## complaint

The complaint, in summary, is that Lloyds Bank Plc said N's commercial loan was in default but N considers this was wrong. It says that, as a result, it suffered financial losses.

## background

I issued a provisional decision in February 2016 partly upholding the complaint (copy attached).

Both parties haven't agreed with my provisional decision. In summary, N said:

- It is disappointed that I have only awarded compensation for the security covenant breach fee and not for other losses claimed. It is correct that there were concerns about N's financial position around early 2011. However, the primary cause for this financial difficulty was the mis-sold Interest Rate Hedging Product (IRHP).

  Had the bank sold N a 3 year IRHP that product would have come to an end in early 2011. That would have meant N would not have been any financial difficulty or at the risk of breaching the loan agreement in April 2011. The notice of default in April 2011 gave the bank opportunity to insist on the renegotiation. It is therefore fair and reasonable to assess the position N would have been in the absence of the default in April 2011by looking at the position without the original mis-sold IRHP.

- N has not brought the 'Consequential Loss Claim' in connection with the mis-sale of IRHP to the ombudsman because of the ongoing review of it by the bank. As such N does not want the service to deal with consequential loss claim as a result of mis-sold IRHP. And so any acceptance of the final decision for this complaint doesn't settle the consequential loss claim.

Lloyds said, in summary:

- The property in question hadn't been properly registered by N's solicitors. They were N's agents. Therefore the error was not caused by the bank.

- N was in financial difficulty and there had been earlier breaches but the bank allowed N more time. The restructuring in July 2011 was a consensual agreement between the bank and N. And the covenant breach fee was part of that restructuring agreement.

## my findings

I've reconsidered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint. Having done so, I see no reason to depart from my provisional conclusion. However, I have given below my comments to the parties' submissions following my provisional decision.

I note that N's representative has reiterated that N doesn't want us to deal with the consequential loss claim of the mis-sold IRHP. For avoidance of doubt, I have not considered under this complaint N's consequential loss claim relating to the mis-sale.

I note the bank's reference to other earlier breaches but this complaint, as set out by N's representative in its letter of April 2014, relates to the Notice of Default letter and the Event

of Default letter issued in April 2011. N says that the Notice of Default is invalid and therefore the Event of Default as well. It says that this error precipitated a chain of events whereby it was forced to renegotiate its loan facilities with the bank resulting in financial losses to it.

So, in relation to this complaint, the questions I need to consider are:

(1) did the Notice of Default in April 2011 lead to the Event of Default in April 2011?
(2) was the Notice of Default incorrectly issued as claimed by N?
(3) and if so, was the bank responsible for this error?
(4) and if so, what were the losses caused to N as a result of this error?

There was indeed a Notice of Default in April 2011 leading to the Event of Default letter in April 2011. The Event of Default letter effectively states that the security covenant would be breached if at any time the bank determines that the total amount owed exceeds 50% of the latest valuation of all properties. It then states that as per the latest valuation, the loan was 52% of the aggregate value of all the properties.

The letter states under paragraph 2.2.: "*The latest valuations of the Properties … showed that the Loan was 52% of the aggregate of the value of all property*". And Paragraph 2.3 states: "… *the Bank requested that you remedy the position set out in paragraph 2.2 above. As at the date of this letter you have failed to do so and consequently, an Event of Default has occurred under Clause 6.1.(a) of the Agreement (the '**Relevant Default**')"*

So, it is clear that the event of default in April 2011 arose out of the security covenant breach. There is no reference to any other breaches or N's financial difficulties.

N says that there was actually no security covenant breach as the figure of 52% was wrong. It says this happened because the bank erroneously left out a property. It has pointed out that if the property was included, the loan to value figure would have been under 50%.

The bank says that the property was not included because the charge over it was not properly put in place. It appears that N signed the charge documents in 2008 in favour of the bank but the charge was not registered.

The bank says that the property in question was not properly registered by N's solicitor and it was N's agent. Therefore it says that the error was not due to the bank. However I note that the same solicitor was acting on behalf of N and the bank. And I consider that the failure to properly register the charge was the bank's fault and not N's.

