

# Finance Update

Welcome to Taylor Wessing's January 2006 update summarising what we think are the more interesting recent legal developments in banking and finance.

## Banking: Material Adverse Change

Although the material adverse change (or "MAC") event of default wording is often the subject of heated negotiation, it is very rare for banks to rely on the clause and even rarer for such reliance to be the subject of litigation. It was therefore interesting to see that the Supreme Court of Victoria last year considered a bank's right to rely on its MAC clause. Whilst the decision has no binding effect on any English court, decisions of the courts in Australia and New Zealand are often cited, especially where there is little or no English judicial authority on the subject.

### The Facts

A company borrowed money from Westpac to purchase a supermarket business. At the same time, its sole director, Cai, borrowed to purchase the supermarket property and guaranteed the company facility, the guarantee being secured on the supermarket property. The facility was provided on Westpac's general terms, which included the right to call a default and terminate the facility if 'in the opinion of the Lender there is a material adverse change in or affecting any Security, or the business, capital, assets or financial condition of any one or more of [the borrowers] or anyone who gives a Security;' Four years after the facility was put in place, the Director of Public Prosecutions obtained a restraining order preventing any person from dealing with the supermarket property owing to allegations of breach of the law relating to tobacco sales. Notice was served on Westpac to the effect that any withdrawal of funds from an associated account for which the property was security would be a dealing with the supermarket property and therefore in breach of the order. As the tobacco law breach risked the supermarket losing its packaged liquor licence and would possibly result in its supermarket franchise agreement being terminated and as the bank could no longer permit the facility to be drawn down, Westpac considered there had been a material adverse change to the business of the borrower and affecting the Security. It therefore served notice to this effect and made demand on the borrower and guarantor who promptly applied for an injunction restraining the bank from terminating the facility.

The judge considered the existence of the restraining order made it reasonably open to the bank to form the opinion it said it did and the evidence supported the fact that it had formed such an opinion. As a result the bank was held to be entitled to withdraw the facility and make demand.

### Comment

The judgment is not particularly long or reasoned but does provide useful guidance as to how a bank can rely on this type of clause. Essentially the judge suggests a subjective objective test in that the bank has to form the opinion, and the formation of such opinion must be reasonable. When acting for a borrower one would always try to insert a 'reasonable' to qualify the exercise of its opinion by the bank but it seems, on the basis of this judgment at least, even if one does not do so, the court would do it for you. Banks traditionally dislike qualifying the exercise of their judgment in this way as it opens up the argument as to whether or not they were reasonable, thereby potentially delaying the bank's ability to exercise its rights. However, it might be that this case makes banks more amenable to the amendment, at least in relation to the MAC clause.

*Cai & Ors v Westpac Banking Corporation [2005] VSC 317*

## Administrative Receivers: The ability to rely on the project finance exemption

One of the few exceptions to the rule that an administrative receiver can no longer be appointed post Enterprise Act is section 72E Insolvency Act 1986 which permits the appointment of an administrative receiver in relation to a project company which is a financed project and includes step in rights. Unfortunately little guidance is provided as to precisely how these requirements should be interpreted. However, the Court of Appeal has confirmed the decision last year in *Feetum and ors v Levy and ors* (reported in the May 2005 Update) on the interpretation of the term 'financed' project and some clarification as to what is meant by step in rights.

The legislation provides that a project is 'financed' if under an agreement relating to the project, a project company incurs or, when the agreement is entered into, is expected to incur, a debt of at least £50 million for the purposes of carrying out the project. The decision confirmed that the assessment of whether the project company was expected to incur the debt was to be assessed at the time the facility agreement was entered into and that the expectation must be assessed with as much objectivity as possible so that a facility offering 'up to' the required amount with no real expectation that such amount could or would ever be drawn will not satisfy the requirements. The court also reiterated that the ability to appoint an administrative receiver did not constitute step-in rights since otherwise there would have been no need to refer to such rights in the exception. However the courts declined to provide a precise definition. The High Court had also ruled that a project was not limited to a construction or engineering operations and could include, as in this case, the development of technology but unfortunately this was not subject to the appeal and therefore was not considered by the Court of Appeal.

*Cabivision v Feetum & ors [2005] EWCA Civ 1601*

## Contract: Be careful if you spot errors in the other side's drafting

When negotiating a contract, sometimes one sees wording inserted where the other side has got its drafting muddled and the amendment actually works to your advantage rather than against. The temptation is to feel a bit smug and leave it as is. However, a recent decision by the Court of Appeal suggests you should in some cases resist the temptation.

### The Facts

In the case, the landlord's solicitor inserted a proviso to a notice in a new lease based on a previous lease. The tenant's attention was not drawn to the amendment but fortunately his solicitor was diligent and spotted the change had been made. The solicitor understood the intention behind the amendment and apparently thought the landlord's solicitor was 'trying it on' but did not delete it as he realised that, when read literally, the landlord's solicitor had got it wrong so that the proviso applied to the landlord's notice rather than the tenant's. Unfortunately for him, the landlord successfully obtained an order that the proviso should be read so that it did apply to the tenant's notice after all.

### Comment

The tenant's solicitor clearly would have made every effort not to agree the amendment had it been drafted correctly, yet by keeping silent, in the end the amendment was imposed on his client without any negotiation on the subject. In most cases, a contract is a balancing act of allocation of risk and the situation is unlikely to arise. No duty arises where the issue is a matter of commercial judgment. Moreover, the law relating to mistake is far from clear. The Court of Appeal refused an application for rectification last year in *George Wimpey UK Limited v VI Components Limited [2005] EWCA Civ 77* (reported in the May 2005 Update) but in that case the contract was much more complicated and the mistake easier to overlook, yet the court found there was no evidence the defendant had known that Wimpey had not realised the agreement had been amended. Therefore, where an error is spotted and discussed, the safest course is for the error to be pointed out and the issue negotiated rather than run the risk of protracted litigation and ultimately having the amendment made without a chance to negotiate it away.

