

Finance Update
February 2010

OLSWANG



General Finance

General Finance News

Banking Act 2009

Under the Banking Act 2009, the Bank of England, the Treasury and the Financial Services Authority gained new powers to minimise possible threats to financial stability. From 31 December 2009, the Bank of England obtained specific powers: once the Treasury makes a recognition order if it is concerned that a particular inter-bank payment system is deficient or its disruption would threaten the stability of the UK banking system, the Bank of England can then stop the system operating or require specific rules to be put in place or specific action to be taken. The Treasury has published guidance on the recognition process for inter-bank payment systems – see [here](#).

Basel Committee

During December 2009, the Basel Committee on Banking Supervision published proposals, for consultation, to strengthen global capital and liquidity rules (see [here](#) and [here](#)). These proposals were put forward to try to address the problems of the current financial crisis in relation to the regulation, supervision and risk management of global financial institutions. The proposals cover the following key areas: raising the quality, consistency and transparency of the capital base; strengthening the risk coverage of the capital framework; the introduction of a leverage ratio as a supplementary measure to the current Basel II risk-based framework; measures to promote the build up of capital buffers in good times; and the introduction of a global minimum liquidity standard for internationally active banks. Comments on these proposals should be submitted before 16 April 2010.

Bribery Bill

The **Bribery Bill** was introduced into the House of Lords on 19 November 2009, where it received its first reading. The original draft of the Bill (which was published in March 2009) was based on the work of the Law Commission. It was widely welcomed in principle, but aspects drew criticism and concern. As a result, the new version of the Bill contains some significant changes, most notably that the new criminal offence of corporate bodies and partnerships negligently failing to prevent bribery has been amended to remove the requirement to prove negligence, therefore making it a strict liability offence. Other important amendments include extending the Bill to apply in Scotland and amendments to the offence of bribing a foreign public official. Although the Bribery Bill may not be passed before the next general election (due in June 2010 at the latest), the UK has received criticism for its out-of-date and ineffective laws and so a new government is likely to take the Bribery Bill forward.

Cheques

British banks have confirmed that cheques will gradually be phased out and the Payments Council Board have stated that central cheque clearing will be closed during 2018. However, before doing this it will undertake a full review into cheque usage during 2016.

Debt buy-backs

On 14 October 2009, the Government announced a change to the law in relation to debt buy-backs. In the past, when a borrower bought its own debt at a discount this was taxable, however, if an affiliate of the borrower bought this debt, it was tax free. From 14 October, this exception will only be available for 'those debt buy-backs that are undertaken as part of genuine corporate rescues'. This tax change will be included in the next Finance Bill, but it will apply retrospectively to debt buy-backs taking place on after 14 October 2009. Therefore, until the draft legislation is produced, buy-backs taking place after this date will have to be carefully considered.

Department for Business, Innovation and Skills (BIS)

On 27 October 2009, BIS published a [consultation paper in relation to credit cards and store cards](#). This consultation looks at five areas: allocation of payments; minimum payments; unsolicited credit increases; re-pricing of existing debt; and simplicity and transparency of costs. The consultation was open until 19 January 2010 for comments.

On 8 January 2010, BIS published a new strategy entitled 'Going for Growth' to boost long term, strong and sustainable economic growth in the UK. See [here](#) for more information.

European Commission

The European Commission has adopted legislative proposals in order to strengthen the supervision of the European financial sector. These proposals included the establishment of three new bodies:

- a European Systemic Risk Board: will identify risks, issue early warnings to Member States and produce recommendations to minimise these risks;
- a European System of Financial Supervisors: will supervise individual financial institutions; and
- new European Supervisory Authorities: the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority; will take over the roles of the current Level 3 Committees, develop proposals for technical standards and provide co-ordination roles in an emergency situation.

Financial Services Authority (FSA)

On 5 October 2009, the FSA published its final rules on the liquidity requirements expected of firms to enhance their liquidity risk management practices (see [here](#)). The rules include: principles of self-sufficiency and adequacy of liquid resources; enhanced systems and control requirements; and a new regime for foreign branches that operate in the UK. It was expected that the qualitative aspects of the new regime would be put in place before the end of 2009.

On 22 October 2009, the FSA published a [discussion paper](#) looking at the problem of systemically important 'too-big-to-fail' banks, following on from the Turner Review published earlier in 2009 and to stimulate debate at the Turner Conference, which took place in November 2009. The paper looks at the problems posed by firms seen as too-big-to-fail and goes on to consider some potential reforms which could be introduced to address these problems.

From 1 November 2009, a new banking conduct regime came into effect, including the new **Banking Conduct of Business Sourcebook** (BCOBS). In the past the FSA was unlikely to exercise its powers unless a contravention with the Principles for Business (with respect to accepting deposits and issuing electronic money) (Principles) would have implications for confidence in the financial system or the relevant firm's adequacy of capital. Under the new regime the FSA will also monitor compliance with the Principles in a business context.

