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In The Know

Leveraged Finance Newsletter

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Can an obligor's consent be taken at face value?

What to consider when borrower consent to a loan transfer is required

Welcome to the November edition of "In the Know", Baker McKenzie's leveraged finance newsletter that analyses significant trends and salient legal issues for participants in leveraged finance and high-yield markets around the globe.

Lenders and their legal advisers carefully check the capacity of obligors and the due authorisation of their signatories when a deal commences. In this edition, we consider the issues arising when consent is needed from obligors during the life of a facility. The recent English case of *CRF I Ltd v. Banco Nacional de Cuba and another* [2023] EWHC 774 (Comm) is a cautionary reminder of the consequences of failing to obtain obligors' approval going forward.

*A version of this article first appeared in the October 2023 issue of "Butterworths Journal of International Banking and Financial Law".

Key takeaways

- An obligor's capacity and authority to give consent is a matter for the law of such obligor's jurisdiction of incorporation.
- The giving of requisite consent is relevant not only at the outset of a transaction but may also be necessary to ensure the smooth operation of the facility throughout a transaction.
- Where prior obligor consent is required to transfer a loan participation, contemporaneous evidence as to capacity and authority should be provided.
- Contractual conditions to assignments or transfers should be strictly complied with to ensure that an effective transfer of legal title occurs.

Capacity and authority to consent

Creating a valid facility agreement, like any other contract, involves several different elements. These include, under English law, the requirements of offer and acceptance, certainty of terms and the intention to create legal relations. A crucial concern for any lender is ascertaining the obligors' capacity to enter and perform obligations under the facility agreement and that the persons executing the facility agreement on their behalf have the requisite authority. It is standard practice for the lender's legal counsel to check each obligor's constitutional documents, corporate authorisations and director's certificate, and issue a legal opinion confirming the existence of actual capacity and authority. For UK borrowers, this is despite sections 39 and 40 of the UK Companies Act 2006, which provide that third parties dealing with a UK company are not adversely impacted by any limitations on capacity or authority in a company's constitutional documents.

Cross-border transactions introduce a further element. English law recognises parties' freedom to choose any law to govern contractual rights — see Article 3(1) of Reg (EC) No. 593/2008 of 17 June 2008 on the law applicable to contractual obligations (as it now forms part of the UK's domestic law) (Retained Rome I) — but the issues of companies' capacity and agents' authority to bind their principals (such as directors' ability to bind a company) are outside the scope of Retained Rome I.[1] Under English conflict of laws rules, the law of an obligor's jurisdiction of incorporation is the applicable law for considering those points. Accordingly, it is market practice to require opinions from legal counsel in each relevant jurisdiction that addresses these issues.

However, what happens after a facility agreement is signed? There are events that will, or may, subsequently occur that require an obligor (or its agent) to execute further finance documentation or consent to certain acts. One example, in syndicated facilities, is where the obligors' prior approval is required for a lender to transfer its rights (and, where applicable, obligations).

Transfer provisions

Absent any contrary contractual provisions, the starting position under English law is as follows:

- **Novation**: a "transfer" of rights and obligations, being a replacement of one original party with a new party involving extinguishing the original rights and obligations and creating new rights and obligations on identical terms, requires the consent of all parties.
- **Assignment**: An assignment of rights only does not require the consent of any other party.

1 Articles 1(2)(f) and 1(2)(g) of Retained Rome I respectively.

This position is typically altered by negotiation, such that:

- Some novations and assignments require obligor consent to be sought (and provided) at the time of the relevant transfer.
- By executing the facility agreement, up-front consent to future transfers to specific persons or categories of persons is given by the obligors in advance.

This latter mechanic was judicially approved in *Habibsons Bank Ltd v. Standard Chartered Bank (Hong Kong) Ltd* [2010] EWCA Civ 1335.

Is obligor consent required?

A typical loan trade is made on "a trade is a trade" basis — if the required consent is not obtained or any other transfer condition not met, the parties must still settle the trade. When approached by, or contacting, a potential buyer of their participation, a lender must consider any applicable transfer conditions before agreeing to any trade. They should form a view on whether a transfer to the potential buyer is "pre-approved", requires specific consent or is prohibited. This may involve reviewing any applicable prohibited and/or pre-approved new lender lists and considering any relevant definitions, such as "loan-to-own investors" or "industry competitors". Where the position is unclear, the parties should consider seeking further legal advice or, adopting a cautious approach, request obligor consent.

How is effective obligor consent provided?

