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 Capital Market developments and alternative financing. Please get in touch if it raises any issues that you would like to discuss.

Jeremy Walsh, Head of Banking and Corporate Recovery Department

Big 4 Audit Monopoly and Loan Agreements

On 21 October 2011, the OFT referred the supply of statutory audit services in the UK to the Competition Commission for consideration. On 22 February 2013, the Commission provisionally determined that there was an adverse effect on competition and consequently assumed a duty under section 134(4) of the Enterprise Act 2002 to decide on action or make recommendations. The Commission has therefore published a list of possible remedies on which they seek responses by 18 March 2013. One of the 10 possible remedies on which views are sought is to prohibit contractual clauses in template documents limiting the audit choice to the Big 4 firms. The Commission specifically refers to the optional provisions contained in the LMA Leveraged Loan Agreement (the definition of auditors) which requires the use of a Big 4 audit firm for the duration of the loan agreement.

Madame X: a storm in a tasse de thé?

The November 2012 Spotlight issue focussed on non-exclusive jurisdiction clauses and the possible consequences of the case of *Madame X v Rothschild [2012]* where the French cour de cessation decided that a clause conferring a unilateral right in favour of a financial institution to bring proceedings before alternative courts to those of a jurisdiction to which the counterparty had submitted contravened the purpose of article 23 of the Brussels regulation (ECMo.44/2001). The LMA published a paper on the issue on 24 January 2013, urging members to evaluate the risks and benefits of including jurisdiction clauses of this type (as exemplified by the LMA jurisdiction clause) in loan agreements. While such clauses will be of immediate concern where one of the counterparties to the relevant document is French, the LMA notes that although a decision of the French court, the cour de cessation judgment is a ruling on European Union law and may have persuasive authority in courts across the EU. The potential risk is that a jurisdiction clause of a type considered in the French case may be held to be entirely invalid (or determined by the French court), or that an EU court may feel compelled to refer the matter for determination to the Court of Justice of the European Union, or that a litigant may seek to obtain tactical advantage by frustrating or causing delay to a lender's court proceedings by invoking the French judgment. As noted in the November 2012 spotlight article, the French court decision is surprising on a number of fronts and, as the LMA paper notes, it is arguable that courts in England and Germany would be unlikely to follow it. The uncertainty introduced by the case is unwelcome.

GAME and *Goldacre*

The spate of High Street retail failures has coincided with a completely predictable preoccupation on the part of High Street tenants and their advisers with the timing of administrators' appointments. *Goldacre (Offices) Ltd v Nortel Networks UK Ltd [2009]* established that rent payable in advance and falling due during the course of the administration would be a prioritised administration expense, but *Leisure Norwich (II) Ltd v Luminar Lava Ignite Limited and others [2012]* established the logical consequence that where rent falls immediately before a company going into administration, that rent, if unpaid, would not constitute an administration expense. Administrators therefore tend to be appointed within days of the traditional rent quarter day. In fact PwC were appointed as GAME's administrators twenty four hours following the March quarter date on which rental was due and GAME's landlords lost their entitlement to rent for the quarter commencing in April. PwC has filed an application for directions to the Companies Court following negotiations with the relevant landlords, presumably to avoid the delay and cost attendant upon further litigation, but also, perhaps, in tacit recognition that the current rules are perceived to be arbitrary and fail to achieve a fair and proper prioritised obligation to pay rent by reference to the specific period during which the landlords' assets are being used for the benefit of other creditors of the company in administration.

Spotlight on…Capital Market Developments and alternative financing

A year ago, we featured a Spotlight issue on the Refinancing Wall and alternative debt sources. The High Yield Bond market was showing incipient promise at that time and has since afforded a solution to many companies in search of refinancing packages and faced with banks more disposed to accept write downs than concede amend and extend packages. The trend towards high yield as a refinancing solution has also of course received impetus from investors looking for ever elusive yields. At the same time, due to heightened demand, the pricing for issues has dropped and investors have even accepted "portability" provisions which tolerate changes in the Issuer's equity ownership.

Access to a competitive high yield market is appropriate for those Issuers seeking to raise £200m or above, but that market is less accessible to potential issues in the small to mid-cap market facing a less amenable syndicated loan market. Private high yield debt (a product available to both large cap and mid-cap deals) offers a possible solution, obviating an offering memorandum, a rating procedure, any formal US disclosure requirements and ancillary SEC Rule 10b-5 opinion and utilising an LMA style loan agreement as a wrapper – albeit incorporating high yield commercial terms and defaults and setting out separately scheduled New York law governed high yield regime covenants. Such private high yield arrangements may well be complemented by an English law governed Super Senior ranked revolving credit facility affording access to working capital and benefitting from an English law governed Intercreditor Agreement.