The FSA has announced a range of measures to help investors who got unsuitable advice or misleading materials in relation to Lehman-backed structured products. The actions it is taking include: asking all sellers to review how they sell products against the new standards (this applies to all structured products not just Lehman-products) and informing customers that some plan managers, which marketed Lehman-products and are not in administration, may still mean that customers may be able to claim from the FSCS.

Financial Services Bill

The Financial Services Bill was introduced to Parliament on 19 November 2009. The aim of the Bill is to ensure stronger financial regulation and corporate governance, as well as enabling consumers to seek redress and compensation from banks. The Bill includes the following:

- tougher rules on pay and bonuses to ensure that remuneration policies do not encourage risk taking, following the recommendations set out in Walker Review on Corporate Governance;
- the creation of the Council for Financial Stability, to focus on managing systemic risk and to protect financial stability in the UK and internationally;
- new powers for consumers to collectively challenge banks in court as well as the creation of a financial education body and a free money guidance service; and
- enhanced powers for the FSA, including powers to take action when firms and individuals are guilty of misconduct and the power to prohibit, or require the disclosure of, short selling activities.

See the **Olswang Financial Services Regulatory Bulletin – Q4 2009** for more information.

HM Treasury

On 25 November 2009, the Treasury launched a consultation on mortgage regulation, setting out proposals to extend the scope of FSA regulation to include second-charge mortgages and buy-to-let mortgages and to protect borrowers when mortgage lenders sell mortgage books on to third parties. The consultation period ended on 15 February 2010.

The Treasury has announced the support of major UK banks for G20 bonus reform proposals. Many banks, including, Bank of America, Merrill Lynch, Citigroup, Credit Suisse, JP Morgan and Nomura confirmed their support of the FSA rules and the supporting Code on remuneration practices as well as the related G20 agreement. Many EU banks with major London branches also confirmed that they would implement the G20 agreement and would comply with the FSA in relation to their UK-based employees.

Loan Market Association (LMA)

Following discussions with a group of mezzanine investors, a revised version of the LMA Intercreditor Agreement has been posted on the LMA website. A number of optional provisions have also been

introduced, either in the form of drafting options or notes in the agreement. These changes have required revision to the LMA Financial Covenants and a revised version of these has also been posted on the website. Some changes have also been made to the Primary Leveraged document to reflect the final implementation of the Companies Act 2006.

The LMA has also been working on producing a revised loan trading documentation suite, combining par and distressed terms. This suite is now finalised and was launched on 25 January.

Lugano Convention

In October 2007, the EU, Iceland, Norway, Denmark and Switzerland agreed on a convention to replace the 1988 Lugano Convention on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. This new instrument was the **2007 Lugano Convention (new Lugano Convention)**. The new Lugano Convention entered into force in the EU and Norway on 1 January 2010, and from that date will govern issues of jurisdiction and enforcement of judgments as between EU Member States and Norway. It has not been ratified by Switzerland or Iceland, therefore, questions of jurisdiction and enforcement as between EU Member States, Switzerland and Iceland will therefore continue to be governed by the 1988 Lugano Convention.

Pre-Budget Report

On 9 December 2009, the Chancellor of the Exchequer presented the 2009 Pre-Budget Report. The Report contained a number of measures, including, among other things:

- a temporary non-deductible bank payroll tax of 50% which will apply to discretionary bonuses above £25,000, in whatever form, awarded to bank (and building society) employees during the period from 9 December 2009 to April 2010. It is also intended that remuneration practices will be changed in the long term as a result of new corporate governance and regulatory reforms the UK Government is putting in place;
- the introduction of a Code of Practice on taxation for banks, which the Government expects all banks operating in the UK to adopt;
- a consultation in relation to the UK covered bond market;
- the introduction of a new specific Governance Code for Building Societies; and
- additional 0.5% rises in National Insurance Contributions from April 2011 (in addition to the pre-announced 0.5% rises).

For more information see the Olswang Pre-Budget Report Blog [here](#).

Rome I

The **Rome I Regulation (Regulation (EC) No. 593/2008 on the law applicable to contractual obligations) (Rome I)** came into force on 17 December 2009. It applies in all the EU Member States, except Denmark, and to all contracts concluded as from 17 December 2009 (i.e. those concluded on, as well as after, that date).

Prior to the coming into force of Rome I, the rules for determining which law the court should apply when resolving a contractual dispute were set out in the Rome Convention on the Law Applicable to Contractual Obligations 1980 as enacted in the UK by the Contracts (Applicable Law) Act 1990. Rome I has converted the Rome Convention into a regulation, whilst at the same time modernising the rules on contract where appropriate.

