The limited effectiveness of a "no waiver" clause: an important warning for lenders and a useful reminder of other fundamental points of lending practice

Introduction

A recent High Court case (*Lombard North Central Plc v European Skyjets Ltd*[1]), provides some important reminders for lenders. Although not creating new law as such, the guidance in this case will be of interest to lenders when negotiating the terms of a loan facility and when looking to exercise their rights following the occurrence of a default.

The main takeaway is that "no waiver" clauses in a loan agreement and reservation of rights wording in correspondence do not always operate to preserve a lender's rights. A lender's actions may override these, particularly positive actions towards the borrower that can be argued to affirm the continuation of the loan facility. The result may be that a lender is found to have impliedly waived a right to call an event of default including, as in this case, in relation to a payment default.

The case is also worth highlighting because, in reaching his decision, Foxton J had to consider a number of other fundamental issues which will be of interest to lenders and borrowers alike. These points include the following:

- that there is no need to specify the correct event of default in an acceleration notice, where this is not specifically required by the facility agreement, provided that an event of default subsists which permits the lender to serve the notice;
- what is required to establish that an event of default has occurred based on a material adverse change (MAC);
- whether there is a de minimis test for a payment default; and
- whether there is a duty of good faith in relation to a lender's right to terminate or accelerate.

Background

The case concerned what was described internally at the lender (Lombard) as a "problem" account. The borrower (Skyjets) was repeatedly late with its monthly loan repayments pursuant to a USD 8.8 million loan agreement. Lombard began levying late payment charges and was in correspondence with Skyjets. Lombard then terminated the loan and enforced the security it had taken in support of the loan over the aircraft owned by Skyjets. The main issue before the High Court was whether Lombard had validly terminated the loan agreement so as to enable it to take possession of the aircraft under the mortgage. The issues highlighted above are discussed in more detail below, together with our advice to lenders on each issue.

Five main points of interest for lenders

1. Beware of the doctrine of waiver and don't expect to be saved by "no waiver" provisions or a reservation of rights statement

As is customary, the contract provided that a payment default (as distinct from certain other defaults) did not have to be continuing to be an event of default entitling the lender to terminate the loan and demand immediate repayment of all outstanding amounts. The court was satisfied that, as matter of construction of the contract, the lender's right of termination could be exercised "at any time" after the event of default.

1 [2022] EWHC 728 (QB)

However - and this is the key point for any lender to remember - the right of a lender to sit on a right of termination arising from a late paid instalment, only to exercise its right much later (even after it has been paid), is modified by the doctrine of waiver. Under this doctrine, the conduct of the lender in the period after receipt of late payment *may* be held to have waived any right to terminate on account of that late payment.

All that is needed to establish waiver, for these purposes, is clear evidence that the lender has accepted late payment "as if it were punctual" or that there is such a delay in refusing late payment "as might reasonably cause the [borrower] to believe that it has been accepted".

On the facts of this case, it was found that email correspondence from the lender amounted to an offer of additional time to clear what was outstanding and thereby render the payment "punctual". As such, it was found that the lender had implicitly waived its right to terminate based on late payments. Further, the court found that the lender's decision to charge interest on late payments was consistent only with the lender deciding to keep the contract in being despite the late payments. It was held that Lombard could not, therefore, rely on previously missed repayment instalments (which had been paid late by the time the termination notice was served) as events of default because it had waived its rights to do so.

Lenders should note also that Lombard failed with its argument that the "no waiver" provision in the contract and/or the "reservation of all rights" statement in the email correspondence served to prevent an implied waiver. A typical "no waiver" clause seeks to ensure a party's failure to enforce or delay in enforcing its contractual rights or remedies (whether intentionally or inadvertently) does not result in its losing its rights and remedies under the loan agreement.

The court recognised that such clauses or statements can be effective but they cannot prevent anything said or done by the lender from having its "objective effect". In other words, it's not enough for a lender to point to a "no waiver" clause in a contract or to rely on the "ritual incantation" of reservation of rights language in correspondence with the borrower. The court will have regard to all of the circumstances, including the nature and terms of any reservation of rights which has been communicated and the nature and consequences of any demand for future performance of the borrower's obligations under the contract.

Our advice to lenders on this point:

- ensure that the loan agreement contains a well drafted "no waiver" clause;
- be aware that taking positive action in response to an event of default by the borrower may override protections within the loan agreement, for example the "no waiver" clause, where the lender's conduct could be taken to contradict those protections. This should be considered carefully, ideally with legal advice, when contemplating what actions are to be taken; and
- "no waiver" and "reservation of rights" clauses/wording will not always be effective to preserve contractual rights.