The provision of contemporaneous obligor consent may be one of the conditions for creating a valid agreement for a loan transfer. The same analysis applying to the obligor's entry into the facility agreement applies to the giving of its consent to the transfer.

In *CRF I Ltd v. Banco Nacional De Cuba and another* [2023] EWHC 774 (Comm), the high court, in deciding whether it had jurisdiction in relation to the non-payment of certain English-law-governed debts, first needed to ascertain whether those debts and a related guarantee had been validly assigned to the claimant (who was not the original lender). Under the terms of the debt agreements, the prior consent of the debtor, Banco Nacional de Cuba (BNC), not to be unreasonably withheld, was required for any assignment. For the benefit of the guarantee to transfer to the assignee, the consent of the guarantor, the Republic of Cuba (Cuba), was required.

Cockerill J set out the relevant applicable laws.

- Capacity and actual authority: Cuban law
- Apparent authority: English law
- Meaning of "prior consent": English law

She concluded that, as a matter of English law, prior consent had been given to the transfer, as evidenced by an email request to BNC for consent and BNC's emailed response accepting the assignment "in principle" (and requesting further documentation to be sent to it to process the assignment). The court interpreted BNC's email as constituting consent, with the provision of documentation as a condition subsequent that was later fulfilled when that documentation was provided to and accepted by BNC.

While the court concluded, after hearing expert evidence on the relevant Cuban law from both sides, that BNC had capacity to give consent to the assignment of debts and the persons giving that consent had sufficient authority to do so, it found that the relevant provisions of the guarantee (including that communications were to be made to the State Finance Committee, and not BNC) and the Cuban Civil Code meant that BNC did not have capacity to consent to the assignment of the guarantee on behalf of Cuba. There were no grounds under English law to find that BNC had capacity or authority to consent on behalf of Cuba. No representation was ever made by Cuba (or anyone else) to CRF I Limited (or anyone else) that could form the basis for any apparent authority.

Lenders and agents should not take at face value that the person giving consent to a transfer has capacity and authority to act for their own entity or for other obligors.

At the outset of a transaction, steps should be taken to reduce the likelihood of future issues arising, including the following:

- Ensuring that obligor board resolutions specifically authorise individuals (or "any director") to provide consent to future transfers
- Ensuring an "obligors' agent" provision is included in the facility agreement, whereby all obligors irrevocably authorise the obligors' agent to, among other things, approve transfers
- Ensuring "pre-approval" to certain transfers is as wide as possible

Where contemporaneous consent is required, while it is impractical to require new corporate authorisations and legal opinions, lenders and agents should do the following:

- Check that the persons consenting to the transfer are referred to in the original board resolutions and, if not, request evidence of their authority
- Particularly where there is no "obligors' agent" provision, request specific confirmation from those persons of their capacity and authority to bind other obligors

What if no consent is obtained when it is contractually required?

As between the obligors and the lenders, any purported transfer failing to meet contractual conditions is ineffective. In *Barbados Trust Co Ltd v. Bank of Zambia and another* [2007] EWCA Civ 148, a facility agreement provided that the borrower's prior written consent was required for any assignment, but that consent would be deemed given if the borrower did not reply to a request for consent within 15 days. The lender purported to conclude a transfer before the expiry of that period. The court of appeal held that the transfer failed and legal title to the debt in question was not transferred to the "new lender". As noted above, "a trade is a trade" and, in such circumstances, the seller and buyer of the loan are obliged to find an alternative solution, such as a sub-participation arrangement. In contrast, as seen in *Musst Holdings v. Astra Asset Management* [2023] EWCA Civ 128, it is possible for a consent requirement to be waived through conduct. In that case, the court of appeal held that a contract was successfully novated due to the counterparty's conduct, despite the counterparty not providing the contractually required prior written consent and the inclusion of a no-oral-variation clause. A novation does not constitute a variation of a contract and so is not prevented by a clause requiring variations to be made in writing.

Practical considerations

These cases highlight the following:

- The strict requirements for transfer, including requesting and obtaining any required obligor consent, should be followed. Obligors should choose their words and actions carefully when responding to a transfer request, for example, if further information is needed to make a decision, expressly state: "This does not constitute our consent to the proposed transfer".
- Lenders should not accept an obligor's consent at face value — check existing evidence or request new evidence that the person giving consent has sufficient authority to act on their behalf and on behalf of other obligors and require that a specific representation be included in the consent communication that actual capacity and authority exists in respect of all relevant obligors.
- Facility agents should regularly review authorised signatory details and check that any individual consenting to a transfer request is included.

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