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 in the finance sector, including a spotlight on a number of recent Court of Appeal cases focusing on the quality of investment advice given shortly before the financial crisis. Please get in touch if it raises any issues that you would like to discuss.

Jeremy Walsh, Head of Banking and Corporate Recovery Department

LMA LIBOR wording

Limitless numbers of finance documents are in circulation based on the Loan Market Association ("**LMA**") Primary Document formulation, which defines LIBOR by reference to a Screen Rate which refers to the British Bankers' Association Interest Settlement Rate displayed on the Reuters Screen. The new administrator of LIBOR is currently the subject of a selection process, but it is quite clear that a definition of Screen Rate referring to the British Bankers' Association will eventually be otiose.

The LMA reported on 11 March that it had made strong representations to the authorities to the effect that the transition to new LIBOR arrangements should ensure the undisturbed continuation of existing contractual relationships and it might be expected that this already constitutes a significant priority for all those preoccupied with the transition. The existing LMA formulation already anticipates Agent intervention and consultation on the replacement of the agreed page, or the service ceasing to be available, but it would be convenient if such a step could be avoided by some statutory sleight of hand. As for documents currently being developed, the LMA has proposed an alternative definition of Screen Rate which anticipates the replacement of the British Bankers' Association as administrator of LIBOR and the possible replacement of the Reuters screen pages.

Insolvency Service on the verge of... insolvency?

It has been reported that the Insolvency Service is in financial trouble. Experts have suggested that the service would be insolvent had it not received an emergency cash injection from the Department for Business, Innovation and Skills (**"BIS"**) in the last few years. The problems are believed to be rooted in the sharp fall in the number of insolvencies, resulting in a decline in fees and asset recoveries. The agency has also failed to maximise the recovery of assets from collapsed businesses through its Official Receiver function. The Insolvency Service disputes that it is insolvent as it holds £14m cash on its balance sheet. However, it required £89m of cash from BIS between 2008 and 2012 according to its annual accounts.

Financial Transaction Tax – *Quo Vadis?*

In January 2013 the EU Counsel of Finance Ministers adopted a proposal (promulgated by 11 Eurozone countries under the "enhanced co-operation rules") to introduce a financial transaction tax at 0.1% for shares and bonds and 0.01% for derivatives applicable to any party to a relevant transaction based in a participating member state. Press comment suggests that discussions surrounding the implementation of the tax are not proceeding smoothly, with disagreements emerging about the scope of the tax (France allegedly favours its own arrangements introduced in August 2012 which are restricted to dealings in major equities, whilst other countries are arguing for various exemptions), its implementation (Germany is apparently proposing an initial application to bonds and equity transactions, with a deferment of the tax on derivatives) and the mechanics of its payment, collection and distribution. Speculation that the imposition of any FTT may eventually devolve to a national level is, however, possibly premature given the EU's proven ability to develop policy from apparent confusion.

Pre-packs: a(nother) review

The Government has announced an independent review into pre-pack administrations (the second independent review in as many years) to launch in late Spring. The review will focus on improving the transparency of pre-pack arrangements, drill down on areas of abuse, and aims to shed light on how pre-packs are working in practice. Pre-packs make up approximately 25% of all administrations, according to the Insolvency Service figures.

Spotlight on… claims, credibility, suitability and the financial crisis

In *Rubenstein v HSBC [2012]* the Court of Appeal concluded that the claimant had been let down by his advisers. The claimant, concerned to preserve the capital represented by his house proceeds of £1.25m, expressly requested a no-risk investment and relied on HSBC's mistaken representation that the market investments which they proposed were "the same as cash". Following the 2008 runs on AIG and Merrill Lynch, his capital was reduced to a nominal amount. Notwithstanding a breach of statutory duty under section 150 of FSMA, the court at first instance, consistent with previous High Court decisions (*Camarata Property Inc. v Credit Suisse Securities (Europe) Ltd [2012]*) had concluded that *Rubenstein's* claim must fail on the basis that the 2008 financial crisis was unforeseeable. The Court of Appeal, however, chose to focus on the claimant's requirement to be protected from exposure to market forces. That the extreme market turbulence was unexpected was immaterial in these circumstances. *Rubenstein* paved the way for other FSMA claims by private individuals which might otherwise have been frustrated by foreseeability defences.

