TRAVERS SMITH

Finance Monthly

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Welcome to the monthly finance bulletin from our banking and corporate recovery department. This issue contains our usual overview of some recent market developments and trends in the finance sector, including a spotlight on unilateral jurisdiction clauses. Please get in touch if it raises any issues that you would like to discuss.

Jeremy Walsh, Head of Banking and Corporate Recovery Department

Rembrandts Retouched

In *Bathurst Regional Council v Local Government Financial Services and Others (No. 5) [2012] FCA 200*, the Australian Federal Court awarded 13 NSW councils damages of AUD30m against Standard & Poor's, ABN Amro Bank N.V. and Local Government Financial Services for negligent mis-selling, mis-rating and making misrepresentations in relation to the issue of "grotesquely" complex securities known as constant proportion debt obligations (CPDOs), more colloquially known as Rembrandt notes. The notes were rated AAA by S&P who were commissioned to rate the notes by the arranger, ABN Amro. LGFS were retained to market and sell the notes in 2006. The notes were also sold in quantity in the US and Europe and there has been much speculation that the Australian decision may spawn further litigation. The Australian court held that the AAA ratings allocated by S&P were influenced by ABN Amro's financial model, which was based on unreasonably optimistic assumptions and specifically aimed at Australian municipalities precluded from investing in sub-investment grade debt. Significantly, the court rejected arguments that the financial crisis was the real cause of the loss and concluded that (i) S&P owed a duty of care to potential investors who, like the councils, were insufficiently qualified to make an independent appraisal of the security; (ii) S&P had failed to take adequate steps to bring disclaimers of liability to the attention of the councils; and (iii) the ratings constituted negligent advice rather than a mere statement of opinion.

Other courts in common law jurisdictions may of course reach different conclusions on each of these points and the decision is in any event being appealed in Australia by S&P.

Vickers – Different Strokes for Different Folks

George Osborne has urged the Parliamentary Commission on banking standards (ironically established by the coalition government) to resist any inclination to unpick the Vickers' proposals which may have been encouraged by evidence recently taken from Paul Volcker, the architect of alternative ringfencing models in the US. At the same time, the major clearing banks are divided in terms of the appropriateness and speed of implementation of the Vickers' reforms. Whilst Santander broadly accept the Vickers' proposals and judge the 2019 deadline to be appropriate, Barclays and HSBC have called for implementation of the new rules before 2019. In contrast, Lloyds and RBS have proposed some softening of the 2019 deadline and a significant re-think of the ringfencing proposals, respectively. It is also difficult to detect consistency in the approach of Mervyn King, who has suggested to the Commission that he would prefer a full separation between investment banks and their retail operations and his deputy governor, Paul Tucker, who has backed the Vickers' reforms. One can only speculate as to the representations which the Bank of England Governor designate, Mark Carney, might have made to the Commission, but he is known to advocate flexible regulation and is a critic of the Volcker ringfencing model. The Commission is scheduled to respond by December 18.

Gray in the Shade

Briggs J's recent decision in *Re Lehman Brothers International (Europe) (in administration) [2012] EWHC 2997 (Ch)* constitutes fertile ground for finance and insolvency lawyers. Amongst other pertinent issues, Briggs J explored the nature of a "general lien" (concluding that this was a floating charge); confirmed that such a general lien was capable of securing obligations of both LBIE and its affiliates (notwithstanding the absence of any trust or fiduciary relationship); and, significantly, concluded that notwithstanding that the general lien was a floating charge, it could still be a security financial collateral arrangement (SFCA) benefiting from the Financial Collateral Arrangement (No. 2) Regulations 2003 (the "**Regulations**") provided that it was created after the date of implementation of the Regulations.

Spotlight on… unilateral jurisdiction clauses

It is not unusual in facility agreements for each of the parties to submit to the exclusive jurisdiction of particular courts, but for the lenders to be permitted to bring proceedings before the courts of an alternative jurisdiction. The LMA Leveraged and Investment Grade facility agreements each include unilateral jurisdiction clauses which enshrine this approach.

