vote on any matters and will be taken to not be a Lender in connection with matters requiring a 100% vote.

There is an alternate suggestion that allows a Borrower to purchase debt in distressed circumstances such as if it pays less than par, or if it is purchased through one of two processes involving all the Lenders. However, at the end of the process the relevant portions of the Facility A Loans are extinguished, meaning they are not part of the Facility and are not part of the voting arrangements.

If some special arrangement is needed in connection with Borrower Affiliates there are certainly less draconian approaches, for instance there could be particular matters that the Affiliate may not vote on, such as acceleration following payment default, adjustment to the definition of Majority Lenders etc. But if an equity holder has such a strong view about the direction a business should be taken that it is prepared to put some money on the table then it ought to have a vote in respect of at least some things or circumstances.

26 CHANGES TO THE OBLIGORS
This clause deals with the relationships between the Arranger, the Agent and the Lenders as between themselves.

Even though most of this relates to the position of the Finance Parties inter se, as all roads lead to the Borrowers in the end it requires attention. In particular we note the following:

Clause 27.5(e)

This Clause provides that the Agent may engage lawyers and various advisors. Perhaps while a Default is subsisting this may be permissible without consent but if there is no Default there should be consent, quotes for fees etc.

Clause 27.7

This Clause relate to instructions and discretion of the Agent. The Agent has been given much more power and discretion to work with and to act with or without instructions. With the emergence of a broader range of financiers this may be of concern to the Borrower who ends up with the consequences.

Clause 27.11

This deals with removal or replacement of the Agent. It only provides for ‘consultation’ with the Company. Again if a Default is continuing this may be appropriate, but consent is appropriate if there is no Default. The role of the Agent is obviously important to the Company.

Clause 27.16

This clause provides for recoupment of internal costs. Again this may be permissible if a Default is continuing but otherwise the Agency Fees are intended to cover this.
SECTION 11
ADMINISTRATION

Section 11 has had several important concepts added to it.

31.11 Disruption to Payment Systems etc

Provisions have been added to deal with a Disruption Event in payment systems but it is very conditioned and at the option of the Agent and there is no direct reference to waiver or remedy of any pre-existing payment default. The useful aspect is that once agreed with the Agent any changes need only be communicated to the Finance Parties without requiring their approval.

38 INSTRUCTIONS AND DECISIONS

Voting and decision making have been a focus in the updating of the APLMA suite. The new clause 38 allows a Lender to abstain, in whole or in part, or to be excluded if it fails to respond within a certain period. Defaulting Finance Parties are disenfranchised.

Voting arrangements are something that Borrowers should pay more attention to. The 'snooze you lose' provision above is welcome, as is the more aggressive approach which is that if you fail to vote you will be taken to have approved the Company’s request.

39 CONFIDENTIALITY

A confidentiality clause has been added.

The confidentiality clause is generally useful and has balanced drafting. It is only one way, so there are no duties on the Borrower. It is generally to be preferred to the equivalent clause in the Asian edition. There are a couple of exceptions that Borrowers may wish to look at. One is the ability to share information with potential assignees. As previously noted this ought to be something the Borrower is engaged with, and there is an optional provision in this regard. Also the Finance Parties may disclose to any ratings agency and this is again something Borrowers often like to be in control of.
SECTION 12
GOVERNING LAW AND ENFORCEMENT

26. GOVERNING LAW
COMMENTARY ON CERTAIN ISSUES UNRELATED TO THE SYNDICATED FACILITY AGREEMENT

Tripartites

Overview of the role of Tripartite Agreements

Tripartite Agreements or Deeds (Tripartites) are common in project financings. For Borrowers and Contractors, they are somewhat of a necessary evil.

The basic purpose of a Tripartite is to establish a direct contractual relationship between the Finance Parties and the major contractors, including suppliers, off-takers, key consultants, etc (Contractors). The aim is to protect against the key contracts being terminated in the event that the Finance Party appoints a receiver to the Borrower. A Tripartite gives the Finance Parties a period to maintain the status quo and keep the contracts with the Contractors on foot while the Finance Parties consider their next steps.

In our experience, a Tripartite is not effective in saving a project or in tying Contractors to uneconomic positions for an extended period. Economics are more useful.

Occasionally Finance Parties will attempt to achieve direct recourse to the Contractor for performance of the relevant contract (Contract) by the Contractor or the Borrower in the case of the Sponsor. If this is to be entertained by the Contractor and the Sponsor, it should be recorded in a separate document where the exact consequences and need for the recourse can be given appropriate scrutiny and separated from unrelated promises/remedies.

