TRAVERS SMITH

Finance Monthly

April 2014

Welcome to the monthly finance bulletin from our banking and corporate recovery department. This issue contains our usual overview of some recent market developments and trends in the finance sector, including a spotlight on Tacking and further advances. Please get in touch if it raises any issues that you would like to discuss.

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On demand means on demand

Unsurprisingly, the Court of Appeal has determined that a loan expressed to be due and repayable on written demand was repayable on demand. In *Swallowfalls v Monaco Yachting & Technologies SAM [2014]*, the relevant credit agreement permitted early repayment both on demand *and* following the occurrence of any one of a number of events of default. The CA rejected the borrower's argument that the right to accelerate on an event of default had no meaning if the loan was intended to be repayable on demand, concluding that the ability to require repayment on demand was clear and may simply have been included to avoid dispute concerning default.

Guardian Care Homes settled

In November 2013, in a decision unlikely to have been welcomed by banks party to interest rate swaps linked to a LIBOR determination, the Court of Appeal, endorsing Flaux J's judgment in *Graiseley Properties v Barclays Bank [2013]* (aka the *Guardian Homes* case) allowed Graiseley to amend particulars of claim on a swap mis-selling case to include an allegation that Barclays had made implied representations with respect to the accuracy of LIBOR. The CA acknowledged that Barclays' case (which relied in part on exculpatory wording) was also persuasive but the awareness of senior management of LIBOR manipulation might have been sufficient to negate any exculpatory wording. The case was scheduled to be heard this month, but it transpires that the parties have settled out of court. In November, the CA also allowed a similar amendment to claim in the case of *Deutsche Bank AG v Eurotech [2013]* and that case is still pending.

Greenclose – high days and holidays

The central issue in the case of *Greenclose v National Westminster Bank plc [2014]* turned on the interpretation of Clause 12(a) of the 1992 ISDA Master Agreement. The bank had the contractual right to extend a collar arrangement for two years but was required to do so by 11am London time on 30 December 2011. Greenclose argued that the notice had not been properly served. The bank delayed until 30 December to serve the notice; they then chose to send the notice by fax which generated a NOAN failed transmission response; they subsequently attempted to send an e-mail to the CEO's e-mail address which resulted in an out of office response; and they eventually left a voicemail message by phone which the court concluded merely drew attention to the earlier fax and e-mail rather than itself constituting notice. In any event Clause 12(a) of the 1992 ISDA Agreement refers to the notice details in Part 4 of the ISDA Schedule which in this case included a postal address and telephone number, but no e-mail address or fax number. It was argued for the bank that Clause 12(a) referred to the means by which notice "may be given" and that this did not preclude alternative methods. Several text books supported the bank's contention that the methods of notice were permissive and not mandatory, but the High Court concluded that the phrase "may be given in any manner set forth" permitted notice to be served by the means listed and in no other way. Accordingly notice could only be served in writing, delivered in person or by courier or by registered or certified mail. No e-mail address had been provided but the court concluded (rather surprisingly) in any event that the reference in Clause 12(a) to despatch by electronic messaging system did not include e-mail, their conclusion being supported by the User's Guide to the 2002 ISDA Master Agreement which refers to modifications which "permit e-mail delivery". Practitioners will be reminded by this case to ensure the ISDA Schedule notices section is completed properly; to use a courier in delivering important notices; if operating to a deadline to accommodate the possibility of mistakes and communication failures – and if at all possible, to keep clear of "high days and holidays" as days on which notices must be served.

Spotlight on… Tacking and further advances

Section 94 of the Law of Property Act 1925 (**LPA**) provides that, in the absence of any agreement, any legal or equitable mortgagee, whether in respect of real or personal property can make a further advance after the subsequent creation of a second priority mortgage, which benefits from the first priority security and ranks in priority to the subsequent mortgage (i.e. those advances may be "tacked" onto the first priority security) only in circumstances where (a) the further advance was made by the earlier mortgagee when he/she had no notice of the subsequent mortgage; <u>or</u> (b) the terms of the earlier mortgage impose an obligation to make a further advance. In circumstances where there is no obligation to make a further advance, then the earlier mortgagee will be on constructive notice of any registration, regardless of whether he/she was actually aware of that registration.

Section 94 of the LPA does not apply to registered land, but a reasonably similar set of rules is set out in section 49 of the Land Registration Act 2002. Rule 108 of the Land Registration Rules 2003 also requires the first priority mortgagee to enter the fact there is an obligation to make further advances on the register. What constitutes a "further advance" is a fundamental question and until recently no case law has afforded any assistance on this issue. The High Court has, *In the matter of Black Ant Co Ltd (in administration) [2014]* had recent occasion to consider the meaning of "further advance". The first priority mortgagee in this case was on notice of the second priority charges but had registered an obligation to make further advances under Rule 108. As a matter of fact (as is often the case) no such obligation existed – the relevant facility letters regulated term facilities drawable on day one and there was no revolving facility. The first priority mortgagee required the borrower to execute fresh facility letters and the second priority mortgagee argued that in essence (a) the original advances had been repaid and further advances regulated by the new facility letters made; (b) the capitalisation of interest and fee amounts as principal under the new facility letters amounted to further advances; and (c) tacking was impossible and the second priority charges had priority over the earlier charges granted to the first priority mortgagee.

