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 Process Agents. Please get in touch if it raises any issues that you would like to discuss.

Jeremy Walsh, Head of Banking and Corporate Recovery Department

Auditor Appointment Clauses – Retrospective Regulations

Last year, the Competition Commission concluded that with effect from October 2014, new loan agreements would need to adopt a formulation different from the current definition of Auditor set out in the LMA Leveraged Facility. The Commission determined that clauses controlling the appointment of an auditor (important provisions given the reliance of lenders on auditors with respect to the provision of accounts and related financial covenant testing) will need to confine themselves to "objectively justified auditor selection criteria", although the new requirements would not retrospectively apply to agreements concluded prior to October 2014. The LMA has not so far proposed alternative wording to accommodate the Commission's requirements and the Competition and Markets Authority has announced a further consultation over the Summer. This is no doubt in response to parallel EU measures recently approved by the EU Parliament and adopted by the EU Council which will become effective in April 2016, if not before. The new regulations, unlike the UK Competition Commission's proposals, will have retrospective effect. Any future or existing contractual provisions which restrict an entity's choice of auditor to "certain categories or lists of statutory auditors or audit firms" will be null and void and there will be no grandfathering.

Current clauses adhering to the LMA Leveraged Facility Agreement approach on auditor definition will therefore become unenforceable during the course of 2016. Such provisions will need to be reviewed and some leverage to agree alternative formulations may be afforded by normal Event of Default provisions relating to unlawfulness and invalidity and certain repeating representations being breached (subject to questions of materiality being satisfied). Lawyers have speculated that such formulations may necessarily devolve to a requirement for simple Majority Lender approval to the appointment of an auditor, but this is hardly consistent with the intent and spirit of the prospective regulations.

In Distress

The exercise of distress as a remedy (primarily in the context of the recovery of rent arrears) is referenced in many facility agreements as an Event of Default. The "Creditors' Process" event of default set out in clause 28.8 of the LMA Leveraged Facility Agreement is a prime example. References to distress also commonly occur in floating charge automatic crystallisation provisions. The common law remedy of distress with respect to rent arrears was abolished on 6 April under section 71 of the Tribunals, Courts and Enforcement Act 2007 which sets out a statutory mechanism for commercial rent arrears recovery. References to "distress" are, however, likely to be retained in the clauses alluded to above, first because a right to levy statutory distress remains available in other contexts (such as the ability of the HMRC to levy distress with respect to the collection of taxes and the ability of Local Authorities to do so in the context of the collection of rates and Council Tax) and secondly because such claims often refer to the exercise of processes analogous to distress which may well encompass the new procedures. Such clauses may conceivably be expanded to specifically refer to the seizure of goods pursuant to a rent arrears recovery process.

The Inexorable March of UK Schemes of Arrangement

In *Re APCOA Parking (UK) Ltd and Ors [2014]*, the High Court sanctioned a scheme of arrangement for the APCOA Group. The unusual feature of the case was that the relevant Facilities Agreement was governed by German law and included a submission to the jurisdiction of the German courts. An English Scheme of Arrangement can be sanctioned by an English court for a foreign company whose COMI is outside England and Wales only if it can be wound up under the Insolvency Act 1986 but this test is frequently satisfied where finance documents are governed by English law and subject to the exclusive jurisdiction of the English court. Alternative means of establishing a "sufficient connection" have included carrying on business in the UK or having assets within

Spotlight on… Process Agents

Where a counterparty to a loan agreement has submitted to the jurisdiction of the English courts but does not have a registered office in England and Wales, then the absence of a clause identifying a named agent and address within England or Wales upon which court process can be served can lead to complex considerations and questions being raised at the time of any dispute. These will include whether the defendant has UK branches or agencies which might be served, but ultimately the conclusion may be not only that service of process must be effected outside the jurisdiction but also that the prior permission of the English courts must be obtained. The courts' permission will be dependent on whether the claim fits within one of twenty jurisdictional gateways; the applicant having at least a reasonable prospect of success; and whether England is the most appropriate forum for bringing the claim. The court will also need to consider draft particulars of claim and whether a particular address for the defendant permits the conclusion that the defendant "may well be found" in a particular country. In the context of a loan agreement containing a submission to the courts of England and Wales, each of these requirements may be relatively easily satisfied, but the time and expense involved in addressing these issues and the practical inconveniences of actually achieving correct service overseas affords a compelling argument in favour of a properly drawn clause appointing a process agent located in England and Wales.