Tripartites can become exceptionally complex, especially where Contractors have securities and the Tripartite becomes partly a priority/intercreditor deed. Such arrangements can involve a combination of step in and step out rights for the various security holders. Occasionally, the Contractor will also want a right to buy the project debt or the project itself from an appointing Finance Party. This gives rise to questions of equity valuation and Sponsor rights and makes Tripartites difficult documents.

We have seen Tripartites proposed for hedges in the national electricity markets. Electricity markets are among the most volatile markets in the world. As a result, asking a hedge counterparty not to exercise default rights for any period can be extremely difficult and, depending on the size and nature of the hedge, can potentially be a very expensive arrangement.

Negotiating a Tripartite Agreement

Lawyers acting for a Finance Party usually argue three main themes:

(i) Tripartites are required to get the project up and running;

(ii) Tripartites are in the interest of the Contractor because Finance Parties will be the Contractor's only source of payment in the event that there are solvency issues with the project; and

(iii) Tripartites are in the interest of the Borrower because they make the Finance Party feel more comfortable in the event that there is a problem. Therefore, the Finance Party is less likely to appoint. If the Finance Party does appoint, the Tripartite provides for the Contracts to remain on foot which will help preserve value for equity.
Of course, all this can quickly change if there is a problem with the economics of the project. Further, the negotiation phase can sour relations between the Borrower, the Sponsor and the Contractors which can involve significant cost and is not good for the project generally.

A common mistake made by Borrowers is not getting on top of Tripartites early enough. Sometimes it is impossible to get them organised in a proper order because of the way the project develops. As ever, the answer is competitive tension - the Tripartite or its key terms should be part of the competitive tension in appointing a bank or bank group. Rarely, however, are they attached to term sheets. We recommend that the actual terms and not just an undertaking to enter into a Tripartite, should be part of the tender for the major suppliers and contractors.

**Specific Issues**

The key issues in a vanilla Tripartite are as follows:

**Acknowledgement of the execution of the security**

This is necessary to ensure that the execution of the security does not, of itself, result in a breach of the relevant contract. This is in the Borrower’s interests and should be readily pursued. Even if there is no Tripartite the Borrower should ensure that the execution of security does not breach a term of a key contract as this may in turn be a default under the financing documentation.

**Notice of default or potential default**

This seemingly innocuous requirement can be problematic in a distressed situation and has the potential to expose the Contractor to claims from the Borrower. Notification to the Finance Parties and responses to enquiries from the Finance Parties also opens up a direct dialogue between the Finance Party and the Contractor which may not be in the Borrowers’ best interests.

When acting for the Borrower, we prefer that the Contractor is required to give a notice within a certain period prior to enforcing default rights (in preference to a notice of the default itself). We also prefer that the only remedy against the Contractor is that the Contractor is unable to terminate until after the applicable notice period has elapsed. This means the Borrower is more likely to control the discussion (initially at least) and the Contractor is not faced with a claim for damages from the bank for not notifying the Finance Parties. No doubt the Contractor would, one way or another, seek to recover this cost from the Borrower.

This approach may also give the Borrower or the Finance Party a basis to attack a putative termination notice.

Tripartites rarely have termination dates or periods. In theory, this means that these notification requirements can continue after the debt is repaid which is inconvenient. For this reason we recommend that termination dates and periods are drafted into the document.

**Grace periods**

Finance Parties will commonly seek an additional period of time to consider the project and decide whether they will remedy defaults. There are three possible outcomes:

- the grace period can run concurrently with the relevant grace period under the Contract;
- the grace period can commence when the grace period commences under the Contract but run longer than the original grace period; and
• the grace period for the bank can run after the grace period under the Contract.

The third option enlarges on the Contract from the Contractor’s perspective, and is usually the best option for the Borrower because:

• it will make the Finance Parties more comfortable at the commencement of the transaction;

• if there are difficulties, the more time the Finance Parties have to consider options without having to make a formal appointment, the better; and

• the bank’s additional grace period may give the Finance Party time to negotiate something with the Contractor.

For the reasons outlined above, we think it preferable for the Finance Parties’ grace period to run from the time of receipt of a copy of the Contractor’s default notice. This gives rise to a key question - what will the Finance Party be liable for during the extended grace period? Generally if the relevant default is the appointment of a receiver they will be responsible for obligations during the period or the appointment. This is no great ‘give’ by the Finance Parties because their receiver will be liable for those amounts in any event. We take this up further in the context of step in rights.

