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 Directors' deflected duties – the tipping point. Please get in touch if it raises any issues that you would like to discuss.

Matthew Ayre, Head of Finance

Benchmarks and new criminal offences

On 22 December, the Chancellor of the Exchequer announced that the government will extend the legislation originally put in place to regulate LIBOR to cover seven further financial benchmarks. The manipulation of such benchmarks (which are WM/Reuters 4pm London Fix, the main global forex benchmark; SONIA and RONIA, the benchmarks for overnight index swaps; ISDAFix, the main global benchmark for swap rates; London Gold Fixing and the LMBA Silver Price, the benchmarks for gold and silver prices; and ICE Brent Index, the benchmark for crude oil) will result in a criminal offence with a maximum penalty of seven years in jail.

Autumn statement: Spanking banking and challenging equity

Banks are unlikely to have found the Chancellor's Autumn Statement encouraging. The Government has announced its intention to restrict the carry forward of losses by banks and building societies such that they may only be used to offset up to 50% of profits.

Whilst the private equity industry has welcomed the fact that an attack on carried interest arrangements has not materialised, management fees, which are currently subject to capital gains tax at 28% are proposed to be treated as income and taxed at between 40% and 47%. This is on the basis that the fees are effectively treated as a profit source rather than as a means to defray overheads. The new rules may obviate some of the advantages of using Limited Partnership structures.

The stamp duty treatment of "cancellation" schemes of arrangement (frequently used in conjunction with UK company takeovers under which existing shares in a target company are cancelled and new shares issued free of stamp duty) is to be brought into line with a "transfer" scheme of arrangement, under which existing shares in the target company are transferred to the acquirer and subject to a charge to stamp duty.

Finally, the existing tax rules relating to the release or capitalisation of a corporate's debt (for instance on a debt restructuring) result in a tax charge of 20%, unless the structure falls within the current debt-for-equity exemption which requires HMRC clearance. Whilst simple amend and extend exercises have not required excessively careful tax planning, the position is more complicated from 1 January 2015, because new accounting standards will result in the relaxation of certain debt obligations potentially giving rise to a new tax charge. New rules introduced with effect from 1 January 2015 will, however, obviate both the above risks where immediately before the release or amendment or refinancing, it is reasonable to assume that there would be a material risk that at some time within the next twelve months, the company would be unable to pay its debts. Practitioners are slightly concerned that if any restructuring benefitting from the new rules is unsuccessful and formal insolvency proceedings are not averted, it may make it easier for a liquidator to bring a wrongful trading claim. It should however be possible for directors in such circumstances to establish that they have done everything they could to minimise losses to creditors.

FTT misses year-end deadline

Finance ministers from the eleven countries which have participated in the "enhanced co-operation" procedures permitting the implementation of the financial transaction tax in those participating states failed to agree on the details of the tax in December 2014, which means that the FTT is unlikely to be implemented by the targeted January 2016 deadline. On 6 May 2014 it was agreed by all participating countries (except Slovenia) to aim for a tax on equity transactions and "some" derivatives by 1 January 2016. The law was first debated in June 2010 and was approved in the European Parliament in December 2012 and by the European Council in January 2013.

Brussels Regulation recast

Council Regulation (EC) 1215/2012 (the "Recast Brussels Regulation") on jurisdiction and the recognition and enforcement of judgments comes into effect on 10 January 2015, together with the Civil Jurisdiction and Judgments (Amendment) Regulations 2014. The new legislation

Spotlight on… Directors' deflected duties – the tipping point

Section 172(1) of the Companies Act 2006 sets out the fundamental duty of a director of a company to promote the success of that company. A director must act in the way he/she considers in good faith would be most likely to promote the success of the company for the benefit of its members as a whole. The section sets out six considerations to which a director must have regard (none of which include the interests of creditors). Section 172(3), however, makes it clear that the basic duty is subject to any enactment or rule of law requiring directors to act in the interests of creditors in certain circumstances. These conflicting injunctions result in considerable tension at a time when a company is under financial stress and a substantial body of case law is preoccupied with identifying what the tipping point is, and when it occurs.

The determination of when a director must prioritise the interests of creditors over the interests of the company and its shareholders is clearly of fundamental importance, not least to the director. In order to avoid wrongful trading claims (and the possibility of having to make a personal contribution to the assets of the company and being subject to a disqualification order) on a winding up of a company, a director must be able to identify the point at which he/she knew or ought to have known that there was no reasonable prospect of the company avoiding an insolvent liquidation, and thereafter must be able to demonstrate that he took all reasonable and proper steps to minimise the potential loss to the company's creditors (section 214(2) and (3) Insolvency Act 1986). The wrongful trading test self-evidently identifies as a tipping point a time when the company is proximately, not actually, insolvent. Similar disqualification and contribution consequences flow in the case of a transaction at an undervalue (s. 238 IA 1986) and a preference (s.239 IA 1986) but in these cases actual insolvency under s.123 IA 1986 must be established at or before the occurrence of the relevant transaction. Recent case law has if anything obfuscated the precise point at which a company is insolvent. Even where a company is currently able to pay its debts as they fall due, a failure to properly anticipate, having regard to its assets, that it will be unable to meet its prospective and contingent liabilities, will persuade a court to a finding of insolvency (*BNY Corporate Trustee Services Limited & others v Eurosail [2013] UKSC 28*). Against this background, directors may be entirely forgiven for seeking professional advice well before the tipping point - provided they are able to identify what it is, and anticipate it.

