2.3 In the absence of contrary agreement, an overdraft is repayable on demand[7] and the bank is entitled to charge interest,[8] which may be compounded annually or semi-annually.[9]

LOAN FACILITIES[10]

Types of facilities

2.4 Loan facilities take many forms. The most basic ('term loans') provide that the bank is committed throughout a specified period (the 'commitment period') to make advances upon request by the company up to a maximum amount, with all the advances being repayable together, either in instalments or in one lump sum ('bullet repayment'). Alternatively, the facility may be 'revolving', in that the company can borrow for a selection of periods, repay and borrow again. The facility

7 *Williams and Glyn's Bank Ltd v Barnes* [1981] Comm LR 205; *Barclays Bank plc v Green and Challis* [1996] 4 JIBL N–82. The bank must, however, still honour cheques drawn on the account before repayment is demanded: *William Rouse v The Bradford Banking Co Ltd* [1894] AC 586 at 596 per Lord Herschell LC. Once the bank has demanded repayment, it must allow the borrower such time as is necessary to implement payment procedures before it can take proceedings: *Toms v Wilson* (1863) 4 B&S 442; *Lloyds Bank Ltd v Margolis* [1954] 1 All ER 734 at 738; *Cripps (Pharmaceuticals) Ltd v Wickenden* [1973] 2 All ER 606; *Bank of Baroda v Panessar* [1987] Ch 335; *Lloyds Bank plc v Lampert* [1999] BCC 507. However, this requirement does not apply if the debtor has already admitted that he is unable to pay: *Sheppard & Cooper Ltd v TSB Bank plc* [1996] 2 All ER 654. See also *Buckingham and Co v The London and Midland (Bank) Ltd* (1895) 12 TLR 70.

8 As to which, see further **5.24**ff.

9 *IRC v Holder* [1931] 2 KB 81, affd on different grounds sub nom *Holder v IRC* [1932] AC 624; *Paton (Fenton's Trustee) v IRC* [1938] AC 341; *National Bank of Greece SA v Pinios Shipping Co No 1, The Maira* [1990] 1 AC 637. The House of Lords in the last case expressly left open the question of whether the bank (in the absence of agreement) is entitled to compound interest at intervals of less than 6 months (though quarterly compounding has since been approved by the Court of Appeal as being in accordance with modern banking practice: *Kitchen v HSBC Bank plc* [2000] 1 All ER (Comm) 787 at 791 per Brooke LJ). See also *Emerald Meats (London) Ltd v AIB Group (UK) plc* [2002] EWCA 460, in which the Court of Appeal held that, in the absence of agreement to the contrary, the bank was entitled to charge interest in accordance with its standard terms. The right to compound (as opposed to simple) interest terminates when the relationship of banker and customer terminates, eg because the customer dies (*Fergusson v Fyffe* (1841) 8 Cl&Fin 121; *Crosskill v Bower* (1863) 32 Beav 86; *Williamson v Williamson* (1869) 7 Eq 542) or closes his account (*Crosskill v Bower*, above), but not merely because the bank demands payment (*National Bank of Greece SA v Pinios Shipping Co No 1, The Maira*, above). Cf *Bank of Credit and Commerce International SA v Malik* [1996] BCC 15.

10 On loan facilities generally, see Wood, *International Loans, Bonds, Guarantees, Legal Opinions* (2nd edn, 2007), Chapters 1–9; Tennekoon, *The Law and Regulation of International Finance* (1991), Chapter 5; Ellinger, Lomnicka and Hooley, *Ellinger's Modern Banking Law* (4th edn, 2006), pp 706–724; Ferran, *Principles of Corporate Finance Law* (2008), pp 319–341; Cranston, *Principles of Banking Law* (2nd edn, 2002), pp 304–324; Rhodes, *Syndicated Lending* (4th edn, 2004); Penn, Shea and Arora, *The Law and Practice of International Banking* (1987), Chapter 6; *Encyclopaedia of Banking Law*, paras F(3150)–F(4999); Gabriel, *Legal Aspects of Syndicated Loans* (1986).

may be available in a single currency or in a selection of currencies with an ability to switch from one to another (a 'multi-currency option') and it may be made available by a single bank or by a group of banks ('syndicated').

2.5 A facility may take the form either of an 'advance' facility (where the banks make cash advances to the company) or of a 'bill' or 'acceptance' facility (involving the 'drawing' of bills of exchange on the banks). A bill of exchange[11] is an order by one person (the drawer) to another person (the drawee) requiring the drawee to pay a stated sum of money to a specified payee or to his order or to the bearer of the bill. When a company 'draws' a bill under a bill facility or acceptance facility, the company (as drawer) executes the bill and delivers it to the bank (as drawee), which pays the drawer an amount less than the face value and 'accepts' the bill, ie by signing the bill, agrees to pay the bill if it is delivered to the bank on maturity. The bank then sells (or 'discounts'[12]) the bill in the market. The amount payable to the company and the amount at which the bank sells the bill are calculated by reference to the 'Eligible Bill Discount Rate', the published rate at which bills of exchange are discounted in the bill discount market. On maturity of the bill, the holder will present it to the accepting bank for payment of the face value and, under the terms of the facility, the company will be obliged to reimburse the bank for the amount which it pays out.

2.6 A further kind of facility is a 'swingline'. This is a committed facility providing for very short-term advances (typically up to 7 days), and is generally put in place to support a commercial paper programme.[13] Its purpose is twofold: first, if the company has to repay a tranche of commercial paper and does not want to issue a new tranche on the repayment date because of what it sees as temporarily adverse market conditions, it can repay through the use of the swingline facility and issue the commercial paper (and thereby repay the swingline advance) a few days later; and, secondly, it reassures potential purchasers under the commercial paper programme that the company will be able to repay them on maturity regardless of market conditions.

Conditions precedent

2.7 One feature common to virtually all facilities is that the bank's obligations to make advances do not immediately arise on the signing of the loan agreement but are subject to the satisfaction by the borrower of certain conditions precedent.[14] There are two types: conditions precedent

11 Defined in Bills of Exchange Act 1882, s 3(1). Bills of exchange are negotiable instruments: see further **15.3**ff.

12 Due to the fact that the bill will be sold at less than its face value.

13 See further **Chapter 4**.

14 Where the facility is to finance the cash element of a takeover offer, though, the conditionality that is acceptable is very limited. This is because the offeror's bank or

the deposit against the loan, leaving £40 of the deposit. It would then share the £100 with the other banks, as a result of which an amount would still be left owing to it under the loan, which it could then set off against the remaining £40, and then share with the other banks.[28]

2.20 A typical pro rata sharing clause might read as follows:

1.1 Payments to Finance Parties

If a Finance Party (a '**Recovering Finance Party**') receives or recovers any amount from the Borrower other than in accordance with Clause [ ] (*Payment mechanics*) and applies that amount to a payment due under the Finance Documents then:

(a) the Recovering Finance Party shall, within three Business Days, notify details of the receipt or recovery to the Agent;

(b) the Agent shall determine whether the receipt or recovery is in excess of the amount the Recovering Finance Party would have been paid had the receipt or recovery been received or made by the Agent and distributed in accordance with Clause [ ] (*Payment mechanics*), without taking account of any Tax which would be imposed on the Agent in relation to the receipt, recovery or distribution; and

(c) the Recovering Finance Party shall, within three Business Days of demand by the Agent, pay to the Agent an amount (the '**Sharing Payment**') equal to such receipt or recovery less any amount which the Agent determines may be retained by the Recovering Finance Party as its share of any payment to be made, in accordance with Clause [ ] (*Partial payments*).

