

Finance Update
April 2010

OLSWANG



General Finance

General Finance News

Building Societies

At the end of March, HM Treasury published a discussion paper entitled '**Building Society Capital and Related Issues**'. This paper looks at the challenges building societies have faced as a result of the financial crisis and how the sector has reacted to these challenges. It then goes on to put forward suggestions for the future, including:

- modification of existing capital instruments so they are more resilient in times of stress; and
- enhancement of the government's role in supporting societies to raise capital for stability and growth.

The Building Societies (Financial Assistance) Order 2010 was published on 10 April. This Order modifies the Building Societies Act 1986 to make it easier for a 'qualifying institution' to offer or to provide financial assistance to a building society. A 'qualifying institution' is defined as the Bank of England, the European Central Bank or any other central bank of a member state within the European Economic Area and 'financial assistance' includes giving guarantees, indemnities or other type of financial assistance.

During March, the Financial Services Authority (FSA) confirmed the transfer of the engagements of the Chelsea Building Society to the Yorkshire Building Society.

Credit Rating Agencies (CRAs)

At the end of March, the **Credit Rating Agencies Regulations 2010** were published. The Regulations implement the European Regulation on Credit Rating Agencies and make a variety of provisions, including:

- updating the process for credit rating agencies to apply for certification and registration; and
- giving the FSA regulatory and enforcement powers over credit rating agencies.

European Commission (EC)

On 23 March, the EC published a consultation on the results of the study into the operation and impact of the Statute for a European Company (SE) (see [here](#)). The SE gives companies operating in more than one Member State the ability to organise their business under one European label. However, the SE has been very popular in some Member States and less popular in others. This consultation aims to discover why this is and to put together possible suggestions for improvement in the future. The deadline for responses is 23 May 2010.

Financial Services Authority (FSA)

The FSA has published its business plan for 2010/2011, setting out its work programme and priorities for the next year (see [here](#)). This focuses on a number of key areas, including:

- deliverance of effective supervision backed by credible deterrence;
- promotion of financial stability; and
- continuing the need to embed organisational and cultural change to implement intensive supervision.

The **Financial Services Act 2010** was passed by Parliament on 8 April 2010. Parts of the Act come into force immediately and certain of these change some of the objectives, powers and duties of the FSA, including the new financial stability objective and the duty to create a consumer financial education body.

HM Revenue & Customs (HMRC)

On 8 March, HMRC published revised guidance on thin capitalisation in its **International Manual**. The changes include substantial rewriting of the existing guidance and the introduction of new sections on accountancy issues and credit ratings.

On 8 April, HMRC published draft guidance on the new rules for the taxation of debt buy-backs, contained within Schedule 15 of the Finance Act 2010 (for detailed information see [here](#)). The deadline for comments on the draft guidance is 28 May 2010.

Loan Market Association (LMA)

A revised version of the LMA Intercreditor Agreement has been posted on the LMA website.

The changes that have been made are:

- to the length of the perpetuity period specified in Clause 16.19 (*Perpetuity period*) which has been updated to refer to a perpetuity period of 125 years to reflect the period mandated by the Perpetuities and Accumulations Act 2009 which has just come into force; and
- to the cross-references to Clause 14.3 (*Treatment of SFA Cash Cover and Senior Lender Cash Collateral*).

A mark up highlighting the changes made has also been posted on the LMA website.

International Swaps and Derivatives Association (ISDA)

At the start of March, ISDA and the International Islamic Financial Market (IIFM) jointly issued the first Shari'ah compliant master agreement for over-the-counter derivatives, the ISDA/IIFM Tahawwut (Hedging) Master Agreement. This document was developed under the guidance of the IIFM Shari'ah Advisory Panel for this project and in consultation with market participants. It is designed to be used between two principal counterparties as a master agreement and it is a new framework, although the document is similar to the conventional ISDA Master Agreement. However, certain key mechanisms and provisions, such as early termination events, closeout and netting, are developed based on Islamic Shari'ah principles.

Office of Fair Trading (OFT)

The OFT has published irresponsible lending guidance, entitled '**Irresponsible lending – OFT guidance for creditors**'. The guidance makes clear what the OFT considers are irresponsible lending practices and sets out guidance for creditors, including, not using misleading or oppressive behaviour when advertising, selling or enforcing a credit agreement; treating borrowers fairly; and explaining key features of credit agreements to enable borrowers to make an informed choice.

Perpetuities and Accumulations Act 2009

The **Perpetuities and Accumulations Act 2009** came into force on 6 April. The main changes are the introduction of a single 125 year perpetuity period which will always apply (although a shorter period can still be chosen) and trustees will now be able to accumulate income for the whole of the trust period.

