TRAVERS SMITH

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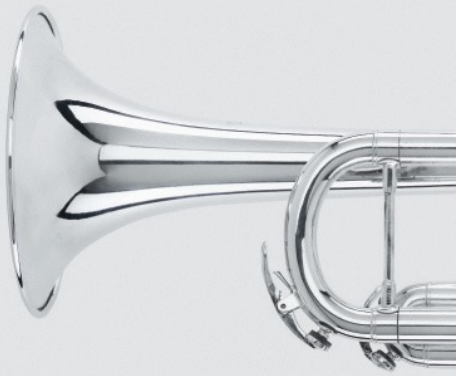

Welcome to the monthly finance bulletin from our banking and corporate recovery department. This issue contains our usual overview of some recent market developments and trends in the finance sector, including a spotlight on the duties and liabilities of an Agent Bank and Lender. Please get in touch if it raises any issues that you would like to discuss.

Jeremy Walsh, Head of Banking and Corporate Recovery Department

Modernisation of the Insolvency Rules

The Insolvency Service has published the "Modernisation of rules relating to insolvency law" consultation, setting out proposals to simplify, reorder and replace the existing Insolvency Rules 1986 (IR). The new rules: (i) bring together 24 statutory instruments and create a single set of rules organised on clearer and more logical lines, (ii) use plain English, making the rules easier to understand and to improve consistency across insolvency procedures, (iii) incorporate all the amendments made to the IR since they came into force, (iv) facilitate the electronic submission of documents and (v) will incorporate amendments arising out of policy changes, including the government's Red Tape Challenge initiative, aimed at reducing unnecessary regulation and simplifying procedures.

UK Challenges: Update on Short-Selling Rules, LIBOR supervision, FTT and Bankers' Bonus Caps

The European Court of Justice (ECJ) is tasked with interpreting EU law and ensuring its equal application across all EU Member States. The ECJ is composed of one judge from each of the 28 Member States, sits in panels of 3, 5 or 13 judges and is advised by 9 Advocates General who give legal opinions prior to the Court's deliberation. Such legal opinions are not binding but are highly influential and are followed in the majority of cases. The UK's challenge to the EU's Short-Selling Regulation (no. 236/2012), which is restricted to the powers conferred on the European Securities & Markets Authority (ESMA) to intervene in markets and ban short-selling in exceptional circumstances has received support from an Advocate General's opinion issued on 12 September, which agreed that such powers exceed what can legitimately be adopted as a harmonising measure. ESMA's role was also proposed to expand to include supervision of LIBOR under draft EU Regulations published in June, but revised regulations issued on 18 September have withdrawn this proposal in favour of enhanced information exchange between national supervisory bodies and compliance with a central code of conduct, yet to be formulated. On 6 September, the Legal Service of the General Secretariat of the Council of the European Union also supported the main plank of the UK's legal challenge to the FTT proposals being pursued by 11 member states under the "enhanced co-operation" procedure, concluding that it is discriminatory and likely to lead to distortion of competition. The European Commission, which supports the introduction of FTT, is not necessarily bound by opinions issued by the Council's Legal Service, but the FTT waters are now additionally muddied, with commentators fearing the undisciplined introduction of national impositions creating distortions in the market. Finally, on September 26th, the UK Treasury filed another challenge at the ECJ, this time directed against the provisions of CRD IV which seek to place a cap on bankers' bonuses equivalent to twice their base salaries. The principal objection is that the provisions are unfit for purpose and easily circumventable by increases in base salaries which will simply increase lenders' fixed costs.

Shadow Banking: Recent European Commission & FSB Initiatives

In 2012, Michel Barnier identified the Shadow Banking industry as one of his main priorities for 2013 and the EU Green Paper published in 2012 focused on the systemic problem presented by unregulated entities (having no access to central bank funding or deposit insurance) providing credit intermediation services to the traditional banking system. On 4 September, the European Commission followed up its Green Paper with a communication on Shadow Banking and a proposal for new rules for money market funds (MMFs) which hold 38% of short term debt issued by the banking sector and 22% of short term debt securities issued by Governments and the corporate sector. The proposals seek to manage liquidity to ensure that MMFs are able to repay investors requiring funds at short

Spotlight on…the duties and liabilities of an Agent Bank and Lender

The High Court case of *Altria III Limited v MD Mezzanine S.A. Sicar & Others [2012]* analysed the extent of duties owed by a security trustee in the context of Senior, Mezzanine and Intercreditor arrangements familiar to market practitioners. In that case, the court concluded that the extent of the trustee's duties towards the mezzanine lenders was no greater than that owed by an enforcing mortgagee to a mortgagor. The recent case of *Torre Asset Funding Limited & Another v Royal Bank of Scotland [2013] EWHC 2670 CH*, which analysed the extent of an Agent's duties to lenders on the occurrence of an event of default was similarly disappointing to mezzanine claimants. In the *Torre* case the borrower went into administrative receivership in September 2008 which resulted in recovery of half the senior debt, and no mezzanine returns. The mezzanine lenders argued that (i) in July 2007, the borrower had provided revised financial statements to the Agent which indicated that it could not meet interest payments, that this constituted an event of default and that the Agent had failed in its duty to notify the mezzanine lenders of that default; (ii) in October 2007, the borrower provided the Agent with financial statements which amounted to an Annual Budget, which the Agent had failed to circulate to the lenders as contractually obliged; and (iii) in January 2008, the Agent had misrepresented to the syndicate lenders the reasons why the Borrower was seeking to defer an interest payment, which was in reality to avoid the inherent event of default referred to at (i) above.

