TRAVERS SMITH

Finance Monthly

February 2012

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; and includes a spotlight on the Refinancing Wall and Alternative Debt Sources. Please get in touch if it raises any issues that you would like to discuss.

Jeremy Walsh, Head of Banking and Corporate Recovery Department

Pre-packs Reform re-packed

The Department for Business Skills and Innovations has announced that it will not be introducing new legislative control over pre-packs. This follows two years of consultation; a tepid response from all interested parties to proposals announced in June 2011; a tactical withdrawal in October 2011 with further proposals promised; and finally complete abandonment on 26 January 2012.

BIS is now focusing on the steps which might be taken within the existing regulatory framework to improve confidence and transparency.

LIBOR Probes

It should be difficult to manipulate rate setting systems which rely on quotes from 20 or so institutions, exclude about 20% of the most extreme quotations and then establish the rate on the basis of the average of the remaining quotes. If the rate fixing process has been subject to abuse, this might suggest extensive collusion. According to a recent FT article (10.02.2012) US, UK, Japanese and EU regulators are currently investigating the manipulation of LIBOR, EURIBOR and TIBOR during the financial crisis in 2007 and 2008. The article refers to whistle blowing approaches made to authorities by a number of banks, including Barclays, UBS and Citigroup following internal investigations, with a number of employees being suspended or disciplined at each of the above banks and at RBS, JP Morgan Chase and Deutsche Bank. The FSA has deployed eight separate teams of investigators. Regulators are apparently looking at three different possibilities. First, that at the height of the financial crisis, bank rates may have been kept artificially low to avoid concerns about financial strength; secondly that traders interfered with rate setting procedures at their own and other banks in order to make money on interest rate derivatives; and thirdly that traders were tipped off in advance by bank employees or interdealer brokers on interest rate direction.

FATCA, Volker, FTT …extraterritorial effects

A US enactment, the Foreign Account Tax Compliance Act ("**FATCA**") in its original form provided that all foreign financial institutions would be subject to a 30% withholding on all US source income (including interest and principal) unless that institution signed an agreement with the IRS accepting reporting obligations in relation to direct and indirect US account holders. The legislation emerged in March 2010 and was to apply to all loan agreements signed after 18 March 2012, but with the possibility that loan agreements subsisting before 18 March 2012 may be subject to the regime where they are subsequently amended or where they include tranches capable of drawdown after 18 March 2012. On 8 February 2012 the IRS published draft regulations and a joint statement of agreement in principle between the US, France, Germany, Italy, Spain and the United Kingdom which would permit the financial institutions in those five jurisdictions to enact legislation under which foreign financial institutions will discharge their reporting obligations not to the IRS, but to their local tax authorities under the umbrella of existing tax treaties. This may facilitate compliance by foreign financial institutions since conflict of law problems involving confidentiality issues are likely to be eliminated. The grandfathering date has been extended from 18 March 2012 to 1 January 2013 – a reflection of the fact that as the March deadline approached it became clear that few if any financial institutions were able to confirm that they would be able to make the necessary disclosures to the IRS particularly since the FATCA regulations were most unclear. The new regulations also ameliorate the "pass-through withholding" rule under which a foreign financial institution would agree to

Spotlight on… the Refinancing Wall and Alternative Debt Sources

The consensus of economic commentators is that the US$4 trillion of global corporate debt maturing over the next four years (with particular pinch points in 2013/2015) would be challenging at the top of the economic cycle but presents severe difficulties against an uneven global recovery and at a time when banks are under extraordinary regulatory compulsion to repair their balance sheets and meet tight capital adequacy requirements. The shrinking collateralised loan obligation (CLO) market, which currently accounts for 60% of outstanding leveraged buy-out debt is compounding these difficulties. Standard & Poor's reported CLO issuance in 2010 of US$1.4 billion compared with US$38.6 billion in 2006.

Certain sectors are seeing lender retreat, with Nationwide BS, Clydesdale and Yorkshire Banks and Eurohypo and Société Générale all ceasing UK property lending over the last few months. This is particularly discouraging since recent surveys of lenders have identified the Property and Construction sector as being the one in which the bulk of refinancing is to take place in the next two years.

