TRAVERS SMITH

Finance Monthly

January 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 the *Unicredit* case. Please get in touch if it raises any issues that you would like to discuss.

Jeremy Walsh, Head of Banking and Corporate Recovery Department

IRS – Final FATCA Regulations

On 18 January, the IRS published final regulations under FATCA. These are five hundred pages long and require detailed consideration, but a significant and welcome development for practitioners and market participants is that the grandfathering period within which binding legal agreements can be concluded such that payments thereunder are not subject to FATCA withholdings, has been extended by twelve months – from 1 January 2013 to 1 January 2014. The regulations also clarify that where collateral is posted to secure a swap issued prior to expiry of the grandfathering period, the collateral itself benefits from grandfathering. Further clarification, against the background of the growing body of intergovernmental agreements (**IGAs**), is given as to the registration and reporting requirements imposed on Foreign Financial Institutions. As at 18 January, the US Treasury Department announced that the UK, Denmark, Ireland, Switzerland, Spain and, recently, Norway had each signed model IGAs.

New Part 25 of the Companies Act 2006

A final version of The Companies Act 2006 (Amendment of Part 25) Regulations 2013 was laid before Parliament on 10 January and will come into force on 6 April 2013. In summary all charges and mortgages (subject to certain specific exceptions such as charges over rent deposits in favour of landlords) will need to be registered within, as now, a twenty-one day period from creation, in contrast to the previous regime which imposed a registration requirement only with respect to particular types of charge. Save for floating charges, the current separate filing regime for Scottish companies will disappear. It will be possible for the registration of charges to be effected electronically. New, pared-down registration forms will be produced which reflect the fact that a certified copy of the charge instrument will be filed and become available for public inspection. In order to file electronically, lenders or their representatives (or anyone other than the subject company) presenting particulars for registration will need to apply for a lender authentication code (**LAC**). Companies will have their own separate authentication code. LACs will be available, on application, in February.

Basel III Liquidity Rules softened

In welcome news for banks following a successful lobbying campaign, the Basel Committee on Banking Supervision announced on 7 January an amendment to calculation methods and an increase in qualifying liquid assets which constitutes a significant relaxation of the draft requirements announced in 2010. These restricted qualifying assets to government and blue-chip corporate bonds. The recent announcement permits 15% of the required assets to include equities, lower-rated corporate bonds and higher quality mortgage-backed securities. In addition only 60% of the liquidity requirement will need to be achieved by 2015, with the balance being phased in over a four year period.

Financial Collateral Regulations – still problematical

Unclear drafting and consequent judicial disagreement over the key concepts of control, possession and excess financial collateral integral to the application of the Financial Collateral Arrangements (No. 2) Regulations 2003 (the **Regulations**) to security financial collateral arrangements have persuaded the Financial Markets Law Committee (**FMLC**) to call for the Regulations to be statutorily amended. The FMLC have pointed out that "possession" of collateral in the form of cash or financial instruments is satisfied under the Regulations where the collateral has been credited to a collateral-taker's account and the collateral-provider's rights are limited to the substitution of financial collateral of the same or greater value or the withdrawal of excess financial collateral. This begs the question as to whether the withdrawal of income or the exercise of voting rights by the collateral-provider or its ability to value the collateral by reference to the secured obligations means that the right of "possession" would not be satisfied. The FMLC has identified a similar issue in determining whether a collateral-taker has the necessary degree of "control" in circumstances where the

Spotlight on…the *Unicredit* case: acting reasonably?

Unlike English law, many civil code jurisdictions require contracting parties to apply principles of good faith and fair dealing when implementing contractual terms. Absent any contractual restriction, English law merely requires parties to exercise discretions honestly and in good faith and not arbitrarily or capriciously *(Socimer International Bank Ltd (in liquidation) v Standard Bank London Ltd [2008]*). This may explain the proliferation of clauses in English law finance documents imposing constraints on the unfettered exercise of discretions (e.g. "acting reasonably", "such consent not to be unreasonably withheld"). Surprisingly, there is comparatively little English case law to assist in determining whether the withholding of consent is unreasonable in the context of a finance document. Necessarily, such case authority as exists will turn on particular facts and may therefore be an intrinsically unreliable type of precedent. *Porton Capital Technology Funds and Others v 3M UK Holdings Ltd and another [2011]* required the court to determine whether sellers under a purchase agreement had in breach of their obligation unreasonably withheld consent to the purchaser's cessation of marketing activities (in the context of an earn-out provision). The court applied the same criteria as those used in landlord and tenant cases and held that it was for the party seeking the consent to establish that the other party's refusal was unreasonable. That other party did not have to establish that its decision was justified, merely that it was reasonable and, significantly, the refusing party did not have to have regard to the requesting party's interests when making its decision (unless the requesting party thereby suffered disproportionate prejudice). In the recent case of *Barclays Bank PLC v Unicredit Bank AG and another [2012]* Barclays had issued guarantees at Unicredit's request in conjunction with a synthetic securitisation arrangement and in return for quarterly payments over the five year duration of the guarantees. Unicredit could terminate the guarantees in certain circumstances, but subject to Barclays' consent, which had to be determined in a "commercially reasonable manner". Barclays refused consent unless it was paid an amount equal to five years fees. The court, applying the *Porton* principles, found in favour of Barclays which it determined could have regard solely to its own commercial interests and merely show that a reasonable commercial man might have reached the same decision. Barclays could ignore the impact on Unicredit, who did not suffer disproportionate prejudice. The case may conceivably be distinguished by subsequent courts on the basis that the words used were "commercially reasonable" but given the logical application of *Porton* principles, this is by no means certain.