The court found that the circumstances summarised in (i) above did constitute an event of default, but that the Agent's duty to notify the syndicate arose only when it was aware of a default or was notified of a default. A duty to enquire as to the occurrence of an event of default was inconsistent with duties contractually described as "solely mechanical and administrative in nature". The court also found as a matter of fact that the financial information referred to in (ii) above did not constitute the Annual Budget but different information, in respect of which the Agent was not under a duty to circulate, since those duties were confined to the mechanical and administrative. Finally, the court concluded that the Agent had failed in its duty to take reasonable care to give an accurate explanation for the interest roll-up referred to in (iii) above – but not in its capacity as Agent (in respect of which the contractual exclusions as to the assumption of a duty of care applied) but rather in its capacity as a lender seeking consent to a variation. The court concluded nevertheless that the mezzanine lenders did not actually suffer any loss from the interest deferment itself. Standard agent exculpation clauses in LMA documents quite clearly work.

notice and to promote stability by requiring MMFs to establish a pre-defined capital buffer. The proposals also seek to enhance reporting requirements so that risks may be better evaluated and monitored and to tighten the prudential rules applied to regulated banks in their operations with "shadow banks". The proposals (which the Commission asserted would be in line with the recommendations of the Financial Stability Board (FSB) endorsed by the G20 Leaders in St. Petersburg on 5/6 September) also focus on the lack of transparency of markets pre-occupied with securities lending and repos, an issue which is the principal focus of the policy documents issued by the FSB on 29 August 2013. The particular concern of the FSB is with the consequent long chains of investors with ultimate claims on the same asset and their solution is to impose a cap on the amount capable of being secured by loans of securities. The FSB wants a 0.5% haircut for corporate debt securities with maturities of less than 1 year and up to 4% as a haircut on securities of 5 years or more.

In the courts

Jetivia SA & anor v Bilta (UK) Limited (in liquidation) & ors [2013] EWCA Civ 968

The Court of Appeal has upheld the decision of the lower court by refusing to strike out a claim by a company in liquidation against, among others, its former directors, on the basis of the public policy principle *ex turpi causa* (preventing a party from asking the courts to assist where the cause of action relied upon is founded on an immoral or illegal act).

Bilta had been the vehicle of a VAT fraud under which European Emissions Trading Scheme Allowances (EUAs) were purchased and then resold by Bilta at a loss, enabling its overseas suppliers (including Jetivia) to make a profit. Bilta was unable to pay the £38m of unpaid VAT on the transactions and went into liquidation. The company and its liquidators brought a claim to recover the unpaid VAT against its two former directors, sole shareholder and overseas suppliers.

The key issues the Court of Appeal (CA) had to determine were whether the actions of the directors who were party to the conspiracy could be attributed to the company. The CA affirmed the principle set out in *Re Hampshire Land Co [1896]* that the law will not attribute the fraud or other unlawful conduct of the director to the company when the company itself is the intended victim of such conduct. The CA also held that it was not appropriate to apply the "sole actor" exception to the *Hampshire Land* principle (where there is a fraudulent sole director/shareholder and the company has no independent directors innocent of the fraud), as this was a claim by the company against its fraudulent directors and also involved the breach of duties to creditors. The CA dismissed the appeal and allowed Bilta's claim to proceed.

This decision clarifies that the "sole actor" exception is of limited application and that the *ex turpi causa* principle will not preclude a company bringing claims where it is itself the victim of a fraud, whether or not such fraud was committed by all directors or a one-man company.

Data Power Systems Limited and others v Safehosts (London) Limited and others [2013] EWHC 2470 (Ch)

Insolvency alone is not sufficient to engage the court's jurisdiction for an administration order to be made. A mere assertion from a qualified insolvency practitioner that one of the statutory purposes of administration is achievable will not be enough for the court to make an administration order, in the absence of credible supporting evidence. In this case, the court refused the application for an administration order but exercised its powers under s.125 of the Insolvency Act 1986 to make such order as it thinks fit and (despite there being no application for such an appointment) treated the application as a winding up petition and appointed a provisional liquidator.

Recent transactions

We have recently advised **Trainline Investments Holdings Limited and Exponent Private Equity**, on its £190m dividend recapitalisation and refinancing of the Trainline group of companies. The new debt package comprised a £140m unitranche facility provided by Ares Capital Management, Babson Capital, Bank of Ireland and Bluebay Asset Management and a £50m super senior revolving credit facility provided by Barclays Bank plc and HSBC Bank plc. The transaction was the largest unitranche facility put together for a UK-based company this year and the second largest across Europe.

Department News

We welcome Eisuke Kimura, from Japanese law firm Anderson Mori, who has joined the department for a three month secondment.

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