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 Football Creditors' Rule. 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 issues FATCA Riders

Riders, designed to present a range of possible options, have been issued by the LMA for use in conjunction with their investment grade and leveraged facility documents. In the absence of final IRS regulations, the LMA has emphasised the intermediary nature of the riders and the need to seek US tax advice. A further qualification is that the Riders assume that most loans entered into in 2012 will be grandfathered – in other words that FATCA withholding will only apply if grandfathering is lost (whether by increases in commitments or the exploitation of unconnected facilities after 1 January 2013 or otherwise). The Riders alternatively accommodate an allocation of risk of FATCA withholding to borrowers or lenders. It should be noted that clause references in the Riders assume use of the investment grade facility and will need to be amended for the leveraged facility document.

Demand Bond or Guarantee?

The classification of a surety document as a demand bond or guarantee has significant implications for the beneficiary relying on it. A demand bond creates a primary liability, whilst a guarantee is no more than a secondary liability, wholly dependent upon the validity and enforceability of the underlying contractual obligations. The beneficiary under a demand bond merely has to make demand, without establishing that a default has occurred under the contract benefitting from the bond and is quite unaffected by any time, indulgence, variations or amendments to the underlying contract which would normally excuse a guarantor from performance of its secondary obligation.

Until the recent case of *Wuhan Guoyu Logistics Group Co Ltd and others v Emporiki Bank of Greece SA [2012]* court decisions suggested that where a surety instrument payable on simple first demand was issued by a bank, it was highly likely that it constituted a demand bond.

In *Wuhan*, the judge placed greater emphasis on the text of the instrument, which whilst including primary obligation language, also referred to a "guarantee [of] payment by the buyer" permitting the conclusion that the existence of a sum due pursuant to the underlying contract was a necessary prerequisite to payment under the instrument, which was therefore a guarantee. A classification as a demand bond required a more contracted form of obligation, to pay as primary obligor on first written demand.

Pensions Regulator Statement

In *Bloom and others v Pensions Regulator and others [2011] EWCA Civ 1124* (14 October 2011), the Court of Appeal ("CoA") upheld the High Court's decision that the costs of complying with financial support directions ("FSDs") issued by the Pensions Regulator against companies during an administration rank as an expense of that company's administration. This decision (the subject of appeal at the Supreme Court) prompted wide concerns from insolvency practitioners that elevating the costs of complying with FSDs to "super priority" status (payable ahead of unsecured creditors, floating charge holders and administrators in respect of their own remuneration and expenses) would stifle the rescue culture and prevent banks from lending.

The Pensions Regulator has recently published a statement which sets out its approach to FSDs in insolvency situations, which is intended to provide reassurance that its intention is not to frustrate legitimate insolvency and restructuring processes or to have a negative impact on the lending market. In particular, the Regulator has stated that he has no intention of deliberately delaying the issue of an FSD until after an insolvency event in order to achieve "super priority" status and the effect of the statement in practice may well neutralise the super-priority of FSDs. Please click here to access the Pensions Regulator's statement.

Spotlight on… the Football Creditors' Rule

Since 2003, when the football creditors' rule (the "**Rule**") was introduced, approximately 30 clubs in England and Wales have entered administration, half of them since 2009. The Rule requires clubs playing in the Football League or Premier League to comply with League Rules and insolvency policies, which include a requirement that if a club goes into administration and wishes to retain its League membership and/or avoid relegation, it must exit via a CVA and on terms that all the club's debts to football creditors (players, managers and other League clubs) are paid in full or fully secured. A CVA requires approval of over 75% (by value) of creditors but once achieved, the CVA proposals bind all unsecured creditors. Many of the high value creditors of football clubs are in fact football creditors benefitting from the Rule and despite HMRC's implacable opposition in principle to any such proposed CVA, its significant voting rights (particularly if its debts are classified as unascertained or unliquidated) frequently prove inadequate to avoid implementation of a CVA which, as in Crystal Palace's case, resulted in football creditors being paid in full and unsecured creditors (including HMRC) being paid 2p in the £.

HMRC has challenged the Rule in the courts several times, arguing unsuccessfully that the ability of football creditors to vote at the CVA constitutes unfair prejudice and failing in its assertion that a rule which so obviously contravenes the principle that unsecured creditors should be treated equally on insolvency is "unfair, unlawful and unacceptable". In its most recent challenge (*Revenues and Customers Commissioners v Football League Limited [2012] EWHC 1272 (Ch)*) HMRC wasted powder and shot. The Judge commented that "the detachment of HMRC's claim from ... any particular case causes some difficultly" and concluded that whether the Rule contravened either the *pari passu* principles or the anti-deprivation rule depended entirely on the surrounding factual matrix, intention and timing of a real case.