The High Court held (no doubt to the relief of first priority mortgagees in a similar position to the lender in this case) that (a) the obvious purpose of the new facility letters was to subject the existing advances to revised terms and that no language had been used or account entries made which implied any deemed repayment or further advance; and (b) rolling up interest and fees recharacterised the debt but could not be regarded as the making of a further advance.

In the courts

Saville v Central Capital Limited [2014] EWCA Civ 337

The Court of Appeal has overturned the decision of the lower court and allowed an appeal by a couple who took out a 5 year payment protection insurance (PPI) contract when they entered into a 25 year loan. In the first instance, the defendant broker was found to be in breach of its statutory duty under the Insurance: Conduct of Business Rules (ICOBS) which were at that time in force. ICOBS imposed a general duty to ensure that policies recommended met the needs and demands of the customer and there was a duty to assess the customer's requirements. The judge in the lower court, however, found that the claimants had failed to establish that their loss was caused by the defendant's breach of statutory duty. The claimants appealed and the Court of Appeal allowed the appeal. It was held that the test to be applied to the issue of causation in an action for breach of statutory duty is the one set out in the 2011 case of *Harrison & Harrison v Black Horse Limited*. That is, to ask whether, if the duty had not been breached, the damage would have occurred. Although the Savilles were well aware that they had purchased a 5 year PPI policy, the trial judge had not considered whether the policy actually met the claimants' needs. Had the defendant made 'open and fair enquiries' directed at the level and length of cover required, the claimants may not have entered into that policy. Floyd LJ commented that knowing about some characteristic of a complex product is different from wanting that characteristic 'if given a free choice'.

Distinguishing the facts from those in *Harrison v Black Horse*, the judge found that (unlike the finding in favour of the lenders in *Harrison*) there was evidence that the breach of ICOBS caused the claimants' loss, as the Savilles would not have purchased the PPI had the defendant not breached its duties.

Bucci v Carman (liquidator of Casa Estates (UK) Limited) [2014] EWCA Civ 383

The Court of Appeal has considered the application of the balance sheet insolvency test, following the Supreme Court's decision in *Eurosail* last year, which held that the 'point of no return' test was not appropriate to determine whether a company was balance sheet insolvent. The CA was required to determine the solvency status of a property investment company in order to resolve whether amounts paid out by the company to Mrs Bucci (company secretary) were transactions at an undervalue. The Company went into insolvent liquidation in March 2009 and the first instance judge found it to be "marginally insolvent on a balance sheet basis" at the relevant times in March 2007 and from December 2007. The Company, however, was also receiving substantial sums of money from investors at the relevant times, such that it was cashflow solvent. The Company only reached the "point of no return" at the end of 2008 when the Dubai property market crashed. On appeal, the High Court held that the point of no return test was not the correct test to apply in accordance with the Supreme Court decision in *Eurosail* and that the company had been balance sheet insolvent from March 2007. Bucci appealed on the basis that if a company was cash flow solvent, there was no need to examine whether it was balance sheet insolvent unless it had contingent or prospective liabilities.

Moreover, it had not been open to the High Court to reopen the issue as to balance sheet insolvency if the first instance judge had determined that the Company was cashflow solvent.

The Court of Appeal dismissed the appeal. It held that the balance sheet test was not excluded merely because a company is for the time being paying its debts as they fall due. The two tests feature as part of a single exercise- to determine whether a company is unable to pay its debts. *Eurosail* showed that the cash flow test is both flexible and fact-specific. The CA judgment suggests that the courts should adopt a commercial approach and not simply ask whether the company is paying its debts as they fall due, but *how* it is managing to do so? A company may be on any commercial analysis insolvent, but able to pay its debts for the time being. The CA also held that if an appeal court comes to the conclusion that a lower court has applied the wrong legal test, it is entitled to apply the correct legal test itself. The decision leaves practitioners seeking certainty with something of a dilemma. A snap shot consideration of whether a company is able to pay its debts as they fall due is as unhelpful as an arithmetic analysis of assets compared with liabilities. The important question of solvency apparently requires a more complex holistic analysis.

Transaction News

We have advised a Bidco funded by an international investor group led by Promethean Investments on the acquisition of Albemarle & Bond out of administration. As a result of the acquisition, the Bidco has acquired 128 of the 187 pawnbroker branches and 628 out of 809 jobs have been saved.

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