TRAVERS SMITH

# *Finance Monthly*

*June 2013*

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

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## PIKs and Cov-Lite...again

Features characteristic of pre-crisis loans have been emerging for some time now as lenders search for high yielding assets and borrowers become accustomed to the alternative flexibility offered by incurrence based bond covenants. Dealogic, the data provider, has suggested that PIK Financings (which generate high interest returns on subordinated tranches of "Payment in Kind" notes) are resurgent both in the US (eight PIK deals worth US$2bn so far in 2013) and in Europe (five PIK deals worth US$2bn during the same period). According to S&P Capital IQ "covenant-lite deals" also comprise 35% of overall US loan outstandings, and 56% of US leveraged loans issued since the beginning of 2013.

In Europe, Deutsche Bank has recently reported that year to date volumes of European cov-lite loans have now exceeded each annual total since 2008/2009. Whilst Nomura have recently highlighted that "pure" cov-lite loans have all been Euro-denominated tranches of US cov-lite loans, the recent €2.5bn acquisition by BC Partners of the German publisher Springer Signs and Business Media has been heralded as the first large European cov-lite buy-out loan and more may follow, assuming continuity in market conditions.

## Double Taxation Treaty Passport changes

Practitioners will be familiar with the relief afforded by Double Taxation Treaties (against the gross-up risk arising on interest payments on loans made by non-UK resident lenders acting through a permanent establishment outside the UK) and, since 1 September 2010, the availability of the "Passport Scheme", which colours the entire LMA Tax clause. The Scheme permits lenders to obtain a five year "Passport" from HMRC on the basis of applicable Double Taxation Treaty provisions. Prospective borrowers verify the passport status of their non-resident lenders and until very recently were required to inform HMRC of the intended passport exploitation, by filing a form DTTP2 within 30 days of entering into the loan, regardless of when the first interest payment date occurred. In a recent relaxation of rules, HMRC now only requires the DTTP2 to be filed at least 30 working days before the first interest payment date. LMA Tax clause wording is predicated on the previous regime but an LMA alert issued on 14 June announced that there would be no change to the current timing requirements in the clause, on the basis that it is still mutually advantageous for the DTTP2 to be filed soon after entering into the loan relationship.

## Triodos – "within the purview"

The December 2012 Finance Monthly Spotlight highlighted the fact that the inclusion in a guarantee of reasonably specific protective wording designed to preserve a guarantee in the event of a variation to the underlying obligation has often proved to be a curious exception to the traditional English law approach of requiring persons to be bound by their written agreements. In *Triodos Bank v Dobbs [2005]* the Court of Appeal concluded that specific guarantee wording permitting variations of a borrower's obligation under a loan agreement was inadequate to ensure the survival of the guarantee where the relevant variation gave rise to a different obligation which was not "within the purview" of the original agreement. The courts have experienced some difficulty in applying the guideline. In *Close Brothers Ltd v Ridsdale [2012]* the High Court, distinguishing *Triodos*, held that a guarantee of obligations under a facility agreement which had been amended three times could benefit from protective language and survived the variation exercise. In the recent case of *CIMC Raffles Offshore (Singapore) Ltd and another v Schahin Holding SA [2013]* the Court of Appeal was asked to give consideration to a first instance summary judgment in relation to a guarantee where there had been material changes to the underlying contract and concluded that the matter should be referred to trial. This was on the basis that, in addition to the inclusion of guarantee preservation wording, one of the "decisive" grounds for the first instance decision was that the

## Spotlight on…Comfort Letters

Comfort letters are usually encountered where a lender makes some kind of accommodation to a company within a group and requires support from a parent or significant company within that group. In many cases, the lender would prefer a formal guarantee, but the parent prefers to give something less. This may be for all sorts of reasons – a desire to avoid showing a contingent liability on a balance sheet; third party covenant restrictions; or perceived *ultra vires* issues. This awkward compromise was likened by Staughton J. in a 1987 case to a "*gentleman's agreement...an agreement which is not an agreement, between two persons neither of whom is a gentleman, whereby each expects the other to be strictly bound without himself being bound at all*".

Whether a comfort letter actually gives rise to an obligation capable of being enforced is almost entirely a question of construction. A statement of fact, for instance, that the relevant accommodation to a subsidiary has been made with the full approval of the parent, may allow a lender to seek damages for misrepresentation but even if that statement was untrue when made, there may be grave difficulties in establishing that the loss flows from the misrepresentation. It has been clearly established that a statement of policy or intention to the effect that the parent is to provide a subsidiary with sufficient resources to fulfil its obligations will not result in legal responsibility should that policy or intention change. It is, however, not impossible to formulate wording which gives rise to an actual obligation. Clearly in order to generate a legally binding obligation, clarity of wording must be accompanied by an intention to create legal obligations but in the absence of an express disclaimer, this may be easy to establish. The normal contractual rules, however, also apply and so there must also be consideration flowing from the lender.