1.2 Redistribution of payments

The Agent shall treat the Sharing Payment as if it had been paid by the Borrower and distribute it between the Finance Parties (other than the Recovering Finance Party) in accordance with Clause [ ] (*Partial payments*).

1.3 Recovering Finance Party's rights

(a) On a distribution by the Agent under Clause 1.2 (*Redistribution of payments*), the Recovering Finance Party will be subrogated to the rights of the Finance Parties which have shared in the redistribution.

(b) If and to the extent that the Recovering Finance Party is not able to rely on its rights under paragraph (a) above, the Borrower shall be liable to the Recovering Finance Party for a debt equal to the Sharing Payment which is immediately due and payable.

1.4 Reversal of redistribution

If any part of the Sharing Payment received or recovered by a Recovering Finance Party becomes repayable and is repaid by that Recovering Finance Party, then:

[28] On pro rata sharing clauses, see further Gabriel, *Legal Aspects of Syndicated Loans* (1986), pp 181–190; *Encyclopaedia of Banking Law*, para F(3503).

(a) each Finance Party which has received a share of the relevant Sharing Payment pursuant to Clause 1.2 (*Redistribution of payments*) shall, upon request of the Agent, pay to the Agent for the account of that Recovering Finance Party an amount equal to the appropriate part of its share of the Sharing Payment (together with an amount as is necessary to reimburse that Recovering Finance Party for its proportion of any interest on the Sharing Payment which that Recovering Finance Party is required to pay); and

(b) that Recovering Finance Party's rights of subrogation in respect of any reimbursement shall be cancelled and the Borrower will be liable to the reimbursing Finance Party for the amount so reimbursed.

1.5 Exceptions

(a) This Clause shall not apply to the extent that the Recovering Finance Party would not, after making any payment pursuant to this Clause, have a valid and enforceable claim against the Borrower.

(b) A Recovering Finance Party is not obliged to share with any other Finance Party any amount which the Recovering Finance Party has received or recovered as a result of taking legal or arbitration proceedings, if:

(i) it notified that other Finance Party of the legal or arbitration proceedings; and

(ii) that other Finance Party had an opportunity to participate in those legal or arbitration proceedings but did not do so as soon as reasonably practicable having received notice and did not take separate legal or arbitration proceedings.

Assignment and novation

2.21 It is also common to provide that the banks may transfer their interests, either by assignment (in the case of rights only) or by novation (where both rights and obligations are to be transferred). Novation can usually be effected with minimum effort, by virtue of a 'substitution certificate' or 'transfer certificate'. A similar commercial effect can also be achieved by sub-participation. All these methods are considered in **Chapter 15**.

Available Facility. Any cancellation under this Clause 1.1 shall reduce the Commitments of the Lenders rateably.

1.2 Voluntary prepayment

(a) The Borrower may, if it gives the Agent not less than [ ] Business Days' (or such shorter period as the Majority Lenders may agree) prior notice, prepay the whole or any part of any Loan (but, if in part, being an amount that reduces the Base Currency Amount of the Loan by a minimum amount of [ ]).
(b) A Loan may only be prepaid after the last day of the Availability Period (or, if earlier, the day on which the Available Facility is zero).

1.3 Restrictions

(a) Any notice of cancellation or prepayment given by the Borrower under this Clause shall be irrevocable and, unless a contrary indication appears in this Agreement, shall specify the date or dates upon which the relevant cancellation or prepayment is to be made and the amount of that cancellation or prepayment.
(b) Any prepayment under this Agreement shall be made together with accrued interest on the amount prepaid and, subject to any Break Costs, without premium or penalty.
(c) The Borrower may not reborrow any part of the Facility which is prepaid.
(d) The Borrower shall not repay or prepay all or any part of the Loans or cancel all or any part of the Commitments except at the times and in the manner expressly provided for in this Agreement.
(e) No amount of the Total Commitments cancelled under this Agreement may be subsequently reinstated.

If the Agent receives a notice from the Borrower under this Clause it shall promptly forward a copy of that notice to the Lenders.

(For defined terms, see earlier examples)

(ii) Eurobonds

5.10 Whether the issuer will have a general right of optional redemption, and if so whether at par, or at a premium and whether of part of the issue on several occasions, or only of all of the issue at the same time, will vary from issue to issue. The option can usually be exercised at any time where the interest is payable at a fixed rate, but only at the end of an interest period where interest is payable at a floating rate.

5.11 Irrespective of whether a general right of optional redemption is included, it would be normal, as seen earlier,[26] for the issuer to have a redemption option in the event that it becomes obliged to gross-up for tax. Unlike the case in a loan facility, this would only permit redemption

[26] At **3.4**.

of all the issue, not merely the affected part of it, and the option will normally only be exercisable if the obligation to deduct arises from a change in law or regulation (ie not if it merely results from the issuer readjusting its tax affairs). Furthermore, the option will, like the general right of optional redemption, be exercisable at any time if interest is payable at a fixed rate, but only at the end of an interest period if interest is payable at a floating rate (thus differing from the equivalent provision in a loan facility, which is normally exercisable at any time during an interest period, subject to the 'broken funding' costs indemnity).

5.12 A typical general optional redemption provision in a eurobond issue (in this example, a fixed rate issue with a trustee, where redemption is to be at par and can be partial), would read as follows:

(1) The Issuer may, having given not less than 15 nor more than 30 days' notice to the Bondholders in accordance with Condition [ ] (*Notices*) (which notice shall be irrevocable and shall specify the date fixed for redemption), redeem all the Bonds, or from time to time some only (being US$[ ] in principal amount or an integral multiple of US$[ ]), on or at any time after [ ] at their principal amount together in each case with interest accrued to the date of redemption.
(2) In the case of a partial redemption of Bonds, Bonds to be redeemed will be selected, in such place as the Trustee may approve and in such manner as the Trustee may deem appropriate and fair, not more than 30 days before the date fixed for redemption. Each notice of partial redemption will specify the aggregate principal amount, and the serial numbers, of the Bonds to be redeemed, the serial numbers of Bonds previously called for redemption and not presented for payment and the aggregate principal amount of the Bonds which will be outstanding after the partial redemption.
(3) Upon the expiry of any notice as is referred to in paragraph (1) above the Issuer shall be bound to redeem the Bonds to which the notice refers in accordance with the terms of such paragraph.

5.13 A typical tax redemption provision in a eurobond issue (in this example, a fixed rate issue with a trustee) would read as follows:[27]

(1) If the Issuer satisfies the Trustee immediately before the giving of the notice referred to below that:
  (a) as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction, or any change in the application or official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after [*date of subscription agreement*], on the next

[27] This follows a form recommended by ICMA (the International Capital Market Association). For an analysis of the effect of a clause that departed from the ICMA model form, see *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2005] EWHC 973 (as to construction of the clause) and [2006] STC 1195 (as to the factual determination of 'reasonable measures' in the light of that construction).

expense and acting reasonably, forthwith request the Auditors (in conjunction with an investment bank in London of international repute selected by the Issuer and approved by the Trustee) to determine as soon as practicable what adjustment (if any) to the Conversion Price is fair and reasonable to take account thereof) provided that (A) the adjustment would result in a reduction in the Conversion Price, and (B) the Auditors and such merchant or investment bank are so requested to make such a determination not more than 21 days after the occurrence of the relevant event or circumstances.

