TRAVERS SMITH

Finance Monthly

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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 the Pledge as a security device. Please get in touch if it raises any issues that you would like to discuss.

Jeremy Walsh, Head of Banking and Corporate Recovery Department

Crowdfunding

Crowdfunding websites which raise equity or finance in small amounts from large numbers of people over the internet have attracted the scrutiny of the FCA, which in October 2013 published a bulky consultation paper (CP 13/13) in advance of the adoption of its consumer credit role in April. On 6 March 2014, the FCA published a Policy Statement constituting its response to the feedback generated by the consultation paper. Key proposals in CP 13/13, so far as Loan-based crowdfunding platforms are concerned, are to be implemented, including compliance by such platforms with conduct of business rules (particularly with respect to disclosure) and the rules relating to dispute resolution, client money segregation and protection and continuity of service on platform failure. Minimum capital requirements will, however, be lower than those currently applying.

The specific concerns highlighted by CP 13/13 in relation to Investment-based crowdfunding are also reflected in the recent Policy Statement. Although arranging the sale of unlisted equity or debt securities already amounts to the regulated activity of arranging deals in specified investments, the FCA's preoccupation is with the level of sophistication of potential retail clients. Accordingly, direct offer financial promotions will only be capable of being communicated to self-certified or certifying sophisticated investors, high net worth investors, clients confirming the receipt of regulated investment advice/management services from authorised persons, venture capital/corporate finance institutions and retail clients confirming a 10% maximum investment by reference to their net investible financial assets.

Consumer Rights Revolution

Those lawyers frequently, or even occasionally, preoccupied with contracts with individuals will shortly be obliged to forget old friends such as the Sale of Goods Act 1979, all the Supply of Goods and Services Acts and Regulations, UCTA 1977, the Unfair Terms in Consumer Contracts Regulations and the Competition Act 1998 and instead embrace the Consumer Rights Act. The Bill is at the Committee stage in the Commons and when it eventually completes its legislative process, it will replace and consolidate the above statutes, remove inconsistencies and address the digital age.

Debentures – what's in a word?

"Debenture" can mean an instrument creating a number of security interests, or merely an instrument evidencing debt, or a loan stock instrument (usually secured) issued by a company to raise loan capital.

In Fons HF (in liquidation) v (1) Corporal Limited (2) Pillar Securitisation SARL [2013] the High Court had to consider a Share Charge granted by Fons which extended to shares (identified in a Schedule to the Charge) in Corporal Limited. The definition of Shares, in a possible excess of zeal, extended to “all other stocks, shares, debentures, bonds, warrants, coupons or other securities now or in the future owned by (Fons) in Corporal from time to time or any in which it has an interest”. Fons had also entered into two unsecured shareholder loans with Corporal under which Corporal owed money to Fons and it was concluded by Pillar (to whom the share charge had been transferred) that the loans were worth rather more than the shares. The High Court, influenced by the *Rainy Sky* school of sensible business construction (a school subject to a number of hard knocks recently) concluded that a reasonably objective observer would not understand the definition of Shares to include the right to be repaid under unsecured loan agreements and rejected Pillar’s argument that the security over “debentures” encompassed the unsecured loans.

The Court of Appeal (CA) on 20 March 2014, reversed the High Court decision and concluded that the Share Charge did extend to the entitlement under the unsecured loans as well as the shares. The Court of Appeal judgment points to the fact that the term "debenture" has not received any precise legal definition. The CA looked at the context of the use of the word- in conjunction with “bonds, warrants

Spotlight on… the Pledge as a security device

Whilst security created by way of mortgage derives from a title or proprietary transfer and security created by way of charge derives from an equitable construct of encumbrance, a pledge, possibly the oldest of security devices, requires the transfer of possession of the relevant assets. Sufficient surrounding evidence is also required to determine that what is being created is a pledge which confers a special interest in the asset conferring a power of sale on default, rather than a gift or a lien arrangement (which merely enables retention of possession until payment rather than the ability to sell the relevant asset and apply its proceeds in satisfaction of the relevant debt).

The pledge, of course, is not confined to pawnbroking arrangements. The requirement of the transfer of possession is satisfied by constructive possession. The delivery of documents of title to goods, such as a bill of lading is at the cornerstone of documentary credit arrangements and the delivery of keys to a warehouse where goods are retained may confer a pledge.

