TRAVERS SMITH

Finance Monthly

November 2011

Welcome to the monthly finance bulletin from our banking and corporate recovery department. This issue includes an overview of some recent market developments and trends in the finance sector, as well as a spotlight on asset-based lending. Please get in touch if it raises any issues that you would like to discuss.

Jeremy Walsh, Head of Banking and Corporate Recovery Department

Moody's Downgrades: Credit Agreement Implication

On 7 October 2011 credit rating agency Moody's downgraded RBS (A2 to Aa3 – two notches); Lloyds TSB (Aa3 to A1 – one notch); Santander (Aa3 to A1 – one notch); and Nationwide (Aa3 to A2 – two notches) together with the Co-operative Bank and seven building societies. The ratings downgrade may have consequences for typical clauses within credit agreements requiring cash and instruments to be maintained with or issued by an "Acceptable Bank" with a minimum rating set by Moody's. If the specified minimum rating is no longer achieved by the financial institutions with which a borrower maintains cash or through which it obtains instruments, the borrower's deposit and investment arrangements may need revision to ensure that they are compliant and that covenants dependent upon the defined terms referable to "Acceptable Bank" are not prejudicially affected.

FATCA Legislation – New 30% withholding tax

A US enactment, the Foreign Account Tax Compliance Act ("FATCA") provides that all foreign financial institutions will be subject to a 30% withholding on all US source income, unless they sign an agreement with the IRS accepting reporting obligations in relation to direct and indirect US account holders. The legislation applies to all loan agreements signed after 18 March 2012.

FATCA's principal purpose is to ensure disclosure of tax evaders to the IRS. Most UK financial institutions appear willing to comply with the reporting requirements. Borrowers will accordingly benefit from clauses dis-applying the usual obligations to gross up and indemnify lending banks from increased costs and tax impositions with respect to a FATCA withholding.

Any agreement sourcing payments from the US and subsisting before 18 March 2012 which is subject to material modification after that date will also be subject to FATCA. Credit agreements serviced by US source income which predate 18 March 2012 containing revolving or capex facilities capable of drawdown after 18 March 2012 may also be subject to the FACTA regime. Subsisting loan agreements with payments sourced from the US may therefore benefit from immediate attention.

Overseas Companies: No obligation to register security interests in the UK

With effect from 1 October 2011 there is no longer any requirement for an overseas company that has registered a UK establishment with the UK Registrar of Companies to register any registrable charge it creates over UK property.

Searches against the registers maintained at Companies House relating to overseas companies established in the UK will reveal only charges created and registered prior to 1 October 2011.

In the courts

The promotion of pensioners on insolvency

The Court of Appeal has elevated certain debts due to pension trustees of defined benefit pension schemes above unsecured creditors in an insolvency, admitting that its decision "would lead to some serious consequences".

The Pensions Regulator has powers under the Pensions Act 2004 to issue a Financial Support Direction ("**FSD**") requiring financial and contractual support to be given by members of a group to the employer of a group pension plan. A failure to comply with the FSD is likely to lead to a Contribution Notice ("**CN**") requiring an employer (or its associated or connected persons) to fund any deficit.

Spotlight on… asset-based lending

Asset-based lending (commonly referred to as ABL) is a form of secured lending where the lender advances funds based on the value of certain types of the borrower's assets. Such assets typically comprise receivables and inventory; however ABL can also be utilised to finance plant and machinery, intellectual property rights and real estate.

Commonly structured as a bilateral revolving facility, ABL is ideal for financing working capital and turn-around situations. It can also be used to finance corporate acquisitions. With the abolition of the financial assistance prohibition for private companies, ABL is an increasingly attractive option for acquisition financing as the cost of debt is lower and there are fewer restrictive covenants, representations and warranties and events of default. Whilst achievable, there is still a divide to be bridged between the traditional ABL model and private equity-backed acquisitions in the leveraged market. Mechanisms such as 'certainty of funds', equity cures and 'permitted' actions require explanation and to be built into standard form documentation which is usually not LMA-based.