The various comfort letters considered in *Carillion Construction Ltd v Hussain & Anor [2013]* contained unequivocal obligations to provide sufficient funds to enable a subsidiary to meet its liabilities and to continue as a going concern for specific periods. The letters were addressed not to the lender but by the parent to the board of directors of its subsidiary. The lender, however, ingeniously argued that the failure to enforce the obligation by the subsidiary or its administrators constituted a transaction defrauding creditors under Section 423 of the 1986 Insolvency Act. The argument failed, because the letters were addressed to the board (not the subsidiary) for the purpose of enabling the directors to sign off year-end accounts and because no obvious consideration had passed from the board or the subsidiary to the parent in return for its support obligations. Cumulative case law suggests that if a lender needs a guarantee, it should take a guarantee.

guarantee was worded to impose primary liability, an irrelevant consideration in the opinion of the Court of Appeal.

Sir Bernard Rix's judgment makes interesting observations on "the purview" doctrine and whether it can be excluded by clearly drafted provisions in a guarantee. Sir Bernard Rix noted that the doctrine has its origins in the Court of Appeal decision in *Trade Indemnity Company Limited v Workington Harbour and Dock Board [1937]* where it was established that even very wide words in a guarantee anti-avoidance clause may not assist with respect to alterations which are not within "the general purview of the original guarantee". In determining that the issues were not susceptible to summary decision, Sir Bernard Rix referred to difficulties of analysis presented by the jurisprudence being "somewhat opaque". He also referred to criticism of the *Triodos* decision in a leading work on guarantees on the basis that the decision gives no guidance as to "where the line is likely to be drawn in the future" between those variations falling "within the purview" of the original agreement and those which fall outside it.

## *Assenagon v Azevedo*: Exit Consents

In *Assenagon Asset Management SA v Irish Bank Resolution Corporation Ltd [2012]* the High Court concluded that the exit consent process used in the bond restructuring, which cancelled and virtually eliminated the value of the bonds retained by the dissenting minority, constituted an abuse of the power of the majority noteholders to bind the minority. In the recent Court of Appeal case of *Azevedo and another v Imcopa [2013]* an exit consent process on less coercive terms was held to be valid, since the dissenting bondholders merely lost the opportunity to receive an interest instalment which was available to all consenting bondholders.

## In the courts

*HSBC Bank plc v Tambrook Jersey Ltd [2013] EWCA Civ 576*

The Court of Appeal has overturned April's High Court decision, and held that English administrators can be appointed over Tambrook Jersey Ltd (a company with its COMI in Jersey) at the request of the Royal Court of Jersey. The High Court had held that the letter of request from the Jersey court was not sufficient for the English courts to assist as a foreign court pursuant to s.246 Insolvency Act 1986 ("**IA**"), and that local insolvency proceedings were required to be in place, or at least contemplated, for the English court to assist.

The Court of Appeal confirmed that courts are not precluded from making or requesting orders under s.246 IA if insolvency proceedings are not already in place in the requesting state. This decision endorses the principle of 'modified universalism' and the role of the English courts in supporting cross-border co-operation in insolvency cases.

*Grupo Hotelero Urvasco S.A. v Carey Value Added S.L. & Anor [2013] EWHC 1039*

There is little case law to assist in the interpretation of material adverse change ("MAC") clauses in loan agreements. Although this decision asserts that each MAC clause should be construed on its own facts, it provides useful guidance in interpreting whether there has been a material adverse change in a borrower's financial condition from the date the agreement was entered into, to the date of a request for an advance.

On review of the facts in *Grupo*, Blair J held: (i) that an assessment of the financial condition of a company should begin firstly with reference to financial information at the relevant times, but need not be limited to financial information. Other 'compelling evidence' as to financial condition might include, as in *Grupo*, the borrower stopping payment of bank debts; (ii) for a change to be 'material', it must significantly affect the borrower's ability to perform its obligations (in particular, the obligation to repay) under the loan in question; and (iii) a lender cannot trigger a MAC clause on the basis of pre-existing circumstances which were known to it at the date of the agreement – this will not constitute a change.

## Recent transactions

We have recently advised:

- **Pret a Manger** on its £375m refinancing, which is being underwritten and syndicated by Rabobank, HSBC, Société Générale, Bank of Ireland, ING, BNP Paribas and RBS. The facilities were provided to refinance Pret a Manger's existing facilities and finance a distribution to Bridgepoint and other shareholders; and
- **1st Credit (Holdings) Limited**, a leading UK debt purchase company, on the issue of £100m senior secured private placement notes due 2020 through J.P. Morgan and a £20m revolving credit facility with RBS. This was a significant transaction in the debt purchase sector, demonstrating how mid-market corporate can access the high yield market without a full public high yield issuance. It underlines our position as one of the leading advisers to the debt purchase sector.

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