TRAVERS SMITH

Finance Monthly

January 2014

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 Auditor appointment 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

LIBOR to ICE: Documentary Implications

The Loan Market Association (LMA) has produced two notes dated 23 January 2014 on the assumption by ICE Benchmark Administration Limited of the administration of LIBOR from the British Bankers' Association (BBA), which is scheduled for 1 February 2014. One of the notes focuses on a possible interim change to the current proposed wording in the LMA Primary Documents. This change is confined to the simple replacement, in relation to the Screen Rate definition set out in documents concluded on or after 1 February 2014, of the reference to the BBA with a reference to ICE Benchmark Administration Limited.

The second note, focusing on legacy forms of LMA Primary Documents, refers to the fact that the current version of the LMA Primary Documents, whilst still retaining the reference to BBA in the definition of Screen Rate, refers to "any other person which takes over the administration of that rate" and accordingly accommodates the changes in the LIBOR administrator to be effected on 1 February 2014. The note also refers to forms of LMA Primary Documents in effect prior to July 2013 (although with effect from April 2013, the LIBOR definition was footnoted to refer to freestanding riders which acknowledged the possibility of a change in the administrator) which simply referred, in the definition of Screen Rate to the "British Bankers' Association Interest Settlement Rate" without provision for any change in LIBOR administrator. The LMA attaches advice from Antony Zacaroli QC and Clifford Chance LLP on the consequences of the change in the LIBOR administrator for the references to the British Bankers' Association Interest Settlement Rate (BBA LIBOR) in pre-July 2013 Primary Documents. This concludes that a court would seek to give effect to the underlying intention of the parties and interpret references to BBA LIBOR as being references to any successor rate having substantially the same attributes as BBA LIBOR. Given that ICE have confirmed that "there will be no change to the calculation of LIBOR at this time", the opinion concludes that ICE LIBOR will retain substantially the same attributes as BBA LIBOR and that a court would interpret the references to BBA LIBOR in the pre-July 2013 LMA Primary Document as references to ICE LIBOR.

Completion Security Discharge: Show me the money

Inordinate amounts of time are spent by lawyers on completion mechanics - particularly where, as normal, existing security over a borrower's assets is to be discharged against the payment of funds advanced by a new lender keen to ensure that, at the time of the advance, the relevant assets are free from security. Tortuous arrangements involving dependent undertakings are negotiated, each of the parties bringing their own particular version of "market practice" into the mix. The City of London Law Society Land Law Committee, in conjunction with the CLLS Financial Law Committee and the Association of Property Lenders, has produced a Protocol setting out arrangements for the provision of dependent undertakings. The Protocol is entirely voluntary, but may in time represent both best practice and market practice. The Protocol is aimed at completion arrangements involving the discharge of mortgages of commercial property, but could equally be applied to all security discharge arrangements involving high value property. The Protocol assumes, as is the case with most completion arrangements, that the purchase monies will be held by a particular firm of lawyers (the Protocol rather robustly assumes that this will be the seller's solicitors or the seller's bank's solicitors) to the order of the buyer and that the release of such monies by the buyer is dependent upon the delivery of appropriately identified discharge documents by the seller's solicitors in accordance with undertakings issued by the seller to the seller's bank and the buyer's solicitors. The Protocol at least provides a template for the arrangements and undertakings and helpfully addresses the principal preoccupations of the various

Spotlight on… Auditor Appointment Clauses: too many cooks...

The UK Competition Commission (CC) published its final report on auditor appointments on 16 October 2013. One of its principal proposals was that the inclusion of provisions in facility agreements restricting auditor choices to lists or categories would, with effect from 1 October 2014, be prohibited. As a concession to Loan Market Association (LMA) representations, however, the CC was prepared to permit parties to loan agreements to require that auditors meet "objectively justified criteria", provided such criteria encompassed skill, expertise in a particular area and appropriate geographical reach (as opposed to reputation or international recognition). The CC specifically recommended that the LMA "appropriately" amended its template documents. The CC was expected to produce a formal order to this effect over the Spring and Summer of 2014, with that order applying to agreement provisions with effect from 1 October 2014.

Within the next few weeks, however, the European Parliament and Council are likely to adopt a Directive and Regulation which reforms the provision of statutory audit services within the EU. Both the Directive and the Regulation include provisions prohibiting clauses in loan agreements restricting statutory auditor choices to lists or categories of audit firms. At the time of its announcement in October 2013, the CC was aware of measures being considered by the EU but nevertheless published its recommendation as there were "as yet no definitive EU proposals", noting that it would be "able to amend its remedies, if necessary, in light of agreed EU measures". The dual proposals are broadly similar but, of course, inconsistent. The LMA has, by an alert dated 27 January 2014, noted the implicit inconsistencies between the dates on which the Regulation and the Directive are proposed to come into effect. It is also unclear as to how the latitude conceded by the CC with respect to "objective justified criteria" is to be accommodated at the EU level. In addition, the EU provisions, once introduced, would appear to have retrospective effect such that clauses in existing contracts will be rendered null and void.