Indications of recovery in the European High Yield Bond Market (quiescent since Summer 2011) are encouraging but corporates and their sponsors, particularly in the mid-market, will need to explore sources of finance alternative to traditional bank lending and bond issues.

Private equity firms may in the short term solve the lack of bank appetite by independently funding or refinancing transactions as evidenced by recent deals, but these approaches allow time to refinance on acceptable terms rather than eradicating the medium term need for finance. Asset based lending may be increasingly used as an alternative to more orthodox means of refinancing provided that the tightly structured management and reporting regime can be accommodated.

Non-bank lenders in the mezzanine market are providing blended senior and mezzanine tranches as a one-stop solution in a "unitranche" package. These are convenient but quite highly priced packages. France has seen active unitranche activity over the last year.

Other non-bank lenders such as debt funds and hedge funds might also be expected to be seen alongside more traditional banks in lender syndicates.

withhold US tax from payments to other foreign financial institutions that were not participating in the disclosure regime. The pass-through arrangements were originally intended to be implemented so as to result in withholding with effect from 1 January 2015 and that date has also been pushed back to 1 January 2017.

The new regulations constitute good news for banks and other FFIs in the five European jurisdictions which have declared their intention to implement the new treaty arrangements and the delay in implementation will allow other jurisdictions to consider entering into similar arrangements and/or for the regulations to be further clarified. A number of outstanding issues remain, however, and the entire conceit of legislation passed by the US government which obliges financial institutions around the world to make disclosures about their clients for tax evasion purposes or suffer a significant financial penalty would be remarkable were it the only recent extraterritorial legislative adventure.

New proposals extending the Volker Rule, part of the US Dodd – Frank Act will, according to some commentators have an effect "worse than FATCA". The Volker Rule has been extended by narrowing an exception for non-US banks so that any bank with a branch or agency in the US will be covered. Many European banks with asset management arms will be barred from managing asset management products that are not US Mutual funds. This is exercising the EU Commission which has stated that it is not prepared to accept extraterritorial consequences. The UK meanwhile, is attempting to resist the EU extraterritorial consequences of the Financial Transaction Tax, which may extend to the UK notwithstanding the exercise of veto powers.

In the courts

Porton Capital Technology Funds & others v 3M UK Holdings Ltd & Anor
[2011] EWHC 2895 (Comm)

This case provides guidance as to what would constitute "unreasonable" withholding of consent. It centered on a dispute relating to the provision of consent to terminate an earn-out arrangement under a Share Purchase Agreement but it suggests that principles developed in landlord and tenant disputes which aim to determine in what circumstances a consent could be "unreasonably" withheld will be extended to other commercial contracts.

In a recent note issued by the Loan Market Association ("**LMA**") it is argued that, by analogy, if a lender wishes to contend that a borrower has unreasonably withheld consent to a transfer by one lender to another lender under a loan facility agreement, the following principles are likely to be taken into consideration:

(a) if consent is required from the borrower, the burden will be on the lender to show that the borrower's refusal was unreasonable;

(b) the extent to which something is reasonable will depend on the individual facts and circumstances;

(c) a refusal does not have to be right or justified – it just needs to be based on reasonable grounds from the perspective of the borrower; and

(d) the borrower will not be required to have regard to a lender's interests when making its decision, unless the latter is likely to suffer disproportionately as a result.

Recent transactions

We have recently advised:

- **Primary Capital** on the purchase of the Hawkin's Bazaar business from the administrators of Tobar.
- **Quarto Group Inc.** on a $95m revolving credit facility made available by a club of five banks which was used to refinance its maturing revolving credit facility.

Travers Smith News

Travers Smith were shortlisted for 'Restructuring Team of the Year' at the recent Legal Business Awards.

Department News

We are delighted to welcome Senior associate Douglas Hawthorn to the department. Douglas joins us from Hogan Lovells and specialises in Corporate Recovery.

Practice Development

Paul Lyons and Matthew Ayre are travelling to Mumbai next month to attend an IBA sponsored Global Mergers and Acquisitions Conference. Paul Lyons will be participating in a panel discussion about LBOs in India.

Jeremy Walsh and Ben Davis will also be in Paris next month visiting a number of clients and local law firms.

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