Covenants

5.47 It is also usual for the company to give certain covenants for the protection of the conversion rights, for example, not to reduce share capital, not to modify the rights attaching to the shares into which the holders can convert, not to issue shares with more favourable rights, etc.[115] Certain of these covenants may, however, be ineffective as a result of the decision of the House of Lords in *Russell v Northern Bank Development Corporation Ltd and Others*.[116] Their Lordships held that any provision in an agreement to which the company is a party (and also, possibly, the whole agreement) is void if it is inconsistent with a direct statutory power (eg the power under s 135 of the Companies Act 1985[117] to reduce capital by special resolution, or the power under s 9 of the Companies Act 1985[118] to alter the articles by special resolution).[119] As a result of the decision, the practice has now developed in issues of convertible securities of: (a) incorporating a severability clause, so that, if any covenant is void, it does not taint the others or indeed the whole agreement; and (b) providing that breaches of the covenants also take effect as events of default, so that, if they are void as covenants, they nevertheless are still capable of triggering a prepayment obligation.

5.48 A typical set of covenants (in this example, in a eurobond issue with a trustee) would read as follows:

[115] Similar covenants are also often given in loan agreements, in order to protect the banks against favourable treatment by the company of its shareholders.

[116] [1992] 3 All ER 161.

[117] To be replaced by s 641 of the Companies Act 2006 from 1 October 2009.

[118] To be replaced by s 21 of the Companies Act 2006 from 1 October 2009.

[119] The decision is contrary to previous authority to the effect that, whereas a company cannot preclude itself from altering its articles, it can nevertheless be liable if the alteration is in breach of a contractual obligation to a third party: see, eg, *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656 at 673 per Lindley MR; *Baily v British Equitable Assurance Co* [1904] 1 Ch 374 at 385 (reversed on other grounds [1906] AC 35); *British Murac Syndicate Ltd v Alperton Rubber Co Ltd* [1915] 2 Ch 186; *Southern Foundries (1926) Ltd v Shirlaw* [1940] AC 701 at 740–741 per Lord Porter; *Cumbrian Newspapers Group Ltd v Cumberland & Westmorland Herald Newspaper & Printing Co Ltd* [1986] BCLC 286 at 305–306. See also Davenport [1993] LQR 553 and [1993] *Butterworths' JIBFL*, p 469; McGlynn [1994] Co Lawyer 301.

Whilst any Conversion Right remains exercisable, the Issuer will, save with the approval of an Extraordinary Resolution (as defined in the Trust Deed) or with the prior written approval of the Trustee where, in the Trustee's opinion, it is not materially prejudicial to the interests of the Bondholders to give such approval:

(a) at all times keep available for issue free from pre-emptive rights out of its authorised but unissued capital such number of Ordinary Shares as would enable the Conversion Rights and all other rights of subscription and exchange for and conversion into Ordinary Shares to be satisfied in full;

(b) not issue or pay up any securities, in either case by way of capitalisation of profits or reserves, other than (i) by the issue of fully paid Ordinary Shares to the Ordinary Shareholders and other persons entitled thereto or (ii) by the issue of Ordinary Shares paid up in full out of profits or reserves (in accordance with applicable law) and issued wholly, ignoring fractional entitlements, in lieu of a cash dividend or (iii) by the issue of fully paid equity share capital (other than Ordinary Shares) to the holders of equity share capital of the same class and other persons entitled thereto, unless in any such case the same gives rise (or would, but for the fact that the adjustment would be less than one per cent of the Conversion Price then in effect, give rise) to an adjustment of the Conversion Price;

(c) not in any way modify the rights attaching to the Ordinary Shares with respect of voting, dividends or liquidation nor issue any other class of equity share capital carrying any rights which are more favourable than such rights but so that nothing in this paragraph (c) shall prevent (i) the issue of any equity share capital to employees (including directors holding executive office) whether of the Issuer or any of its subsidiary or associated companies by virtue of their office or employment pursuant to any scheme or plan approved by the Issuer in general meeting or which is established pursuant to such a scheme or plan which is or has been so approved, or (ii) any consolidation or subdivision of the Ordinary Shares or the conversion of any Ordinary Shares into stock or vice versa, or (iii) any modification of such rights which is not, in the opinion of an investment bank in London of international repute selected by the Issuer, approved in writing by the Trustee and acting as an expert, materially prejudicial to the interests of the holders of the Bonds, or (iv) without prejudice to any rule of law or legislation (including regulations made under sections 783 to 790 of the Companies Act 2006 or any other provision of that or any other legislation), the conversion of Ordinary Shares into, or the issue of any Ordinary Shares in, uncertificated form (or the conversion of Ordinary Shares in uncertificated form into certificated form), or the amendment of the Articles of Association of the Issuer to enable title to securities of the Issuer (including Ordinary Shares) to be evidenced and transferred without a written instrument, or any other alteration to the Articles of Association of the Issuer made in connection with the matters described in this paragraph or which is supplemental or incidental to any of the foregoing (including any amendment made to enable or to facilitate procedures relating to such matters and any amendment dealing with the rights and obligations of holders of securities, including Ordinary Shares, dealt with under such procedures), or (v) any issue of equity share capital where the issue of

6.39 It might be thought, given the above, that the Regulations apply to most forms of security over cash and marketable securities. However, one of the requirements that needs to be satisfied for the Regulations to apply is that the collateral must be 'in the possession or under the control of' the collateral-taker. The Regulations (and the Directive), however, are silent as to what constitutes possession or control in this context. A fully perfected legal mortgage of financial collateral will almost certainly meet the requirement, but a less formal equitable charge may not, and a floating charge is unlikely to. Until there has been case-law on the point, it is unclear, for example, whether an arrangement that constitutes a fixed charge (in the light of the reasoning in the *Spectrum Plus* and *Brumark* decisions[81]) exhibits the necessary degree of 'control' for the purpose of the Regulations, or indeed the extent to which the Regulations can apply to certain floating charges.[82]

Effect of the Regulations

6.40 The principal consequences in relation to a security financial collateral arrangement if the Regulations do apply are as follows:

(a) The registration requirement in s 395 of the Companies Act 1985[83] does not apply (if it would otherwise do so).[84] However, given the uncertainty described above in relation to the meaning of 'possession' and 'control', the prevailing practice is still to register as before, out of caution.

(b) Certain provisions of the Insolvency Act 1986 are disapplied in respect of the arrangement. These include: the moratorium which arises on an administration of the chargor;[85] the obligation to set aside the 'prescribed part' under s 176A of the Insolvency Act 1986;[86] the provisions of s 245 of the Insolvency Act 1986 regarding the avoidance of floating charges;[87] and the provisions of s 754 of the Companies Act 2006,[88] which require a floating charge holder taking possession of assets subject to the charge (other than in a winding up) to pay preferential creditors first.[89]

(c) Where the security is over book entry securities held through one or more intermediaries,[90] the Regulations clarify that the law applicable to determine the validity of the collateral arrangement (and related proprietary and perfection issues) is the law of the country in which the relevant account is situated[91] – the so-called PRIMA (Place of Relevant InterMediary Account) principle.

securities, money market instruments, and 'claims or rights' relating to any of those financial instruments. The 'claims or rights' referred to are probably meant to be those, for example, arising against an intermediary in relation to securities credited to an account with that intermediary.

81 See **6.50**.

82 Particularly as the definition of 'security financial collateral arrangement' (in reg 3) makes it clear that the right of a collateral-provider to substitute equivalent financial collateral or to remove excess financial collateral will not prevent the financial collateral being in the possession or under the control of the collateral-taker. In addition, certain provisions of the Regulations disapply provisions of the insolvency legislation that would otherwise be applicable to floating charges (e g regs 10(5), 10(6)) – indicating that in certain circumstances floating charges are envisaged as capable of constituting security financial collateral arrangements.