The LMA has understandably announced that it will not amend the Auditors definition in its template documentation until the EU legislation is in final form. In the meantime, practitioners must advise their clients as to the prospective changes, the precise timing and terms of which are uncertain. This is a recurring predicament and all too often the result of parallel legislative reforms resulting from initiatives with a common purpose addressed in different ways. In recent years, practitioners preoccupied with consumer credit, banking regulation and derivatives contracts have become uncomfortably familiar with the phenomenon.

parties, although experience suggests that a buyer's bank prepared to advance monies in expectation of the delivery of fresh security will also have specific concerns with respect to the disbursement of its advances against such fresh security which may warrant the provision of undertakings in addition to those anticipated by the Protocol.

Revised LMA Standard Terms and Conditions for Par and Distressed Trades

The LMA Terms and Conditions (last amended 14 May 2012) relating to Par and Distressed Trades have been amended following a "Plainer English" exercise and go live on 3 March 2014. Trades subject to LMA Terms agreed before 3 March 2014 will be subject to the existing terms and conditions. A pdf blackline showing changes against the current version is available on the LMA website.

In the courts

Day v Shaw & Anor [2014] EWHC 36 (Ch)

Lenders are normally preoccupied with issues of undue influence and the application of the principles outlined in *RBS v Etridge* when considering the provision of a guarantee or security by a spouse for the obligations of their partner or that partner's business. In this case, Mr and Mrs Shaw had executed third party mortgages over the jointly owned matrimonial home to support a payment covenant with respect to loans made to Avon, a business in which both Mr Shaw and his daughter were directors and guarantors.

Morgan J was unaware whether Mrs Shaw had at any time contended that the *RBS v Etridge* principles operated to relieve her of liability under the mortgage, but was prepared to afford some indirect relief to Mrs Shaw in a different context through the little-known doctrine of the equity of exoneration.

Following enforcement of the third party mortgages, equity remained in the matrimonial property which would normally be expected to be divided between Mr and Mrs Shaw. Mr Day, however, had obtained a judgment debt against Mr Shaw supported by a charging order over his interest in the matrimonial home for an amount in excess of Mr Shaw's remaining equity interest in the house. It was argued on behalf of Mrs Shaw that she had a prior entitlement to her husband's residual share in the house by the doctrine of the equity of exoneration. The doctrine emerged at the turn of the 20th century and has affinities with the equitable right of a surety (i.e. Mrs Shaw) to be indemnified by the principal debtor (i.e. Mr Shaw). The equity of exoneration is not, however, confined to a personal right of indemnity but gives rise to an enhanced proprietary interest in the mortgaged property on the part of a joint mortgagor such as Mrs Shaw. That enhanced interest in the proceeds of the property notionally due to Mr Shaw would, if established, promote Mrs Shaw's status to that of a secured creditor and defeat the competing interest of Mr Day as holder of a charging order against Mr Shaw's interest. The difficulty in the present case was that whilst the doctrine would clearly have been applicable where Mr Shaw was the principal debtor, the principal debtor was in fact Avon. Morgan J, however, chose to draw a distinction between Mr Shaw and his daughter (who had previously sought bankruptcy protection) on the one hand as the main sureties for Avon and Mr & Mrs Shaw on the other as mortgagors and "sub-sureties". It therefore followed that Mrs Shaw as a sub-surety was entitled to an indemnity from Mr Shaw, allowing the application of the equity of exoneration.

Interestingly, given the uncommon application of the doctrine it was also recently considered in *Lemon v Chawdha [2013]*, but in that case held inapplicable on the basis that the security had been conferred, not for the sole benefit of a co-surety, but for the benefit of both spouses In *Day v Shaw*, it was not contended that Mrs Shaw had benefitted from the business of Avon. The result of the case may have been different if this point had been successfully argued.

Transaction News

We have advised:

- **Shawbrook Bank Limited** in connection with a term loan facility made available to a special purpose vehicle backed by a major UK loan servicer for the purpose of acquiring a mortgage loan portfolio;
- **Shawbrook Bank Limited** on the revolving credit facility made available by Shawbrook to a specialist lender, to fund the provision of guarantor loans;
- **Shawbrook Bank Limited** on a revolving credit facility made available by Shawbrook to a non-status commercial lender in the UK market to fund the provision of loans secured on property.

Department News

We welcome Vanessa Battaglia, who has joined us on secondment from the Brazilian firm Demarest E Almeida Advogados.

Matthew Ayre
matthew.ayre@traverssmith.com
+44 (0)20 7295 3304

Ben Davis
ben.davis@traverssmith.com
+44 (0)20 7295 3339

Andrew Gregson
andrew.gregson@traverssmith.com
+44 (0)20 7295 3206

Danny Peel
daniel.peel@traverssmith.com
+44 (0)20 7295 3441

Charles Bischoff
charles.bischoff@traverssmith.com
+44 (0)20 7295 3378

Andrew Eaton
andrew.eaton@traverssmith.com
+44 (0)20 7295 3427

Peter Hughes
peter.hughes@traverssmith.com
+44 (0)20 7295 3377

Jeremy Walsh
jeremy.walsh@traverssmith.com
+44 (0)20 7295 3217

Travers Smith LLP
10 Snow Hill
London
EC1A 2AL
T: +44 (0)20 7295 3000
F: +44 (0)20 7295 3500
www.traverssmith.com