2. A demand for payment can be valid despite containing errors or incomplete information

A termination notice (or demand) can be valid despite: (a) failing to correctly identify the Event of Default relied upon and including an Event of Default which has not in fact arisen, provided the acceleration clause does not require identification of the specific event of default in the notice; and (b) inaccurately specifying the amount due.

In this case, Lombard cited an event of default which had not in fact occurred. It was held that because the termination clause did not require Lombard to identify the event of default relied upon and because there was no "cure period" provided for, it was enough that an event of default did exist, regardless of it not being specified in the termination notice. It was considered important that (a) "no cure period" was provided for as Skyjets was therefore no worse off by reason of the inclusion of an invalid ground than if nothing had been said and (b) there were subsisting events of default (including in relation to the aircraft maintenance warranty) entitling the lender to serve an acceleration notice, despite those events not being specified in the notice.

Similarly, it was found that Lombard was permitted by the termination clause to require Skyjets immediately to repay all sums due and that Lombard was not required accurately to specify the amount due. The notice was valid and effective even though it inaccurately overstated the sums due (because it included claims for accrued late payment charges that the lender later accepted were not due). This is in line with previous authority on

this point, including a previous case in which a demand for “all monies” due from borrower to lender was held to be valid.

Our advice to lenders on this point:

- check the terms of the relevant finance documents to determine what information is required to be included in the acceleration or termination notice and adhere to it; and
- if the loan agreement does require the event of default to be specifically identified, the acceleration/termination notice should be drafted accordingly.

3. There is no *de minimis* test for a payment default

There is no scope for a *de minimis* obligation so far as the failure to pay instalments under a loan is concerned. When the parties have made a breach of a particular obligation a condition giving the right to terminate, that right is available “without regard to the magnitude of the breach”. The court found, on the facts, that Lombard had failed to discharge its burden of establishing that there was an outstanding balance, alleged to be in a sum of just below $200, at the time of the termination. In obiter comments in the judgment, reassurance was offered that had Lombard established this sum was outstanding (a ‘trifling amount’ as it may be), that would have been sufficient to engage the termination right without further enquiry.

4. There is no duty of good faith in relation to a lender’s right to terminate

The termination right was an "absolute contractual right" for the lender to exercise for its own purposes, as it saw fit. A contractual duty of good faith is not relevant to a lender’s termination rights.

In certain limited circumstances, the courts might imply a general duty of good faith in a contract (the duty of rationality, often referred to as the “Braganza duty”)[2]. Foxton J gave this argument short shrift, holding that it is clear that a lender’s decision whether or not to exercise a termination right is not in the nature of a contractual discretion to which the Braganza duty applies.

5. Lombard succeeded in satisfying the court that a MAC had occurred

The material adverse change clause in the contract was subjective, in that to be engaged Lombard needed to be of the opinion that a MAC had occurred in the business, assets, condition etc of Skyjets. The court confirmed (following existing authority)[3] that, for the purposes of such a clause, it is necessary for the court to be satisfied that Lombard formed the requisite opinion at the time (and that the opinion was honest and rational). It was not necessary objectively for the event relied upon to have had an adverse effect.

It was found on the facts that a MAC had, in Lombard’s honest and rational opinion, occurred and was continuing at the time of the termination – the relevant person at Lombard had formed a subjective view based on a review of Skyjets accounts which showed large trading losses and cash flow insolvency.

Points 3, 4 and 5 above offer reassurance to lenders in three respects:

- a right to terminate a loan based on failure to pay will be available where the parties have made breach of that obligation a condition giving the right to terminate, without regard to the amount of the sum that has not been paid. There is no scope for a de minimis obligation in this regard;
- when considering whether to exercise a right to terminate under the loan agreement there is no requirement to exercise this right in good faith – this right may be exercised for the lender’s own purposes and in its own interests as it sees fit; and
- if seeking to rely on the material adverse change clause, there is no need for the material adverse change to have had an objectively adverse effect where the clause itself is subjective. The precise wording of the MAC clause should be reviewed carefully, with legal advice, before relying on it.

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2 *Braganza v BP Shipping Ltd* [2015] UKSC 17

3 *Cukurova Finance International Ltd v Alfa Telecom Turkey Ltd* [2016] AC 923