The recent case of *Bassano v Toft & Ors* [2014] concerned an impecunious musician who owned a viola insured for £350,000. The musician raised separate loans of £50,000 (on an unsecured basis, but on terms that the viola would be sold by the lender who nevertheless failed to retain possession of the instrument); £100,000 on the basis of a chattel mortgage which proved to be invalid for want of registration under the Bills of Sale Act); and £130,000 (on the basis of a commercial pawnbroking agreement which required possession to be retained by the pawnbroker on a pledge basis). The three lenders were oblivious of the others' arrangements. At the musician's request, the pawnbroker released possession of the viola to a dealer to allow inspection by potential purchasers, but on strictly controlled terms that the dealer would retain possession. This the dealer failed to do. By an improbable set of circumstances, the viola came to be left in the first lender's shop and the curtain was raised on a predictable legal free for all. By a court sanctioned arrangement the first lender purchased the viola, thus generating proceeds. The musician advanced arguments, on the basis of the Consumer Credit legislation, as to the invalidity of the remaining loans, but these were unsuccessful. The principal argument raised against the second lender, the pawnbroker, was that he had parted with possession and thus forfeited his pledge interest. The court preserved the pawnbroker's secured, prior position as against the second, unsecured lender. The pawnbroker had not voluntarily surrendered his interest, merely delivered up goods on a documented agency basis which was defeated by the unauthorised delivery of possession to a third party.

and coupons" and considered counsel's argument to the effect that the wrap around reference to "other securities" suggested an intended reference to some kind of bundled derivative investment which was tradable. The CA, however, concluded that "securities" was simply a synonym for investments. The shareholder loans were instruments evidencing debt (notwithstanding that loans had not even been advanced under one of the shareholder loan agreements) and therefore within the possible meaning of the word debentures. The CA acknowledged that this was the possible meaning. It did not make it the *correct* meaning. The Court however, had to consider whether there was anything within the Share Charge which would persuade an interested observer to conclude that the word should be given a narrower meaning and the CA concluded that there was nothing within the document to exclude the shareholder loans from the relevant definition of Shares.

In the courts

Barclays Bank plc v Unicredit Bank AG and another [2014] EWCA Civ 302

The Court of Appeal has upheld the High Court's decision in 2012 and concluded that Barclays was entitled to have primary regard to its own commercial interests when considering the provision of consent to an early termination of guarantees which was required to be determined in a commercially reasonable manner. Barclays had sought a price for its consent which constituted no more than the return which it could have expected had the contract run its expected course. If Barclays had demanded a price "way above" what could be reasonably expected, then it would not have been acting in a commercially reasonable manner. Arguments raised by Unicredit on the basis of the entire agreement clause were rejected. The clause was not available to exclude evidence or argument about the way in which parties exercise rights given to them by the contract.

Schmid v Hertel [2014] C-328/12

The ECJ has clarified the scope of Article 3(1) of the EU Insolvency Regulation (the "**Regulation**"). In the above case, the court had to consider whether Article 3(1) gave courts of the member state within the territory of which insolvency proceedings have opened the jurisdiction to determine an action to set a transaction aside by virtue of insolvency brought against a person whose place of residence or registered office was not within the territory of a member state.

The ECJ ruled, in the 2009 case of *Seagon* (C-339/07), that courts of the member state did have jurisdiction to decide an action to set a transaction aside where the defendant's registered office is in, or they reside in, another member state. In *Schmid*, the liquidator of a debtor whose COMI was situated in Germany brought an action to set aside a transaction with a Swiss individual.

On review of the Regulation, the ECJ found that there was no express requirement for a cross border element in order for the Regulation to apply, nor was it limited to matters involving at least two member states. The objectives of Article 3(1) to promote foreseeability and legal certainty supported an interpretation to the effect that it does create jurisdiction to decide an action to set aside a transaction brought against a person who resides *outside* the EU. The court acknowledged that the implications of this decision would mean that defendants to an action to set transactions aside could be sued in a foreign court, but the Regulation provides sufficient clarity to parties not situated in a member state of the possibility that they may face proceedings in the courts of the member state in which the debtor has its COMI.

Transaction News

We have advised:

- the **McColl's group** on its post-IPO £85,000,000 multicurrency revolving credit facility made available by a club of lenders.
- **HSBC Bank plc** on Hawksford International's acquisition of Singapore-based Janus Corporate Solutions. Hawksford, backed by UK mid-market private equity house Dunedin, is an award-winning, successful and leading independent wealth structuring company specialising in preserving and enhancing wealth.
- **ECI Partners** on its investment in the £57m management buy-out of Avantia Insurance. Avantia operates the online consumer home insurance brand HomeProtect.
- **Shawbrook Bank Limited** on the senior revolving credit facility made available by them to finance (along with a mezzanine term facility) the purchase of a UK specialist consumer finance provider.

Department News

We are delighted to welcome two associates to the department. Chris Brooks joins us from Clifford Chance LLP and Fiona Swords joins us from Simpson Thacher & Bartlett LLP.

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