83 To be replaced by s 860 of the Companies Act 2006 (scheduled to be brought into force on 1 October 2009).

84 Regulation 4(4).

85 Regulation 8. The right of an administrator to dispose of charged property which is the subject of such an arrangement is also taken away.

86 Regulation 10(3). On the 'prescribed part', see further **6.95**.

FLOATING CHARGES[92]

The nature of a floating charge

6.41 As seen earlier,[93] a charge may be either 'fixed' or 'floating'. Where it is fixed, it attaches to the asset immediately and the chargor can only deal with the asset subject to the charge. But where the charge is floating, the chargor may deal with the assets covered by the charge in the ordinary course of its business without reference to the creditor.[94] The charge does

87 Regulation 10(5). On s 245, see further **6.49**.

88 Formerly s 196 of the Companies Act 1985.

89 Regulation 10(6). There may have been a technical mistake in the wording of the Regulations. If Companies Act 2006, s 754 is disapplied it should follow that Insolvency Act 1986, s 40 (requiring receivers appointed by floating charge holders, other than in a winding up, to pay preferential creditors first) should also be disapplied, but it was not. Consequently, where the security is a floating charge (and the company is not in winding up), preferential creditors need to be paid first if the charge holder appoints a receiver but not if it enforces by taking possession.

90 Such as securities held in CREST, Euroclear or Clearstream, or through a custodian.

91 Regulation 19.

92 See generally Gough, *Company Charges* (2nd edn, 1996), Chapters 5–16; *Goode on Legal Problems of Credit and Security* (4th edn, 2008), Chapter 4; Ferran, *Principles of Corporate Finance Law* (2008), pp 367–392; *Gore-Browne on Companies*, Chapter 30; Ellinger, Lomnicka and Hooley, *Ellinger's Modern Banking Law* (4th edn, 2006), pp 781–794; *Encyclopaedia of Banking Law*, paras E(1051)–E(1100); Benjamin, *Financial Law* (2007), pp 384–393.

93 At **6.5.**

94 *Brunton v Electrical Engineering Corpn* [1892] 1 Ch 434; *Robson v Smith* [1895] 2 Ch 118. What is the 'ordinary course of business' will depend on the circumstances of each case: see, eg, *Ashborder BV v Green Gas Power Ltd* [2005] BCC 634; *Countrywide Banking Corpn Ltd v Dean* [1998] AC 338; *Cox Moore v Peruvian Corporation Ltd* [1908] 1 Ch 604; *Hubbuck v Helms* (1887) 56 LT 232; *Re H H Vivian & Co Ltd* [1900] 2 Ch 654; *Re Borax Co* [1901] 1 Ch 326; *Willmott v London Celluloid Co* (1886) 34 ChD 147; *Robson v Smith* [1895] 2 Ch 118; *Robinson v Burnell's Vienna Bakery Co* [1904] 2 KB 624; *Heaton & Dugard Ltd v Cutting Bros Ltd* [1925] 1 KB 655; *Brunton v Electrical Engineering Corpn* [1892] 1 Ch 434; *Re Hubbard & Co Ltd* (1898) 79 LT 665; *Davey & Co v Williamson & Sons* [1898] 2 QB 194; *Wallace v Evershed* [1899] 1 Ch 891; *Edward Nelson & Co v Faber & Co* [1903] 2 KB 367; *Re Standard Rotary Machine Co Ltd* (1906) 95 LT 829; *Re Ind, Coope & Co Ltd* [1911] 2 Ch 223; *Harmer v London City & Midland Bank Ltd* (1918) 118 LT 571; *Re Anglo-American Leather Cloth Co Ltd* (1880) 43 IT 43.

such company's books.[193] A charge over future book debts is also registrable.[194] A letter of hypothecation[195] will be registrable as a charge on book debts if (as it usually does) it extends to the proceeds of sale of the goods in question.[196] However, an insurance policy does not constitute a book debt,[197] nor, it has been held, does a credit balance in the company's bank account.[198]

(f) A floating charge on the undertaking or property of the company

6.72 Floating charges have already been considered at **6.41**ff. A floating charge is registrable under this category even though it is over part only of the undertaking or property.[199]

(g) A charge on calls made but not paid

6.73 Charges on uncalled capital have been considered above.[200] This category applies where calls have been made but not yet paid. Such calls are a form of debt, but are not regarded as book debts.

(h) A charge on a ship or aircraft or any share in a ship

6.74 A legal mortgage[201] of a registered British ship must be made in the form prescribed under the Merchant Shipping Act 1995, and is

[193] *Independent Automatic Sales Ltd v Knowles & Foster* [1962] 1 WLR 974; *Official Receiver v Tailby* (1886) 18 QBD 25 at 29–30 per Lord Esher MR, rvsd on other grounds sub nom *Tailby v Official Receiver* (1888) 13 App Cas 523; *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142.

[194] *Independent Automatic Sales Ltd v Knowles & Foster* [1962] 1 WLR 974; *Re Brush Aggregates Ltd* [1983] BCLC 320.

[195] See **6.6**.

[196] *Ladenburg & Co v Goodwin, Ferreira & Co Ltd* [1912] 3 KB 275.

[197] *Paul & Frank Ltd v Discount Bank (Overseas) Ltd* [1967] Ch 348.

[198] *Re Stevens* [1888] WN 110; *Re Brightlife Ltd* [1987] Ch 200; *Northern Bank Ltd v Ross* [1991] BCLC 504; *Re Buildlead Ltd (No 2)* [2005] BCC 138 at 159. Cf *Re Permanent Houses (Holdings) Ltd* [1988] BCLC 563 at 566–567 (where Hoffmann J pointed out that his judgment in *Re Brightlife Ltd* had been concerned with the construction of the term 'book debts' in a charging document, and expressly left open the construction of the term for the purposes of s 395). See also *Re Bank of Credit and Commerce International SA (No 8)* [1998] AC 214 at 227 (where Lord Hoffmann, while expressing no view as to whether a deposit with a bank is a book debt for registration purposes, noted the view of Lord Hutton in *Northern Bank Ltd v Ross* that an obligation to register is unlikely to arise). See also **6.50**.

[199] *Re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284 at 298 per Cozens-Hardy LJ, affd sub nom *Illingworth v Houldsworth* [1904] AC 355.

[200] At **6.67**.

[201] The formalities under the Merchant Shipping Act 1995 do not apply to equitable mortgages and charges. A duly registered legal mortgage of a ship has priority over an equitable charge previously created, even where the legal mortgagee has notice of the equitable charge: *Black v Williams* [1895] 1 Ch 408; *Barclay & Co Ltd v Poole* [1907] 2 Ch 284.

registrable under that Act.[202] The mortgaging of aircraft is governed by s 86 of the Civil Aviation Act 1982 and the Mortgaging of Aircraft Order 1972,[203] which provide for the registration of such mortgages in a register to be maintained by the Civil Aviation Authority.[204]

(i) A charge on goodwill or on any intellectual property

6.75 Goodwill has been defined as 'the benefit and advantage of the good name, reputation, and connection of a business. It is the attractive force which brings in custom. It is the one thing which distinguishes an old-fashioned business from a new business at its first start'.[205] It accordingly follows that goodwill cannot be assigned or charged except together with the business to which it attaches.