The recent unreported commercial court case of *DVB Bank SE v Isim* held that good service had been effected upon a process agent irrevocably appointed under such a clause even where that agent had gone into liquidation prior to service being effected. The lapse of the agent's authority upon liquidation did not affect the operation of the clause and the lender was entitled to judgment in default, there being no acknowledgement of service or defence. Whilst the case offers reassurance and certainty to lenders, loan and security counterparties such as borrowers and chargors need to be more circumspect in their approach to such clauses, because it is fundamentally important that the process agent is at all times willing and able to respond in a timely and reliable manner to the receipt of court process by forwarding it immediately to the defendants. The acceptance of appointment by a process agent on terms that clearly set out the duties assumed is of vital importance to the borrower/chargor and the risks and responsibilities assumed by the process agent readily explain the frequency of appointment of commercial agents and the reluctance of law firms to assume the function. The interest of the lender, on the other hand would appear to be limited to the mere provision of a name and address within the jurisdiction.

the jurisdiction.

In this case, an extension of a loan maturity date was sought by the APCOA Group to agree a restructuring with its lenders but the difficulty was that such an extension required unanimous lender approval, which was unachievable. Expert evidence was presented to the court but if given, the English court's order would be recognised and given effect in Germany, thus satisfying the second limb required to be established for the court to sanction a scheme achieving an extension to the maturity date. The first limb – that APCOA had "sufficient connection" with the English jurisdiction – was satisfied by a Majority Lender (66⅔%) approval, in accordance with the terms of the Facility Agreement, to a change in the governing law to English law and an amendment to the jurisdiction clause to accommodate an exclusive submission to the English Courts. This was a novel development, but one which, after careful consideration, the High Court approved. Another novel issue was the fact that first and second priority creditors (usually required to vote in separate classes) were permitted to vote together in the same class – although there seems to have been considerable community of interest and economic return between the creditor classes and German law would have treated both classes equally in German insolvency proceedings.

Premature, not decisive

Whilst the European Court of Justice has rejected the UK's challenge to the Financial Transaction Tax as premature given the inchoate nature of the current proposals, it does not preclude a later challenge. It is therefore likely that the UK will advance similar arguments based on inappropriate extraterritoriality and the imposition of costs on those member states, such as the UK, remaining outside the "enhanced co-operation" group, when and if the scope of the FTT crystallises.

In the courts

Landesbank Hessen-Thuringen Girozentrale and others v Bayerische Landesbank, London and another [2014] EWHC 1404

The court was required to consider the interpretation of an application of payments clause in a £396m loan facility relating to the purchase of the 'Gherkin' building. Clause 9.7(a) provided that if an amount was received under any Finance Document which was "less than the amount then due", the Facility Agent had to apply that amount against amounts outstanding under the Finance Documents in the following order: "Clause 9.7(a) first, to any unpaid fees and reimbursement of unpaid expenses or costs (including break costs and hedging break costs) of the Facility Agent". Secondly, to the unpaid fees and expenses of the Lenders, thirdly, to unpaid interest; fourthly, to unpaid principal; fifthly, to all other amounts due under the Finance Documents, in each case on a pro rata basis.

BLB (the Facility Agent and the Hedging Lender) argued that it was entitled to apply inadequate amounts received by it in, inter alia, prioritised satisfaction of hedging break costs under Clause 9.7(a), ahead of any payments of principal and interest due to the Lenders. The other Lenders disputed this.

Flaux, J found in favour of the claimant lenders, and held that the facilities agreement carefully distinguished, in all other circumstances, between BLB in its role as Facility Agent and its role as Hedging Lender, and the terms were separately defined. Where the term "Facility Agent" was used in Clause 9.7(a), it meant BLB in its capacity as Facility Agent, and was not shorthand for BLB acting in any other capacity, i.e. as Hedging Lender. Accordingly, if there was a shortfall in payments, the Facility Agent was obliged to apply amounts received to unpaid interest and principal due to the Lenders in priority to sums due to the Hedging Lender. The practical effect of this construction was that BLB recovered nothing in respect of its hedging break costs.

The court reached its conclusion despite the words in parentheses (specifically referencing hedging break costs) and BLB's argument that, if the phrase "Facility Agent" in Clause 9.7(a) did not extend to BLB in its capacity as the Hedging Lender, the words in brackets were meaningless and the court should, as customary, strain against a construction which rendered any part of the contract meaningless. Flaux, J held that whilst the court would resist a construction whose effect would be to render an entire clause meaningless, this was not such a case. It was quite clear from the recitals and the other provisions in the facilities agreement that where the phrase "Facility Agent" was used it meant BLB in its capacity as Facility Agent: it did not have a more extended meaning.

Transaction News

We have advised **The Royal Bank of Scotland plc** in relation to a new investor call bridge facility made available to Beechbrook Mezzanine II L.P.

Department News

We are delighted to announce that Jonathan Gilmour will become a partner in the firm's Banking and Corporate Recovery Department with effect from 1 July 2014.

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

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

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

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

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

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