

## Case: GSO Credit, Barclays and HCC International – Construction of LMA terms and conditions for secondary debt trading. When purchasing assets, obligations follow.

The second ever case to come before the Financial List (a specialist list set up to handle cases related to the financial markets and which would benefit from being heard by judges with particular expertise in the financial markets) concerns a dispute over the construction of the terms of a secondary debt trade carried out on the May 2012 version of the LMA Standard Terms and Conditions for Par and Distressed Trade Transactions ("**2012 LMA Standard Terms**"). Although specific to its facts, the case is interesting for its analysis of what is bought and sold when trading on LMA standard terms and conditions. The case involved a sale of "a position" under a surety bonds facility and focused on whether (a) the seller's contingent obligations under surety bonds issued at the time of trade formed part of the "Purchased Assets" and (b) those surety bonds constituted a "funded" or "unfunded" portion of the "Purchased Assets" for the purposes of the calculation of the "Settlement Amount". The decision was crucial to both seller and buyer as it determined whether a "Settlement Amount" payment was due from the seller or buyer. Mr Justice Knowles CBE ruled that the trade was a sale of the seller's "interest" in the surety bonds facility, which included not only rights to reimbursement from the borrower under the facility agreement but also the obligations of the seller under the issued surety bonds. The case highlights the need for users of the LMA standard terms and conditions to be familiar with their terms, particularly when the subject matter of the trade is not a plain vanilla loan with a drawn and/or undrawn commitment.

### Summary

HCC was the lender under a surety bonds facility, one of a number of facilities made available to Codere SA, the borrower under a senior facilities agreement (the "**SFA**"). HCC agreed to issue surety bonds (defined broadly as a guarantee,

indemnity performance bond, documentary credit or other instrument of suretyship) in favour of certain public authorities in Spain and Italy. The surety bonds facility required the borrower to pay the lender the amount of any claim by any beneficiary of the surety bonds. HCC entered into a

trade to sell to Barclays (who on-sold its position to GSO in a back-to-back trade) £23.7m of its commitment under the surety bonds facility which equated to the value of its contingent liabilities under all surety bonds it had issued. No demand had been made under those bonds

and no money had been paid out by HCC. The trade did not settle because the parties were in dispute over what had actually been bought and sold. HCC contended that it had only agreed to sell its reimbursement rights as lender against the borrower under the SFA and not its obligations to the public authorities under the issued surety bonds. It also contended, for the purposes of the calculation of the settlement amount due in respect of the trade, that the surety bonds constituted a "funded" portion of the traded commitment because they constituted a drawing under the facility and caused a reduction in the available commitment. GSO did not agree. GSO contended that it had purchased HCC's commitment under the SFA (including reimbursement rights) as well as HCC's obligations under the issued surety bonds and that it expected to be required to pay out on any claims made under the surety bonds. GSO also contended that the issued surety bonds represented an "unfunded" portion of the traded commitment as HCC had not been required to make payments in respect of the surety bonds.

The task of the court was to work out which of the parties was right by analysing the language used in their contract. In interpreting the documentation, the judge stated that the court would seek to (i) respect the parties' choice, (ii) understand the commercial

context and (iii) provide certainty and consistency in matters of business.

In support of its contention, HCC argued that the term "Purchased Assets" excluded "Purchased Obligations" and therefore obligations owed by HCC to the public authorities under the surety bonds did not form part of the "Purchased Assets". According to HCC, this meant that only its rights to be reimbursed by the borrower were transferred. In addition, HCC was of the view that the term "Purchased Assets" only related to the rights of a lender under or in respect of the "Credit Documentation" which, in this case HCC argued, referred to the SFA - not the surety bonds. It was accepted by all parties that HCC had traded its "position under the SFA" but the judge found that this meant HCC had traded both its liability to pay claims made under the surety bonds it had issued pursuant to the SFA together with its right to be paid an equal sum by the borrower. The judge made the point that any other interpretation would result in the seller retaining exposure under the surety bonds facility (less the amount received on the trade) whilst selling the benefit of the borrower's repayment obligation to the buyer. The use of the terms "interest" and "participation" in the definition of "Purchased Assets" were wide enough to include HCC's participation in the surety bonds as well as its obligations as issuer

of those surety bonds. The judge made a number of observations in reaching this result including the fact that the 2012 LMA Standard Terms were littered with references to "Purchased Obligations" and that the LMA Users Guide expressly states that the "Purchased Assets" include the obligations and liabilities of the seller attributable to the "Traded Portion". The court was therefore satisfied that the trade included the economic burden of the seller's obligations under issued surety bonds.

The judge also rejected HCC's argument that for the purposes of the calculation of the settlement amount under Condition 13 of the 2012 LMA Standard Terms, the issued surety bonds were "funded". The judge found that "Purchased Assets" are generally "funded" to the extent that money has been paid by the seller to a third party rather than to the extent drawn as a result of the issuance of the surety bonds. Again, the judge pointed to the LMA Users Guide to support this view, where it referred to "...where the drawn credit is funded (for example a conventional term or revolving loan facility)" and the situation "where the asset in question, although 'drawn' is not actually funded (for example, a letter of credit)".

The decision is consistent with the secondary loan market's expectations as to what is traded under LMA standard terms and conditions. A sale and purchase

of a loan on LMA standard terms and conditions is a trade of all rights and obligations attaching to the "Traded Portion" except the "Retained Obligations". If the parties to a trade do not intend this outcome, this must be agreed at the time of trade and documented in the trade confirmation.

Parties trading on LMA standard terms and conditions should note that the LMA standard terms and conditions were amended in 2014 to expressly clarify that a trade encompasses both rights and

obligations of a seller in respect of the "Traded Portion".

This is a first instance decision of the High Court and may therefore be the subject of an appeal by HCC. A request for permission to appeal must be made within 21 days after the date of the decision of the High Court (29 January 2016).

[GSO Credit and others \(Claimants\) v Barclays Bank PLC \(Defendant\) v HCC International Insurance Company PLC \(Third Party\) \[2016\] EWHC 146 \(Comm\)](#)

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