Supreme Court

The Supreme Court has granted Enviroco Ltd leave to appeal the decision in the case of *Enviroco v Farstad Supply A/A [2009] EWCA Civ 1399*. (See the **March 2010 Finance Update**.) In this case it was held that where a parent company provided shares in its subsidiary as security for a loan and the shares were registered in the name of the lender, the subsidiary would no longer be a subsidiary within the meaning of sections 736 and 736A of the Companies Act 1985.

The appeal is due to take place in October this year.

Interest Rates

On 8 April, the Bank of England announced that interest rates would again be held at 0.5% and that it would continue with the £200 billion programme of asset purchases financed by the issuance of central bank reserves (both of these proposals were unanimously agreed by the Monetary Policy Committee).

On 8 April, the European Central Bank held interest rates at 1% across the eurozone.

World markets

According to the British Chamber of Commerce (BCC), during the first quarter of this year there has been some economic improvement within the services sector but some indicators within the manufacturing sector have worsened. The BCC recorded growth of 0.2% in the first quarter of 2010, compared with growth of 0.4% in the final quarter of 2009. However, the manufacturing purchasers' index increased to 57.2 from 56.5 in February, the highest level since October 1994 (any number above 50 is indicative of growth).

According to figures from the National Institute of Economic and Social Research, the British economy grew by 0.4% in the first quarter of 2010 and has so far managed to avoid a double dip recession and according to the Organisation for Economic Co-operation and Development the British economy is set to grow faster than other countries within the eurozone but its growth is likely to be uneven and unpredictable.

The general election in May and the potential of a hung parliament have caused Sterling to drop against the US Dollar and the Euro. Gold prices have risen to their highest levels so far this year due to the uncertainty in the currency markets and concern about the Greek debt crisis. Standard and Poor's has cut the Greek sovereign debt rating to BBB-, the first time a euro member has lost its investment grade rating

since the introduction of the single currency in 1999. Iceland also risks having its credit rating downgraded to junk status by Moody's unless it manages to resolve its debt disputes with Britain and the Netherlands.

In the US, payrolls during March increased by the largest amount in three years and unemployment figures remained stable at 9.7%. There was an increase in the number of home sales in February, according to the National Association of Realtors and figures from the Institute for Supply Management indicated the best monthly growth for the services sector since May 2006. In light of these figures, US shares have moved higher and the Dow Jones closed above 11,000 for the first time in 18 months.

General Finance

General Finance Cases

Bank duty of care

In the case of *Titan Steel Wheels Ltd v The Royal Bank of Scotland Plc* [2010] EWHC 211 it was held that a purchaser of derivative products was precluded by the terms of the agreement (which stated that the bank would not provide advisory services) from claiming that the bank owed it an advisory duty of care.

Facts: T had been a customer of RBS for many years. T's income is predominantly in Euros and much of its expenditure is in Sterling. Therefore, it needs to sell Euros and purchase Sterling on a regular basis. In order to manage its foreign currency liability it entered into currency swap transactions with RBS. This claim concerned two currency swaps entered into in June and September 2007, governed by the 1992 ISDA Master Agreement. These two transactions were entered into following telephone conversations with RBS with follow up confirmations drawing T's attention to RBS's standard terms of business. These terms of business stated that RBS '*do not act as your advisor or in a fiduciary capacity. For the avoidance of doubt, we are providing you with an execution only service, with no advisory services.*' Subsequently, as result of entering into these to swaps, T became liable to RBS for £2.8m plus interest.

Issues: Was RBS liable to T for negligently advising T to take these products which were unsuitable for its needs?

Decision: The claim was dismissed. T could not claim against RBS due to the existence of the contractual terms between T and RBS stating that RBS was not providing an advisory service and did not owe T a duty of care. It was held that the terms of business formed part of the agreement between T and RBS by virtue of the signatures on the relevant confirmations and by course of dealing between the parties. It was also held that RBS did not owe T a common law duty of care.

Contract formation

The case of *RTS Flexible Systems Limited v Molkerei Alois Müller GmbH & Co KG* [2010] UKSC 14 illustrates the pitfalls of commencing performance of services before a contract is finalised, and the circumstances in which a "subject to contract" draft contract may nevertheless be binding.

