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WHEN IS A FUNDED SUB-PARTICIPATION NOT A PARTICIPATION?

Yieldpoint Stable Value Fund LP v Kimura Commodity Trade Finance Fund Ltd
[2024] EWCA Civ 639 (Court of Appeal)

Executive Summary

In a case closely watched by the trade finance community and users of the BAFT form of participation agreement, the UK Court of Appeal has overruled the lower court's decision which had recharacterised a funded participation agreement as a fixed term loan.

The Facts and the Issue

Anglo-American and Kimura Commodity Trade Finance Fund Ltd agreed to provide a loan of USD 45m to Minera Tres Valles SPA, a Chilean mining company. In connection with this loan, Kimura entered into a funded participation agreement with a funding entity, Yieldpoint Stable Value Fund LP, pursuant to which Yieldpoint provided USD 5m to Kimura.

The participation agreement was governed by English law and incorporated the terms of a Master Participation Agreement for Trade Transactions based on the Bankers Association for Finance and Trade standard form ('the MPA'). The parties agreed a "Maturity Date of the Participation" of 31 March 2022 (the 'Maturity Date') together with Special Conditions allowing Yieldpoint to give notice if it wished to renew its participation. The mining company defaulted before 31 March 2022, following which Yieldpoint sought repayment of USD 5m from Kimura. Yieldpoint argued that the inclusion of a "Maturity Date" meant that the participation was not a participation but was a **fixed term loan** repayable by Kimura on the Maturity Date. The Lender disputed this.

High Court Judgment

The High Court held "*not without discomfort*" that, on its proper interpretation as a matter of English law, the agreement was a fixed term loan and not a true sub-participation and that Kimura was liable to repay the USD 5m to Yieldpoint. Kimura appealed.

Court of Appeal

In its judgment on 18 June 2024, the Court of Appeal reversed this and held the agreement was a sub-participation with the participant taking credit risk on the mining company as ultimate debtor.

The Court of Appeal judgment included the following points.

- If the parties had intended to make an entirely different deal, such as a fixed term unsecured loan, they would surely have abandoned the MPA structure and executed a simple loan agreement.
- A single term should not be read as indicating an intention to overturn the entire structure of a master participation agreement.
- Whilst there was no doubt the parties had agreed that the master participation would end on 31 March 2022 and the participant's investment would be redeemed, what was not discussed was what would happen if the ultimate debtor defaulted before the Maturity Date – the Court of Appeal noted that parties often focus on what will happen if all goes according to plan without addressing what they consider to be the unlikely situation of default, leaving that to the written terms.
- The High Court judge had erred in principle by considering whether various provisions could be surmounted by the Maturity Date and special conditions - the correct approach would have been to "*reach a coherent interpretation of the entire contract*" and only look to prioritise provisions if that did not work.

- The High Court had been wrong to discount Kimura's argument that the participant's argument was highly uncommercial and undermined the commercial sense of the MPA.
- The "Maturity Date" could be interpreted as entitling the participant to be repaid on the Maturity Date, at par, absent a default by the ultimate debtor prior to that date.

HFW Comment

This decision has been welcomed by users of funded participation agreements and in particular to users of the BAFT form. Parties entering into a participation arrangement must proceed with caution and careful drafting of any special conditions is essential so as to fit clearly within the whole, in particular if a market template is being used. This is particularly important where the departure has potential to impact the "normal" (i.e. limited) recourse of the participant. Provisions for the allocation of credit risk and recourse on a default by the ultimate debtor, and the lender's obligations towards the participant, must be clearly documented, and must be consistent with the rest of the contract.

It is HFW's understanding that Yieldpoint has applied for permission to appeal to the UK Supreme Court. The HFW team will continue to keep an eye on the case and any other market developments affecting the trade finance industry.

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