The Law Applicable to Contractual Obligations (England and Wales and Northern Ireland)

Regulations 2009 (SI 2009/3064) came into force on 17 December 2009. The Regulations have modified the current legislation in England and Wales and Northern Ireland in the light of Rome I by disapplying the Contracts (Applicable Law) Act 1990 in relation to contracts concluded on or after the 17 December 2009 (the Rome Convention and the 1990 Act will continue to apply to contracts concluded before that date).

Treaty of Lisbon

The Treaty of Lisbon entered into force on 1 December 2009. It has amended both the Treaty on the European Union (**TEU**) and the Treaty Establishing the European Community, which will now be known as the Treaty on the Functioning of the European Union (**TFEU**). The Law Society has produced a useful guide to the Treaty (see [here](#)). References to EU terminology in UK legislation have been updated by s. 3 of and the schedule to the European Union (Amendment) Act 2008, which came into force on 1 December 2009 by virtue of the European Union (Amendment) Act 2008 (Commencement No. 1) Order 2009 (SI 2009/3143) (see [here](#)).

The amendments made by the Treaty of Lisbon have, among other things, changed the organisation of the European courts. There will now be a Court of Justice of the European Union, which comprises three courts:

- the Court of Justice (formerly the ECJ);
- the General Court (formerly the Court of First Instance); and
- the Civil Service Tribunal.

Value Added Tax (VAT)

The standard rate of VAT reverted to 17.5% on 1 January 2010.

Walker Review

On 26 November 2009, Sir David Walker published his **final recommendations** from his review of corporate governance practices in UK banks and other financial institutions. Most of these recommendations follow those set out in the interim draft published in July 2009 (see the **August 2009 Olswang Finance Update**). The main change is a greater flexibility over the amount of time a non-executive director should commit to their financial institution.

Interest Rates

On 4 February, 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.

Throughout the final quarter of 2009 and into the first few months of 2010, the European Central Bank held interest rates at 1% across the euro zone and the US Federal Reserve held interest rates between 0% and 0.25%.

However, the Reserve Bank of Australia unexpectedly raised its interest rates in October 2009 from 3% to 3.25%, amid signs that Australia's recovery from the economic crisis was increasing in momentum.

World markets

According to the Organisation for Economic Co-operation and Development (OECD) economic growth and recovery is expected in almost all global regions during the course of 2010. In the OECD's Economic Outlook, released in November 2009, it stated that it expected combined gross domestic product (GDP) in its 30 developed countries to grow by 1.9% in 2010, having previously forecast in June 2010 that it expected GDP growth of only 0.7% in these countries during 2010.

In September 2009, Ben Bernanke, chairman of the Federal Reserve, declared that the US had emerged from recession but warned that recovery was likely to be slow. France and Germany also reported economic growth during the second quarter of 2009.

According to the Office of National Statistics (ONS), Britain's economy began growing again during the fourth quarter of 2009, however, the country's GDP was only 0.1% larger than the previous quarter. During January 2010, the Chartered Institute of Purchasing and Supply and Markit Economics, which is based on a survey of manufacturers, rose to 56.7, the highest level since October 2004, supporting the figures showing the country has emerged from recession. Goldman Sachs has even expressed the view that, due to sterling's depreciation, which will help boost exports and economic growth, Britain will have a much stronger than predicted recovery over the next few years, this view was backed up by figures released by the OECD.

Figures from the ONS also showed that unemployment fell in the three months to November, for the first time in 18 months. However, the number of people working part-time increased by nearly 100,000 in the same period, indicating that many workers are being encouraged to work part-time rather than lose their jobs entirely.

During the course of December the FTSE 100 index reached its highest level in 15 months, achieving its largest annual rally since 1997. The FTSE 250 index also reached a peak for 2009 during December. Both indices had been supported by low interest rates and the quantitative easing currently being undertaken by the Bank of England. However, in recent weeks shares in markets across the globe have fallen in relation to fears that certain European countries (namely Greece, Spain and Portugal) are unlikely to be able to reduce their budget deficits as fast as they have indicated, which will put them at risk of becoming trapped in spiralling debt. In particular, there have been rumours of a Greek bailout as their national debt has breached the 100% of GDP level. In light of this, investors have been selling European assets and the euro has fallen against the dollar and sterling.

General Finance

General Finance Cases

Bank charges

The case of *Office of Fair Trading v Abbey National plc and others* [2009] All ER (D) 271 followed the cases decided over the last couple of years between these parties (summaries of these decisions can be found in the [May 2008 Finance Update](#), the [October 2008 Finance Update](#), the [February 2009 Finance Update](#) and the [March 2009 Finance Update](#)).