The French Cour de cassation (No. 11-26.022 dated 26 September 2012) has, however, recently endorsed the decision of the Paris Court of Appeal which permitted a Spanish bank customer (notably not a consumer) to institute proceedings before the French courts notwithstanding her submission to the exclusive jurisdiction of the Courts of Luxembourg. The customer had opened an account with a Luxembourg bank but through a French financial institution and argued that the unilateral right of the financial institution to bring proceedings before alternative courts to those of Luxembourg contravened the purpose of Article 23 of the Brussels Regulation (EC No. 44/2001), which countenanced exclusive jurisdiction "unless the parties have agreed otherwise". The Cour de cassation supported the conclusion of the Paris Court of Appeal that the unilateral right of one party to commence proceedings in an alternative court was invalid under article 23 of the Brussels Regulation, but also held that a jurisdiction clause in these terms offended the civil code requirements of mutuality of obligation and was a "potestative" term in favour of the bank and therefore void. A potestative term is a French law concept which is invoked where the performance of an obligation by one party (in this case submission to exclusive jurisdiction) is entirely dependent upon the determination of that party. French lawyers have questioned the appropriateness of applying the potestative concept to unilateral jurisdiction clauses and noted that this approach is inconsistent with previous decisions at the Appeal Court level. The decision of the Cour de cassation is doubly surprising because (a) the Paris Court of Appeal did not consider potestative issues at all and relied on their interpretation of the Brussels Regulation; and (b) the Cour de cassation applied French law to a jurisdiction clause within a contract governed by Luxembourg law.

The French decision is not therefore immune to challenge but the integrity of a unilateral jurisdiction clause within a contract to which a French party is subject or which by virtue of the location of assets or performance of an obligation may be subject to consideration by the French courts, is now in doubt. France now joins Russia, China and Poland as jurisdictions where the validity of unilateral jurisdiction clauses may be challenged.

The Regulations requirement that relevant collateral has to be "in the possession or under the control" of the collateral taker in order to be an SFCA was held by Vos J in *Gray v G-T-P Group Ltd (re F2G Realisations Ltd) [2010]* to have precluded the possibility of (a) a security interest in the nature of a floating charge being an SFCA; and (b) intangible property from being capable of being "in the possession" of a person. Briggs J, however, concluded that it was perfectly possible for the concept of possession to extend to intangibles and for a charge which might be otherwise classified as a floating charge to qualify as an SFCA. The reason why it did not so qualify in this case was that the charge constituted security for the obligations owed both to LBIE and its affiliates and LBIE lacked the necessary degree of possession and control to police the withdrawal and substitution of collateral in relation to obligations owed to its affiliates.

The Point of an "Agent for Service" clause

Our colleagues in our Litigation and Commercial IP and Technology Teams have recently prepared a briefing note on the importance of including an agent for service clause in contracts concluded with counterparties based outside the jurisdiction of England and Wales and we intend to circulate this to our readership shortly.

In the courts

Heis and others v MF Global Inc. Re Global UK Limited (in special administration) [2012] EWHC 3068 (Ch)
In this case, the High Court was required to analyse the precise status of special administrators appointed under, and companies which are the subject of, the special administration regime introduced under Regulations made in February 2011. The Regulations addressed the perceived inadequacy of insolvency procedures as they affected investment banks, particularly with respect to the timely return of assets to investors. In practice this predominant preoccupation of the special administration regime might be expected to frustrate the achievement of one potential objective of administration, which is the rescue of the company as a going concern.

The Court was asked to consider provisions of the Global Master Repurchase Agreement 2000 version (GMRA) concluded between two companies in the MF Global Group to regulate the conclusion of repos made between them. The issue focused on whether the entry of one of the parties into special administration triggered an automatic event of default, or an orthodox event of default requiring notice to be served by the non-defaulting party. This was far from an academic question, since resolution of the point made a significant monetary difference to the calculation of the net amounts payable by the parties. The only insolvency event which resulted in an automatic event of default under the GMRA was the presentation of a petition for winding-up *or any analogous proceeding* or the appointment of a liquidator *or any analogous officer*. The GMRA 2000 version "Act of Insolvency" events of default have, with the GMRA 2011 version, become slightly more proximate to the definition of "Bankruptcy" in the ISDA Master Agreement, but it should be noted that the 1992 and 2002 versions of the ISDA documents still differ in a number of material respects from the GMRA documents.

The issue which had to be considered by the court in its consideration of the GMRA was whether a petition for special administration and the appointment of a special administrator was analogous to a winding-up procedure.

Notwithstanding the greater points of comparison which exist between the special administration regime and liquidation than between ordinary administration and liquidation, the court held that the special administration regime was not analogous to liquidation and consequently that an automatic event of default had not been triggered under the GMRA.

Recent transactions

We have recently advised:

- The Royal Bank of Scotland plc as agent in connection with the amendment and restatement of a revolving facility made available to the Arrow Global group to finance the acquisition of non-performing loans. Arrow Global is a leading debt purchaser.
- The Royal Bank of Scotland plc on a £20,000,000 multicurrency revolving bridge facility made available by it to Fund III of Growth Capital Partners, a blended debt and equity provider.

Department News

We are delighted to welcome associate Andrew Crotty to the department. Andrew joins us from Morrison & Foerster LLP.

Firm News

We are delighted to have won the Law Firm of the Year 2012 award at the Legal Week awards ceremony.

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