In *Basma Al Sulaiman v Credit Suisse Securities (Europe) Limited and Plurimi Capital LLP [2013]* a wealthy woman brought a claim for approximately US$30m alleging the mis-selling of investments. Unlike *Rubenstein* the claimant sought "double digit" growth. Investment recommendations were made on an advisory basis by both defendants, which led in 2005/2007 to leveraged investments in structured notes. As a consequence of the 2008 financial crisis, a margin call was made which the claimant failed to meet and the investments were subject to a forced sale at significant loss. The claimant alleged breach of statutory duty under section 150 of FSMA in that contrary to the Conduct of Business Rules, the defendants had failed to take reasonable steps to explain the risks attendant upon the investment. Written advice had, however, been given as to the margin call risk and the claimant's suggestion that explanations should have been oral (given her ignorance of concepts such as margin call and pledge) were held by the Court of Appeal not to be credible. It was further held that the claimant's evidence as to her wealth and financial competence was "impossible to credit" and that the claim was an attempt "to hold others liable for her own risk-taking".

Al Sulaiman is consistent with a similar Court of Appeal decision in *Zaki & Ors v Credit Suisse UK Ltd [2013]* involving a sale of the same kind of product to a private individual expressly seeking high returns. The key determinant of these cases appears to be whether investment advice had been suitably matched to the investment experience, financial competence and risk appetite of the client, regardless of incidental technical breaches.

New Security Registration Regime

The new Part 25 Registration regime will apply to charges created on or after 6 April 2013 for both companies and limited liability partnerships.

The charges registrable under the new regime are no longer limited to classes/types of charge. From 6 April, *all* charges created by any UK incorporated company on or after 6 April 2013 will be registrable, subject only to limited exceptions (principally, rent deposit charges, charges created by Lloyd's members to secure obligations with respect to that member's underwriting business, charges created in favour of central banks and security financial collateral arrangements).

The criminal sanctions for failing to register charges will no longer apply. However, the sanction of invalidity will continue to apply, such that charges which are not registered within 21 days of creation will be void against a liquidator, administrator or creditor and the monies secured by such charge shall become immediately payable.

Registration forms will become much simpler, reflecting the fact that certified copies of the charging instrument itself will become publicly available at Companies House. Also, submission may be completed on paper, as before, or via a new electronic filing system.

Rescue Process and the supply of crucial goods and services

Section 233 (applicable to companies) and Section 372 (applicable to individuals) of the Insolvency Act 1986 affords some assurance to insolvency officers as to the continued supply of gas, water, electricity and "communications services" following insolvency events. On 27 February 2013, the government proposed amendments to the Enterprise and Regulatory Reform Bill 2012 - 2013 conferring powers to introduce legislation which operates to ensure the supply of other crucial goods or services. That legislation could facilitate expansion to sections 233 and 372 widening the class of suppliers and the subject goods or services – in particular with respect to the provision of essential IT supplies and services. The legislation would also give the government power to increase the protections available with respect of the continuation of essential supplies beyond those conferred by sections 233 and 372 – such as to nullify termination events in a supply contract which relate to certain insolvency contingencies such as a company entering into administration or an individual entering into an individual voluntary arrangement.

In the courts

Joint administrators of Lehman Brothers International (Europe) v Lehman Brothers Finance S.A. [2013] EWCA Civ 188

The Court of Appeal has at the request of the administrators of LBIE, reversed a first instance decision by Briggs J and has determined that the 2002 ISDA Master Agreement (**"2002 ISDA"**) should be interpreted according to its own terms and that the close-out provisions should not be construed in the same way as those in the 1992 ISDA Master Agreement.

A number of cases focusing on the close-out provisions of the 1992 ISDA Master Agreement have made it clear that in calculating a close-out payment based on the value of the terminated transaction as at the date of termination, the assumption must be that the transaction would have run to its contractually scheduled termination date, even where it was unlikely that the terminated transaction would have run to term. This is the so called "value clean" principle.

The Court of Appeal had to consider whether the same assumption must be made in the context of the close out provisions of the 2002 ISDA. At first instance Briggs J concluded that it did, and the parties had to ignore the possibility that the transaction would have terminated earlier then envisaged. The Court of appeal held that the terms of the 2002 ISDA set a different approach and that liabilities payable on closing out could be determined, pursuant to section 14 of 2002 ISDA, by ascertaining the value of a replacement transaction carried out on the same terms as the 'material terms' of the terminated transaction.

In this case, a side letter executed by LBIE and LBF which clearly meant that the transaction would not have run its scheduled course, constituted a 'material term' for the purposes of the revised definition of Close-out Amount in the 2002 ISDA and should properly be taken into account when determining the value of replacement transactions. The Court of Appeal further noted that the application of the value clean principle in the 1992 ISDA Master Agreement had produced "unreasonable results". It affirmed that where more than one meaning was possible the court should prefer that which is more consistent with business common sense (as per the Rainy Sky SA case). Giving effect to the terms of the side letter when calculating the close out amounts was within the realms of business common sense and within the definition of Close-out Amount in the 2002 ISDA, even if giving effect to the side letter in this way conflicted with the application of the value clean principle.

Recent transactions

We have recently advised Martin McColl on its refinancing with senior and mezzanine facilities provided by a club of lenders.

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