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 in the finance sector, including a spotlight on Notices of Assignment. Please get in touch if it raises any issues that you would like to discuss.

Jeremy Walsh, Head of Banking and Corporate Recovery Department

Twin Peaks – the new regime

In 2010 Chancellor George Osborne announced the intention to abolish the Financial Services Authority and on 1 April 2013, each of the Financial Conduct Authority ("FCA") and Prudential Regulation Authority ("PRA") began its work. There has been much press comment about the potential overlap of the responsibilities to be discharged by the two institutions, but lawyers have also been preoccupied at a micro level with the implications of the new regime on well-entrenched references to the FSA in their documentation. The transitional provisions set out in paragraph 3 of Schedule 20 to the Financial Services Act 2012 are of considerable help so far as legacy references in documentation are concerned, since they enable references to the FSA to be construed on or after 1 April 2013 as references to the FCA, or PRA or the Bank of England, depending on context. For documents executed after 1 April 2013, lawyers will be carefully reviewing their standards for redundant references to the FSA, both in its capacity as supervisor and with respect to its functions as the UK Listing Authority under Part VI of FSMA 2000, which are now assumed by the FCA.

The perplexing disappearance of the Mandatory Costs Schedule

The transfer of the FSA's functions to the FCA and PRA on 1 April coincided with the Loan Market Association's removal of the recommended form of Mandatory Costs Schedule from its website, which was explained as a consequence of "operational difficulties" encountered by agents of lending syndicates.

These difficulties are apparently derived from the fact that syndicates will include all kinds of credit institution subject to numerous variables in the calculation of additional costs to which they are subject. The Mandatory Costs, traditionally added to the other pricing indices of funding cost (e.g. LIBOR) and profit (e.g. Margin), are rather arbitrarily founded on the recovery by lenders of the costs they assume in contributing to the running costs of the Bank of England, the FSA (now the FCA and the PRA) and, theoretically, the European Central Bank. That contribution is, in the case of Bank of England, FCA and PRA costs, based on a percentage of the Eligible Liabilities or Modified Eligible Liabilities of the relevant lender, which are calculated not by reference to overall loan exposure, but deposits maintained with the relevant lender. The Mandatory Costs assumed by lenders by reference to the Bank of England running costs are only payable if they are banks (as opposed to funds) making sterling loans from a UK facility office and if the relevant Eligible Liabilities are sterling deposits with maturities of less than 2 years. A different set of variables applies to the Mandatory Costs assumed by lenders with respect to the FCA and PRA running costs. The "Modified" Eligible Liabilities also only apply to lenders lending from a UK facility office, but the charge is based on sterling and non-sterling loans (with a reduced rate for non-sterling) and different rules apply if the relevant lender is incorporated in a jurisdiction other than the UK. Mandatory Costs derived from the ECB cost are relevant where lenders originate loans from a facility office in a participating member state and are simply self-certified by the relevant lender. Given the number of variables alluded to above, the overarching task of the agent to formulate an overall mandatory cost based on weighted averages and the surprisingly small recoveries involved, the protagonists could perhaps be forgiven for dispensing with the whole exercise.

Contracting parties and good faith

In the January 2013 edition of Finance Monthly, the Spotlight article contrasted the English courts' approach with that of courts in US and European jurisdictions which habitually apply principles of good faith and fair dealing when interpreting contractual terms. This statement requires reconsideration following the High Court case of *Yam Seng Pte v The International Trade Corporation Ltd [2013]* and the Court of Appeal decision in *Mid-Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd [2013]*. In the *Yam*

Spotlight on… the radical consequences of receipt of a Notice of Assignment

Many contracts will contain clauses prohibiting assignment (whether in absolute terms or conditional on consent) by the parties to it to a third party. This protects a debtor or other obligor from the consequences of dealing with a different creditor who may perhaps be less amenable to commercial give and take. The House of Lords held in *Linden Gardens Securities Ltd v Lenesta Sludge Disposals Ltd [1994]* that such a clause will render any assignment ineffective against the obligor, who will not be compelled to pay any attention to any written communication informing him of the assignment. Only limited types of contracts are, absent a non-assignment clause, unassignable. These include employment contracts or contracts for personal services where the obligor is placing trust in the contract counterparty and where the rights assigned involve personal skill and confidence. Clearly, a contractual obligation to pay a sum of money is, absent anything else, perfectly capable of being assigned by the relevant creditor to a third party assignee.

