TRAVERS SMITH

Finance Monthly

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Welcome to the monthly finance bulletin from our finance and restructuring group. This issue contains our usual overview of some recent market developments and trends in the finance sector, including a spotlight on what happened to the refinancing wall. Please get in touch if it raises any issues that you would like to discuss.

Matthew Ayre, Head of Finance

Caps on Insolvency Practitioners' fees

On 3 March, the government laid before Parliament new rules requiring insolvency practitioners to provide fee estimates to creditors for approval. The rules, which are anticipated to be in force by October 2015, apply to administration, creditors' voluntary liquidation, compulsory liquidation and bankruptcy. The current approach is for insolvency practitioners to charge on an hourly basis and, according to the Government's press release, the average hourly charge is currently £375. The rule change will not apply to Scotland, where remuneration is controlled by the court reporter system. R3, the insolvency trade body and the Chartered Institute of Credit Management have welcomed the new rules as measures introducing trust and transparency. A similar regime, albeit introduced via professional conduct rules, has worked successfully in Australia for some years. The provision of an estimate (which effectively acts as a cap on fees without further creditor approval) at an early stage in the proceedings will no doubt require prescient management on the part of insolvency practitioners. It is unclear whether insolvency practitioners will be able to apply to court for an increase in fees if creditor approval is not obtainable and it is also feared that lack of creditor interest at a later stage of insolvency proceedings may reduce the impact of the new rules. The intervening general election may also frustrate implementation in October 2015.

Building Societies and Floating Charges

On 26 March 2015, building societies became empowered to create floating charges over their assets, having been previously prohibited from doing so under the Building Societies Act 1986. The law change results from the Government's intention to permit building societies to access the markets in the same way as banks and derives from the danger that certain fixed security customarily taken from financial institutions in the context of "delivery by value" transactions could be recharacterised as floating security by the courts applying the control test in *Spectrum Plus*. Banks are able to use Treasury Bills in repo transactions in order to generate cash. The counterparties to the repo transaction agree the cash amount of the repo and can effect the transfer through CREST, but the bank needs to create a charge in favour of the settlement bank over its assets which then runs a floating charge recharacterisation risk. Building societies have therefore been so far precluded from participating, and miss out on yield.

"All approved": all confused?

Unusually, the only clear principle that can be extrapolated from the highly fact-specific Supreme Court decision of *Carlyle v Royal Bank of Scotland Plc [2015] UKSC 13* is that an appellate court has very limited power to reverse findings of fact made by a first instance judge who has heard all of the evidence. The facts were that Mr Carlyle purchased a plot of land for development from the Gleneagles Hotel. It was a condition of the purchase that the plot be developed within a given time period and so Mr Carlyle was absolutely clear that funding from RBS for the purchase was dependent upon funding also being made available by RBS for the development costs. Mr Carlyle only proceeded to the conclusion of binding contracts for the purchase of the plot against a telephone confirmation from RBS that funding for both proposals was "all approved". The first instance judge so concluded on the facts – and further that the RBS call constituted a binding promise from RBS to advance both the plot purchase price and make available a facility for the development costs. The Second Division of the Inner House, the appeal court in Scotland, upheld the bank's appeal, concluding that the phone conversation was an indication of a decision in principle only; that a legal obligation was dependent on the conclusion of a written loan agreement; and that no obligation could have been concluded absent agreement on essential terms, such as the maximum amount of drawdown, the interest rate, the repayment instalments and the security to be provided for the loan. The Supreme Court understood the conclusions reached by the Scottish appeal court and Lord Hodge suggested that on the facts, he might have shared their view that no binding obligation had been concluded to

Spotlight on… what happened to the refinancing wall

A KPMG report in 2011 noted that US$4trillion of world debt was scheduled to mature within the following four years and, like many other articles, anticipated an almost insuperable refinancing challenge. Banks, perceived to be the primary, if not one-stop, solution to this problem, were distracted by increased domestic regulation, impeded by more onerous capital adequacy rules and preoccupied with repairing their balance sheets. The KPMG Report correctly anticipated greater reliance on the high yield bond market, but expressed reservations about its accessibility to small and medium size companies and doubts about whether it was of durable dependence during a time of geopolitical nervousness in Europe. In addition, political unrest in the Middle East and North Africa were thought highly likely to result in increased oil prices, with prejudicial consequences for world economies. The KPMG report was pessimistic about the future of the credit markets in the Americas and Europe, less so for Asia. All economies were thought to be susceptible to rising interest rates and inflation.