Step in and step out

In addition to an extended grace period, many Tripartites have an ability for the Finance Party, and occasionally the Contractor, to step into the Contract or the project as applicable. Again, the key question in these circumstances is what does the Finance Party become liable for? In particular, is the Finance Party liable for antecedent defaults, particularly payment defaults subsisting at the date of the step in?

From the Borrower’s perspective, it can be useful for this liability to transfer risk to the secured Finance Parties if they are more likely to take a view on the project. This also encourages the Contractor to continue working which may add value to the project. On balance, we tend to quietly support the Contractor on this point. However, it is a case by case matter.

Amendments to the contract

Most, but not all, Tripartites include a provision that the Borrower and the Contractor will not amend the relevant contract. There are a many variations and carve-outs to this provision because it affects the ability of the parties to deal with the contract in circumstances where the project is running smoothly.

Some Tripartites even extend this prohibition on amendment to an undertaking by both the Borrower and the Contractor that they will perform the Contract in favour of the Finance Parties, giving them standing in respect of all of the provisions of the Contract. Even the Borrower should be concerned about the availability of such recourse to the Contractor by the Finance Parties, let alone its own position.

If the contract allows for variations, pursuing changes through the variations regime is arguably not an amendment or a cessation of performance. We prefer that this is stated expressly in the contract so as to avoid any arguments to the contrary.

The Contractor is well within its rights to argue that amendments to the contract are a matter for the Facility Agreement between the Finance Parties and the Borrower. The Borrower would be wise to support this argument.
Sale of the secured property, purchase options on the part of the Contractor of the project or the project debt and assignment of the relevant contract.

We have seen Finance Parties and Contractors who, in a distressed situation, attempt to predetermine the outcome for equity. These attempts are invariably met with suspicion and are problematic for the Borrower. For example, there are complex considerations that call into question director’s duties on the part of the asset owner, as well as questions regarding valuation methodology, process and other matters.

Other Acknowledgements

There are a number of other acknowledgements by the Contractor, including the taking of certain steps that will remedy the default under the contract. These steps include:

- paying money in the case of a payment default,
- overcoming the relevant ‘detriment’ in the case of other defaults or
- appointing a receiver in the case of insolvency.

The primary reason these seemingly innocuous statements are included is so Finance Parties can ensure that, in the case of appointment, irremediable defaults can be remedied and in other cases, when a Finance Party is remediing, to defeat arguments that strict compliance with the contract is necessary.

The Borrower needs to give these acknowledgments careful thought in the context of the general scheme of the Tripartite. There is a risk that the Borrower can be cut out of the loop where it has consented to performance by the Finance Parties, even if there is no receiver appointed. This is concerning as the Borrower may have a different view of the value of the Contract or the relationship with the Contractor may have soured giving rise to significant questions regarding how the Borrower will arrange and prosecute potential claims against the Contractor.

The Finance Parties have all the personal rights that the Borrower had under the contract.

This allows for the Finance Parties to apply for discretionary remedies such as specific performance. In further support of this, the Tripartite may contain a provision for the availability of equitable relief in respect of the Tripartite itself. Occasionally less subtle versions are used, such as an express acknowledgement that equitable relief will be available even if there will be no loss or damage from the non-compliance.

Acknowledgement of the Finance Parties’ rights are fairly essential to the operation of the Tripartite. The Borrower has little opportunity to protest against these provisions, notwithstanding that implicit in the Borrower’s acceptance of these provisions is a diminishment in the Borrower’s capacity to exercise the relevant right. This is because a right can only be exercised in a particular way. An acknowledgement by the Borrower that it will do everything necessary to assist the implementation of the Tripartite can sometimes represent an express acknowledgement of the reduction of the Borrower’s rights.

The finance party is not liable under the contract unless it expressly assumes an obligation.

In effect, this allows the Finance Parties to have their cake and eat it too, insofar as they have all the rights under the contract for a time but none of the obligations. Of course the Contractor will retain the right to terminate if the non assumed obligations are not performed by the Finance Parties.
The Borrower may wish to stop payment, in which case the Contractor may complain to the bank who pays for fear of losing warranties. The amount paid would form part of the Borrower’s debt to the Finance Parties and may even contribute to a trigger of Leverage or DSCR ratios. This puts the Borrower in a very poor negotiating position with both the Finance Parties and the Contractor. This may be appropriate in some projects but not in others.

It is often assumed that this is not a matter to be dealt with by the Borrower, however we suggest that this is a mistake.

Limitation of rights of set off

If it is a one way (as is commonly the case) this should not be a cause for concern for the Borrower.