6.76 Intellectual property is defined in s 396(3A) of the Companies Act 1985 (s 861(4) of the Companies Act 2006) as any patent, trade mark, registered design, copyright or design right, or any licence under or in respect of any such right. Taking these in turn:

(i) Patents

6.77 A mortgage[206] of a patent or application or right in a patent or application is void unless it is in writing and signed by or on behalf of the mortgagor.[207] Registration of the mortgage in the register of patents is not essential for validity, but a duly registered mortgage has priority over an earlier unregistered mortgage, so long as the later mortgagee did not know of the earlier mortgage.[208]

(ii) Registered trade marks

6.78 Registered trade marks can be either UK registered trade marks[209] or Community trade marks[210] (which are applied for in respect of, and

[202] Merchant Shipping Act 1995, Sch 1, para 7. Where two or more mortgages are registered in respect of the same ship, the priority of the mortgagees between themselves shall be determined by the order of registration: ibid, Sch 1, para 8(1).

[203] SI 1972/1268, as amended.

[204] A duly registered mortgage has priority over any other mortgage or charge of the relevant aircraft, other than a prior registered mortgage: Mortgaging of Aircraft Order 1972, SI 1972/1268, art 14(1).

[205] *IRC v Muller & Co's Margarine Ltd* [1901] AC 217 at 223–224 per Lord MacNaghten. See also *Churton v Douglas* (1859) Johns 174 at 188 per Page Wood V-C.

[206] Defined as including a charge for securing money or money's worth: Patents Act 1977, s 130(1).

[207] Patents Act 1977, s 30(6). In the case of a mortgage by a body corporate, references to being signed by or on behalf of the mortgagor include references to its being under the seal of the body corporate: ibid, s 30(6A).

[208] Patents Act 1977, s 33(1).

[209] Under the Trade Marks Act 1994.

[210] Under Council Regulation 40/94/EC (which is directly applicable in all Member States).

the most subordinated tranche (known as the 'first-loss' piece) being the first to bear any shortfall on the cashflow from the underlying assets, followed in ascending order by the intermediate or mezzanine tranches. The ABS are usually rated by one or more of the main credit rating agencies (Standard & Poor's, Moody's and Fitch), with the highest tranche(s) having the highest rating and the first-loss tranche having either a very low rating or not rated at all. The ratings address for investors the likelihood of their being paid the amounts due on the ABS, and consequently much of the structuring process for these deals is driven by the rating agencies' criteria for assigning particular levels of rating to the various tranches of the ABS.

7.20 These common themes are described in more detail below, and then the four main transaction types are described in more detail.

7.21 Terminology in relation to structured finance is often imprecise. In particular, the term 'securitisation' is sometimes used in a wide sense to cover all these forms of structured finance (ie meaning, essentially, the issue of ABS that convert the cashflows from a set of receivables into another set of cashflows). In this chapter, however, 'securitisation' is used in its narrower (and original) sense, to mean the second of the four main transaction types referred to above (the main distinguishing feature of which is the issue of ABS backed by receivables that are not themselves securities).

COMMON THEMES

The SPV and insolvency remoteness

7.22 As mentioned earlier, the issuer of the ABS is usually referred to as a special purpose vehicle (SPV), special purpose company (SPC) or special purpose entity (SPE). The SPV may be intended to be used for only the one transaction (a 'single-issuance vehicle') or for a succession of similar transactions (a 'multi-issuance vehicle'). The SPV will ordinarily be structured so as to be insolvency-remote (ie reducing as much as possible the risk of it being declared bankrupt or insolvent), and so as to eliminate any unnecessary drain on the cashflows of the structure.

7.23 The latter objective (eliminating unnecessary drains on cashflows) is usually achieved by:

(a) Establishing the SPV, so far as possible, in a zero or low-tax jurisdiction – this is considered further below.

(b) Restricting the SPV from engaging in activities other than the transaction(s) in question, and in particular restricting it from having employees and subsidiaries.

(c) Structuring the SPV's arrangements with its various service providers (the roles of which are considered further below) so as to reduce or eliminate any VAT charges.

(d) Providing in the 'waterfalls' (ie the priorities of payment) that the amounts payable to service providers, etc, in priority to payments on the rated tranches of the ABS are capped at specified levels, with any residual amounts only being payable after the rated ABS tranches have been paid in full.

7.24 The former objective (insolvency-remoteness) is achieved by a combination of elements, including:

(a) Establishing the SPV, so far as possible, in a zero or low-tax jurisdiction, or, if this is not possible, in a jurisdiction where the amount of tax can be agreed with the tax authorities in advance (so that a cash reserve can be maintained in the structure for that amount). This is in order to reduce the risk of the tax authorities being able to wind up the SPV for non-payment of tax.

(b) Prohibiting the SPV from engaging in activities or incurring indebtedness other than under the transaction(s) in question. This is usually done through both contractual limitations in the transaction documents and constitutional limitations under the objects clause in the SPV's memorandum of association.

(c) Prohibiting the SPV from having any employees, and from merging or consolidating with any other entity (since, if that other entity had liabilities, that would increase the risk of insolvency of the resultant merged entity).

(d) Requiring all creditors of the SPV to agree that their claims are limited in recourse solely to the cash derived from the underlying assets backing their ABS (and only in accordance with the priorities of payment in the relevant waterfall), and that any residual shortfall will be extinguished.[25] Whilst these limited recourse provisions are most obviously relevant in the case of a multi-issuance vehicle (in order to prevent the creditors under one transaction obtaining recourse to the underlying assets backing another of the SPV's

[25] Such limited recourse provisions are in effect a form of subordination (the validity of which, under English law, is now beyond doubt: see further **Chapter 8**). Limited recourse provisions used not to be possible in the case of a UK SPV, as HM Revenue & Customs took the view that these provisions made the interest payable by the SPV dependent on the results of a business, with the result that the payments were treated as distributions rather than interest and were thus not deductible for the SPV. This concern has been removed by the Taxation of Securitisation Companies Regulations 2006, SI 2006/3296, which allow UK securitisation SPVs to pay corporation tax on a small, pre-set, profit margin irrespective of deductibility.

the company's constitution.[12] A person shall not be regarded as acting in bad faith by reason only of knowledge that an act is beyond the powers of the directors under the company's constitution.[13] In addition, a third party is not bound to inquire whether there is any limitation on the powers of the directors to bind the company or to authorise others to do so.[14]

9.10 On the face of it, these provisions would seem to provide comprehensive protection for creditors against the risk of an internal lack of authority on the part of the company. However, some difficulties do remain:

(a) The exact effect of the requirement that the creditor be acting 'in good faith' is unclear. Section 35A(2) of the Companies Act 1985 (s 40(2)(b)(ii) of the Companies Act 2006) provides that a person shall be presumed to have acted in good faith unless the contrary is proved, and (as described above) that a person will not be regarded as acting in bad faith merely because he knows of a lack of authority. However, it does not follow that the lack of such knowledge automatically equates to good faith, merely that some other factor over and above (or instead of) knowledge is necessary for bad faith.[15] Consequently, where the creditor has a close commercial relationship with the company and consequently knows of, or deliberately shuts its eyes to, restrictions on the directors' authority, the protections under these sections may not necessarily be available.

(b) The provisions refer to the power of the board (in the case of the 1985 Act) or the directors (in the case of the 2006 Act) to bind the company, or to authorise others to do so, being free of limitations. It does *not* say that the board/directors shall be deemed to have exercised the power to authorise others to bind the company. Consequently, the protections would not appear to be available where the transaction is entered into by an officer (such as the corporate treasurer) who has not in fact been authorised by the board/directors: in that case, validity will be tested by reference to the actual or ostensible authority of the officer and the *Turquand* rule described earlier.