Facts: The banks appealed to the Supreme Court against the decision that the Office of Fair Trading (OFT) was entitled to assess the fairness of certain bank charges (see the [May 2008 Finance Update](#)) under the Unfair Terms in Consumer Contracts Regulations 1999 (Regulations). The Regulations apply to almost any term that has not been 'individually negotiated' - i.e. standard terms and invalidate a term which is 'unfair'. The appeal was only in relation to whether the OFT could launch an investigation into whether the bank charges for unauthorised overdrafts were fair, the Supreme Court did not need to actually decide whether the bank charges for unauthorised overdrafts were fair. The issue was whether the charges were 'price and remuneration' as 'against the goods and services supplied in exchange' within the meaning of the Regulations. Such terms (along with the definition of the main subject matter of the contract) often referred to as 'core terms', are exempt from the fairness test under Regulation 5, provided they are in plain intelligible language. All other terms in consumer contracts (often referred to as 'non-core terms') are subject to the fairness test. A term "*which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights...to the detriment of the consumer*". An unfair term is not binding on the consumer. Furthermore, terms which are potentially unfair often attract scrutiny from the OFT (or sector regulators) even in the absence of consumer complaints.

Decision: The Supreme Court overturned the decisions of the High Court and the Court of Appeal. It gave detailed consideration to the scope of the non-core terms exception in Regulation 6(2) and unanimously ruled that the unarranged overdraft charges in relation to personal current accounts are part of the price paid by customers in exchange for the package of services making up a current account. Significant points from the judgment include:

- that the language of Regulation 6(2)(b) contained no indication that only the 'essential' price or remuneration was relevant, but that any monetary price or remuneration payable under the contract fell within the provision; accordingly the Court of Appeal had been wrong to find that the charges were not core terms;
- the fact that the charges were contingent, and that the majority of consumers did not incur them, was irrelevant; and
- the charges were not concealed default charges designed to discourage customers from becoming overdrawn.

It was also noted that in the absence of the charges, banks would not be able to profitably provide current account services without a fee. Therefore, the OFT cannot make an assessment of the fairness of the charges because, provided they are expressed in plain English, they fall within the 'core terms' exemption under Regulation 6(2)(b).

Comment: This decision was received with dismay by the OFT and by those bank customers awaiting the outcome of the case and looking for compensation for unauthorised overdraft charges. At the end of December, the OFT announced that in light of this decision, any investigation into the fairness of these charges under the Regulations would now have a very limited scope and low prospects of success. Therefore, it has decided against taking forward such investigation. However, the OFT has also stated that it is committed to reforming the personal account market and that it intends to survey banks and consumer groups in relation to this issue over the next few months.

The wide interpretation given to 'price or remuneration' will have implications for suppliers in all sectors, not simply the financial services sector. For example, in the light of this decision, certain aspects of the High Court's decision in *Office of Fair Trading v Foxton's Ltd* [2009] EWCH 1681 (Ch) (a case involving the enforceability of estate agents' renewal commissions) are to be appealed.

ISDA Master Agreement

In the case of *BNP Paribas v Wockhardt EU Operations (Swiss) AG* [2009] EWHC 3116 (Comm) it was held that the close out provisions in an ISDA master agreement were not penalties.

Facts: The parties had entered into an ISDA master agreement with accompanying schedule, under which a number of transactions were entered into. W failed to pay the money due to BNP under several of these transactions and notices served on it to remedy the non-payments were ignored. Therefore, BNP decided to terminate all the transactions and set an early termination date in respect of all outstanding transactions. BNP then submitted a statement showing the early termination amount plus default interest which was due and payable by W. W failed to pay this amount and BNP commenced proceedings.

W argued that the close out provisions were penalties under English law and therefore were unenforceable, the non-payment of several sums was not serious enough to entitle BNP to terminate all transactions under the master agreement and the early termination amount was not a genuine pre-estimate of the loss suffered by BNP as a result of the non-payment.

Issue: Are the close out provisions in the ISDA master agreement penal and therefore unenforceable?

Decision: W's argument was rejected. It was held that both of the methods set out in the master agreement for calculating the early termination amount (i.e. the amount required to put BNP in the position it would have been in had the agreement not been validly terminated on W's breach) were not extravagant or unconscionable and did not become unconscionable on the basis that the innocent party (in good faith) carried out the valuation. It was also held that the agreement was not penal just because it required W to pay amounts that were due and unpaid prior to the termination date.

Real Estate Finance

Real Estate Finance News

Building Societies Association (BSA)

The BSA has developed a set of **mortgage instructions** for its members. These are known as the BSA Mortgage Instructions and came into effect on 1 January 2010. Use of these Instructions is voluntary for BSA members and BSA members who are also members of the Council of Mortgage Lenders (CML) can continue to use the CML Lenders' Handbook.