In these circumstances, the service of written notice on the debtor fundamentally alters the rights of that debtor and the way in which it must perform its contractual obligations – regardless of whether the debtor consents to the assignment or acknowledges the notice. In addition to other significant advantages accruing to the assignee serving notice, there are three main consequences for the debtor receiving notice. First, the debtor must effect payment to the third party assignee and if, in error, it pays to the original creditor, it can be made to pay again to the assignee. Secondly, the debtor cannot agree alterations or variations to the assigned contract with the original creditor – the debtor must deal with a possibly less amenable assignee. Thirdly, the debtor cannot raise "new equities" which arise following the service of notice. Essentially, if the debtor is owed money by the original creditor pursuant to an obligation arising after the receipt of notice it cannot exercise the equitable remedy of setting off or subtracting the sums owed by the original creditor from the sums required to be paid by it to the assignee of that original creditor.

Case law has established that the mere registration of a security assignment at Companies House (rather than the service of notice of assignment in writing) is not sufficient to constitute constructive notice to the debtor and the recent case of *Santander UK plc v Harrison and another [2013]* constitutes obiter authority to the effect that internal account entries disclosed under the requirements of the Data Protection Act 1998 do not constitute sufficiently express notice either. The service of a simple written notice is, however easily achieved and confronted with the consequences referred to above, the debtor receiving notice may have cause to regret his failure to include a non-assignment clause in the relevant contract.

Seng case, the claimant argued amongst other things that there was breach of an implied term that the parties would deal with each other in good faith. The judge concluded that the English courts were "swimming against the tide" and that it might be justified to imply a duty of good faith in joint venture, franchise and distributorship arrangements and other contracts which related to long term business relationships. In *Mid-Essex*, the Court of Appeal referred to *Yam Seng* and applied a restraining leash. It considered the question of good faith as being "sensitive to context" and confirmed that whilst a duty of good faith arose in fiduciary relationships (such as employment contracts) there is no <u>general</u> doctrine of good faith in English law.

In the courts

BMA Special Opportunity Hub Fund Ltd and others and African Minerals Finance Ltd [2013] EWCA Civ 416

This is a Court of Appeal judgment following a 2012 High Court decision much preoccupied with contract construction rules. The judge was compelled to consider ambiguous provisions in a loan agreement requiring a prepayment fee to be paid on “voluntary prepayment” within the first 12 months of the loan. The central issue was whether the prepayment of the loan following a refinancing was a mandatory prepayment, or a voluntary prepayment- the latter triggering a prepayment fee.

The High Court judge attempted to apply the Supreme Court principle in *Rainy Sky* (that where there were two possible constructions, the court was entitled to prefer the construction most consistent with business common sense).

The judge gave consideration to arguments raised by the lenders to the effect that the prepayment fee is supposed to compensate the lender for early repayment; a strict interpretation in favour of the borrower would result in the borrower being able to avoid payment by manipulation; and that it was difficult to envisage circumstances arising where prepayment was not occasioned by a refinancing, but concluded that these were not sufficiently compelling. The High Court ruled against the lenders- applying a strict construction even though the Judge acknowledged that the arguments were "evenly balanced" and was “very uncertain” that this conclusion accorded with business common sense.

The CA decision was awaited with some interest, and many commentators thought that the High Court decision might be reversed. In fact the CA has dismissed the appeal.

Pointedly commenting that the negotiation of the loan over three months generated US$ 1.9m in legal fees over 6 sets of law firms, Aikens LJ assumed that the provisions of the loan agreement were intended to be precise. The courts could not be expected to determine business common sense just from the lender’s perspective. To characterise the prepayment of the loan as voluntary in circumstances where there was a clear contractual obligation on the borrower to prepay following a refinancing was “an abuse of language”. Aikens LJ noted that it would have been a simple drafting matter to ensure that prepayment fee was payable both on a mandatory and voluntary prepayment within the first year.

Recent transactions

We have recently advised:

- **Silverfleet Capital** on the financing of their acquisition (subject to obtaining regulatory clearances) of Ipes, one of Europe's leading providers of fund administration and outsourcing services to the private equity industry, in a £50m transaction, from RJD Partners. The banking facilities were made available by Lloyds TSB Bank plc and HSBC Bank plc;
- **Silicon Valley Bank** in relation to the financing of a private equity backed global software company; and
- **Siblu** on its €80m refinancing, which was provided by a syndicate of five lenders including Barclays and Société Générale as arrangers and credit funds Haymarket Financial, Babson and Tikehau. Siblu is a French holiday park operator owned by Bridgepoint Development Capital.

Department News

- Senior associate Lauren Davies will shortly begin a six month secondment with Silicon Valley Bank.
- Tommy van't Hul has completed a three month secondment from Dutch law firm, AKD.

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