(c) The limitations which are overridden are those arising under the company's constitution (defined as including certain resolutions and

12 Section 35A(1) of the 1985 Act, s 40(1) of the 2006 Act.
13 Section 35A(2) of the 1985 Act, s 40(2)(b)(iii) of the 2006 Act.
14 Section 35B of the 1985 Act, s 40(2)(b)(i) of the 2006 Act.
15 See, eg, *Barclays Bank Ltd v TOSG Trust Fund Ltd* [1984] BCLC 1 at 18 (rvsd [1984] AC 626 without affecting this point), where Nourse J held that good faith is different from mere absence of notice and requires that the relevant person acts 'genuinely and honestly'.

agreements).[16] However, it has been held at first instance that these do not include quorum requirements,[17] and so a board decision purportedly taken at an inquorate board meeting would appear not to be 'cured' by the provisions.

(d) As with a transaction beyond the company's capacity, the directors remain liable to the company for their breach of duty.[18] It is also theoretically possible that, even though the transaction has been preserved under ss 35A and 35B of the 1985 Act (s 40 of the 2006 Act), the creditor may still be required to hold any proceeds as constructive trustee for the company.[19]

(e) Under s 322A of the 1985 Act (repeated with no change of substance in s 41 of the 2006 Act), the protections of ss 35 and 35A of the 1985 Act (s 40 of the 2006 Act) do not apply where the transaction exceeds a limitation on the powers of the directors under the company's constitution and the other parties include a director of the company or its holding company, or a person connected with such a director. In those circumstances, the transaction is voidable at the instance of the company[20] and, whether or not it is avoided, such parties[21] and any director who authorised the transaction are liable to account to the company for any gains they make and to indemnify the company against any loss it suffers.[22] The transaction ceases to be voidable if, inter alia, it is affirmed by the company.[23] Though the section does not affect the ability of any other party to the transaction to rely on s 35A of the 1985 Act (s 40 of the 2006 Act), the court may make an order affirming, severing or setting aside the

16 Section 35A(3) of the 1985 Act, s 17 of the 2006 Act.
17 On the basis that a quorum requirement is not a limitation on the power of the board to bind the company but rather a limitation on what constitutes a decision of the board: *Smith v Henniker-Major & Co* [2002] BCC 544. The decision was upheld by the Court of Appeal ([2002] BCC 768), but only one judge (Carnwath LJ) supported the first instance reasoning on this point.
18 Section 35A(5) of the 1985 Act, s 40(5) of the 2006 Act.
19 On the basis of either knowing receipt or being an accessory to a breach of fiduciary duty. This is because s 35A(5) of the 1985 Act and s 40(5) of the 2006 Act preserve the liability not just of directors but also of any other person, and the tests of liability are different: whereas the requirement for validity under s 35A(1) of the 1985 Act (s 40(1) of the 2006 Act) is good faith, and good faith is presumed unless the contrary is proved, a third party's knowledge needs to be 'unconscionable' for knowing receipt or 'objectively dishonest' for accessory liability, without a similar presumption to the contrary being applicable (*BCCI (Overseas) Ltd v Akindele* [2001] Ch 437 at 455 per Nourse LJ; *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 at 390).
20 Section 322A(1) and (2) of the 1985 Act, s 41(1) and (2) of the 2006 Act.
21 Unless they can show that they did not know that the directors were exceeding their powers: s 322A(6) of the 1985 Act, s 41(5) of the 2006 Act.
22 Section 322A(3) of the 1985 Act, s 41(3) of the 2006 Act.
23 Section 322A(5) of the 1985 Act, s 41(4) of the 2006 Act. The other circumstances where the transaction ceases to be voidable are where: restitution is no longer possible; the company has been indemnified for any loss resulting from the transaction; or avoidance would affect rights acquired, bona fide for value and without actual notice of the directors exceeding their powers, by a person who was not a party to the transaction.

contained in a separate deed poll for the benefit of the holders[4] or, in the case of bearer securities, endorsed on the securities themselves, so that the benefit of the guarantee passes by negotiation of the securities.[5]

TYPES OF GUARANTEE

11.2 The term 'guarantee' is used loosely and is often used to refer to what is strictly an indemnity rather than a guarantee (or, possibly, a mixture of the two). Under a guarantee, the guarantor agrees that, if the borrower does not meet a legally binding obligation, the guarantor will be liable for the borrower's debt or default. The guarantor's liability is secondary, or 'collateral': it is dependent on the borrower's default, and, in the absence of agreement to the contrary by the guarantor, will be extinguished if the borrower is not itself liable[6] or if there is a material variation of the borrower's liability, such as an extension of time to pay,[7] an amendment to the terms of the underlying debt that could prejudice the guarantor,[8] a release of the borrower[9] or a set-off, counterclaim or

4 As to deeds poll, see **19.7**. As a result of the Contracts (Rights of Third Parties) Act 1999, third party beneficiaries now have direct rights of action under contracts to which they are not party. However, the rights envisaged by the Act arise where a contract is entered into between A and B that is intended to confer a benefit on C. Where (as here) the intention is for A (the guarantor) to confer rights unilaterally on C (the holder) without C needing to execute an assignment of his rights to a subsequent holder of his bonds, the deed poll remains the most efficient method of achieving this.

5 As to which, see **15.3**ff.

6 *Coutts & Co v Browne-Lecky* [1947] KB 104; *Swan v Bank of Scotland* (1836) 10 Bligh NS 627; *Brown v Blaine* (1884) 1 TLR 158; *Coutts & Co v Stock* [2000] 2 All ER 56; *Lloyds and Scottish Trust Ltd v Britten* (1982) 44 P&CR 249; *Heald v O'Connor* [1971] 2 All ER 1105; *Anglo Petroleum Ltd v TFB (Mortgages) Ltd* [2003] EWHC 3125 at [23].

7 *Rees v Berrington* (1795) 2 Ves Jun 540; *Samuell v Howarth* (1817) 3 Mer 272; *Petty v Cooke* (1871) LR 6 QB 790 at 794–795 per Blackburn J; *Bolton v Buckenham* [1891] 1 QB 278; *Rouse v Bradford Banking Co Ltd* [1894] AC 586; *Polak v Everett* (1876) 1 QBD 669 at 673–674 per Blackburn J; *Overend, Gurney & Co Ltd v Oriental Financial Corporation Ltd* (1874) LR 7 HL 348; *Mahant Singh v U Ba Yi* [1939] AC 601 at 606; *Creighton v Rankin* (1840) 7 Cl & Fin 325 at 346–347; *Clarke v Birley* (1889) LR 41 ChD 422; *Holme v Brunskill* (1878) LR 3 QBD 495 at 505–506 per Blackburn J; *Ward v National Bank of New Zealand Ltd* (1883) LR 8 App Cas 755 at 763; *Moschi v Lep Air Services Ltd* [1973] AC 331 at 348 per Lord Diplock. There must, however, be a binding agreement between creditor and borrower to extend time, and not merely delay: *Clarke v Birley* (1889) 41 ChD 422; *Carter v White* (1883) 25 ChD 666; *Mahant Singh v U Ba Yi* [1939] AC 601 at 606.