*Littman v Aspen Oil (Broking) Ltd [2005] EWCA Civ 1579*

## Property: REITS - still on track

The property industry was heartened by the recent announcement that real estate investment trusts or REITS will be included in the 2006 Finance Bill which will be produced next summer. The proposal is intended to be restricted to UK resident publicly listed companies which distribute 95% of their net taxable profits. Following the publication on 14 December of draft legislation for consultation on the creation of UK REITS, HM Revenue and Customs has published an update of the draft legislation, which also includes arrangements for groups of companies.

To read the draft legislation or an executive summary of it, please go to

[http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?\\_nfpb=true&\\_pageLabel=pageLibrary\\_ConsultationDocuments&propertyType=document&columns=1&id=HMCE\\_PROD1\\_025090](http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_025090)

## Administrators and liquidators

The recently reported case of *In the Matter of Dollarland (Manhattan) Ltd* provides a slightly surprising but in some ways realistic view of administrators.

### The Facts

A creditor wished to appoint a liquidator and the company wished to appoint an administrator. Whilst the judge acknowledged it would be some £2,000 more expensive to appoint a liquidator, the judge decided in favour of liquidation since there would not only be independence of the officeholder from those concerned with the company but that independence would be seen to be assured. The judge considered that the creditor had genuine reasons and concerns for wishing to see appointed officeholders who had not been selected by the company.

### Comment

This decision is surprising in that the whole purpose of replacing administrative receivers with administrators was because administrators are officers of the court even if not appointed by it and have a duty to perform their functions in the interests of the company's creditors as a whole. By making the decision he did, the judge seemed to be acknowledging the risk of bias, albeit only the risk of a perception of bias in the appointment of an administrator by the company as opposed to a liquidator by the court. In so doing he is perhaps acknowledging the feeling among many practitioners that it is useful for creditors to have the right to appoint an administrator (by holding a qualifying floating charge) on the basis that the person they appoint is likely at the very least to be 'in tune' with what the creditor wants to happen. It is a worrying thought that a creditor wishing to appoint a liquidator might attack this right (which was, after all given in the legislation to creditors as a sop to their losing the right to appoint an administrative receiver) as showing bias. However, this case is first instance only so it remains to be seen if it will be followed.

## Consumer Credit: Mortgages

The Financial Markets Law Committee has published a paper on the unfair relationships provisions of the Consumer Credit Bill which is now before Parliament. The paper concentrates on the implications for securitisation but the comments are equally applicable to whole loan sales of pre M day mortgages.

The main point is that the Bill replaces the extortionate credit bargain provisions of the Consumer Credit Act 1974 with provisions which allow a court to adjust an unfair relationship between a lender and borrower. The Bill does not define unfairness and appears to create a great deal of uncertainty as to the basis on which transactions are vulnerable to attack.

The unfair relationship provisions will not apply to regulated mortgage contracts but (after the expiry of a transitional period) will apply to mortgages taken out before 31 October 2004 irrespective of the size of the loan.

*The Bill is expected to become law later this year.*

## Accountancy: True and Fair View

A reminder that section 235 Companies Act 1985 now provides that the auditors now report whether the accounts give a 'true and fair view in accordance with the relevant financial reporting framework' rather than simply a 'true and fair view'. As a result lawyers acting for borrowers might increasingly start adding this wording to standard warranties on accounts. It is only really relevant where the borrower uses IFRS rather than UK accounting standards since IFRS aims at achieving a 'fair presentation' of a company's results rather than a true and fair view and it was for this reason s235 was amended. Even if the relevant borrower does not use IFRS there seems to be no reason not to agree the amendment as this is what the auditor's statement should say. However it is not LMA standard which simply refers to 'true and fair'.

## Further information

For further information or advice other than in relation to insolvency matters please contact either the person at Taylor Wessing with whom you generally deal or:

**Rodney Dukes**

E-mail: [r.dukes@taylorwessing.com](mailto:r.dukes@taylorwessing.com)  
Tel: +44 (0)20 7300 4189

**Bob Gayford**

E-mail: [b.gayford@taylorwessing.com](mailto:b.gayford@taylorwessing.com)  
Tel: +44 (0)20 7300 4192

**Paul Harrison**

E-mail: [p.harrison@taylorwessing.com](mailto:p.harrison@taylorwessing.com)  
Tel: +44 (0)20 7300 4191

**Simon Lovell**

E-mail: [s.lovell@taylorwessing.com](mailto:s.lovell@taylorwessing.com)  
Tel: +44 (0)20 7300 4605

**Dominic Ross**

E-mail: [dl.ross@taylorwessing.com](mailto:dl.ross@taylorwessing.com)  
Tel: +44 (0)20 7300 4282

**Peter Shepherd**

E-mail: [p.shepherd@taylorwessing.com](mailto:p.shepherd@taylorwessing.com)  
Tel: +44 (0)20 7300 4141

For further information or advice relating to insolvency matters please contact:

**Alison Goldthorp**

E-mail: [a.goldthorp@taylorwessing.com](mailto:a.goldthorp@taylorwessing.com)  
Tel: +44 (0)20 7300 4891

**Michael Frawley**

E-mail: [m.frawley@taylorwessing.com](mailto:m.frawley@taylorwessing.com)  
Tel: +44 (0)20 7300 4849

**Nick Moser**

E-mail: [n.moser@taylorwessing.com](mailto:n.moser@taylorwessing.com)  
Tel: +44 (0)20 7300 4866

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