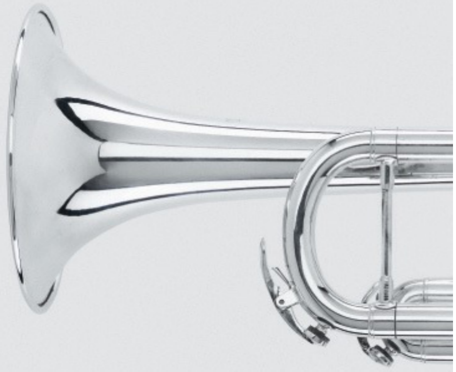
TRAVERS SMITH



# Finance Monthly

## April 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, includes a spotlight on Rent as a Prioritised Expense on Insolvency and includes a link to a recent article on important case law affecting derivatives. Please get in touch if it raises any issues that you would like to discuss.

*Jeremy Walsh, Head of Banking and Corporate Recovery Department*

### New LMA Real Estate Finance Facility Agreement

The Facility Agreement forms recommended by the Loan Market Association (**LMA**) for use where borrowers are of investment grade status or where loans are made on a leveraged basis for target company acquisitions have been in place for many years and are now joined by a form of loan agreement promulgated for use in a real estate investment finance (as opposed to development finance) transaction. The new form of investment finance facility assumes:

(i) the formation by a UK Parent of subsidiaries incorporated in England and Wales;

(ii) the borrowing by those subsidiaries by a syndicate to finance the acquisition of one or more properties located in England, Wales or Scotland; and

(iii) the provision of security in favour of a security trustee on behalf of the lenders.

### Proposed SME Bankruptcy Reform

In June 2010, a private member's bill, the "Secured Lending Reform Bill" was presented to Parliament with the principal aim of emasculating receivers' rights to exercise a power of sale under the Law of Property Act 1925. It was proposed that this right be subject to court order following proceedings initiated, not by the receiver, but by the mortgagee directly. The Bill also proposed abolition of the right of peaceable re-entry of a property by the mortgagee or receiver and permitted the mortgagor to apply to court to achieve a variation of mortgage terms relating to interest rate and/or repayment profile. The Secured Lending Reform Bill was scheduled for a second reading on 30 May 2012, but was not moved for debate and there is no indication as to when or whether the Bill will progress further.

Similar legislative revisions have, however, recently been proposed by a group of Conservative MPs, led by the MP who presented the Secured Lending Reform Bill. The latest proposals call for further bankruptcy law reform, which extends not only to a revision of receivers' powers under the LPA 1925, but an extension of the administration procedure to sole traders and small businesses as well as limited companies and limited liability partnerships. The proposals have been welcomed by the British Chambers of Commerce, but less warmly received by R3, the insolvency industry trade body, and insolvency professionals.

### Volcker Rule Postponed

There has been much extra-territorial criticism of the US Volcker Rule ban on proprietary trading, due to be introduced in July 2012. The Volcker Rule as drafted is thought to impact on the non-US operations of foreign banks, in that exemptions available to US banks with respect to US government debt would not similarly extend to non-US sovereign debt traded by foreign banks operating in the US. The Federal Reserve has announced that there will not be an immediate application of the rule from July, but a two year period expiring on July 21 2014 to allow banks to accommodate the Rules. Some commentators have suggested that the Rule is very likely to be relaxed during the two year period, particularly if regulators postpone the finalisation of the Rule until after the presidential election.

### Derivatives

*In Lomas and others v JFB Firth Rixson Inc and others [2012] EWCA Civ 419*, the Court of Appeal handed down its judgment in the appeals of four High Court rulings on the interpretation of Section 2(a)(iii) of the ISDA Master Agreement. One of the key findings is that where there is an Event of Default, payment obligations under Section 2(a)(iii) are suspended but not extinguished. Please ***click here*** for a summary of the principal findings of the judgment.

### Spotlight on… Rent as a Prioritised Expense on Insolvency

In an administration or liquidation, debt constituting an administration expense or an expense of the liquidation will rank in priority of distribution below the claims of holders of fixed charges but above distributions to preferential creditors, floating chargeholders and all unsecured claims. In order to achieve this elevated position, an expense must fall within the criteria set out in the Insolvency Rules. One common criteria is that the debt should constitute a "necessary disbursement" of the administration or liquidation. Frequently the retention of business premises is of pivotal importance to the ability to continue in trade (for however short a period). The principle is of relevance to both liquidation and administration processes and was first recognised in *Re Lundy Granite Co ex P. Heaven [1871] LR6 Ch App 462* when the Court of Appeal concluded that if a third party's assets are used for the benefit of other creditors of a company, then the appropriate priority should be accorded to that third party's claim. That rent on business premises should be so prioritised is underscored by the fact that, in an administration a landlord's right to forfeit his lease is suspended by the moratorium imposed under the Insolvency Act 1986.