8 Known as the rule in *Holme v Brunskill* (1878) LR 3 QBD 495. A variation of the principal contract that has the effect of altering the guarantor's rights will discharge the guarantor unless it is unsubstantial and clearly does not prejudice the guarantor (*Holme v Brunskill* (1878) LR 3 QBD 495 at 505 per Cotton LJ; *Egbert v National Crown Bank* [1918] AC 903 at 908–909; *Credit Suisse v Borough Council of Allerdale* [1995] 1 Lloyd's Rep 315 at 361, 365–366 (upheld [1997] QB 306); *Bolton v Salmon* [1891] 2 Ch 48 at 54; *National Bank of Nigeria Ltd v Awolesi* [1964] 1 WLR 1311; *Rees v Berrington* (1795) 2 Ves 540 at 543 per Lord Loughborough LC; *Re Darwen and Pearce* [1927] 1 Ch 176 at 183; *Marubeni Hong Kong and South China Ltd v Government of Mongolia* [2004] 2 Lloyd's Rep 198 at 225–226 (affd [2005] Lloyd's Rep 231); *ST Microelectronics NV v Condor Insurance Ltd* [2006] 2 Lloyd's Rep 525; *Barclays Bank plc v Kingston* [2006] 2 Lloyd's Rep 59; *Lloyds TSB Bank plc v Hayward* [2005] EWCA Civ 466. For examples of amendments which did not discharge the guarantor, see *Sanderson v Aston* (1873) LR 8 Exch 73; *Frank v Edwards* (1852) 8 Exch 214; *Egbert v National Crown Bank* [1918] AC 903; *Wittmann (UK) Ltd v Willdav Engineering SA* [2007] EWCA Civ 824.

9 *Carter v White* (1883) 25 ChD 666 at 670 per Cotton LJ; *Mahant Singh v U Ba Yi* [1939] AC 601 at 606; *Commercial Bank of Tasmania v Jones* [1893] AC 313; *Webb v Hewitt* (1857) 3 K&J 438; *Perry v National Provincial Bank of England* [1910] 1 Ch 464 at 471 per Cozens-Hardy MR.

10 *Bechervaise v Lewis* (1872) LR 7 CP 372; *Murphy v Glass* (1869) LR 2 PC 408; *Trafalgar House Construction (Regions) Ltd v General Surety and Guarantee Co Ltd* [1996] AC 199; *Thornton v Maynard* (1875) LR 10 CP 695; *Hyundai Shipbuilding and Heavy Industries Co Ltd v Pournaras* [1978] 2 Lloyd's Rep 502 at 508 per Roskill LJ (upheld [1980] 2 All ER 29); *BOC Group plc v Centeon LLC* [1999] 1 All ER (Comm) 53 (upheld [1999] 1 All ER (Comm) 970).

11 'An indemnity is a contract by one party to keep the other harmless against loss, but a contract of guarantee is a contract to answer for the debt, default or miscarriage of another who is to be primarily liable to the promisee': *Yeoman Credit Ltd v Latter* [1961] 2 All ER 294 at 296 per Holroyd Pearce LJ; see also *Heald v O'Connor* [1971] 2 All ER 1105; *Moschi v Lep Air Services Ltd* [1973] AC 331; *Argo Caribbean Group Ltd v Lewis* [1976] 2 Lloyd's Rep 289; *General Produce Co v United Bank Ltd* [1979] 2 Lloyd's Rep 255; *The Anemone* [1987] 1 Lloyd's Rep 546 at 555; *Clement v Clement* (1996) 71 P&CR D19; *Goulston Discount Co Ltd v Clark* [1967] 2 QB 493; *Western Credit Ltd v Alberry* [1964] 2 All ER 938; *Stadium Finance Co Ltd v Helm* (1965) 109 Sol Jo 471; *Davys v Buswell* [1913] 2 KB 47 at 53–55 per Vaughan Williams LJ; *Harburg India Rubber Comb Co v Martin* [1902] 1 KB 778 at 784–785 per Vaughan Williams LJ; *General Surety & Guarantee Co Ltd v Francis Parker Ltd* (1977) 6 BLR 16 at 21.

12 See **11.13**.

13 See, eg, *Moschi v Lep Air Services Ltd* [1973] AC 331 at 349 per Lord Diplock; *Western Credit Ltd v Alberry* [1964] 2 All ER 938 at 940–941 per Davies LJ; *Yeoman Credit Ltd v Latter* [1961] 2 All ER 294 at 296 per Holroyd Pearce LJ; *Trafalgar House Construction (Regions) Ltd v General Surety & Guarantee Co Ltd* [1996] 1 AC 199 at 208 per Lord Jauncey; *Perry v National Provincial Bank of England* [1910] 1 Ch 464; *MS Fashions Ltd v Bank of Credit and Commerce International SA* [1993] Ch 425 at 436 per Hoffmann LJ; *Stadium Finance Co Ltd v Helm* (1965) 109 Sol Jo 471; *Harburg India Rubber Comb Co v Martin* [1902] 1 KB 778 at 784–785 per Vaughan Williams LJ; *Greene King plc v Stanley* [2001] EWCA Civ 1966 at [77] per Jonathan Parker LJ; *Pitts v Jones* [2008] QB 706; *IIG Capital LLC v Van Der Merwe* [2008] 2 Lloyd's Rep 187. However, outside the banking context, there is a presumption that, in the absence of clear words indicating a primary liability, a contract will be construed as a guarantee rather than an indemnity (*Marubeni Hong Kong and South China Ltd v Mongolian Govt* [2005] 1 WLR

defence available to the borrower.[10] Under an indemnity, though, the indemnifier undertakes the obligation itself and agrees to be liable whether or not the borrower is also liable. The liability is primary and does not depend on the borrower's obligation, nor on its default.[11] The distinction is important not just in defining the extent of the 'guarantor's' liability but also because, by s 4 of the Statute of Frauds (1677), a guarantee is unenforceable by action unless the agreement or some memorandum or note thereof is in writing and signed by the guarantor or his authorised agent.[12] However, there is no similar requirement for indemnities.

11.3 Whether a contract is a guarantee or an indemnity is a matter of construction, with the substance of the agreement being determinative rather than any particular labels used.[13] Provisions to the effect that the 'guarantor' is liable 'as a principal debtor and not merely as a surety' and

11.22 It is also common to express the guarantee as a 'continuing' guarantee and/or as applying to the 'ultimate balance' of money owing by the borrower. These provisions are designed to exclude the effect of the rule in *Clayton's Case*,[41] as a result of which repayments by the borrower of subsequent, unguaranteed borrowings would, if not specifically appropriated by the borrower or the creditor[42] to the later borrowings, operate in discharge of the earlier, guaranteed borrowing and thereby reduce the liability of the guarantor. Where either or both of these provisions (or other wording indicating a similar intention) is included, this is effective to prevent the liability of the guarantor being reduced in such circumstances.[43] If the guarantor is unwilling for the guarantee to be unlimited, however, the usual solution is to insert a limit on the amount payable.[44]

11.23 Other protective provisions commonly inserted in a guarantee include:

(a) a 'non-competition' clause, under which the guarantor agrees that, while any amount remains owing to the lender, it will not exercise any right of subrogation against the borrower in respect of amounts already paid by the guarantor under the guarantee or prove in a liquidation of the borrower in competition with the lender[45]; and

(b) a suspense account provision, allowing the lender to hold any partial payments[46] by the guarantor in a separate 'suspense' account until the full amount due has been paid. The amount in the suspense account is stated not to reduce the amount due, so that the lender can prove for the full amount in a liquidation of the borrower and thereby potentially increase the liquidation dividend receivable.[47]

441). However, a provision that the lender's rights will not be affected by any 'amendment or variation' of the underlying loan facility will not protect the lender where the underlying loan facility is replaced by a new facility (*Triodos Bank NV v Dobbs* [2005] 2 Lloyd's Rep 588).

41 *Devaynes v Noble* (1816) 1 Mer 572.

