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Lombard v. Skyjets: Key Takeaways for Lenders and Restructuring Professionals

By Bevis Metcalfe, Matthew Smith, William Sugden and Matthew Mazenier*

Actions will speak louder than words—whether in the form of a "no waiver" provision in a contract or an express reservation of rights—when a court is considering a lender's response to a borrower's default on its financing arrangements. The authors of this article discuss a recent English High Court decision, which provides some important guidance for lenders and restructuring professionals when communicating with distressed borrowers.

The recent English High Court decision *Lombard North Central Plc v. European Skyjets Ltd*[1] provides some important guidance for lenders and restructuring professionals when communicating with distressed borrowers. Actions will speak louder than words—whether in the form of a "no waiver" provision in a contract or an express reservation of rights—when a court is considering a lender's response to a borrower's default on its financing arrangements. While there are no massive surprises to emerge from the decision, the breadth and creativity of some of the arguments advanced by the borrower's lawyers nonetheless provided the court with the opportunity to provide additional certainty to market participants.

BACKGROUND

In October 2008, the lender ("Lombard") loaned c.US$8.8m to the borrower, European Skyjets Limited, ("Skyjets"). The funds were used to purchase an aircraft. The loan was secured by a first ranking mortgage over the aircraft and was repayable through monthly instalments.

Between 2009 and 2011 the borrower missed several instalment payments. This led to restructuring discussions between the parties and fees being levied

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[1] [2022] EWHC 728 (QB).

by the lender in return for a de facto forbearance from exercising its right of acceleration. By November 2012, the borrower was deemed to be insolvent and Lombard demanded the borrower pay the outstanding sum (by that time, c.$US5.8m). The following month, the borrower went into administration and Lombard commenced proceedings for the outstanding balance, maintaining that its actions in terminating and accelerating the loan agreement, and enforcing its security and selling the aircraft, were valid. The borrower brought a counterclaim, arguing that Lombard had not been entitled to terminate the loan agreement or sell the aircraft. The borrower also claimed damages arising from Lombard having breached its equitable duties when enforcing the security and selling the aircraft.

DECISION AND KEY TAKEAWAYS

The court found in favor of Lombard. Lombard was judged to have been entitled to terminate and accelerate the loan agreement albeit on the basis of misrepresentation and material adverse change events of default (see point 3 below), and to enforce its security. This was despite the acceleration notice itself citing a non-payment event of default which the court concluded did not constitute a valid basis for exercise of the acceleration right.

The court's judgment includes some important considerations for lenders when dealing with distressed borrowers, set out below.

1. "No Waiver" Clauses and Reservation of Rights Letters

Throughout the lending relationship the borrower missed a number of payments. Lombard had, over this time, permitted the borrower extra time to make these payments and indeed accepted late payments. As such, the borrower argued that Lombard was not entitled to rely on these late payments as cause to terminate and accelerate the loan agreement. Lombard responded by arguing that the "no waiver" provision in the loan agreement, coupled with having issued reservation of rights letters, meant that it was entitled to rely on these missed payments as grounds for acceleration.

The court found that Lombard had, through its conduct, waived its right to rely on the missed payments to terminate and accelerate the loan agreement. Indeed, this was the case even though the termination / acceleration provision in the loan agreement did not require a default to be continuing when the acceleration notice was served. The "no waiver" provision and reservation of rights correspondence were ineffective to displace Lombard's affirmation of the contract by conduct.

Lenders should remember that their conduct in affirming breaches of the agreement will override provisions purporting to protect them in the loan agreement or in contemporary correspondence. This conduct could include giving the borrower more time to pay, accepting late payments, charging and accepting a late payment fee, and delaying in taking action.

2. Lender's Obligations When Assessing the Value of a Secured Asset for The Purposes of a Financial Covenant

The loan agreement included a financial covenant that was assessed by dividing the value of the aircraft by the amount outstanding under the loan. The relevant clause stated that the value of the asset was to be assessed in the Lender's opinion.

The court determined that the clause required the lender to act reasonably, despite there being no such obligation in the clause itself. The court did not accept the borrower's argument that the clause required the lender to have first taken all reasonable steps to ascertain the open market value of the aircraft. The court also rejected the borrower's argument that the lender was required to take steps to increase the value of the aircraft.

3. Relying on a Material Adverse Change

The loan agreement stated that an event of default will occur if "in the opinion of the Lender, a material adverse change occurs in the business, assets, condition, operations or prospects of a Group Company or any Credit Support Provider." For a lender to rely on such an event of default to terminate an agreement the court stated that it must be satisfied that the opinion was honest and rational, and formed when the notice was served. The court was satisfied, based on evidence, that Lombard had considered that the financial health of the borrower's business was materially worsening, and that the business was cash-flow insolvent.

The court noted that on the wording of the clause, it was not necessary that the material adverse change must actually have had an objective adverse effect. However, lenders should carefully review such provisions and seek legal advice on the terms of the clause in question before taking action on the basis of a material adverse change event of default.

4. Lender's Obligations When Selling the Secured Aircraft

Lenders have a duty when selling a secured asset to take reasonable steps to obtain a proper price for the asset. Skyjets contended Lombard had not discharged this duty, by account of its conduct when storing the asset, the sale process it approved, and the price that was set. Some of the conduct complained of by the borrower included that Lombard should have sought cheaper storage, that the external valuation obtained by Lombard was too low, and that there were deficiencies in the sale process, including around the time it took for

Lombard to appoint a selling agent and to commission an external valuation, and the aircraft not being advertised in certain trade journals. The judge was not persuaded that any of these factors meant that Lombard had fallen short of the duty.

While this outcome is consistent with long-established legal principles, lenders should always ensure they do take steps to meet this duty when looking to enforce and sell a secured asset. Such steps may include obtaining specialist valuation and sales advice. Alternatively, lenders may elect to appoint a receiver or administrator to affect the sale rather than the mortgagee itself, and effectively transfer this risk to the relevant officeholder.

5. The Implied Duty of Good Faith

Lastly, the court rejected the borrower's (highly ambitious!) argument that Lombard's decision to terminate the loan agreement on the basis of an event of default was subject to the *Braganza* duty. The *Braganza* duty, in short, requires a party to exercise a contractual discretion rationally and in good faith. In other words, Lombard's right to terminate was not of the type to which this implied duty to act in good faith applied; Lombard was able to exercise this termination right for its own purpose as it saw fit.