TRAVERS SMITH

Finance Monthly

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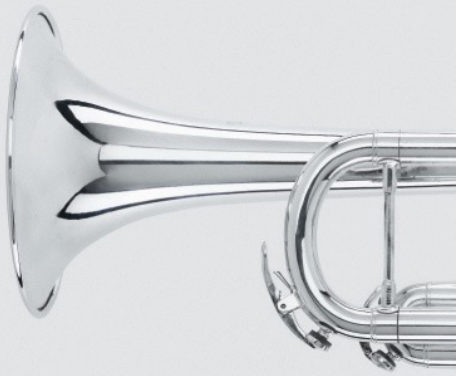

Welcome to the monthly finance bulletin from our banking and corporate recovery department. This issue contains our usual overview of some recent market developments and trends in the finance sector, including a spotlight on the Bills of Sale Acts and the case for their reform. Please get in touch if it raises any issues that you would like to discuss.

Jeremy Walsh, Head of Banking and Corporate Recovery Department

Limited Recourse Provisions and Insolvency

Until the case of *ARM Asset Backed Securities S.A. [2013] EWHC 3351* it had generally been thought that a company was insolvency remote where it assumed obligations under a guarantee or covenant to pay extending to all the liabilities of a third party, but on the basis of a grant of "limited recourse" security where recourse was explicitly restricted to the realised value of the assets which were the subject of that security. It was thought that in such circumstances the relevant company (assuming no other liabilities) would at all times be able to discharge its liabilities by exhausting a limited asset pool and could not in any practical sense be susceptible to an insolvent winding up by virtue of the assumption of such liabilities. In the *ARM Asset* case, a company entering into such an arrangement was held to be unable to pay its debts, both on a cashflow and balance sheet basis because its obligation had been assumed for the full debt liabilities, notwithstanding that the creditor had a limited right of *recovery*. The decision looks perverse, with potentially wide reaching consequences for wholesale funding structures using SPVs and for legal opinions which are expected to express a view on "bankruptcy remote" vehicles. It was, however, an expedient decision in the context of an expedited *ex-parte* application. By conveniently concluding that the relevant Luxembourg company (which had its COMI in England) was insolvent, the court was not obliged to address potentially difficult questions as to whether a petition for winding-up on just and equitable grounds was an "insolvency proceeding" justifying the exercise of jurisdiction by the English courts on COMI principles. It is hoped that in future it might be distinguished and that it will not establish a general precedent.

Banking Reform Bill – so much more than Vickers

The Financial Services (Banking Reform) Bill has passed into law following royal assent. The principal Vickers ring-fencing component which obliges banks to separate investment banking from retail activity will have a long gestation period and be the subject of detailed secondary legislation in 2014. Associated Vickers' proposals which are implemented include bail-in powers and additional primary-absorbing capacity requirements. The Reform Bill, of course, also implements a number of eclectic recommendations as to governance made by the Parliamentary Commission on Banking Standards. Such measures include a new 'senior persons' regime and a broader licensing regime applicable to those bankers assuming specific risks, with an associated criminal offence of reckless mismanagement of a bank. In addition, the Reform Bill introduces a duty on the FCA to impose an overall cap on credit costs charged by short term lenders such as payday lenders (the details of which require further work), the elevation of depositors above other unsecured creditors of banks on insolvency, a new economic regulator regime for UK payment systems, and a new special administration regime applicable to the operators of systemically important inter-bank payment systems and securities settlement systems.

In the courts

Re Magyar Telecom B.V. [2013] EWHC 3800 (Ch)

The High Court has sanctioned a scheme of arrangement of a Dutch company which changed its COMI from the Netherlands to England, and whose obligations (under bonds) were governed by New York law.

The purpose of the scheme was to amend the rights enjoyed by the bond holders under the New York law governed indenture, by exchanging the existing bonds for new notes and equity. The court was satisfied that the scheme had a sufficient connection with the English jurisdiction and that the scheme itself would achieve its purpose.

Unlike other recent foreign company schemes which have been sanctioned by the English court, the documents were not governed by English law. The judgment usefully confirms other factors which are

Spotlight on… The Bills of Sale Acts as candidates for reform

Practitioners concerned with the provision of security by non-corporate debtors (including partnerships of individuals) are obliged to address the inconveniences presented by the Bills of Sale Act 1878 and the Bills of Sale Act (1878) Amendment Act 1882 (the Bills of Sale Acts). These were described by Lord McNaughton in 1888 as being badly drawn, unclear and "beset with difficulties" and have been subject to regular judicial and Law Commission criticism. In response to recent consultations, the Law Commission is again considering the inclusion of a review of the Bills of Sale Acts as part of a package of reforms to be submitted to the Lord Chancellor in the Summer of 2014.