Financial Services Authority (FSA)

On 19 October, the FSA published its **Mortgage Market Review** in the form of a discussion paper. The key features of the review include, among other things: imposing an affordability test for all mortgages so lenders become responsible for a consumer's ability to pay; banning 'self-certification' mortgages; and requiring all mortgage advisors to be personally accountable to the FSA. Responses were expected on the discussion paper by the end of January 2010.

Land Registry

On 22 October, the Land Registry announced a five year programme of re-organisation and transformation to cut its costs. The main proposals for the first phase include, among other things: reduction in staff numbers; the outsourcing of some of its functions; and possibly using other government departments to perform some of its support functions.

Stamp Duty

The temporary stamp duty holiday that the government announced during September 2008 ended on 1 January 2010. Stamp duty tax had been removed for properties worth between £125,000 and £175,000. The end of the stamp duty holiday means that the rate for properties between these values and up to £250,000 will revert to 1%.

Real Estate Finance Market

According to figures from the Bank of England, net lending to the commercial property sector was positive in November 2009 at £178m, a reversal of the negative net lending flows of more than £3bn in the previous seven months. During the third quarter of 2009, UK property funds delivered their first positive quarterly returns since the onset of the financial crisis, over three years previously, according to figures from the Investment Property Database (IPD). IPD figures also showed that the commercial property sector delivered in September the highest monthly price growth for more than three years, of 1.1%. These figures continued over the following couple of months, with November showing a rise on commercial property values of 2.4% and according to Cushman & Wakefield, investment in commercial property rose to £2.95bn in the final quarter of 2009, from £1.602bn in the third quarter. According to the CBRE Monthly Index, UK commercial property values continued to rise in 2010, increasing by 0.9% in January.

Figures from IPD show that the volume of property derivatives traded last year was the lowest since 2005 and retail property transaction volumes also fell during 2009, by 32% compared with figures for 2008, according to Jones Lang La Salle. However, PricewaterhouseCoopers have reported a 15% decline in property group insolvencies during the final quarter of 2010, representing a 12% year-on year, fall.

According to figures from the Halifax House Price Index, house prices rose by 2.8% in the third quarter of 2009, returning the average value of a property to the same level as at the end of the third quarter in 2008. House price rises continued, rising 0.9% in November, according to Land Registry figures and 1.4% in November and a further 1% in December, according to figures from the Halifax. The Royal Institute of Chartered Surveyors (RICS) figures have confirmed that demand for property is continuing to outstrip supply, which is contributing to the rise in house prices. During 2009, according to Nationwide, house prices rose by 5.9% in 2009, meaning the over the last decade since 1999 house prices have risen by 117%. According to figures from the Bank of England, mortgage approvals for new house purchases rose almost 5% in November 2009, the first time approvals have risen above 60,000 since March 2008. However, figures from the Bank of England showed that the number of new mortgages approved in December fell by 1.7%, the first fall in the number of new loans for 14 months.

Real Estate Finance

Real Estate Finance Cases

Charging orders

In the case of *Nationwide Building Society v Wright and another* [2009] EWCA Civ 811 the Court of Appeal gave important guidance concerning the effect of an individual's bankruptcy on a pre-existing charging order.

Facts: Mr Wright was adjudicated bankrupt in July 2006 and the estate, which vested in the trustee in bankruptcy, included Wright's share in a property. At the date when the bankruptcy order was made, Wright's share in the property was subject to a charging order in favour of Nationwide Building Society. The interim charging order was made before the presentation of the bankruptcy petition. Although the final order was made after the presentation of the petition, it was common ground that the Nationwide did not then know that the petition was pending. The judge also did not know about the pending petition when he made the final charging order and this was important because the judge would not have made the order if he had known there was a pending petition.

Wright's trustee in bankruptcy applied to discharge both the interim and final charging orders and the application at first instance was successful. Given the balance of interests and the nature of the assets available for distribution to creditors, the court considered it appropriate to exercise its discretion in favour of the trustee in bankruptcy. Nationwide appealed to the county court, which dismissed the appeal. The court held that it had a statutory discretion to discharge or vary a charging order when it considers, after proper consideration of the circumstances, that it is correct to do so. The court found that the lower court's decision was not outside the borders of that which a reasonable judge could reach.

Nationwide appealed to the Court of Appeal. The Court's guidance was sought on whether there was a clear legislative policy that, absent special circumstances, the interests of a judgment creditor, who has obtained the benefit of a final charging order before the commencement of the debtor's bankruptcy, should prevail over the interests of unsecured creditors in relation to the distribution of the bankrupt's estate.