*In Goldacre (Offices) LTD v Nortel Networks UK Ltd [2009] EWHC 3389* the court concluded that where a company in administration continued in occupation of leasehold premises, quarterly rent payable in advance and falling due during the course of the administration would constitute an administration expense. In contrast, the court held in the recent case of *Leisure Norwich (II) Ltd v Luminar Lava Ignite Ltd and others [2012] EWHC 951 (Ch)* that where the advance quarterly rent instalment fell due immediately before a company went into administration, the unpaid rent would not constitute an administration expense, even though the landlord was constrained by the moratorium on proceedings against the tenant and the tenant was occupying property rent free for the benefit of its other creditors. *Luminar* betrays a preoccupation with timing and the date on which obligations are actually incurred which appears inconsistent with the *Lundy Granite* principle.

That the *Luminar* case provides certainty for administrators will be of scant comfort to landlords, who will be aware that the optimum time for an administration appointment (in terms of avoiding the treatment of rent as an administration expense) will fall immediately after a quarter day. On any failure to pay on the relevant quarter day landlords may be expected to consider the immediate exploitation of any forfeiture procedure available prior to any such appointment.

## In the courts

### Broker's duties on close-out

*Euroption Strategic Fund Ltd v Skandinaviska Enskilda Banken AB [2012] EWHC 584 (Comm)*

Euroption traded European equity options and Skandinaviska, a Swedish investment bank with significant operations in the UK acted as its clearing broker. Under the terms of an Exchange Traded Futures and Options Mandate concluded between the two parties, Skandinaviska became entitled to call for a margin to cover increased exposure at a time of market disruption. Euroption failed to provide the margin requested and Skandinaviska became contractually entitled to close out Euroption's equity options. Whilst it was acknowledged that Skandinaviska had acted honestly and in good faith in conducting the close out, Euroption contended that the bank had an additional duty to act competently and with reasonable care and not irrationally. The court refused to admit an additional duty of care, whether as an implied term of the Mandate under the Supply of Goods and Services Act 1982 or as an additional duty of care in tort. Clearing brokers such as Skandinaviska were entitled to act in their own interests and on an urgent basis when closing- out contracts following a customer default, provided they did so in good faith and on a rational basis. They were not obliged to subject close- out procedures to exhaustive analysis and consider the loss of hypothetical investment opportunities.

### Prepayment fees and indemnities

*K/S Preston Street v Santander UK Plc [2012] WL 609053*

A ten year fixed rate term loan concluded between Santander and a corporate borrower anticipated the possibility of prepayment and the borrower exercised that right after seven years. The loan agreement provided for the payment of a prepayment fee, which was not contested by the borrower. The loan agreement also required the borrower to indemnify Santander against "costs, losses, expenses or liabilities" incurred by the bank on prepayment "including loss of profit or opportunity costs." The court was asked to consider the validity of the indemnity clause and, if valid, whether Santander was entitled to recover losses subsisting only at the date of its demand under the indemnity or, as contended by Santander, its loss of interest over the entire ten year term, discounted to accommodate the bank's interest return on the prematurely received principal amount. The court held that the indemnity was valid and that payments under it were clearly expressed to be "in addition" to prepayment fees. There had been no breach and therefore (a) no question of an unenforceable common law penalty arose and (b) any reference to applicable rules with respect to the assessment of future damages on breach were inapplicable. As a matter of pure construction, however, the indemnity clause only entitled Santander to claim for losses incurred up to the date of its demand and not for future losses. It is implicit in the decision that if the indemnity clause had used clearer language, a claim for prospective, extrapolated losses may well have been admitted.

### Try, try again ...

The Supreme Court has recently given permission to Mr & Mrs Harrison to appeal the decision of the Court of Appeal in *Harrison and Harrison v Black Horse Limited [2011] EWCA Civ 1128*. The case will be appealed to the Supreme Court in 2013.

The claimants have attempted to establish that a failure by the lender to disclose commission received from the insurer (amounting to 87% of the cost of the insurance) on a sale of a PPI policy constituted an unfair relationship under section 140A of the Consumer Credit Act 1974 (introduced in April 2007 to replace the "extortionate credit bargain" test). The Court of Appeal emphatically rejected the Harrisons' argument, finding that the Harrisons in this instance had been given an informed choice as to the optional purchase of the relevant PPI, referring to the absence of any regulatory obligation to disclose the existence or amount of commission and emphasising the necessity to establish that the relationship between the lender and borrow is unfair, not the agreement entered into between them.

## Recent transactions

We have recently advised India Hospitality Corp on their acquisition of Adelie Foods (who supply sandwiches to Caffe Nero, Starbucks, among others) and on the associated term loan and account receivables financing.

## Department News

We are delighted to welcome associate Gary Brennan to the department. Gary joins us from Hogan Lovells and specialises in Banking.

Chris Glennie has been seconded to the Legal Unit of The Bank of England.


**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

**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