ABL is by no means a 'quick financing fix' as facilities are tightly structured and managed on a regular, even daily, basis. Reporting requirements are extensive and may seem unduly onerous, particularly if the borrower does not already have in place stringent and frequent reporting practices. The borrower will need to ensure that its systems mesh operationally with the ABL lender's computer system. The security package will include fixed charges and assignments and is likely to necessitate the ABL lenders taking control of the accounts into which receivables are paid and imposing their own systems requirements. To ensure that the ABL facilities work effectively therefore requires attention, co-operation and time from management, which needs to be factored in to any acquisition timetable and process. Technical issues such as set-off rights, prohibitions on assignment, retention of title and leakage on insolvency can also arise as the ABL lender considers which assets it deems "eligible" to finance.

Travers Smith advised Exponent Private Equity earlier this year on an ABL facility which was used towards funding the acquisition of component supplier, Pattonair.

The Insolvency Rules determine whether debts incurred at particular times are provable in an administration or liquidation.

The Court of Appeal was required to consider, in the context of claims made by the Pensions Regulator arising from the Lehman & Nortel insolvencies, whether the debt arising from a CN issued after the commencement of administration was properly provable. The Court of Appeal accepted that upon application of the Insolvency Rules:

- if a CN was issued when the relevant company is in administration, the debt arising was not provable in the administration, but could be proved in any subsequent liquidation; and
- if an FSD is issued while a company is in administration, followed by a CN issued during a subsequent liquidation, this would also enable the debt to be proved in that subsequent liquidation.

The Court of Appeal, however, concluded that if a CN was issued when the relevant company was in administration and there was no subsequent liquidation; or if a CN was issued after the company had gone into liquidation (save where an FSD had been issued prior to that liquidation) the debt arising from the CN was not provable.

As an alternative approach to the CN debt falling into a "black hole", the Court of Appeal considered whether the debt might be payable as an expense of an administration or liquidation. The House of Lords in *Re: Toshoku Finance UK Plc [2002] UK HL6* had concluded that a tax claim falling due during a liquidation constituted a disbursement which had to be paid by the liquidator. The Court of Appeal concluded that Parliament had similarly intended to impose a financial liability on a company in an insolvency process under the Pensions Act 2004. The debt due under a CN would therefore constitute a necessary disbursement of the administrator or liquidator.

The Court of Appeal acknowledged that if classed as an expense in the insolvency, the debt under a CN would be payable with a much higher priority (below creditors holding fixed security but above other creditors and floating charge holders) than debts ordinarily provable.

The decision gives scope for timing manipulation on the part of the Pensions Regulator and may have an affect on pricing and availability of credit to companies operating defined benefit releases.

The Administrators have sought leave to appeal the decision to the Supreme Court.

Bloom & Ors v The Pensions Regulator & Ors [2011] EWCA Civ 1124

Recent transactions

We have recently advised:

- The Royal Bank of Scotland, Lloyds TSB Bank and New Amsterdam Capital on term and revolving facilities made available in connection with the acquisition by TowerBrook of CapQuest, a market leader in the purchase, management and collection of consumer debt;
- Exponent Private Equity on the acquisition of a portfolio of BBC magazine titles, with debt funding provided by GE Capital, Lloyds TSB Bank and Barclays;
- Silverfleet Capital on the acquisition of a majority investment in Aesica Pharmaceuticals, with debt facilities provided by Lloyds TSB Bank, HSBC and Yorkshire Bank; and
- Clinton Cards PLC on the extension of its facilities made available by The Royal Bank of Scotland and Barclays.

Department news

Jonathan Gilmour has recently begun a secondment with Macquarie's commercial lending team, replacing new Travers Smith partner, Ben Davis, who has recently returned from his secondment at Macquarie.

Sam Foskett has also joined The Royal Bank of Scotland for a six month secondment.

We are delighted to welcome back Simon Buckingham, who rejoins the department as a professional support lawyer.

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

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

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

James Richards
james.richards@traverssmith.com
+44 (0)20 7295 3204

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

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

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