I also note the bank's argument that the property was not in the name of N and that would have caused problems with registration in any case. However, I consider that had the bank (or its representative) done its job properly in 2008, this could have been rectified at the time, as it happened subsequently.
Overall, I remain of the view that had the bank properly registered all the properties, it is unlikely that the notice of default in April 2011 for the breach would have been issued.

However, I also remain of the view that whilst the notice of default may have triggered the review, the restructuring would more likely have happened in any case, sooner or later. This is for the reasons I have explained in the provisional decision.

In this regard N's representative has asked that I reconsider my conclusion not to include losses arising out of restructuring such as additional interest and property exit fee. It says

that the bank itself has agreed that the IRHP was mis-sold and that a shorter term IRHP ending in early 2011 was an acceptable alternative product. It says that if that had happened, N would not have been in financial difficulties in 2011 and therefore it would not have been at risk of breaching the financial covenants. And therefore, but the bank's conduct in wrongly giving notice of default, N would not have been at any risk of breaching the loan agreement and so would not have been forced to agree restructuring.

What I am considering here is the extent of any loss suffered by N as a result of what had actually happened. Nevertheless, as pointed out by the adjudicator, it is difficult to say what would have happened in April 2011 following the covenant breach, if N had a shorter term IRHP.

If, as N says, it would not have been in financial difficulties and if there was just a covenant breach with no other issues, the bank may well have chosen not to issue an event of default at the time, as it had done in the past.

Thus, either way, I am not persuaded that these losses arose due to the covenant breach problem.

And it isn't possible for me to say here whether these losses arose as a consequence of the mis-sale. I am not considering that issue here as previously explained.

The bank should however refund the covenant breach fee charged by it, which I understand was 1%. The bank says that the fee was negotiated as part of a consensual solution. However it is the case that the fee was charged for the breach in April 2011 and given my findings on this matter, it is fair and reasonable that the bank refund this fee.

**my final decision**

I partially uphold this complaint. Lloyds Bank Plc should remove all the record of the security default in April 2011 and refund the covenant breach fee together with simple interest at 8% a year from the date the fee was charged until settlement.

Under the rules of the Financial Ombudsman Service, I'm required to ask N to accept or reject my decision before 27 June 2016.

Raj Varadarajan
**Ombudsman**

## Copy of the provisional decision

**complaint**

The complaint, in summary, is that Lloyds Bank Plc said N's commercial loan was in default but N considers this was wrong. It says that, as a result, it suffered financial losses.

**background**

N is a company, which invests in property for rental income. In January 2008 the company obtained a commercial loan of £5.5 million from Lloyds to refinance the property portfolio. And Lloyds sold an interest rate hedging product (IRHP) to cover the loan for 10 years.

The commercial loan was for 10 years at an interest rate of 1.25% above base rate. The loan included financial covenants in relation to cash flow ('cash flow covenant') and the value of securities as a cover to the loan ('loan covenant').

In early April 2011 Lloyds wrote to the company to say that a loan covenant had been breached, because the loan was 52% of the recent value of the property portfolio. As per the covenant the loan should be no more than 50% of the portfolio's value. A week later, Lloyds wrote to say that the loan was in default because the covenant breach hadn't been remedied.

In July 2011 an agreement was signed on behalf of the company and Lloyds to change the loan terms. Amongst other things, the agreement said Lloyds will charge 1% fee for the security breach; Lloyds will charge an exit fee of 2% rising to 3% on the sale of property; the loan interest rate will increase to 3% above base rate and the loan will be repaid by 31 January 2012. And the covenants as well as the repayment provisions were deleted.

Later the company complained to Lloyds that the default was wrong, because one property in the portfolio hadn't been included in the covenant calculation. And if that property had been included, the covenant wouldn't have been breached. The company said that as a result of the default, it had to agree to the change of the loan terms and other fees in July 2011 and that resulted in considerable financial losses to it.

Lloyds replied that it wasn't wrong to remove that property from the calculation because the charge over that property hadn't been registered. Not satisfied with Lloyds' response the company brought its complaint about the default with us.

Separately the company also complained to Lloyds that the IRHP had been mis-sold. Lloyds agreed that the IRHP had been mis- sold and offered a refund of payments based on the company taking an IRHP for three years instead of 10 years in 2008. The company accepted the offer from Lloyds for the mis-sold IRHP.