An additional, increasingly viable alternative to bank financing is Retail Bonds, a product targeted at private investors and facilitated by the London Stock Exchange (LSE) launch of its Order Book for Retail Bonds (ORB) in February 2010. The use of retail bonds seeks to satisfy investor demand for higher yields with possible ISA packaging and accommodates fixed, floating or index linked yields with typical maturities of 5-10 years. ORB bonds must be listed on the Main Market of the Official List, admitted to trade on the LSE and be eligible for settlement through CREST. Unit denominations are usually £100, which contrasts with wholesale bonds where the minimum denomination is €100,000. Issues of retail bonds on ORB range from £10-350m.

Capital markets are of course susceptible to arbitrary closure. If this happens and lending banks continue to retrench, new opportunities may be presented to mezzanine and unitranche lenders, currently largely excluded from large cap high yield structures.

In the courts

Cukurova Finance International Limited and Cukurova Holding AS v Alfa Telecom Turkey Limited [2013] UKPC 2

The Privy Council has held that where powers of appropriation under the Financial Collateral Arrangements (No.2) Regulations 2003 (the "**Regulations**") were properly exercised in respect of security over shares granted to secure a loan, it would in certain circumstances be appropriate for the courts to exercise their jurisdiction to grant relief against that appropriation. In this case, the collateral-taker (whose object in exercising the power of appropriation under the regulations was to expropriate the shares and eliminate the equity of redemption) argued that relief from forfeiture was excluded by the Regulations. The Privy Council decision has clarified that nothing in the Regulations precludes the availability of relief against forfeiture and that such relief is not limited to real property but also applies in relation to proprietary or possessory rights in property.

Angove PTY Limited v Bailey and another [2013] EWHC 215 (Ch)

The claimant Australian wine production company entered into agency and distribution agreements with a UK company that later went into administration (the "**Company**"). The claimant validly terminated the agency and distribution agreements, the effect of which was to terminate the authority of the Company to collect further payments. The defendants (being the liquidators appointed three months after the entry into administration) received sums from two UK customers, one before and one after termination. The court concluded on a true construction of the agency distribution agreement that the relationship between the Company and the claimant was one of agent and principal. However, until such time as the contract had been terminated, the Company had the ability to deduct its commission and prior to termination, the duty to account was personal, not proprietary. It could have been open to the claimant to require the Company to credit all sums collected to a dedicated account and create a trust, but it had not done so, which meant that monies collected by the Company as agent prior to the termination were not impressed with a proprietary interest and in those circumstances the duty to account was a personal right. The claimant therefore had no beneficial entitlement to sums paid by the UK customers *before* the termination but did have a proprietary interest in the sums paid *after* the termination.

Ricoh Europe Holdings BV and others v Spratt and another (Re Danka Business Systems plc (in Members' Voluntary Liquidation)) [2013] EWC Civ 92

The Court of Appeal has dismissed Ricoh's appeal against the first instance decision of Pelling J. Ricoh were entitled to indemnities from Danka under an SPA in respect of pre-completion tax liabilities. When Danka entered into members' (solvent) voluntary liquidation, Ricoh provided an estimate of the maximum of its contingent claims (the quantification of which had yet to be determined) and requested that Danka's liquidators (i) defer taking any further steps until the claims could be quantified; and (ii) ring fence a reserve equivalent to the maximum contingent value of the claims.

The Court of Appeal held that whilst there might be cases where a contingent debt was so imminent that the liquidator could sensibly wait for the event to occur, in this case the contingency was a year away, which was not sufficiently proximate. There was also no legal duty on a liquidator who had already valued contingent claims and admitted them to proof, to provide for the contingency in a *maximum* amount. There was also nothing in Rule 4.86 which required a liquidator of a company to guarantee a 100% return on a contingent debt by assuming a worst case scenario in favour of a creditor. Any valuation of a contingent liability had to be based on a genuine and fair estimate of the chances of the liability occurring. In this case the liquidators had to use their own expertise and that of any relevant advisors to make a realistic estimate of the likelihood of tax liabilities. They had not been obliged, nor were they required, to simply wait and see.

Recent transactions

We have recently advised

- **Harvey Nash Group plc**, the global professional recruitment consultancy and IT outsourcing service provider, on an invoice discounting agreement with RBS Invoice Finance Limited, which raised its invoice discounting facilities to £50m to fund working capital across its international businesses.
- **Export Finance and Insurance Corporation**, Australia's export credit agency, in relation to the issue of USD40,000,000 callable capped floating rate instruments due 17 November 2022, under its USD2.5bn EMTN programme.

Department News

Secondee, Tommy Van't Hul, from Dutch law firm AKD, has joined the department for three months.

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