TRAVERS SMITH

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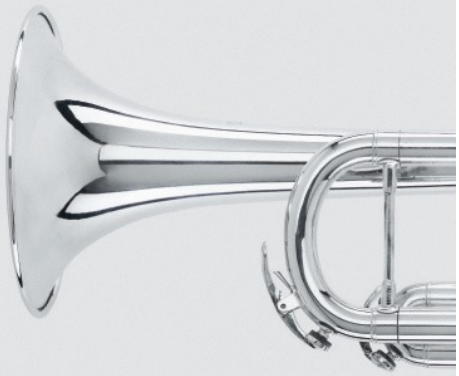

Welcome to the monthly finance bulletin from our finance and restructuring group. This issue contains our usual overview of some recent market developments and trends in the finance sector, including a spotlight on the curious status of Estate Rentcharges as registrable charges. Please get in touch if it raises any issues that you would like to discuss.

Matthew Ayre, Head of Finance

Prejudiced by Without Prejudice

Avonwick Holdings Ltd v Webinvest Limited and another [2014] is a recent High Court case (upheld on an expedited and as yet unreported appeal to the Court of Appeal) which serves as a salutary reminder about the potential dangers of including the term "without prejudice" at the top of correspondence and documents. Lenders and their solicitors had included "without prejudice and subject to contract" at the top of Heads of Terms and in accompanying correspondence with respect to a proposed restructuring. The Lenders wished to admit the Heads of Terms and correspondence in a forthcoming court case. The basic rule is that a document marked "without prejudice" is inadmissible in evidence. The Judge noted the irony that *"it was Avonwick (the Lender) and its solicitors, the party now saying that they are not properly to be regarded as without prejudice, that first marked the documents "without prejudice"."*

Fortunately for the Lenders, the Judge held that the express marking of documents as "without prejudice" is a highly material factor in determining their status, but it is not conclusive. There must be a genuine dispute and a genuine negotiation. In this case, there was no dispute at all about the liability of the borrower to repay the loan, and arguments raised at a later stage to the effect that there was a dispute (late pleadings argued that payment obligations were subject to limited recourse and dependent on payment from third parties) were not supported by the evidence.

The court held that the communications were not covered by "without prejudice" privilege and were admissible in the forthcoming trial. The court was satisfied that the Lenders and solicitors had simply made a mistake.

EBU/BRRD: so much to do, so little time

The European Banking Union (EBU), which is intended to create a system of cross-border crisis management for financial institutions, is founded on the Single Supervisory Mechanism (SSM) which comes into force in November 2014 and the Single Resolution Mechanism (SRS) which was signed in April 2014, each under the supervision of a new European agency, the Single Resolution Board. The SSM and SRS regime only applies to the Euro area member states.

The Bank Recovery and Resolution Directive (BRRD) establishes a new European regime for Banking Resolution across all 28 member states (not just the Euro area member states). The United Kingdom has until 31 December 2014 to adopt and publish the necessary laws to try and transpose BRRD independently of the EBU regime and a lot needs to be done. In July 2014, HM Treasury issued a consultation paper on the transposition and implementation of BRRD in the UK to which, amongst others, the Law Society and City of London Law Society have recently responded. HM Treasury is still analysing feedback. The bail-in stabilisation option introduced by the Financial Services (Banking Reform) Act 2013 will be subject to amendment to facilitate transposition of the BRRD. So far as PRA and FCA rulebook changes are concerned, the PRA consultation closed on 19 September 2014 and the FCA consultation commencing 1 August 2014 closed for comment on 1 October 2014. The BRRD permits postponement of the application of the bail-in provisions until 1 January 2016, but the UK is still aiming to commence legislation on 1 January 2015.

Keeping an eye on the end game

A recent High Court case emphasises the importance of considering practical issues affecting the enforcement of cross-border security at an early stage. In *Standard Bank plc and another v Just Group LLC and others [2014]*, the principal claim was against a Mongolian borrower and Mongolian guarantors under loan facility documents governed by English law in respect of which there was a proper submission to the jurisdiction of the English courts. In support of the defaulted loan obligations, one of the Mongolian obligors had entered into a security assignment of a contract evidencing

Spotlight on… the curious status of Estate Rentcharges as registrable charges

A rentcharge is an annual sum paid by the owner of freehold land to another person who has no other legal interest in the land and was often the means by which owners of land released for development would achieve a regular income. The only rentcharge capable of creation since the prohibition on rent charges under the Rentcharges Act 1977 is an estate rentcharge, which is either used as a device to impose a duty on a freeholder to perform a covenant, or as a means of payment to the rentcharge owner for services performed to the estate. Conceptually, rentcharges appear to have little in common with orthodox charges or mortgages constituting security interests required to be registered under the Companies Act 2006 (CA 2006). Estate rentcharges do not secure a principal sum which means that the immediate acceleration sanction under section 859H of CA 2006 for a failure to register is inapplicable; whilst a right to receive a periodic sum is an interest in land there is no automatic right to possession to facilitate a sale; and the consent of a charge taker to the sale of the land subject to an orthodox charge is not required in the case of an estate rentcharge.