Facts: RTS, a supplier of automated machines for the food industry, had been asked to manufacture and deliver an automated system for packaging yoghurt pots by Muller, the well-known supplier of dairy products. Negotiations as to the exact form of the contract went on for some time and included several different quotations provided by RTS as the scope of the project evolved. The last of these, Quotation J, included a fixed price of £1,682,000 and set out in outline the scope of the work which was to be carried out by September 2005. In order to meet the projected timescales in February 2005 RTS agreed to commence work based on a Letter of Intent (LOI) in which Muller expressed their wish "to proceed with the project as set out in [Quotation J]", with a long form contract to be agreed and signed within four weeks. The LOI went on to state that the long form contract would be based on amended 'MF/1' terms and conditions (a model form contract devised by the Institute of Electrical Engineers), plus other technical terms to be contained in schedules. Clause 48 of the draft long form contract contained a 'subject to

contract' clause which expressly stated it would not take effect until executed. The LOI ultimately expired in May 2005, despite being extended twice as negotiations on the long form contract continued. Nevertheless, RTS continued to work on the project, delivered the machines in September and were paid in the region of 70% of the £1.682m. Although the parties had by this stage reached agreement on most of the terms of the long form contract, it never came to be signed as a dispute broke out as to whether the delivered machines matched Muller's performance requirements. RTS then issued proceedings claiming "*moneys due under a contract, alternatively damages*".

Decision (first instance): The trial judge held that the parties had concluded a contract, albeit a limited one, under which RTS would carry out the agreed work for the £1.682m price as set out in the LOI. He refused to accept however, as was argued in the alternative by RTS, that the contract also incorporated the MF/1 terms, citing in particular clause 48 and the correspondence between the parties as demonstrating a clear intention that those terms would not take effect until signed. The significance of MF/1 in particular was that it contained a liquidated damages clause: if MF/1 was part of the agreement, then RTS' liability to Muller in respect of failing to deliver the machines as promised would be restricted; if it was not, as Clarke J found, then RTS had assumed unlimited liability.

RTS appealed but changed its primary submission before the Court of Appeal, arguing that there had been no contract at all following the expiry of the LOI such that it was entitled to payment for work carried out on a quantum meruit basis, or at the very worst its liability would be limited to repaying the money it had received from Muller.

Decision (Court of Appeal): The appeal was allowed. The Court of Appeal's reasoning was that the 'subject to contract' clause should prevail.

Decision (Supreme Court): The Supreme Court held that a contract had been created after the expiry of the LOI, and that it did incorporate the wider MF/1 conditions. In reaching this conclusion, the Supreme Court effectively amalgamated the logic of both the High Court and the Court Appeal and created a commercially sensible solution.

Comment: The decision can be seen as the latest in the line of cases where the House of Lords or Supreme Court has been willing to adopt a commercial rather than overly legalistic approach. The question of what the parties intended on the facts should not be viewed through the eyes of lawyers, but through the eyes of reasonable businessmen stepping into the parties' shoes. Their lordships were clearly swayed by the fact that in this instance essential terms had been agreed during negotiations which had reached an advanced stage.

Real Estate Finance

Real Estate Finance News

Council of Mortgage Lenders (CML)

On 6 April, CML issued a **Pre-Action Protocol for Possession Claims based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property**. The protocol sets out the behaviour the court will expect from the parties prior to the start of a residential possession claim and it applies to arrears in relation to:

- first charge residential mortgages and home purchase plans regulated by the FSA under the Financial Services and Markets Act 2000;
- second charge mortgages over residential property and other secured loans regulated by the Consumer Credit Act 1974 in respect of residential property; and
- unregulated residential mortgages.

Land Registry

The Land Registry has published a consultation paper entitled '**E-conveyancing Secondary Legislation Part 3**'. This paper seeks comments on proposals to create electronic transfers, completing with electronic signatures and the extension of the use of electronic legal charges. If these proposals come into effect, it would be possible to carry out a residential conveyance issuing most of the documentation electronically rather than in paper form. The consultation period ends on 25 June 2010.

Real Estate Finance Market

According to February's IPD UK Monthly Index, UK commercial property's annual capital growth increased for the first time in two and a half years and capital values were 2.7% higher in February 2010 than in February 2009. According to a report from Savills, lending to the UK commercial property sector has also increased over the last year, loan-to-values have increased and interest rate margins have decreased for better value property investments as lenders again start to compete for business. However, according to Cushman and Wakefield, investment in the central London property market decreased by nearly 50% during the first quarter of 2010, the first quarterly drop in nine months.

According to IPD, institutional European property funds started to generate positive returns in the second half of last year but the recovery was not strong enough to stop a third year of losses. Figures from Reis, have also indicated that the decline of the US commercial property sector has slowed and rents have begun to stabilise, falling 0.8% in the first quarter of 2010 compared with a fall of 4.2% in the first quarter of 2009.