Issue: Whether and in what circumstances a court should exercise its statutory power to discharge or vary a charging order where the debtor has been adjudged bankrupt, but the order was made before the bankruptcy began. Is a creditor entitled to retain the benefit of a charging order over land in the bankrupt's estate where the order predates the bankruptcy order?

Decision: The Court of Appeal held that the courts below were in error in failing to recognise and give weight to the legislative policy that a judgment creditor, who has obtained a final charging order before the making of a bankruptcy order, is not to be deprived of the benefit of his security by reason of the bankruptcy alone. The courts below were wrong to discharge the charging orders and Nationwide, therefore, succeeded in its appeal.

Restructuring and Insolvency

Restructuring and insolvency news

British Property Federation (BPF)

The **BPF** has launched a pre-pack questionnaire based on Statement of Insolvency Practice 16 which landlords can send to administrators. The aim of the questionnaire is enable landlords understand how a property is affected by the administration, uncover information about the buyer of the property and their plans for it and provide them with information which may enable them to challenge the pre-pack.

Office of Fair Trading (OFT)

On 12 November 2009, the OFT launched a market study into corporate insolvency. The study will look at the structure of the market, the appointment process for insolvency practitioners and will identify features in the market which may be harmful, for example high fees or lower recovery rates for certain creditor groups. R3 has announced that it welcomes the study and hopes that it will show that unfounded claims about high practitioner fees will stop as a result.

Restructuring and Insolvency Market

According to Deloitte, administrations across all sectors increased by 10% during the first nine months of 2009, compared to the same period in 2008. However, administrations across the property and construction sectors only rose 7% in the first 9 months of 2009, compared with the same period in 2008 and were down 14% in the third quarter of 2009, compared with the same quarter in 2008. According to Experian's Insolvency Index, the average business insolvency rate was 0.09% in September 2009, the lowest rate since September 2008, however, in contrast small businesses (those with 11 to 25 employees) saw an increase in insolvencies, rising from 0.21% in September 2008 to 0.26% in September 2009. Figures from the Institution of British Insurers show that trade credit insurers paid out £125m during the third quarter of 2009, an increase of £38m from the third quarter of 2008 and during the first three quarters of 2009, the UK saw an increase in retail insolvencies as the financial crisis shifted focus to the high street.

Figures from the Insolvency Service, showed that more than 134,000 individuals went bankrupt, entered into an individual voluntary arrangements or took out a debt relief order in 2009. This is a 26% increase on the figures for 2008 and is the highest figure since records began in 1960. Experts predict that these figures are likely to rise again this year as interest rates increase and more people become unemployed.

Restructuring and Insolvency

Restructuring and insolvency cases

Administration - payment of rent

In the case of *Goldacre (Offices) Ltd v Nortel Networks UK Ltd (In Administration)* [2009] EWHC 3389 (Ch) the question of whether administrators could use their discretion to determine whether they should pay rent as an expense of the administration was considered.

Decision: It was held that the payment of rent was discretionary and should be paid as an administration expense (in this case quarterly and in advance under the terms of the two leases) so long as the administrators retained or used any part of the demised premises for the purposes of the administration. The decision is controversial and gives rise to numerous questions on the responsibilities of administrators of tenant companies, not least as to the status of rent for the period from the date of administration to the next quarter date. Olswang acted for the landlord in this case and for more information in relation to this see [here](#).

'Anti-deprivation' principle

In the cases of (1) *Perpetual Trustee Co Ltd* (2) *Belmont Park Investment Pty Ltd v (1) BNY Corporate Trustee Services Ltd* (2) *Lehman Brothers Special Financing Inc: (1) Daniel Francis Butters* (2) *Neville Barry Kahn* (3) *Nicholas James Dargan (Joint administrators of WW Realisation 8 Ltd & Woolworths Group plc) v (1) BBC Worldwide Ltd* (2) *Entertain Ltd* (3) *BBC Video Ltd* [2009] EWCA Civ 1160 the 'anti-deprivation' principle was considered i.e. would creditors be prejudiced by the switch of priority as it may reduce the assets available for distribution to them? The two cases were considered together as they concerned the same issue.

Facts: The facts of the Perpetual Trustee case were summarised in the [August 2009 Finance Update](#). The appellants appealed on the basis that the judge had been wrong to conclude that the 'anti-deprivation' principle did not apply.

In the BBC case, a joint venture agreement was entered into between W and the BBC. When Woolworths went into administration the BBC gave notice to W, in accordance with the joint venture agreement, requiring W to sell its shares in the joint venture to the BBC, at a fair value, taking into account the termination of a linked licensing agreement. At first instance it was held that parts of the joint venture agreement and licensing agreement, which cross-referenced one another, infringed the 'anti-deprivation' principle but that this could be remedied by deleting these cross references. W's administrators appealed and the BBC cross-appealed.

