

Finance Update

September 2009

OLSWANG



General Finance



General Finance News

Bank Capital

At meeting of the Bank for International Settlements, the central banks represented agreed that banks' capital requirements should be increased in order to reduce the probability of economic crises in the future. However, no timeline has been set for detailing and implementing these proposals.

On 27 July, the European Commission adopted [Directive 2009/83/EC](#), which amends certain provisions in the Capital Requirements Directives ([2006/48/EC](#) and [2006/49/EC](#)). This new Directive details, among other things, how financial institutions need to clarify and explain how they have transferred risks from their balance sheets.

Companies Act 2006

Various legislation and guidance has been published in relation to the Companies Act 2006, including the following:

- the [Financial Collateral Arrangements \(No.2\) Regulations 2003 \(Amendment\) Regulations 2009](#) were published on 10 September. These Regulations make a number of consequential amendments to the [Financial Collateral Arrangements \(No.2\) Regulations 2003](#) to incorporate the provisions of the Companies Act 2006 which come into force on 1 October 2009. These Regulations also come into force on 1 October 2009;
- the [Companies Act 2006 and Limited Liability Partnerships \(Transitional Provisions and Savings\) \(Amendment\) Regulations 2009](#) and accompanying explanatory memorandum were published on 15 September 2009. These Regulations, among other things, amend some of the transitional provisions in the [Eighth Commencement Order](#) to clarify certain provisions in relation to *bona vacantia* property of a dissolved company. These Regulations come into force on 1 October 2009; and
- on 14 September, the Department of Business, Innovation and Skills published non-statutory guidance in relation to some of the changes coming into force on 1 October 2009. This guidance, among other things, sets out the differences between the new model articles under the Companies Act 2006 and Table A of the Companies Act 1985 and also states that when companies amend their articles of association on or after 1 October 2009, the Company can append the copy of the old style memorandum, indicating the provisions now deemed part of the articles, when these are filed at Companies House.



G20

Prior to the G20 Pittsburgh meeting to be held at the end of September, the G20 finance ministers met in London for a 2 day summit at the beginning of September. This meeting was held to discuss the role of international financial institutions and how to withdraw certain of the policies and support given to the financial sector over the past year. The meeting also considered how both national and international regulation could be improved in the future.

On 24th and 25th September, Pittsburgh hosted the **G20 summit** of world leaders from countries representing 85% of the world's economy. At the summit, among other things, these leaders assessed the progress made since previous summits in addressing the global economic crisis and discussed further actions to assure a sound and sustainable recovery from this economic crisis.

International Organisation of Securities Commissions (IOSCO)

On 17 August, IOSCO published its **quarterly update**. The main items covered in this update were hedge funds, short selling, asset-backed securities and unregulated markets and products.

On 4 September, IOSCO published its **final Regulatory Recommendations on Securitisation and CDS Market**. This report included recommendations on:

- wrong incentives in the securitisation market – recommending requiring originators and/or sponsors to retain exposure to the relevant securitised products and recommending enhanced transparency through greater disclosure to investors of these products;
- inadequate risk management practices – recommending provision of regulatory support to enhance disclosure to investors, including on-going information about underlying assets, as well as encouraging investor education to assist in understanding complex financial products;
- regulatory structure and oversight issues – recommending that jurisdictions should reassess their regulatory structure in relation to securitised and CDS products; and
- counterparty risk and lack of transparency – recommending standardising CDS contracts and improvements with regard to disclosure of CDS data.

Limited Partnerships

On 11 August, the **Limited Partnerships (Forms) Rules 2009** were published. These Rules will replace most of the provisions of the **Limited Partnerships Rules 1997** and will replace the forms which are to be used for registering limited partnerships and registering changes to existing limited partnerships. These Rules will come into force on 1 October 2009.



The Companies (Disqualification Orders) Regulations 2009

The **Companies (Disqualification Orders) Regulations 2009** (SI 2009/2471) come into force on 1 October 2009. The Regulations, which are made under s18 of the Company Directors Disqualification Act 1986 (CDDA), apply to any disqualification order made after that date. The CDDA gives specified courts the power to make a disqualification order against any person, preventing them from acting as: a director of a company; a receiver of a company's property; a promoter of a company; or an insolvency practitioner. The 2009 Regulations (which effectively consolidate, with minor amendments, the Companies (Disqualification Order) Regulations 2001) require certain court officers to provide the Secretary of State with particulars of disqualification orders and grants of leave in respect of such orders and of any action taken by a court to vary or revoke an order.