According to the Halifax house price index, house prices increased by 1.1% during March, having fallen during February. This was backed up by figures from Nationwide, showing a house price rise of 0.7% during March. According to Rightmove, the number of properties on the market rose in March to an 18 month high and many economists are predicting that as more properties enter the market the growth in

house prices is likely to stall or begin to fall. However, according to the latest Housing Market Sentiment Survey, four out of five UK homeowners think property prices will continue to rise over the next six months.

Restructuring and Insolvency

Restructuring and insolvency news

Insolvency Service

On 23 March, the Insolvency Service published a consultation paper entitled '**Debt relief orders and pensions**'. Debt Relief Orders (DROs) were introduced in 2009 for people in long term debt difficulties who could not afford to make themselves bankrupt and aim to provide a fresh start for people trapped in debt. This Consultation is inviting views on whether DROs should be opened up for people who would otherwise be eligible but for the fact that they have a future pension right which is small and some years away from coming into payment, (currently if someone has a pension of over £300 they are not eligible for a DRO). The consultation period ends on 23 June 2010.

On 31 March, the Insolvency Service published a consultation paper entitled '**Improving the transparency of, and confidence in, pre-packaged sales in administrations**'. This consultation invites comments on the proposals set out to reform the procedure for pre-pack sales. The consultation period ends on 24 June 2010. The proposals set out, include:

- making no change to the existing framework;
- making non-compliance with SIP 16 a criminal offence;
- requiring a different insolvency practitioner to take office as administrator from the insolvency practitioner who negotiated the pre-pack sale; and
- subjecting all pre-pack sales to the prior approval of the court or the creditors of the company.

Restructuring and Insolvency

Restructuring and insolvency cases

Administration expenses

In the matter of Johnson Machine and Tool Co Ltd: In the matter of Empire Surfacing Ltd [2010] EWHC 582 (Ch) it was held that pre-appointment costs and expenses incurred by the administrator in the period before the company went into administration could not be paid as an expense of that administration.

Facts: This concerned two separate cases where administrators applied for pre-appointment costs to be treated as administration expenses. In each case the costs had been incurred as part of a 'pre-pack' administration.

Decision: Making an order allowing pre-appointment costs to be an administration expense is discretionary. (See *In the matter of Re Kayley Vending Limited [2009] EWHC 904 (Ch)* and the summary of this case in the [July 2009 Finance Update](#).) There is a distinction between an administration for the benefit of the creditors and an administration for the benefit of the management. In the former, but not the latter, it would be appropriate to allow pre-appointment costs to be recoverable as part of the administration. Where (as in these cases) the management were the purchasers, it is difficult to argue that the administration was for the benefit of the creditors. Therefore, in these cases, the pre-appointment costs could not be paid as an expense of the administration.

Administrators' duties

In the case of *BLV Realty Organisation Limited and Another v Batten and Others [2009] EWHC 2994 (Ch) (Re Zegna III Holdings Inc)* it was held that the duty of the administrator to act in the best interests of the creditors as a whole did not mean that this obligation had to be exercised in an identical way in relation to each creditor and was not necessarily unfair where there are commercial reasons for treating certain creditors differently.

Facts: Z was a BVI company incorporated to redevelop a property. The property was purchased with a bank loan secured by an English debenture granted by Z. Z entered into an agreement with BLV to manage and co-ordinate the redevelopment of the property. The redevelopment went over budget and fell behind schedule and Z was unable to pay invoices and fell behind on its loan repayments. As a result of the default the bank applied for an administration order and M were appointed as joint administrators. M reviewed the agreement between Z and BVL and due to the breaches committed by BVL terminated this agreement on the grounds that it was in the best interests of all the creditors to terminate. Other contractors' contracts were not terminated. BVL applied to remove M on the basis that the termination was wrongful, was not in the interests of the creditors as a whole and caused unfair harm to BVL's interests.

Decision: BVL's application was dismissed. There may be good commercial reasons not to treat all creditors in the same way and in such circumstances it is the interests of the creditors as a whole that

prevail over the interests of an individual creditor. Unequal or different treatment was not necessarily unfair treatment. In order to decide whether the termination of the contract was wrongful a full hearing before the Technology and Construction Court would be required.

Centre of Main Interests (COMI)

In *Kaupthing Capital Partners II Master LP Inc (sub nom Pillar Securitisation Sarl v (1) Spicer (2) Shinnors)* [2010] EWHC 836 (Ch) the High Court considered a challenge to the appointment of the administrators over Kaupthing Capital Partners II Master LP Inc. ("Master").