Under the regime relating to the registration of security interests at Companies House which operated prior to 6 April 2013, the CA 2006 clearly excluded any rentcharge from the requirement to register, by excepting from a charge on land "a charge for any rent or other periodical sum issuing out of land". Unfortunately, no specific exception for rent charges is now accommodated under the exclusions operating since 6 April 2013 set out in section 859A(6) of CA 2006 and this has generated a debate about whether estate rentcharges created on or after 6 April 2013 are subject to the Companies House registration regime.

The Land Registry has in practical terms eclipsed the debate by announcing that where an estate rentcharge is granted or reserved upon on or after 6 April 2013 by a company (or Limited Liability Partnership), that estate rentcharge must be registered at Companies House and evidence of such filing provided to the Land Registry when an application is made to them for the substantive registration of such estate rentcharge.

This constitutes a curious state of affairs. Whilst the new registration regime clearly excludes a requirement to register charges over monetary deposits to secure rental obligations owed to a landlord, it now appears necessary to register an interest previously excluded from the registration regime and which lacks most of the traditional characteristics exhibited by a security interest in the nature of a charge or mortgage.

debts due from a Mongolian third party (UBR). The assigned contract was governed by Mongolian law, but had been validly assigned under Mongolian law. Notice of assignment in favour of Standard Bank had been served on UBR, who had failed to pay over to Standard Bank the substantial amounts due under the contract. Standard Bank did not propose to sue UBR as assignee but under an alleged collateral contractual undertaking. There may have been many reasons why Standard Bank chose not simply to sue UBR as assignee, but UBR alleged that the principal reason was that the contract assigned was subject to the jurisdiction of the Mongolian courts. This fact was not disclosed to the English courts at the time of the original application for leave to serve the English claim form on UBR outside the jurisdiction, at which Standard Bank was held to have satisfied the three requirements applicable to circumstances where prior notice of the application was not required to be served on UBR. These were (i) there was a serious issue to be tried on the merits of the claim; (ii) England and Wales was the appropriate forum for trial of the dispute; and (iii) there was a good arguable case that the claim fell within one of the "gateways" provided by the court Practice Directions – in this case that the main claim was against a defendant who had a real issue with UBR which it was reasonable for the court to try and the claimant wished to serve the claim on UBR as a necessary or proper party to that claim. UBR applied to set aside service, arguing that the English court had no jurisdiction to hear the claim. The High Court agreed with UBR. The claim against UBR was not closely bound up with the claim against the main defendants and did not have a "common thread". The High Court held that factors pointing to Mongolia as the proper forum were overwhelming and heavily criticised the claimant's failure to disclose the Mongolian jurisdiction clause, which would have been sufficient on its own to persuade the court to set aside the original permission to serve outside the jurisdiction.

The case usefully delineates the circumstances where the English courts will be disposed to accept that a third party is a necessary or proper party to claims against another defendant and highlights the absolute necessity for full disclosure in such applications. It also reminds practitioners of the importance, in evaluating the real worth of cross-border security, of the practical problems frequently presented by foreign law, enforcement and recovery issues.

EMIR clearing requirements postponed

Under Article 85(3) of EMIR, ESMA was required to submit various reports to the European Commission, Parliament and Council by September 30 2014, including one as to the application of central clearing obligations and the treatment of OTC derivative contracts prior to the imposition of such obligations. Those reports will not now be published until the second half of 2015 which suggests that the clearing requirements of EMIR are unlikely to be phased in before Q3 2015 at the earliest.

In the courts

Watchorn v Jupiter Industries Limited [2014] EWHC 3003 (Ch)

In this case the liquidator claimed that Husky Group Limited, the company in liquidation, had made a transfer of trademarks at an undervalue under s.238 Insolvency Act 1986 (IA) and had entered into a transaction defrauding creditors under s.423 IA. As the Judge noted, s.423 is misleadingly titled and it is not required to show dishonesty.

Mr Thomasson was to all intents and purposes, the controlling shareholder and owner of the Husky Group. The trademarks in dispute had in fact been originally owned by Mr Thomasson and he had assigned their benefit to the Husky Group some years previously for reasons of convenience and expediency for a nominal sum of £10. The Judge commented that Mr Thomasson had made the fatal and not uncommon mistake that, because he and his family owned Husky, they also owned the trademarks. Mr Thomasson persuaded Husky, before Husky went into liquidation but at a time when the court determined as a matter of fact that Husky was insolvent, to transfer the trademarks (then worth £360,000) to Jupiter, a vehicle for Mr Thomasson, for the sum of £1. The Judge had no hesitation in determining that the transfer to Jupiter was intended to put the trademarks beyond the reach of creditors and that the transfer fell within both s.423 IA and, given that Husky was insolvent at the time of transfer, also s.238 IA.

Under both sections, the court has a power to make such order as is appropriate to undo the effect of the transaction. The Judge in this case concluded that a damages award of £360,000 was appropriate. Arguments to the effect that this was inappropriate on the basis that if the trademark transfer had not taken place, Husky would still have gone into liquidation and the trademarks would only have attracted a fire sale price, were rejected as speculation. The Judge had regard to the fact that Jupiter chose to ignore legal advice at the time of the re-transfer that the derisory consideration paid raised corporate governance issues. The case highlights the importance of recognising the separate legal personality of shareholder and company in the context of reviewable transactions.

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