In England, the private member's "Football (Financial Transparency) Bill" received its first reading on 25 June. Despite its title, one of its principle preoccupations is with the proposal that all creditors of a football club are to be compensated equally following administration. The possibility of this bill maturing into legislation is marginal. The success of previous private members bills derives from their addressing issues of pre-eminent social importance, such as abortion and capital punishment. Meanwhile, in Scotland where the Rule is inapplicable, the consequence of HMRC's successful opposition to CVAs is illustrated all too well by the lamentable current condition of Rangers Football Club.

In the courts

VTB Capital Plc v Nutritek International Corp and others [2012] EWCA Civ 808

VTB, an enforcing lender under a $225 million facility agreement was disappointed to recover less than one fifth of the principal amount due to it from the Russian borrower and subsequently argued through the courts that Nutritek, from which the borrower had acquired assets with the assistance of its loan proceeds, had made fraudulent misrepresentations as to the value of such assets and was in fact under common control with the borrower. VTB went further, arguing that Mr Malofeev was the beneficial owner of both Nutritek and the borrower and that both Nutritek and Malofeev should be subject to a contractual claim under the loan agreement. In essence VTB sought to "pierce the corporate veil". VTB relied on various High Court decisions, notably *Antonio Gramsci Shipping Corp. and others v Stepanovs [2011]*, which had suggested that the courts were disposed to ascribe contractual liability to the "puppeteer" behind a puppet company.

At first instance Arnold J was critical of the rationale in *Gramsci*, deciding that the attribution of liability under a contract to a person not party to it was an unnecessary intrusion into the principle of privity of contract. The Court of Appeal agreed with Arnold J on appeal from VTB, concluding that VTB's contention was "nothing more than an appeal to the court to decide the case on the basis of pure fiction". The Court of Appeal was opposed to granting VTB an artificial remedy in contract when it already had a reasonable remedy available in the tort of deceit.

Re BXL Services [2012] EWHC 1877 (Ch)

Insolvency practitioners and lawyers have been confounded by a series of recent conflicting decisions in the High Court regulating the procedural requirements which apply on a directors' out of court appointment of an administrator. One line of cases (the "*Minmar*" cases) constitute authority for the view that the directors of a company are obliged to serve notice of their intention to appoint an administrator on the company itself under Rule 2.20 of the Insolvency Rules 1986 regardless of whether the company had granted a qualifying floating charge. Prevalent practice at the time of the decision in *Minmar (929) Limited v Khalatschi [2011]* was that in the absence of a qualifying floating charge, the service of notice on the company was not required. Practitioners problems were compounded by the inadequacy of court forms to address service absent a qualifying floating charge and the resultant retrospective invalidity of existing administrators' appointments.

The other line of authority differs from the *Minmar* cases in adopting a purposive approach, with the courts in *Re Virtualpurple Professional Services Limited [2012]* and *Re Ceart Risk Services Limited [2012]* concluding that service of notice on the company in a *Minmar* situation (or the FSA, in the case of an FSA regulated company) may be unnecessary and certainly does not invalidate administrators' appointments.

In *BXL*, Judge Pearle QC followed the *Virtualpurple* line of cases. Whilst this recent case, which had reference to all the preceding cases, adds credibility to the alternative approach to *Minmar* and give some reassurance to existing administrators concerned as to the validity of their appointment, it is no more authoritative than the other High Court cases. Practitioners will still be obliged, absent legislative developments or guidance from the superior courts, to adopt a prudent approach and serve notice on the company (or FSA) using imperfect forms – or appoint administrators through the courts.

Recent transactions

We have recently advised:

- The Royal Bank of Scotland plc as agent in connection with the amendment of a revolving facility (with term out) made available to the Arrow Global group to finance the acquisition of non-performing loans. Arrow Global is a leading debt purchaser;
- Calunius Capital LLP, a leading commercial litigation funder, on the taking of security over the proceeds of an arbitration claim;
- The Royal Bank of Scotland plc as agent on the amendment and restatement of the £245m revolving facility (with term out) made available to Cabot Credit Management to finance the acquisition of non-performing loans.

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