

Noteholders entitled to declaration that restructuring of a separate debt amounts to an event of default under the notes

Published 8 December 2016

Fomento De Construcciones Y Contratas SA v Black Diamond Offshore Ltd (Court of Appeal hearing)

The Court of Appeal has rejected an appeal brought by a leading Spanish company ("FCC") against a first instance decision that an event of default had occurred in respect of a debt instrument.

Background

FCC is a Spanish company specialising in construction and city sanitation services. It has two types of borrowing: (1) EUR450m in unsecured convertible notes issued in around 2009, which are subject to English law and jurisdiction ("the Notes") and (2) a Syndicated Finance Agreement, subject to Spanish law and jurisdiction, in an amount of EUR4.5bn, which is divided into two tranches ("Tranche A" and "Tranche B"). In November 2014, FCC announced its intention to restructure Tranche B of the Syndicated Finance Agreement, and in January 2015 the Spanish courts approved the restructuring (in the absence of unanimous approval by all Tranche B debt holders), thereby rendering the Syndicated Finance Agreement binding and legally enforceable. The restructuring had the effect of adversely impacting the interests of Tranche B holders, since it provided for repurchasing of the principal at a 15% discount, a 3 year extension of the term and a reduction in the rate of interest.

Proceedings

In January 2015, certain Tranche B debt holders who are also holders of the Notes issued proceedings in the English courts seeking a declaration that the restructuring of Tranche B constituted an Event of default under the Notes. The significance of such an Event occurring is that it entitles holders to declare their Notes immediately due and payable. Following an unsuccessful challenge to the jurisdiction of the English courts by FCC, in April 2015 the claimant debt holders were successful at first instance in attaining a declaration that an Event of Default under the Notes had occurred. FCC appealed this decision.

Appeal decision

Applying fundamental and established principles of construing a contract, the Court of Appeal has unanimously upheld the first instance decision. The issue before the court was the correct interpretation of the Event of Default provisions contained in the Notes. The claimants relied upon clause 10(f), which provides that an Event will occur if FCC:

"proposes or makes a general assignment or an arrangement or composition with or for the benefit of the relevant creditors in respect of any of such debts."

FCC argued that the words "any of such debts" should be interpreted to mean "all debts" and that "relevant creditors" should be interpreted as "all creditors". FCC relied on the wording of the provision itself (arguing that "any such debts" referred back to an earlier phrase in the same provision: "all its debts") and on what is contended was the commercial unreality of the alternative interpretation, which had the effect of enabling a Note holder to call in its debt simply because FCC had entered into an arrangement with two or more creditors (an arrangement that might be for a relatively small amount of money).

The Court of Appeal rejected these arguments. It held that there was no commercial unreality in construing an Event of Default to cover even relatively modest arrangements with creditors. Default on one debt under a particular contract is capable of cross-defaulting other debts, setting off a chain reaction. Further, under FCCs construction, curious consequences would follow. For instance, an arrangement in relation to a large amount (say EUR1bn) of its debts would not count as an Event unless it involved (which it would not necessarily do) all of its creditors. If "any such debts" was interpreted to mean "all debts", the provision would give little protection to debtors. The parties have in effect agreed that a wide range of possible arrangements could justify sufficient apprehension as to the financial health of FCC as to entitle a Noteholder to rely on them as Events of Default. This interpretation is consistent with a reasonable reading of the contract wording.

Conclusion

The Court of Appeal has followed the first instance judge in applying an "iterative" approach to contract interpretation, whereby rival meanings are checked against other provisions of the document, and their respective commercial consequences investigated. This decision confirms that while the English courts will interpret contracts with a view to commercial sense, they will not reverse an agreement simply because it has draconian consequences for one of the parties.

Authors



Jonathan Brogden

London - Walbrook

jbrogden@dacbeachcroft.com

DAC
DAC BEACHCROFT