Lloyds also said the company could make a claim for any consequential loss arising as a result of the mis-sold IRHP, which the company did. The company hasn't brought the consequential losses claim in connection with the mis-sale to us. It says that it doesn't want us to deal with this matter because it is still pursuing the claim with Lloyds.

One of our adjudicators considered the complaint about the default as a result of the loan covenant breach and concluded that the complaint should be upheld. He said that the problem arose because Lloyds hadn't registered the charge over one property. However that was not due to any error or omission by the company but because of the bank (or its representative). He considered that had the bank done its job properly in the first instance, the calculation in April 2011 would not have shown a covenant breach.

To settle the complaint the adjudicator said Lloyds should put the company in the position as if the default hadn't occurred and the change of loan terms hadn't been made.

The company accepted the adjudication, but Lloyds didn't. It said that restructuring in July 2011 was consensual and had been discussed before the default in April 2011. It said that the company couldn't afford the loan repayments and requirements, so it needed to restructure the loan in July 2011 in any case to remove the repayments schedule.

**my provisional findings**

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Lloyds has pointed out that we had previously decided not to deal with this complaint and we have said that it was better suited for court because the claim exceeded our award limit and that we cannot obtain evidence from third parties.

I have considered whether we should deal with this complaint or should we leave it for a court. Although the amount claimed may exceed our award limit that doesn't prevent us looking at a complaint and recommending payment of an amount in excess of our award limit. And we have been able to reach a conclusion that we feel is fair and reasonable based on what we have. So I consider we can deal with this complaint.

Having reviewed all the submissions, I agree with the adjudicator for reasons explained by him that the default in April 2011 as a result of the security breach was wrong. I accept that had the bank properly registered all the properties, it is unlikely the loan covenant breach would have occurred in April 2011.

This means that I also accept that the company would not have incurred the 1% fee it had to pay for the security breach. Therefore my provisional conclusion is that Lloyds should refund this fee to the company together with interest.

However, I am not persuaded that the other losses claimed by the company arose out of the breach. I note from the available information that early in 2011 both Lloyds and the directors of the company were concerned about the performance of the company and another associated company. In particular, I see that in February 2011 Lloyds and the company had concerns about the company's trading and cash flow. The company had been making losses for a few years and owed money to another business that needed to be repaid. This is confirmed in the company's annual accounts which also confirmed loan covenant breaches in respect of security and cash flow.

The company agreed in February 2011 that some property would need to be sold to reduce the borrowing and would make plans to do that. At that time a review was due but Lloyds agreed to postpone it to May 2011 to enable the directors implement some of the proposed measures such as cutting costs and improving the debtor position. However Lloyds also indicated that at the time of the review the company's borrowing including existing loan would need to be restructured. And it mentioned increasing the loan interest rate to 3% above base rate and charging exit fees on the sale of property.

So it seems to me that Lloyds would more likely have initiated the restructuring in any case in May 2011 and that it would have been along the lines of what actually happened in July 2011. In my view, whilst the default was the occasion that triggered the review, it was not the cause of the losses claimed following the restructure.

The company says it wouldn't have agreed to the change of loan terms in July 2011 if there had been no default in April 2011. However, I note that in February 2011 when Lloyds was discussing with the company about changing the loan terms (such as in the email of 22 February 2011), the company didn't raise any particular objection. I think that both parties were having amicable conversations on

how to resolve the issues and so it seems more likely to me that the company would have agreed to some restructure in any case.

Also, if as the company says, the bank's intention was to use the default as a tool to compel the company to agree to the restructure, that could still have happened because the company later failed the cash flow covenant which was not due to the security breach.

Given all of the above, my provisional finding is that, apart from the fee for the security breach, it wasn't the default in April 2011 that caused the losses claimed by the company as arising out of the restructure in July 2011.

**my provisional decision**

For the reasons I've explained, but subject to any further information and arguments I receive, my provisional decision is that this complaint is partially upheld.

Lloyds Bank Plc should remove all record of the security default in April 2011 and refund the covenant breach fee together with simple interest at 8% a year from the date the fee was charged until settlement.

Raj Varadarajan
**Ombudsman**