Summary

Tripartite Deeds can, on their face, appear simple and straightforward. However, complex issues can arise which are worthy of detailed consideration having regard to the circumstances of the particular project.

Security

The SFA does not refer to security but plainly, regardless of their form most project financing arrangements do.

A commentary on security arrangements is beyond the scope of this work. However a few high level comments are necessary.

The most common mistake that Borrowers and their lawyers make is to undermine the work they have done in negotiating their facility agreement by allowing inconsistent terms in the security documents and trust deeds. Such documents are often accepted on the basis that they are ‘standard banking documents’ and are sometimes printed on forms to reinforce that statement.

Subordination and guarantee documents are the same. As noted previously, if a guarantor proposes to give a guarantee then it should do so. It should not quibble about small points to give it the opportunity to squirm out of the guarantee later. However it should not do more than the Borrower has and agree to fix defects in the banks documents or be responsible for the conduct of the Bank or its officers. For instance, indemnifying the bank in the event of the unenforceability of the Bank’s own documents puts the guarantor in a worse position than the Borrower. The guarantor may have to pay in circumstances where the Borrower will not.

Subordination documents have such a wide array of similar issues and problems. So it may be that a lender will agree to rank after the Finance Partners but that should not always mean that their subordination should be subject to increasing senior debt or charges to the senior debt arrangements they have not agreed to.

A great deal of time and money can be saved if, at a commercial level, it is agreed at the commencement that the terms of the securities should not enlarge the deal agreed in the Facility Agreement.

Personal Property Securities Act 2009 (Cth) (PPSA)

The PPSA received royal assent in December 2009 and is due to commence operation in October 2011. It changes the law relating to security interests in personal property. It replaces a number of Commonwealth, State and Territory Acts and
registers for securities with a single comprehensive national framework for the creation, enforceability and perfection of security interests.

In addition to rationalising the number of laws and registers governing securities in personal property, the PPSA also introduces a range of substantive changes. Although the changes introduced will likely be more important for Lenders, it is important that Borrowers are aware of the developments and the likely steps Lenders will take to protect their interests under the new regime.

We has prepared a range of updates in relation to this legislation and Borrowers seeking more information should feel free to contact us.

Application

The PPSA applies to:

(a) ‘security interests’ in ‘personal property’ (essentially any property other than land and certain statutory rights or entitlements that are specifically declared not to be personal property for the purposes of the PPSA) located in Australia; and

(b) ‘security interests’ granted by Australian individuals, partnerships, corporations and other entities over ‘personal property’ (whether located in or out of Australia).

The Act introduces an expansive ‘substance over form’ definition of what constitutes a ‘security interest’. A ‘security interest’ will arise where, in substance, an interest in personal property provided for by a transaction secures the payment or performance of an obligation.

The Act also deems a number of arrangements to be Security Interests. These Deemed Security Interests include:

- the interest of a transferee under a transfer of accounts receivable or chattel paper;
- the interest of a consignor who delivers goods to a consignee under a commercial consignment; and
- the interest of a lessor or bailor of goods under a PPS lease.

Perfection

A key development introduced by the PPSA is that persons benefiting from a security interest must now take steps to ‘perfect’ their security interest under the PPSA. A failure to perfect a security interest can have consequences. For example:

(a) the assets subject to a security interest may vest in the grantor of the security interest in its insolvency. That is, the assets will be available to the creditors of the grantor of the security interest, even if title to the relevant assets remains with the holder of the security interest;

(b) priority being lost; or

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21. Personal Property Securities Act 2009 (Cth) s 12(3)
22. Personal Property Securities Act 2009 (Cth) s 12(4)
23. The PPSA categorises collateral. For example, accounts, chattel paper, currency, financial products, intellectual property, investment entitlements and motor vehicles. In general, the PPSA applies equally to any collateral in any circumstances. However, different categories of collateral become relevant for the purposes of specific perfection, priority, extinguishment and enforcement rules. Our comments in this summary are purely of a general nature.
(c) the security interest being extinguished on a transfer to a third party.

**Effect on Security Agreements – Demise of the Fixed and Floating Charge**

We do not anticipate major changes to the form of Security Agreements. Subject to the registration requirements of the PPS Register, parties remain free to negotiate the terms of security agreements without the need to satisfy prescriptive requirements.

The PPSA ostensibly sweeps away the distinction between fixed charges and floating charges. Under this regime, a fixed charge is deemed to be a reference to a charge over personal property that is not a circulating asset; a floating charge is deemed to be a reference to a charge over personal property that is a circulating asset. This is effectively a fixed charge over circulating assets.