impacts finance documentation and supporting legal opinions governed by English law in at least two significant ways. The Recast Brussels Regulation facilitates the enforcement of judgments rendered by the courts of an EU member state through the English courts by removing the requirement for registration or any other kind of declaration of enforceability. The judgment creditor merely has to present a copy of the judgment and a certificate in prescribed form to commence the enforcement process. The Recast Brussels Regulation also attempts to address the so-called "Italian Torpedo" phenomena, under which putative judgment debtors have been able to delay judgment by instituting proceedings in the courts of a jurisdiction other than that benefitting from an exclusive jurisdiction clause as soon as a dispute arises. This enables the debtor to take advantage of the *lis pendens* rules which prevent parallel proceedings and favour the court first seised. The Regulation now requires the courts in a jurisdiction other than that benefitting from an exclusive jurisdiction clause to stay proceedings until such time, if ever, as the courts of the selected jurisdiction determine that they have no jurisdiction.

In the courts

NRAM plc v McAdam and another [2014] EWHC 4174 (Comm)

This case related to a large number of unsecured credit agreements entered into between Northern Rock and individual consumers between 1999 and 2008. These agreements were a hybrid mortgage product (95% of a property's value plus an unsecured loan of up to 30% of the home value capped at £30,000). The case was brought against two borrowers in order to determine a dispute involving 41,000 other borrowers.

Prior to April 2008, the Consumer Credit Act 1974 only applied to credit not exceeding £25,000. The two defendants had borrowed, under the unsecured part of their mortgage, the full amount of £30,000. These were therefore unregulated agreements, by common consent, but the Northern Rock paperwork treated all such loans (both regulated and unregulated) as if they were regulated and documented them as such. Northern Rock had failed to observe the requirements of the CCA 1974 in terms of the statements provided to their borrowers, which were not compliant with the Consumer Credit Regulations 2007. Northern Rock acknowledged that failure with respect to those agreements which were regulated (and provided redress) but not the unregulated agreements, the parties to which obtained no redress. Whilst the loans in question were not regulated, the Northern Rock documentation clearly stated that they were. This case is concerned with the effect of these unregulated agreements being treated as regulated agreements. The Judge concluded (in what must be an obiter comment) that Northern Rock had almost certainly warranted that the relevant agreements were regulated and was therefore in breach of that warranty, such that the loss would be the sums the borrower could have recovered had it been a regulated agreement. The difficulty with this was that the claims (pre 2008) were statute barred. The Judge nevertheless found in favour of the borrowers, holding that Northern Rock was prevented by estoppel from denying the defendants the protection and rights conferred by the legislation. The shared assumption was that the agreements would be treated as regulated and the Judge quoted, with approval, Goode on Consumer Credit Law and Practice: "*the principle to be applied is as follows: the creditor is estopped from resiling from all express statements as to the debtor's rights and immunities (whether expressed directly or by reference to the 1974 Act) which could validly have been made terms of the agreement and which represent the common assumption of the parties*".

Goldman Sachs International v Videocon Global Ltd and another [2014] EWHC 4267 (Comm)

Following early termination by the claimant of an ISDA Master Agreement, the claimant sought the recovery of a termination sum. The application was originally dismissed by the High Court due to the failure to provide the defendants with sufficient detail of how the sum had been calculated. Further calculations were provided by Goldmans more than two years after termination of the agreement.

The defendants submitted that in breach of clause 6(d) of the ISDA Master Agreement, the further details had not been provided "on or as soon as reasonably practicable" following the termination date. The Commercial Court nevertheless allowed the application, stating that the fact that the calculations were not served "on or as soon as reasonably practical" following the early termination date did not render the notice ineffective. However, although the claimant was entitled to summary judgment, the provision of notice which was not served "on or as soon as reasonably practicable" was a breach of contract which would found an action in damages if the lateness had caused loss. The Judge concluded that the defendants plainly had a real prospect of establishing at trial that the second notice had not been delivered in a timely fashion in accordance with clause 6(d) of the ISDA Master Agreement.

Department News

We are delighted to welcome Donald Lowe who joins us as a partner. We also welcome new associate, Nihaal Khanna, who joins us from Pinsent Masons.

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