Unregistered Companies Regulations 2009

The **Unregistered Companies Regulations 2009** (SI 2009/2436) come into force on 1 October 2009. They are intended to regulate and consolidate in one place the application of the Companies Acts to unregistered companies, with the effect that the legislative position in relation to such companies remains the same as it did under the Companies Act 1985. The 2009 Regulations will achieve this by applying provisions of the Companies Act 1985 which have not been repealed as well as specified provisions of the Companies Act 2006. The Government intends to review the application of company law to unregistered companies in 2010.

Interest Rates

On 10 September, the Bank of England announced that interest rates would again be held at 0.5% and that it would continue with the £175 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 3 September, the European Central Bank held interest rates at 1% across the euro zone and on 11 August, the US Federal Reserve announced that interest rates would remain on hold at their current rate between 0% and 0.25%. It also said that it would continue its present level of purchases of long-term government debt, aimed at increasing lending and money supply.

World markets

There have been positive signs over the last month of economic recovery on both sides of the Atlantic. Bank of England figures published at the end of August showed that gross domestic product will rise by 0.2% during the third quarter of this year, the first rise since the start of 2008. The Bank of England has also forecast that Britain will grow by 1.3% next year. The Organisation for Economic Co-operation and

General Finance



Development (OECD) figures indicated that the UK progressed from being in a 'trough' in June to 'recovery' in July. The OECD also stated that there were signs of recovery in all G7 economies. In the UK the Chartered Institute of Purchasing and Supply reported figures of 54.1 for the services sector in August (a figure above 50 is indicative of an expansion in this sector). Following publication of these figures at the start of September, sterling rose against the dollar and the euro, but has since fallen back.

However, the International Monetary Fund has reduced its predictions for a recovery in the UK economy this year, despite raising its predictions for global growth. This has been backed by recent figures showing that manufacturing output in the UK fell during August and the OECD has forecast that Britain is likely to be the only major economy not to grow during 2010. Despite signs of recovery, unemployment figures in the US reached a 26 year high in August and the threat of deflation still lingers, as consumer prices in the US fell 2.1% in the year to July.

Lending by UK banks fell by £8.4bn in July, the largest monthly fall since records began in 1997, as banks held on to funds in fear of increasing bad debts. There have been reports that the Bank of England may reduce the interest rates paid to banks on their reserves with the central bank, in an effort to reduce hoarding and get banks lending again.

Finally, the UK's public sector net borrowing increased to £8bn during July, the first July deficit for 13 years. This raised public debt to £800bn, equivalent to £13,000 for every person in the UK.

General Finance



General Finance Cases

Execution

In the case of (1) *Alan Lovett* (2) *Geoffrey Lambert Carton-Kelly v (1) Carson Country Homes Ltd* (2) *Barclays Bank plc* (3) *Registrar of Companies* (4) *Andrew Alexander Jewson* (5) *Edward Charles Carter* [2009] EWHC 1143 (Ch) it was held that although one director had forged the signature of another director on security documents in favour of the bank, the documents were still valid under s44 Companies Act 2006.

Facts: The administration of CCH was divided between its two directors (C and J). C dealt with the practical aspects of CCH and J dealt with all the financial matters. Over the years J had often signed documents on C's behalf, replicating his signature, as this was seen as an efficient means of running the company as long as C was informed of all the documents signed in this manner. B had become concerned about the financial situation of CCH and requested additional security from the company. At a meeting between J and B it was agreed that this security would be given and the relevant security documents were returned to B executed by both C and J. The relationship between C and J deteriorated. B sought to enforce its security and appointed administrators over CCH under the security documents. C claimed that his signature on the document had been forged and therefore the administrators were not validly appointed.

Issues: Did J have authority to sign the documents on C's behalf? If the documents had not been validly executed could B rely on s44 Companies Act 2006 to bind CCH?

Decision: It was held that J did not have authority from C to sign the security documents on his behalf, however, B was a bona fide purchaser for value for the purposes of s44. This section still applied where the signatures on a document were a forgery and B was considered purchaser as they obtained an interest in the property for valuable consideration as in this case B agreed not to take enforcement steps against CCH on the provision of the additional security. As it was common practice for J to sign documents on behalf of C, J was held to have ostensible authority to act on behalf of C and therefore B could rely on the documents as being genuine.

Comment: Emphasis in this case was put on the fact that J had often forged C's signature on documents in the past with C's permission, the outcome may have been different if this had not been the case. However, it does highlight the effectiveness of s44 Companies Act 2006 in protecting a bona fide purchaser for value and banks can draw some comfort from this when documents are not executed in front of them.



