

FUND FINANCE FRIDAY

Equity Commitment Letters under English Law: Beware of the Pitfalls!

July 26, 2019 | Issue No. 38

**By Samantha Hutchinson**

Partner | Corporate Finance, Fund Finance

Equity commitment letters (or ECLs) have become an increasingly common feature of the fund finance landscape, providing flexibility for private-market funds which, for a variety of reasons, either cannot or do not want to assume a primary debt obligation in respect of a particular transaction. We see this particularly with funds in jurisdictions where the incurrence of a financing at fund level may result in adverse tax consequences for the fund (and/or its investors) and where the fund has reached its borrowing/guarantee limits in its fund documentation.

With proper structuring and documentation, the ECL can both address the fund's particular legal/tax/constitutional requirements and provide clear recourse to a lender relying on the ECL for credit support. However, there are certain provisions which might, on first glance, appear to be entirely harmless but which can make a drastic difference to a lender's recourse under an ECL. Below is a sample of some of the many pitfalls that we see with ECLs.

Claim for damages: If the ECL provides that the claims of any counterparty (including the lender if it has third-party rights) are limited to requiring the ECL provider to comply with its obligations under the ECL, the effect of this is likely to be that a claim for damages by a party that has suffered the loss under the ECL is specifically excluded by virtue of this statement under English law. The English courts will generally always award damages where they are a sufficient remedy, rather than specific performance which is always a discretionary remedy for English courts. This simple statement could have the effect of depriving the lenders of any remedy at all under English law. If a lender accepts this statement, an English court -- in exercising its discretion as to whether or not to award specific performance -- is very likely to take into account the sophisticated nature of the financial institution involved and its advisers and consider that the lender should have been aware of the implications of agreeing to such a statement.

Remoteness: In order to be able to sue for damages, a lender will need to be able to demonstrate that it has suffered a loss as a result of a breach of the ECL. That claim for loss

could be contested on the grounds that the loss was "too remote." Clearly, the point of structuring the ECL as an equity commitment is to create something which isn't quite a guarantee. However, the problem with that is that it then distances the lender from the transaction and leaves open a potential defence that the lender's loss is too remote. Including a statement to the effect that the parties acknowledge this is not the case is helpful in evidencing the commercial intentions of the parties in the event of a dispute.

Right of set-off, counterclaim and defence: As the lender is seeking to take the benefit of the ECL, usually either by way of assignment or third-party rights, the lender will take subject to defences which are available to the ECL provider by virtue of its contractual relationship with the direct beneficiary of the ECL under the terms of the ECL. Whilst the lender can contractually restrict what the direct beneficiary can and can't do to mitigate, so far as possible, defences becoming available to the ECL provider, the lender is unable to completely prevent this. Therefore, it is imperative that the ECL provider agrees that it will not exercise any right of set-off, counterclaim or defence.

There are several other aspects of ECLs and the enforcement thereof which need to be addressed/considered by a lender in accepting this type of recourse as credit support. We recently closed a large transaction and had the benefit of our litigation team working alongside us, which proved to be invaluable in identifying the risks inherent with these types of transactions. To have our colleagues' insight prior to an actual litigation was extremely insightful in how to frame the structure and terms of the ECL in order to mitigate risk. They now have a pile of our fund finance precedents for review, so watch this space!