12 August 2013

Ms Laura Carstensen
Deputy Chairman
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

Dear Madam

Statutory Audit Services Market Investigation: Proposed Remedy 3 - Auditor Clauses in Loan Agreements

We refer to the Competition Commission's ("CC") provisional decision on remedies published on 22 July 2013 ("Provisional Remedies Decision") and, in particular, proposed remedy 3 concerning auditor clauses in loan agreements. While we welcome the CC's recognition that a lender may have legitimate commercial reasons for appointing a particular auditor, and that there should not be any prohibition on companies and lender(s) entering into negotiations for the appointment of a specific auditor[1], we have a number of serious concerns about the remedy as proposed.

Our main concerns are as follows:

- The proposed Order extends far beyond the Notice of Possible Remedies published on 22 February 2013 ("Remedies Notice"), which was limited in scope to the *"prohibition of contractual clauses in template documents limiting choice to the Big 4 firms"*, to also outlaw provisions in any future loan agreements *"which restrict or have the effect of restricting a company's choice of auditors to certain categories or lists of statutory auditors"*. This dramatic expansion and restriction on commercial parties' freedom to agree mutually acceptable contractual terms is disproportionate and would have significant adverse effects.

- In particular, we expect that far from making it easier for companies to change auditor, the proposed Order would create an impediment to switching. As the CC appears to accept, lenders have a clear need to ensure that companies to which they lend are subject to appropriate audit services[2]. Unless a lender can specify, within the terms of the loan documentation, the objective criteria which that auditor must satisfy

[1] Provisional Remedies Decision, paragraph 3.296.

[2] Please see, for example, paragraph 3.269 of the Provisional Remedies Decision where the CC acknowledges the importance to international lenders of *"obtaining a high quality of audit of financial covenants in highly leveraged transactions"*.

then it will have no option but to require the company to go through the process of obtaining the prior consent of lenders(s) to any change. As we have submitted previously, this would introduce unnecessary additional complexity and cost into the lending process. Moreover, it would act as a material disincentive to a company changing auditor and therefore appears entirely counter to the CC's aim of facilitating switching and achieving a more competitive market for statutory audit. This appears to be reflected in the evidence received by the CC – we note the statement in the Provisional Remedies Decision: *"We were told that in a large multinational and multi-party transaction, such approval* [of the lenders] *might be hard to achieve and the company might consider it too onerous to pursue it"*[3]. In short, shareholders would be better served if companies could simply elect to switch to an auditor that meets the reasonable terms of pre-agreed criteria.

- Remedy 3 includes a recommendation to the LMA that we amend the auditor clause in our template leveraged loan documentation in line with the provisions of the proposed Order. If, as appears to be proposed, there can be no provision which has the effect of restricting a company's choice of auditor to certain "categories" then it is not clear what, if any, guidance the LMA can provide to its members in relation to auditor selection. For example, would a footnote to the template clause suggesting that a company under a cross-border loan arrangement should be audited by a firm with cross-border capability be prohibited as a "categorization" of eligible auditors? If so, we regard this as a very unfortunate outcome that would be clearly contrary to the interests of lenders, companies and shareholders.

In summary, we submit that the CC should give further careful consideration to the adverse unintended consequences that would result from the proposed intervention in the contractual negotiations between lenders and borrowers. Preventing parties from agreeing an efficient arrangement for the predetermination of potentially eligible auditors by category would be a counterproductive step. Preventing the LMA from giving guidance to its members on appropriate criteria and mechanics for auditor selection would exacerbate the concern.

We would reiterate our earlier submission that a less intrusive measure requiring the deletion of specific reference to the names of the Big 4 firms in our template documentation should be a sufficient remedy. This would enable parties to agree the parameters or an appropriate pool of acceptable auditors upfront.

We would very much welcome the opportunity to meet with the CC to discuss the above points. We shall contact the inquiry team to see whether this may be possible and to arrange a mutually acceptable date.

Yours faithfully

Clare Dawson
Managing Director

[3], Op.cit, paragraph 3.268.