Valuation of shares

The case of (1) *SRM Global Master Fund LP* (2) *RAB Special Situations (Master) Fund Ltd* (3) *Dennis Grainger & Ors v Treasury Commissioners* [2009] EWCA Civ 788 considered the fairness of the basis on which shareholder compensation was to be assessed following the nationalisation of Northern Rock (NR).

Facts: The assumptions, to be made to assess the compensation payable to the shareholders, were that the bank was unable to continue as a going concern and was in administration. It was argued that this was unfair as if assessed in this way the shares in NR would be valued as almost worthless, despite the net assets which NR held when the bank was nationalised, thereby effectively retaining all the value in NR for the taxpayers at the expense of the shareholders. This was stated to be a breach of the shareholders' human rights, primarily being inconsistent with Article 1 of the First Protocol to the European Convention on Human Rights.

Issues: Did the scheme for valuation breach the shareholders' human rights? Should the failures of regulatory authorities be taken into account when assessing the compensation payable to the shareholders?

Decision: The appeal was dismissed. Nationalising NR was undertaken in order to stabilise the UK's economy as no other party was willing to support NR at that time. The basis of the compensation scheme was to put the shareholders in the same position as they would have been had the government not nationalised and the Bank of England not funded NR. There was no underlying motive on behalf of the government to make a profit at the expense of the shareholders. Therefore, the shareholders' human rights had not been breached. The failures of the regulatory authorities were not held to be relevant as it had not been shown that these failings caused the shareholders' losses.

Comment: It is likely that the shareholders will seek leave to appeal to the House of Lords and possibly from there to the European Court of Human Rights. Therefore, the compensation scheme and the amount due to the shareholders is far from settled.

Real Estate Finance



Real Estate Finance News

Land Registry

On 18 August, the Land Registry published its **annual report and accounts for 2008/2009**. This sets out details of the performance of the Land Registry and their employees over the year and included some of the achievements of the Land Registry throughout the year, for example the changes to the Land Registration Rules and the fact that the number of titles held on the Land Registry's database has now reached 22,000,000.

Real Estate Finance Market

According to Savills, August this year showed the first rise in commercial development activity since October 2007 and according to the latest Investment Property Forum Consensus Forecast Survey optimism in the commercial property market has also grown over the last few months. The IPD UK Monthly Index reported 0.2% capital growth for the UK property market in August, the first rise in 26 months, and BDO Stoy Hayward have reported that the number of commercial property transactions throughout June and July remained constant at around 8,000 per month. However, King Sturge have reported that office take-up in London was down by 40% in the first half of 2009 and Moody's have stated that they expect further future losses on UK banks' balance sheets from commercial property transactions.

According to Halifax, residential house prices rose by 0.8% during August, bringing the average price of a home to around the same level as at the end of last year. At the beginning of September, Nationwide also reported a rise in house prices in August, the fifth time Nationwide has reported a rise in house prices over the last six months. According to RICS, optimism has returned to the residential housing market and the number of surveyors reporting a rise (instead of a fall) in house prices was the highest percentage since May 2007. According to the British Bankers' Association, mortgage approvals have risen to the highest number since February 2008 but the gross value remained down by 39% year on year and according to figures from the Financial Services Authority the value of new mortgages at high loan to value ratios of 90% or more fell from 4% in the first quarter of 2009 to 3% in the second quarter. The Financial Services Authority has also expressed concerns in relation to the large number of homeowners on interest only mortgages and the fact that many of these homeowners may have inadequate capital to repay the principal sum outstanding on their mortgages.

Restructuring and Insolvency



Restructuring and insolvency news

During the second quarter of 2009, there were 5,550 corporate insolvencies in England and Wales, an increase of 2.9% on the previous quarter and an increase of 40% year on year, according figures from the Insolvency Service.

Begbies Traynor, the restructuring specialists, have published a survey showing that over the second quarter of 2009 the number of companies with significant financial problems rose 43% year on year, primarily in the recruitment, engineering and manufacturing sectors. Insolvency specialists have also forecast a large number of restructurings during September and October as companies use their working capital to stock up for the festive period and come under pressure to meet year-end financial covenants.

According to figures from the Ministry of Justice, 26,215 repossession claims were issued against homeowners in the second quarter of 2009 compared to 38,832 in the second quarter of 2008, a 32% reduction. It is claimed that this is partially due to government measures preventing home repossessions and low interest rates, which mean that arrears increase less quickly.

The debate surrounding pre-packs continues, with retail landlords campaigning to make pre-pack administrations more transparent and the Association of British Insurers calling on the Insolvency Service to enhance SIP 16, to ensure compliance and to stop the same insolvency practitioner advising a distressed company both before and after administration.

