

LENDERS BEWARE! CONSENTS COME UNDER CLOSER COURT SCRUTINY

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Courts are looking more closely at when it's unreasonable to withhold your consent. Read our latest Insight to find out how it could affect you.

Loan agreements often contain restrictions on when a borrower can deal with its assets. These restrictions typically allow the lender to:

- bring the borrower to the table to scrutinise the terms of any proposed disposal, which in turn can help to preserve the value of the lender's security; or
- call a default if the borrower breaches them.

Types of disposal restriction

However, in the course of commercial negotiations, a restriction that starts out as saying 'the borrower won't dispose of X asset' (an Absolute Restriction) is sometimes changed, for example to:

- 'the borrower won't dispose of X asset without the lender's consent' (a Consent Restriction); or
- 'the borrower won't dispose of X asset without the lender's consent, such consent not to be unreasonably withheld or delayed' (a Qualified Consent Restriction).

Over the last eight months, these types of provisions have come under closer scrutiny from the English courts.

Consent Restrictions

Last October following a High Court ruling, we published an insight looking at the treatment of Consent Restrictions and the risks for lenders in changing an Absolute Restriction to a Consent Restriction (which could ultimately affect how strong a lender's veto rights really are). If you regularly negotiate loan agreements, consent letters or other finance documents, you may wish to read our Insight '[Do the veto rights in your finance agreement really give you an absolute veto](#)', which provides details of the considerations for lenders which come out of that decision.

Qualified Consent Restrictions

Now in 2018, the High Court has also looked at the treatment of Qualified Consent Restrictions.^[1] In its analysis, the High Court concluded that where:

- a loan agreement contained a Qualified Consent Restriction which said: 'if, with the prior approval of the bank (such approval not to be unreasonably withheld or delayed), the property is sold, you shall immediately repay to the bank the net proceeds of sale';
- that property provided security for the bank's lending; and
- the borrower had received an offer for that property (in this case, of over €4 million) which was in line with market valuations;

it was unreasonable for the bank to refuse its consent to that property disposal on the basis that the borrower hadn't made any proposals to secure or repay the remainder of the facility (around €1.7 million).

The reason for the decision

The High Court's rationale was that when security over the property was first provided to the bank, it knew that it wouldn't cover its entire exposure and that there would be an unsecured shortfall. Therefore, the bank in trying to gain additional security to cover its remaining exposure was acting unreasonably. The sale had been proposed at arms' length and at market value, which was reasonable.

As a result, the borrower was able to sell the property without providing additional security.

The lessons for lenders

Both High Court decisions flag important considerations for anyone involved in negotiating loan agreements, consent letters and other finance documents; most importantly, that changing an Absolute Restriction to a Consent Restriction or a Qualified Consent Restriction could weaken the veto that you think you have. If you subsequently try to improve your position as a condition to giving consent, that may be frowned upon by the courts. It's also worth bearing in mind that this could also apply to other types of restrictions in finance documents (for example, restrictions around incurring extra financial indebtedness) and not just disposal restriction clauses.

Ultimately, retaining an Absolute Restriction will provide stronger protection in finance documents, but if you are unsure how re-wording an Absolute Restriction could affect your position, you should always consider taking appropriate professional advice.

If you have any questions or concerns arising from this article, please contact one of our Banking and Finance experts, who would be pleased to help you.

Footnotes:

[1] In the case of *Crowther and another v Arbuthnot Latham & Co Ltd* [2018] EWHC 504 (Comm)

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