Facts: Master was an LP established in Guernsey. Master was used in connection with an investment fund (the "Fund") administered by an English registered LP acting as general partner ("GP"). Master had registered offices in Guernsey, but its head office functions were conducted in London by its operator and investment and other managers.

Another company in the group, before becoming insolvent itself, demanded repayment from Master of its credit facility. Master was unable to comply and administrators were appointed over Master using the out of court process as set out in schedule B1 of the Insolvency Act 1986. The appointment was made using the prescribed form for companies and not the one for partnerships.

It was submitted, *inter alia*, that the appointment of the administrators was void because:

- Master's centre of main interest ("COMI") was Guernsey for the purposes of the Council Regulation on Insolvency Proceedings (1346/2000/EC) ("EC Regs") so the English court lacked jurisdiction in relation to the insolvency ("Issue 1"); and
- the out of court appointment of administrators was formally and substantially invalid as the wrong form had been used when giving notice of the appointment ("Issue 2").

Decision: Issue 1: The test for COMI, as established in *Stanford International Bank Ltd (In Receivership), Re (2010)*, is that there is a presumption that an entity's COMI is in the state where its registered office is located. This presumption can be rebutted by factors which are both objective and ascertainable by third parties. The judge in considering the nature of Master's business and the identity of such third parties noted that all of Masters' business was conducted out of offices in London, prospective investors were informed of this and creditors communicated with English operating companies at the London offices. Master acted as a "letterbox entity" only and therefore the presumption as to COMI had been rebutted on the facts of the case such that the English Court had jurisdiction under the EC Regs.

Issue 2: Although no expert evidence had been submitted, on the evidence presented it appeared that Master (although a body corporate) was not a company under Guernsey law or for the purposes of the Insolvency Act 1986. There was no such thing as a "hybrid" company. The correct form for appointing Master should have been by reference to the fact that Master was a limited partnership not a company. This was a fundamental flaw that went to the validity of the appointment and the appointment was therefore invalid and incurable.

Comment. The case reconfirms that COMI can only be established after consideration of various factors, including most importantly the perception of COMI by third parties doing business with the entity in question. In addition, the case is a caution to insolvency practitioners their appointors and their advisors of the importance of using the correct prescribed statutory form: where it is uncertain what form should be used then appointors must ensure that the information contained in the form describes, as accurately as possible, the entity and the requirements for making an appointment over that entity.

The information in this update is intended as a general overview only of the subjects covered. Detailed specialist advice should always be taken before taking or refraining from taking any action. For more guidance on the changes and their application, please get in touch with your usual Olswang contact.

About Olswang

Olswang is a leading business law firm with a distinctive approach. Our pioneering and problem-solving ethos has established a commanding reputation in the technology, media and real estate sectors, as well as a wide range of other industries.

Founded in 1981, our Firm has grown to a team of over 650, including more than 100 partners, across four European offices. In addition, Olswang has a long-established best friends' network of leading independent law firms throughout the world.

Our Firm continues to be acknowledged as a leading practice in many of our core areas: Olswang was voted TMT Team of the Year 2009 for the second year running at the annual Legal Business Awards; Olswang's Corporate Group won M&A Law Firm of the Year at the M&A Awards 2008 in conjunction with M&A Magazine, and was named Corporate Team of the Year – Mid markets at The Lawyer Awards 2008.

Resourceful drive and a climate of shared knowledge and empowerment are the hallmarks of our meritocratic, unstuffy culture. For the last five years Olswang has been ranked in The Sunday Times 100 Best Companies to Work For and our strong management team is dedicated to the personal and professional development of our people.

Olswang is committed to being a responsible business and has developed Corporate Responsibility programmes that allow us to actively manage the social and economical impact of the Firm's activities. For example, through our Green initiative we recycle almost 90% of our waste and on the 1 May 2009 Olswang achieved CarbonNeutral® accreditation. As part of our Corporate Responsibility strategy we also encourage every member of staff to engage in lasting and meaningful pro bono and volunteering activities, both legal and non legal.

We recruit personalities with a genuine fascination and notable reputation in the sectors they focus on, which is reflected in the quality of our advice. We also understand the importance of achieving our clients' goals and ensure that our advice is, above all else, practical.

From world-class businesses to entrepreneurial startups, the rich diversity of our client base ensures a broader perspective and, as a result, deeper commercial insight. Transactional work is the most obvious feature of the role we perform. However, ongoing non-transactional support is an integral part of our business, and we focus on creating long-term relationships with our clients. We employ a range of proactive initiatives such as client care programmes, secondments, client training and feedback sessions to ensure our client relationships are strong.

At Olswang the passion of our lawyers, the confidence of our approach and the commercial edge to our advice provide a unique and compelling service.

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