According to RICS, there has been a rise in the number of distressed commercial properties entering the market in every region of the world in the second quarter of 2009 despite low interest rates and RICS predicts that a fall in rental income and a rise in corporate insolvency will further increase the number of distressed properties in the market during the second half of 2009.

Restructuring and Insolvency



Restructuring and insolvency cases

Auditors' liability

The case of *Stone & Rolls Ltd (in liquidation) v Moore Stephens (a firm) and another* [2009] UKHL 39 considered auditors' duty of care liabilities.

Facts: S (the sole director and shareholder of C) used C as a vehicle for defrauding banks of millions of dollars. When the fraud was discovered, the principal victim successfully sued C for deceit and was awarded substantial damages. Neither C nor S could satisfy the judgment and C went into liquidation. C's liquidators brought an action in C's name and on behalf of C's creditors for breach of duty in contract and tort against D (C's auditors). C alleged that D's breach of duty in failing to spot the fraudulent activity had prolonged the period during which such activity had taken place and therefore D was liable for the losses incurred as a consequence of that extended period. D applied to strike out the claim and submitted that the action could not succeed because it was founded on C's own fraud. At first instance D's application was rejected, however, the Court of Appeal allowed D's appeal. It ruled that since C was a fraudster under the total control of another fraudster (S) and was party to, and not itself a victim of, the fraud, D owed no duty of care to C to take reasonable care to detect its fraud and therefore the claim ought to be struck out. C appealed to the House of Lords.

Decision: A 3-2 majority of the House of Lords dismissed the appeal, holding that the court would not assist a one-man company to recover losses which had been brought about by its own fraud. S was C's beneficial owner and its directing mind will and S's fraudulent conduct was to be treated as the conduct of C. As S and C were effectively the same person, there was no innocent participator who did not share the guilty knowledge and an individual who for fraudulent purposes ran a one-man company could not obtain an advantage by claiming that the company was not a fraudster but a secondary victim.

The majority also rejected C's argument that the public policy defence ought not to bar claims brought by a company in insolvent liquidation where the creditors were innocent parties who had been defrauded by S: if that were right, it would create a large gap in the public policy defence since most fraudsters (individual and corporate) became insolvent sooner or later and had liabilities to those whom they had defrauded. Had S carried out his frauds directly, neither he nor his trustee in bankruptcy could have resisted the public policy defence. There was no good reason to apply a different rule to a company in liquidation: apart from special statutory claims in respect of misfeasance, wrongful trading etc., it could not assert any cause of action which would not have been available to it before the commencement of its liquidation, and that was especially true in the context of the duties of an auditor which were not owed to a company's creditors.

Comment: Their Lordships' opinions contained potentially significant views on a possible extension of auditors' duty of care beyond the boundaries laid down in *Caparo Industries plc v Dickman* [1990] 2 AC 605. Some of the dissenting opinions were in favour of extending the duty to include the interests of (defrauded) creditors, in particular where auditors have failed to pick up a fraudulent scheme rendering the company increasingly insolvent.

Restructuring and Insolvency



Schemes of arrangement – Companies Act 2006, Part 26

In the matter of Lehman Brothers International (Europe) (in administration) (No. 2) [2009] EWHC 2141 a scheme of arrangement proposed by the administrators was considered.

Facts: The administrators reported that one of the major obstacles to the completion of the administration process was the huge volume of securities held by L in trust for clients. These included prime services clients, those who had deposited securities with L under safe custody arrangements and market counterparties who had posted collateral with L. Not only was there is a huge volume to be dealt with, but the problem was also said to be compounded by deficiencies in L's records and a significant number of clients who had yet to respond to the administrators' requests for statements of what clients understood their own asset positions to be.

This led the administrators to propose a scheme of arrangement which would have provided a system for the resolution of each trust client's position and for analysing any shortfalls in securities over which more than one client had a claim. It would also have included a bar date by which trust client claims were to be submitted so that the scheme would then have been free to proceed.

It was argued for the administrators that the scheme would be confined to clients who not only had proprietary claims but also had pecuniary claims. This gave a potential hook whereby the clients in question could be said to be creditors and therefore covered by s895 of the Insolvency Act 1986, the statutory provision enabling such a scheme.

Issue: Could the court authorise such a scheme in respect of assets which were not the property of the company in administration but simply held in trust for clients?

Decision: The judge identified three reasons in particular why the proposed scheme would interfere with the proprietary rights of trust clients. First, clients in the scheme would have to renounce their rights to particular batches of securities which had been bought in their name and instead claim against a pool of identical securities, potentially resulting in a shortfall. Secondly, the bar date might cause the client to lose its property altogether. Thirdly, each client would be required to provide a series of warranties as a condition of having its property back.