Decision: Both appeals were dismissed and the cross appeal by the BBC was allowed. In relation to the Perpetual Trustee case it was held that the 'anti-deprivation' principle did not apply to the reversal of the order of priority provisions in the documentation because it did not remove property from the insolvent company, it just altered a right given to that company without giving some creditors an unfair advantage over other creditors. In the BBC case, it was held that a provision which terminates a license upon a

licensee's insolvency did not contravene the 'anti-deprivation' principle, therefore the provision for determination of the licensing agreement was not invalid.

Banking (Special Provisions) Act 2008

In the case of *R (on the application of Kaupthing Bank HF) v HM Treasury* [2009] EWHC 2542 (Admin) it was held that the Treasury had acted lawfully in making the **Kaupthing Singer & Friedlander Limited Transfer of Certain Rights and Liabilities Order 2008** (Order) pursuant to section 6 of the **Banking (Special Provisions) Act 2008** (Act).

Facts: Kaupthing (K), as parent and 100% shareholder of Kaupthing Singer & Friedlander (KSF), applied for judicial review of the Order made in October 2008 by the Treasury.

During September 2008 the world financial system was under severe stress and the effects were particularly severe on the Icelandic banks creating a growing concern about their ability to fund their liabilities. On 30 September there was a £37m outflow of deposits from KSF, which led to a 'code red' being declared in relation to KSF's liquidity contingency plan and this meant that there was some uncertainty as to whether KSF would be able to meet all its commitments over the following week. It also meant that KSF was required to drawdown under a £1.1bn deposit arrangement it had with K, however, K was unable to honour this agreement. Therefore, KSF breached its liquidity requirements and it was downgraded by the major credit rating agencies. KSF and the FSA agreed a cash raising plan at the start of October, a few days later the FSA imposed further requirements on KSF, including the ring fencing of certain deposits. On 6 October share trading in the Icelandic banks was suspended, the Icelandic Government enacted legislation to guarantee deposits in Icelandic branches of the banks and the Icelandic currency plunged in value against the euro. K promised funding to KSF, however the funds did not arrive. After email correspondence over the course of the following couple of days the Treasury issued the Order.

Issues: K argued that the Treasury had overreacted and that following this case it intended to claim for damages under the Human Rights Act 1998. K stated that the Order was not made for the purposes specified within the Act and that the Treasury had failed to identify a specific threat to the stability of the UK financial system as a result of KSF's problems.

Decision: It was held that the Treasury had considered the consequences of a failure of KSF and the Order was made within the purposes set out in the Act to protect the stability of the UK financial system. Therefore, the grounds for K's challenge of the Order had no substance and the application was dismissed.

Insolvency – interpretation of contract

In Re Sigma Finance Corporation (in administration) [2009] UKSC 2 the Supreme Court reiterated the need to avoid giving an over-literal interpretation of one provision of a commercial contract, without regard to the context of the agreement as a whole.

Facts: The company was a structured investment vehicle (SIV) established to invest in certain types of asset-backed securities and other financial instruments. It aimed to profit from the difference between the cost of funding its activities and the returns made on its investment portfolio. The company's assets were secured in favour of its secured creditors upon the terms of a security trust deed (STD) made between it and its security trustee. The STD provided that in that event of an enforcement event, such as the company anticipating entering liquidation, there should be a 60-day realisation period, during which the security trustee should use the company's assets to create, so far as possible, two pools of funds relating

to its short and long term liabilities. Clause 7.6 of the STD provided that: "*During the Realisation Period the Security Trustee shall so far as possible discharge on the due dates therefore any Short Term Liabilities falling due for payment during such period, using cash or other realisable or maturing Assets of the Issuer*".

The company received margin calls that it could not honour. Its board resolved that it could no longer continue in business and it informed the security trustee that it had resolved that there was no reasonable likelihood of it avoiding insolvent liquidation. The security trustee appointed receivers.

A dispute then arose between various classes of creditors as to the correct application of the STD where the company had insufficient funds to satisfy all its creditors and had failed to meet a margin call. Parties A and B submitted that the assets fell to be distributed preferentially to the creditors in respect of certain debts, with party A contending that the assets were to be distributed according to the dates when the relevant debts became due, while party B argued that all debts falling due in, or prior to the realisation period were part of a single pool, within which the company's remaining assets fell to be distributed *pari passu*. Parties C and D maintained that the company's remaining assets fell to be allocated equitably as between short and long term liabilities and that, having been so allocated, its short term liabilities fell to be distributed *pari passu* in relation to each other, and that its long term liabilities fell to be treated likewise in relation to each other.

The judge at first instance and the CA (by a majority) construed clause 7.6 as meaning that the remaining assets fell to be distributed preferentially to the creditors whose debts fell due during the realisation period, with distribution to be made according to the dates when payment became due, essentially party A's case. Parties B, C and D appealed.