Many of these completely justified fears have, happily, failed to transpire within the anticipated timescale. Instead, loan pricing has reduced and loan structures and covenants have relaxed. Borrowers, rather than being emasculated, have become empowered. In the US, the economic recovery gathered pace, corporations achieved stronger balance sheets and increased earnings and the high yield bond market responded in a constructive and durable way to an opportunity to achieve yields unavailable elsewhere as inflation and interest rates, unexpectedly, remained low. Between January 2010 and the first quarter of 2012, the average margin over LIBOR on US deals reduced from 3.70% to 2.28% and in the US, groups with debt maturing in 2013/14 refinanced early to take advantage of the more benign regime. In the UK, a similar phenomenon occurred in 2012, with companies raising double the amount in the bond markets compared with the previous year. It seems clear that in 2012, many of the leveraged loans maturing between 2012 and 2014 were refinanced. Smaller and mid-sized firms, with more restricted access to the capital markets, might have been expected to suffer more acute problems in recent years. These firms have, however, also been assisted by low interest rates, a reduction in commodity prices and a proliferation of new entrants and challengers seeking higher returns, into a lending market traditionally dominated by the banks. If anything has happened to the wall, logic would suggest that it has shifted by a few years. It seems almost too much to hope that a similar concatenation of happy events will mature at the next crisis point.

provide the development funding. In order to overturn findings of fact made by a junior court pointing to an opposite conclusion, however, an appeal court had to be satisfied that the trial judge had gone "plainly wrong" – that he could not reasonably have reached the decision under appeal. The Supreme Court could not go so far. The obligation to provide the development funding was ill-defined, but it was open to the trial judge to conclude that the missing detail as to interest rates and the tenor of the loan was capable of being determined by analogy. If it was open to the trial judge to make such a finding of fact, it was not open to the Second Division of the Inner House to reverse that finding.

In the courts

Tael One Partners Limited v Morgan Stanley & Co International PLC [2015] UKSC 12

The Supreme Court has reversed a Court of Appeal decision which held that the purchaser of a transferred participation in a loan agreement was obliged to account to the original vendor/lender for a portion of a repayment premium payable to the purchaser/lender on a repayment date.

Tael was a syndicate lender under a credit agreement concluded in 2009. Tael transferred its rights in respect of a portion of its participation to Morgan Stanley under a contract incorporating the LMA standard terms for par trade transactions. Under the credit agreement, the borrower agreed to pay a fee at the repayment date. Tael claimed that under the terms of the transfer to Morgan Stanley it was entitled to be paid part of the repayment premium to the extent that it pertained to the period prior to the date of transfer. No express provision set out the specific arrangements with respect to the payment premium within the sale documentation, but Tael relied on the provisions of condition 11.9 of the LMA terms which stated that "any interest or fees… payable under the Credit Agreement in respect of the Purchase Assets and which are expressed to accrue by reference to the lapse of time shall, to the extent they accrue in respect of the period before ... the Settlement Date, be for the account of the Seller". As a matter of contractual interpretation, the Supreme Court held in favour of Morgan Stanley. The court held that although there was room to argue that the payment premium constituted "interest or fees" it was held that it was not "expressed to accrue by reference to the lapse of time". The court determined that the payment accrued instead by reference to the occurrence of a defined event and distinguished the method of calculation of the premium (notionally accruing over a period of time) from the accrual of the *right* to the premium. The court held that "it would be more natural to expect the potential value of the right to receive the payment premium to be reflected in the consideration for which the loan was transferred" from the seller to the buyer.

Edgeworth Capital (Luxembourg) S.A.R.L & another v Ramblas Investments B.V. [2015] EWHC 150 (Comm)

The classic tests for establishing the existence of an invalid penalty clause were set out by Lord Dunedin in *Dunlop Pneumatic Tyre Co. Ltd. v New Garage & Motor Co Ltd [1915] AC 79*. The case distinguished, in circumstances where, (as is fundamentally necessary), a payment is required to be made by a person in breach of a contractual term, between a penalty clause and a liquidated damages clause. The defining characteristic of a permissible and enforceable liquidated damages clause is that it is a genuine, covenanted, pre-estimate of damage flowing from the breach. A clause which imposes a payment obligation which is an unconscionable and extravagant amount compared with the greater loss that could conceivably have followed from the breach will be a penalty clause. Similarly a clause which imposes a penalty for a failure to pay a sum of money, where the penalty sum is greater than the sum which ought to have been paid, will be a penalty.

Under the relevant financing agreement, the borrower agreed to pay a fee to the lender when there occurred a "payment event". The "payment event" in this case arose not by virtue of a breach by the borrower, but by virtue of a breach by individual property investors under a related personal loan agreement which resulted in a cross default under the borrower's financing agreement.

First, the court concluded that the rule against penalties could only be invoked if the payment is triggered by a breach of duty owed by the party claiming relief against the rule against penalties – in this case the corporate borrower, which was not in breach of any duty. Secondly, the fee payable would have fallen due for payment in the ordinary course at the maturity of the loan. The event which triggered the premature payment did not increase the borrower's overall obligation and it would be "perverse if [the borrower] was somehow placed in a more advantageous position by breaching rather than performing the … loan".

As an additional observation, the judge stated that if the rule against penalties had been held to apply, the fee, though large, could at the time the loan was concluded (at the height of the credit crunch) probably be commercially justified and the purpose of the clause was not to deter a breach.

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