He went on to find that while the scheme would have involved settlement of some aspects of trust clients' pecuniary claims, it was abundantly clear that the scheme was largely concerned with L discharging its obligations concerned with holding trust clients' property, including in particular the obligation to return that property to its owners. Those property rights were enjoyed quite independently of any personal claims which those clients might have against L arising out of its defaults. In conclusion, the scheme was not directed at trust clients in their capacity as creditors and the statutory regime for a scheme of arrangement did not apply.

Restructuring and Insolvency



Comment: Media reports have speculated that as a result the administration could take many years longer than it would have done under the scheme. The administrators plan to appeal, so the matter may not be at an end.

In the matter of Bluebrook Ltd: In the matter of IMO (UK) Ltd: In the matter of Spirecove Ltd [2009] EWHC 2114 (Ch) mezzanine lenders have had their objection to a scheme of arrangement designed to restructure a group of companies rejected.

Facts: B was a group of companies which operated an international car wash business. B owed approximately £313m to the consortium of senior lenders (S) and approximately £119m to the consortium of mezzanine lenders (M). S and M had entered into subordination arrangements of the sort commonly implemented in transactions of this nature. The subordination arrangements included ranking of the debt both pre-and post-insolvency, a turnover clause, ranking of the proceeds of an enforcement of security, and an option for M to buy out S at par. B's fortunes started to suffer in 2008 and the downturn of trading continued into 2009. B breached certain financial covenants under the senior credit agreement. B failed to pay interest of £13.6m to S and £5.4m to M. Although B was still trading, and was capable of trading profitably on its trading activities, B was balance sheet insolvent. However, due to standstill arrangements entered into with S and M, B was able to continue to meet its immediate needs and trading liabilities from cash reserves. S and M accepted that a restructuring was required and B's board of directors entered into negotiations with both S and M. B agreed a plan which involved S giving up some of their debt in exchange for equity, with the business of the group being transferred to a new corporate structure containing new companies in order to achieve that. The new group would be principally owned by S; the existing group would not retain an interest in the business. At one stage in the negotiations there was a proposal to allow M to participate in the form of share warrants, but that was abandoned.

Issues: M objected to the scheme under seven heads, not all of which are considered in this summary. The principal objections were that a proper view of the value of B demonstrated that there was a realistic possibility that it had a value which exceeded the senior debt, so that B had real value to M notwithstanding their subordination; and that value was being lost to M because the assets were being stripped out for the benefit of S. As such the scheme was part of a restructuring that was unfair to the creditors of B (other than S). In arguing that the scheme treated them unfairly M relied on a valuation which, they argued, demonstrated that they had a "relevant economic interest" and sought to discredit alternative valuations which S had relied on which showed that the "value broke" in the senior debt.

Decision: The Court analysed the pros and cons of the various valuation methodologies and criticised M's valuation as a statistical analysis, conducted by a computer, in order to assess the statistically most likely outputs for variations in a range of inputs which can be quite wide. The Court asserted that "a proper approach to valuation in a case such as this requires some real world judgments as to what is likely to happen (such as a judgment as to the correct weighted average cost of capital), rather than a range to which other ranges are applied in a series of random calculations to come up with some mechanistic probability calculations".

Restructuring and Insolvency



The Court accepted that all valuation exercises have their drawbacks, but preferred S's analysis as it was made on the basis of clearly articulated assumptions, based on professional and expert judgments as to which are appropriate in the circumstances (those judgments sometimes encompassing a limited range).

In order to support the allegation of unfairness, M highlighted that the directors of an insolvent company do not only owe duties to particular sections of the creditors. M suggested that B was acting in the interests of one section of the creditors at the expense, or to the detriment, of the creditors as a whole.

The Court noted that in fact B had entered into arrangements with the section of secured creditors who had priority over subordinated creditors who, on the facts known to them, would not have any interest in the assets because of their subordination. The Court also stated that B's directors were assisting in a disposal on a going concern basis in the interests of B, because it procured a greater level of discharge of debt than would be the case on a break-up or insolvency disposition.

The Court held that M had no right to be included in the scheme, as on the basis of the valuations provided, they had no economic interest in the companies, that the scheme did not unfairly impact on the rights of creditors outside of the class of creditors to which the scheme applied, and there was no realistic alternative to the proposed scheme other than a full-blown enforcement which would be of less benefit to the companies and S. Therefore, the Court approved the scheme.

Comment: The case is seen as a victory for senior lenders in that it provides a useful practical route to a restructuring where there is unanimous approval amongst the senior lenders. The case also provides notable analysis on what a court expects from a valuation.

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