relevant account is in the name of the collateral-provider, and income may be withdrawn, voting rights exercised and collateral effected by the collateral-provider. The FMLC believes that in these circumstances, the Regulations should expressly recognise that the collateral-taker still retains possession and control where the collateral-provider's ability to deal with the account is subject to supervisory rights conferred on the collateral-taker which permit verification and veto on rights of withdrawal and substitution. In addition, the FMLC proposes the introduction of a proper definition of the phrase "excess financial collateral", so that an "excess" will arise where the value of collateral exceeds an amount or other criteria determined by the parties.

In the courts

Saltri III Limited v MD Mezzanine SA Sicar and others [2012] EWHC 3025 (Comm)

The High Court considered whether the enforcement of rights under an intercreditor agreement and subsequent sale of a business by senior lenders was valid. The mezzanine lenders, who realised no value from the sale, requested the court to determine whether the security trustee had complied with its duties and its contractual obligations under the intercreditor agreement. The court rejected both the argument that the security trustee owed fiduciary duties to the mezzanine lenders, and that it was obliged to act in the interests of all lenders (not just the senior lenders) in relation to the enforcement of security.

The court found that the security trustee had complied with the terms of the intercreditor to implement the restructuring which, though effected without the consent of the mezzanine lenders, was not an improper use of the intercreditor agreement, the terms of which provided that the security trustee's only duty to the mezzanine lenders in relation to a sale was equivalent to that of a mortgagee to a mortgagor and this was not a fiduciary duty. As such, the security trustee was only obliged to take reasonable care to obtain the true market value or best price reasonably obtainable for the business at the time of sale. The court was clear that it would give effect to contractual provisions, but would not seek to impose any additional duties on the security trustee to protect other (subordinated) creditors.

Aviva Insurance Limited v Hackney Empire Limited [2012] EWCA Civ 1716

The Court of Appeal has held that a surety's liability under a bond will not be discharged by an employer making additional payments to a contractor under a side agreement. HEL engaged STC to refurbish the Hackney Empire by September 2002. Aviva issued a bond in favour of HEL to secure STC's performance under the building contract. Completion was delayed and by a side agreement, HEL paid £750k to STC to complete the works by May 2003. Completion was delayed again and STC went into administration. HEL claimed against Aviva under the bond.

Aviva argued that its liability under the bond was discharged, following the rule in *Holme v Brunskill [1877]*, as the principals had amended the underlying contract without consulting the surety. The court's view was that the side agreement did not vary the original building contract, and that whilst advance payments of the agreed contract price would serve to discharge the surety's liability, *additional* payments by the employer to the contractor *outside* the terms of the original agreement, would not. The £750k paid to STC was a sum paid outside the original contract, which did not discharge Aviva's liability under the bond. Note that Aviva's liability as surety only related to the original construction contract- it had no liability in respect of STC's failure to repay the £750k to HEL under the side agreement.

Recent transactions

We have recently advised:

- **Silverfleet Capital** on the debt financing of the acquisition of A/S Cimbria for DKK 1,025 million (€137million). The financing is being provided by Nordea. A/S Cimbria, headquartered in Denmark, is a leading global manufacturer of equipment and processing lines for the handling and processing of seed and grain;
- **Silicon Valley Bank** in connection with a corporate loan facility made available to a major financial services business; and
- **The Royal Bank of Scotland International** in connection with investor call bridge facilities made available to two major European private equity real estate funds.

Matthew Ayre
matthew.ayre@traverssmith.com
+44 (0)20 7295 3304

Ben Davis
ben.davis@traverssmith.com
+44 (0)20 7295 3339

Andrew Gregson
andrew.gregson@traverssmith.com
+44 (0)20 7295 3206

Paul Lyons
paul.lyons@traverssmith.com
+44 (0)20 7295 3209

Charles Bischoff
charles.bischoff@traverssmith.com
+44 (0)20 7295 3378

Andrew Eaton
andrew.eaton@traverssmith.com
+44 (0)20 7295 3427

Peter Hughes
peter.hughes@traverssmith.com
+44 (0)20 7295 3377

Jeremy Walsh
jeremy.walsh@traverssmith.com
+44 (0)20 7295 3217

Travers Smith
10 Snow Hill
London EC1A 2AL
T: +44 (0)20 7295 3000
F: +44 (0)20 7295 3500
www.traverssmith.com