Crowell

Client Alert

When Is an Event of Default "Continuing"?

November 4, 2022

Over a decade after Lehman's insolvency, the English High Court handed down a key judgement in *Grant v FR Acquisitions Corporation (Europe) Ltd* [1] on 11 October 2022. The judgement provides commentary on when certain Events of Default have occurred and are "continuing".

Although the court addressed these issues in the context of interest rate swaps entered into pursuant to an ISDA Master Agreement (the "**Transactions**") and the impact of Lehman's UK entity, LBIE, coming out of administration, the judgement may have implications beyond the derivatives market, for example in the context of financing agreements, corporate documentation, and distressed debt trading, as well as cross-border restructuring or insolvency situations.

The context: what are the ramifications?

The appointment of administrators over LBIE in 2008 constituted an Event of Default under the relevant ISDA Master Agreements. LBIE's counterparties could elect either (a) to terminate the Transactions, or (b) to suspend their payment obligations pursuant to Section 2(a)(iii) of the ISDA Master Agreement, which provides a condition precedent to payment that "*no Event of Default … with respect to the other party has occurred and is continuing*".

Where termination would have resulted in a net payment to LBIE due to the way interest rates had moved, LBIE's counterparties elected to suspend their payments for so long as an Event of Default was continuing. However, LBIE is currently solvent and about to come out of administration, so any previously suspended payment obligations will become due (provided that no other Event of Default is continuing). LBIE would be owed principal amounts over £8m and $53m under the respective Transactions, before accounting for interest.

The court's analysis of certain Events of Default

The court addressed a few specific Events of Default under the ISDA Master Agreement and reached the following conclusions:

- **Failure to pay:** this ceased to be continuing in December 2009 by operation of mandatory set-off under UK Insolvency Rule 14.24, i.e. LBIE's payment obligation was discharged.
- **Admission of inability generally to pay debts when due:** this would cease to be continuing by a public statement from LBIE that it has a surplus of assets over liabilities and that it is able to pay its debts as they fall due.

- **Administration:** this would cease to be continuing when the administrators' appointment is terminated, because the appointment was the triggering event or "**state of affairs**", notwithstanding that the "**effects**" of such administration continue.

The court also considered whether a 2018 Scheme of Arrangement (the "**Scheme**") constituted "*a general assignment, arrangement or composition with or for the benefit of creditors*". On interpretation of the ISDA Master Agreement, the court concluded that the Scheme did not constitute a fresh Event of Default because it did not arise in an insolvency context, i.e. due to "**financial distress**". LBIE was solvent at the time of the Scheme and there was no question of any deficit, but a key purpose of the Scheme was to maximise the value of LBIE's surplus by avoiding costly litigation.

However, if the court had concluded that the Scheme constituted an Event of Default, it would have followed that the default would have been "continuing" because the new state of affairs brought about by the Scheme continues to subsist.

The court separately acknowledged that "**one-off**" Events of Default are not "continuing" even if the effects cannot be undone; on the facts, however, LBIE's admission of inability to pay debts was not a "one-off" event because the notice speaks to a continuing inability (unless and until corrected), and the Scheme would not have constituted a "one-off" event even when all steps necessary to accomplish the Scheme have been taken.

Going forward: what parties should consider

The ISDA Master Agreement is an industry standard document, developed for common use in a variety of circumstances by a large number of participants. Accordingly, the court applied certain principles of contractual interpretation, ascribing more than usual deference to the words used.

Nevertheless, one lesson from the decision is that careful attention should be paid to the drafting and wording of events that trigger Events of Default. For example, while the Scheme was not considered an "arrangement" under the ISDA Master Agreement, the conclusion may be different elsewhere; the Scheme is a "compromise or arrangement" under the UK Companies Act 2006.

Consideration should also be given to the contractual implications, losses, rights or discretion that may be exercised by a non-defaulting party. While not considered in this case, an Event of Default may cease to be continuing if (or perhaps only if) it is "waived", and parties should consider common law or equitable doctrines (e.g. the non-defaulting party may be estopped) and statutory rules (e.g. the rights must not be unlawful penalties or extortionate credit transactions under insolvency rules).

All of these things will depend on the precise language, context and nature of your transactions, and parties should review the drafting of Event of Default clauses to ensure they are fit for purpose.

---

[1][1] [2022 EWHC 2532]

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

Charles Wakiwaka
Partner – London
Phone: +44.20.7154.4871
Email: cwakiwaka@crowell.com

Jennifer J. Kafcas
Partner – London
Phone: +44.20.7154.4870
Email: jkafcas@crowell.com

Lauren J. Blaber
Counsel – London
Phone: +44.20.7154.4873
Email: lblaber@crowell.com

Alvino S. Van Schalkwyk
Counsel – London
Phone: +44.20.7154.4872
Email: avanschalkwyk@crowell.com