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Ban on 'big four' auditors clauses comes into effect

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As of 17 June 2016, any term in a contract which[1] has the effect of restricting any audited person's choice of statutory auditor to certain categories or lists of statutory auditors will have no effect. This change, as required to be implemented by Directive 2014/56/EU (the "**Directive**"), has been transposed into English law pursuant to Regulation 12 of The Statutory Auditors and Third Country Auditors Regulations 2016 (the "**Regulations**"). For further information on the aims of the Directive see our previous insight **Reforming EU Audit Services to Restore Investor Confidence**.

Prior to 2014, it was common to include a clause in leveraged facility agreements whereby a borrower's choice of auditors was restricted to one of the four dominant auditors in the market (at that time) or such other auditor as agreed by the 'Majority Lenders'. As the Regulations do not provide for any transitional period or any exemptions (including any grandfathering for agreements with 'big four' auditor clauses which were entered into prior to the Regulations coming into effect), 'big four' auditor clauses contained in existing facilities agreement will no longer have any legal effect. Nor will a looser clause which limits a borrower's choice of auditor to a recognised firm of independent auditors of international standing, as had started to be included in some facility agreements when the (then) UK Competition Commission considered banning 'big four' auditor clauses in 2013.

It is possible that now restrictive choice of auditor clauses will no longer be legally effective, the 'Unlawfulness and invalidity' event of default might be triggered under a facility agreement containing such a clause, as while not illegal, the clause will cease to be binding or enforceable. However, this is less likely to be the case if the event of default is subject to a materiality qualifier. It would also likely be a brave lender who would be willing to call an event of default on this basis. Save for a lack of enforceability, there will be no statutory sanctions for such a clause remaining in a facility agreement.

In November 2014, the LMA amended their recommended form leveraged loan facilities agreement to remove the form of wording that would fall foul of the Directive once it came into effect under national law. Now, under the LMA recommended form, the only control lenders might request in respect of third party approval of financial information is the ability to appoint monitoring accountants separate from the auditors. So far we have seen little take up of the monitoring accountant provisions.

Regulation 12 does not apply to public interest entities (namely, listed companies, credit institutions and insurance entities) although these will be subject to a similar ban from 17 June 2017 under Regulation (EU) No 537/2014 (the "**Audit Regulation**"). However, as from 17 June 2016, the Companies Act 2006 will be amended such that the audit committee of a public interest entity will be required to state, when recommending an auditor for appointment, that no contractual term of the kind mentioned in Article 16(6) of

1 In relation to the conduct of a statutory audit of an audited person.

the Audit Regulation (and similar to that referred to in Regulation 12) has been imposed on the company. This means in practice the prohibition will apply to public interest entities from the earlier date of 17 June 2016.

It remains possible to restrict the choice of auditors for a group company not subject to either the Directive, once transposed into national law, or the Audit Regulation, once in effect, if permissible under local laws. However, it is unlikely that any differing treatment of choice of auditors will work and it appears that many lenders in the market have already accepted that they no longer have this control.

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