In practice, it is likely little will change for Borrowers upon the introduction of the new legislation and the likely effect is that the use of the term ‘Fixed and Floating Charge’ will wither away.

A number of issues we see arising for parties entering an arrangement such as this include:

- Parties should review any negative pledge clauses as a number of arrangements that were not seen as security interests may now be security interests and parties may breach the clause. Outlined later under Clause 22.3 (Negative Pledge) on page 59.
- Be aware that assignments of receivables are caught under the PPSA.
- Bailments and leases between parties in the group concerning plant, equipment and other property may be registrable security interests.
- There are a number of key issues arising in relation to confidentiality and the PPS Register. Where there are cross-charges covered by the PPSA in an intra-group agreement, parties may wish to place those charges in a side document to preserve confidentiality.

**Involvement of Lenders in the running of the Borrower’s business**

Since the decision in the long-running Bell Group litigation, there has been a lot of scrutiny concerning the role of creditors taking security where they may suspect that the directors of the company are actually acting in breach of their director’s duties. At that time banks would take security when things are going bad and then wait for preference periods to pass so that their securities were not ‘green’.

In the Bell Group case, a borrower (which was a member of a corporate group) was experiencing financial difficulty and could not repay a number of outstanding loans. A key reason for this was that its main sources of income were its investments in, and fees from, other companies in the same group which were having their own difficulties.

It entered into a refinancing transaction under which (amongst other things):

- the banks extended the term of the debt;
- the banks obtained a range of guarantees supported by security over principal assets from other members of the group;

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22 Personal Property Securities Act 2009 (Cth) s 339(4) & (5)
23 Key decision in this long-running saga is decision of Owen J in *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* [2008] WASC 239.
• the borrower and the guarantor undertook that all asset sale proceeds were to be used to pay down the debt.

These finance and security documents were executed in early 1990. In April 1991, the borrower appointed a provisional liquidator and the banks realised their security.

The liquidators sued the banks. They alleged the companies were in fact insolvent when they entered into the refinance transactions and granted the securities. Accordingly, the directors were in breach of their fiduciary duties toward the company. They alleged that the banks knew of this breach of duty and, pursuant to the rule in Barnes v Addy, were liable as constructive trustees to return the proceeds they had gained upon realisation of the securities.

The Court held:

• the borrower and its subsidiaries were insolvent at the time of entering into the transaction and granting the securities.

• the directors knew or should have known that the companies were (or nearly were) insolvent and therefore entering the transactions and granting the securities was a breach of the director’s fiduciary duties.

• the banks knew of that breach so were therefore liable as constructive trustees.

Obviously a lot of the controversy around the case dwelled on what was required for the bank to ‘know’ of the breach. His Honour Justice Owen confirmed that, in order to have the requisite knowledge of the directors’ breach of fiduciary duties and thus be liable as a constructive trustee, the bank must have:

(a) actual knowledge;

(b) wilfully shut its eyes to the obvious;

(c) wilfully and recklessly fail to make such enquiries as an honest and reasonable person would make; or

(d) have knowledge of circumstances that would indicate the facts to an honest and reasonable person.

Once Owen J held that the bank had the knowledge referred to in (a), (c) and (d), it followed that they were to be a constructive trustee.

Some commentators have argued that the key implication of the case is that banks will now want/need to ‘[know] whether a customer is telling the truth’ when making representations as to their ability to service loans and grant security in respect of those loans.24 Accordingly, they have suggested that banks will now want a seat at every boardroom with a view to ensuring that they do not inadvertently find their security effectively unenforceable. We respectfully disagree with this view.

The reality of this case is that at that time is was common practice for lenders to give an indulgence to get a security and then keep the group afloat until the securities matured. There is, until the Bell case, no reason not to.

Importantly, there have been a number of important changes made to the Corporations Act that, if effective at the time, may well have led to a different outcome in this case. Most significantly:

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• the Corporations Act (in s 181) now contains a statutory parallel to the general law directors duties and a bank knowingly involved in the breach of these duties can be liable to pay compensation;

• an important change that works to the benefit of banks is the introduction of the new s 187 which allows for companies to put provisions in its constitution that allow it to act in the best interests of its holding company if not insolvent;

• the statutory indoor management rule (ss 128-9) has also been changed to better favour outsiders.

Borrowers should be aware that guarantors within a corporate group are entitled to have a provision in their constitution that entitles it to act in the best interests of their holding company and they should take advantage of this where appropriate. However, they should also be aware that such a provision does not absolve them of taking important precautions in deciding to enter into a guarantee or grant security.