Two areas are impacted by the Bills of Sale Acts in the context of the provision of security by an individual or partnership of individuals. First, a mortgage over chattels (implying the retention of possession by the individual mortgagor over tangible movables) must conform to the 1882 requirements as to content, form and registration or it will be void. Those requirements anticipate that the secured obligation is a specified sum repayable on specified dates (thus excluding a revolving facility or overdraft) subject to prior acceleration following the occurrence of a very limited set of events of default. The goods which are the subject of the bill of sale must be specified in a schedule "with sufficient" particularity. The bill of sale must then be registered within seven days of execution, together with a particular form of affidavit, at the office of the Registrar in the Queen's Bench Division and also at each of the County Courts at the place of residence of the mortgagor and where the relevant chattel is situate. Thereafter such registration must be renewed every five years. The requirement to schedule the property which is the subject of the bill of sale precludes security being taken over after acquired property and frustrates the creation of an orthodox floating charge. Secondly, section 344(4) of the Insolvency Act 1986 provides that a general assignment by an individual of existing and future book debts will be void against that individual's trustee in bankruptcy unless registered pursuant to the Bills of Sale Acts as an absolute bill of sale.

The non-corporate debtors affected by the Bills of Sale Acts include private consumers, sole traders and professionals but also extend to significant partnerships. That the security and registration regime applicable to movable goods and receivables owned by such persons should be determined by an 1882 process based on a complex mass of technical requirements, consistently criticised from its inception and precluding the flexibility afforded by security structures available to corporates, seems absurd.

relevant to establish a sufficient connection to England, for example, the location of the company's assets and creditors. The change in COMI to England was deemed to be a sufficient connection to England, as the only practical alternative to the restructuring proposed by the scheme was formal insolvency proceedings which would be governed by English law. The judge reasoned that the requirement to show a sufficient connection is closely related to the question of whether the scheme would achieve its purpose.

The judgment placed much weight on expert evidence suggesting that the courts of New York, the Netherlands and Hungary would recognise and give effect to the scheme, notwithstanding that it proposed to amend rights governed by New York law. As in many scheme applications, a key factor in the court's decision was the consideration of alternatives to the scheme: in this case, the group would have fallen into formal insolvency proceedings. The authorities suggest that in such cases, the court is likely to sanction the scheme.

Closegate Hotel Development (Durham) Limited and anor v McLean and others [2013] EWHC 3237 (Ch)

The High Court has held that the directors of a company in administration had the power to cause the company to challenge the validity of the appointment of administrators by a bank with a qualifying floating charge. The directors argued that the appointment was prohibited under paragraph 16 of Schedule B1 of the Insolvency Act. The directors contended that the floating charge was not enforceable because the bank was estopped from making an immediate demand for repayment and therefore from exercising its rights under security. The court found no authority for the administrators' argument that the directors could not cause the company to bring the claim (and incur costs for the company) unless they were prepared to offer an indemnity to the company for costs in respect of the costs of the application. This decision has created an ambiguity on the issue of costs. The respondents made no application for security for costs, and although the judge commented that he could not immediately see why costs incurred by the directors and the administrators qualified as an expense of the administration, he was equivocal on the issue. The case begs the question that if the directors' authority to cause a company to challenge the appointment of the administrator is not dependent on the provision by them of an indemnity for costs, and the costs of bringing or defending the challenge does not qualify as an administration expense- who will fund the costs of bringing the action?

Transaction News

We have advised:

- **Equistone Partners Europe** on the simultaneous acquisition of MDNX Group and Easynet. Unitranche debt funding provided by Highbridge and Ares assisted in financing the transaction. Barclays Bank PLC provided a super senior facility to the combined group. The combination of MDNX (a managed network and cloud service provider) and Easynet (a hosting, cloud integration and global managed networks provider) will create the largest independent network and hosting integrator in Europe with the merged operations operating under the Easynet brand going forward.
- **Shawbrook Bank Limited**, a new client to the firm, 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.
- **Bridgepoint Development Capital** on the financing of the acquisition of a minority stake in LOC, the international provider of marine and engineering assurance services to the offshore oil and gas markets.
- **Bridgepoint Development Capital** on the financing of the acquisition of Quotient Clinical, a provider of outsourced, early stage drug development services to the pharmaceutical industry.
- **Kester Capital** on the financing of the investment in Frontier Medical Products Limited, a leading manufacturer and supplier of pressure area care and infection control products to healthcare providers in the UK and continental Europe.
- **Bridgepoint** on the financing of the acquisition of the educational services provider Cambridge Education Group in a deal worth £185 million. Debt for the transaction was provided by HSBC, GE, Bank of Ireland and Alcentra.
- **CLS Holdings PLC** on the £80 million financing of a portfolio of 35 UK (primarily government occupied) properties through an institutional private placement with a single UK institution which will carry a fixed coupon and will be listed.

Season's Greetings to all our readers!

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