Decision: The appeal was allowed. The principles upon which a court should interpret a document, such as the STD, were not in doubt. In this case the focus was on the general nature of the business involved and upon the scheme and wording of the STD read as a whole. The document was one which would be expected to have a consistent meaning as between all parties to whom it applied. The CA's conclusion attached too much weight to what the court perceived as the natural meaning of the words of one sentence of clause 7.6 and too little weight to the context in which that sentence appeared and to the scheme of the STD as a whole.

The resolution of an issue of interpretation in a case like this was an iterative process, involving "*checking each of the rival meanings against other provisions of the document and investigating its commercial consequences*". It was appropriate to exercise judgment in relation to the weight capable of being placed on the STD. The STD was a long and carefully drafted document, containing sentences or phrases which it could, with hindsight, have been made clearer, if the meaning now sought to be attached to them had been specifically considered at the time of drafting. Of much greater importance in ascertaining the meaning that the STD would convey to a reasonable person with the relevant background knowledge was an understanding of its overall scheme and a reading of its individual sentences and phrases which placed them in the context of that overall scheme. Clause 7.6 appeared in the STD in the context of an assumption that the company would retain sufficient assets to cover its secured creditors. It was not intended to deal with a situation requiring the application of priorities between creditors. It was improbable that clause 7.6 could be read as extracting from the short term pool debts which fell due during the 60-day realisation period so as to give priority over other creditors. It was also improbable that the parties would have contemplated priorities being conferred by the fortuitous timing of debts falling due during the realisation period. Clause 7.6 was an ancillary provision which did not override the trustee's absolute

discretion as to the manner in which assets were to be realised. The reasonable person's understanding of clause 7.6 was aided by a clear basic scheme that debts arising during the realisation period were to be part of the short term pool of creditors with the assets to be distributed equitably amongst all the creditors at the discretion of the trustee.

Insolvency – trading losses

In the matter of E D Games Limited [2009] EWHC 233 (Ch) the issue of whether a trading loss was recoverable under section 212 of the Insolvency Act 1998 (IA) was considered.

Facts: ED dealt with computer leisure products and went into creditors' voluntary liquidation in October 2002. The liquidators sought an order, under section 212 IA, that a former director (C) of ED should contribute a sum to ED's assets as he breached his fiduciary duties to ED, as he caused ED not to pay VAT in the months before it went into liquidation. This in turn meant that the company traded for longer and therefore the money owed to the creditors of ED was greater. C applied for the claim to be struck out, or for summary judgment to be awarded, on the basis that section 212 only allowed for recovery of losses sustained by the insolvent company and that any loss resulting from his actions was a loss to ED's creditors and not to ED.

Decision: It was held that a trading loss was capable of being a loss to the company under section 212 IA. In this case the money ED did not pay in tax funded ED to continue to trade and this trading increased the shortfall on ED's balance sheet, meaning a greater shortfall for ED's creditors. This amounted to a loss to ED. Therefore, C's application was dismissed. However, the judge expressed doubts as to how the liquidator may identify and quantify the precise losses involved.

Scheme of arrangement – Part 26 Companies Act 2006

In the matter of Lehman Brothers International (Europe) (in administration) [2009] EWCA Civ 1161 it was held that a proposed scheme of arrangement involving the compromise of claims to assets held on trust did not fall within Part 26 of the Companies Act 2006 and therefore could not be authorised by the court.

Facts: This case followed earlier cases (see the [May 2009 Finance Update](#) and the [September 2009 Finance Update](#)). The administrators appealed against the High Court decision that the scheme of arrangement was not directed at trust clients in their capacity as creditors, so Part 26 of the Companies Act 2006 did not apply. The administrators argued that as long as the proposed scheme was between L and some parties who had a claim as a creditor of L, the court could approve the scheme, even though it would include all the claims of the trust clients.

Decision: The appeal was rejected. Part 26 did not allow a company to compromise the claims of parties who had proprietary interests in the assets of a company, even if those parties were also creditors.

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

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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.

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OLSWANG

London
Olswang LLP
90 High Holborn
London WC1V 6XX
T +44 (0) 20 7067 3000
F +44 (0) 20 7067 3999

Thames Valley
Olswang LLP
Apex Plaza, Forbury Road
Reading RG1 1AX
T +44 (0) 20 7067 3000
F +44 (0) 20 7071 7499

Berlin
Olswang LLP
Potsdamer Platz 1
D-10785 Berlin
T +49 (0) 30 700171-100
F +49 (0) 30 700171-900

Brussels
Olswang LLP
Avenue Louise 326 bte 26
Louizalaan 326 bus 26
B-1050 Bruxelles/Brussel
T +32 2 647 4772
F +32 2 644 2165