42 As, eg, in *Re Sherry* (1884) 25 ChD 692.

43 See, eg, *Westminster Bank Ltd v Cond* (1940) 46 Com Cas 60; *Merle v Wells* (1810) 2 Camp 413; *Wood v Priestner* (1866) LR 2 Ex 66, affd (1866) LR 2 Ex 282; *Laurie v Scholefield* (1869) LR 4 CP 622; *Mason v Pritchard* (1810) 2 Camp 436.

44 As in each of the cases cited in the previous footnote.

45 Waivers and limitations of the right of subrogation are valid (see, eg, *Midland Banking Co v Chambers* (1869) LR 4 Ch App 398; *Re Rees* (1881) LR 17 ChD 98; *Barclays Bank Ltd v TOSG Trust Fund Ltd* [1984] AC 626 at 644 per Oliver LJ (upheld HL); *Re Butler's Wharf Ltd* [1995] 2 BCLC 43 at 50; *Liberty Mutual Insurance Co (UK) Ltd v HSBC Bank plc* [2002] EWCA Civ 691). However, clear words are required (see, eg, *Re Butler's Wharf Ltd* [1995] 2 BCLC 43; *Liberty Mutual Insurance (UK) Ltd v HSBC Bank plc* [2002] EWCA Civ 691).

46 Or even a payment in full, if the guarantee is of only part of a debt.

47 *Commercial Bank of Australia Ltd v Wilson* [1893] AC 181; *Ulster Bank Ltd v Lambe* [1966] NI 161 (Northern Ireland); *Re Butler's Wharf Ltd* [1995] 2 BCLC 43 at 49. There appears to be a suggestion by Dillon LJ in *MS Fashions Ltd v Bank of Credit and Commerce International SA* [1993] Ch 425 at 448 that suspense accounts are ineffective

EXAMPLE 'GUARANTEE'

11.24 By way of example, a typical 'guarantee'[48] clause in a syndicated loan facility would read as follows:

(1) Guarantee

The Guarantor irrevocably and unconditionally:

(a) as principal obligor guarantees to each Finance Party prompt performance by the Borrower of all its obligations under the Finance Documents;

(b) undertakes with each Finance Party that, whenever the Borrower does not pay any amount when due under or in connection with any Finance Document, the Guarantor shall forthwith on demand by the Agent pay that amount as if the Guarantor instead of the Borrower were expressed to be the principal obligor; and

(c) indemnifies each Finance Party on demand against any loss or liability suffered by it if any obligation guaranteed by the Guarantor is or becomes unenforceable, invalid or illegal.

(2) Continuing guarantee

This guarantee is a continuing guarantee and will extend to the ultimate balance of all sums payable by the Borrower under the Finance Documents, regardless of any intermediate payment or discharge in whole or in part.

(3) Reinstatement

(a) Where any discharge (whether in respect of the obligations of the Borrower or any security for those obligations or otherwise) is made in whole or in part or any arrangement is made on the faith of any payment, security or other disposition which is avoided or must be restored on insolvency, liquidation or otherwise without limitation, the liability of the Guarantor under this Clause shall continue as if the discharge or arrangement had not occurred.

(b) Each Finance Party may concede or compromise any claim that any payment, security or other disposition is liable to avoidance or restoration.

(4) Waiver of defences

The obligations of the Guarantor under this Clause will not be affected by an act, omission, matter or thing which, but for this provision, would reduce,

('A creditor cannot sue the principal debtor for an amount of the debt which the creditor has already received from a guarantor'): however, the guarantees in that case did not contain suspense account provisions, and accordingly the statement can be distinguished as being authority merely for the position that applies in the absence of a suspense account provision.

48 Ie in reality combining elements of a pure guarantee, a conditional payment guarantee and an indemnity.

incorporated on the face of the bond, the terms provide that the holder may not enforce against the issuer unless the trustee has been directed by the holders[11] to enforce (and has been indemnified to its satisfaction[12]) and has failed to take action.[13] A typical provision to this effect (in this example, in a eurobond issue) would read as follows:

> (A) The Trustee shall not be bound to take any action in relation to the Trust Deed, the Bonds or the Coupons (including but without limitation, enforcement proceedings) unless (a) it shall have been so directed by an Extraordinary Resolution of the Bondholders or so requested in writing by the holders of at least one-fifth in principal amount of the Bonds then outstanding and (b) it shall have been indemnified to its satisfaction.
>
> (B) Only the Trustee may enforce the provisions of the Trust Deed, the Bonds and the Coupons. No Bondholder or Couponholder shall be entitled to proceed directly against the Issuer to enforce the performance of any of the provisions of the Trust Deed, the Bonds or the Coupons unless the Trustee, having become bound as aforesaid to take proceedings, fails to do so within a reasonable period and such failure is continuing.

(b) The terms invariably provide that only the trustee may accelerate the securities on the occurrence of an event of default. It is common to provide[14] that the trustee may accelerate in its discretion, and shall accelerate if directed by the holders and indemnified to its satisfaction.[15]

[11] Either by a resolution at a meeting of holders or in writing by a specified proportion of the holders.

[12] As to the meaning of the phrase 'indemnified to its satisfaction' see footnote 15 below.

[13] Such a provision is valid: *Rogers & Co v British & Colonial Colliery Supply Assoc'n* (1898) 68 LJQB 14. See also *Pethybridge v Unibifocal Co Ltd* [1918] WN 278 (provision restraining a holder from taking action without the consent of a specified number of the holders held valid); *Highberry Ltd v Colt Telecom Group plc (No 2)* [2002] EWHC 2815 (English public policy did not invalidate a 'no-action' clause governed by New York law); *Elektrim SA v Vivendi Holdings 1 Corp* [2008] EWCA Civ 1178 ('no-action' clause held valid and held to apply not just to claims expressly enforcing the bonds but also to claims which amounted in substance to proceedings to enforce the bonds, such as fraud and misrepresentation claims). Cf *Elliott International LP v Law Debenture Trustees Ltd* [2006] EWHC 3063 (Ch) ('no-action' clause did not apply to opposition proceedings under French insolvency law as these were not proceedings to enforce the terms of the bonds).

[14] For an example provision, see **5.19**.

[15] Such a clause is valid (*Concord Trust v Law Debenture Trust Corporation plc* [2005] 1 WLR 1591). The meaning of the phrase 'indemnified to its satisfaction' in this context was considered by the House of Lords in *Concord Trust*, ibid. Their Lordships held that: in identifying a risk of liability, the trustee does not have to demonstrate that it would actually incur that liability, merely that it is 'reasonably arguable' that it may do so; once such a risk has been identified the trustee is entitled to be indemnified for the consequences on a 'worst case scenario' basis; under English law, an acceleration notice given when no event of default has actually occurred does not expose the trustee to potential liability to the issuer, but is merely an ineffective notice (and therefore the trustee is not entitled to be indemnified in respect of that risk); the position may well be different, though, under an applicable foreign law; in that case the trustee has to show sufficient differences between the foreign law and English law to give 'some substance' to the fear of liability.

(c) Most events (other than failure to pay and winding up) are usually provided not to be events of default unless the trustee has certified that the event is in its opinion 'materially prejudicial' to the interests of the holders.[16] Since this involves the opinion of the trustee, it is not open to the holders to direct the trustee to issue such a certificate.[17]

(d) Any funds received by the trustee after acceleration or enforcement are held on trust, the terms usually providing that the trustee may deduct any remuneration and expenses that remain unpaid by the issuer (the right of 'top-slicing') before payment to the holders. A typical provision to this effect (in this example, in a eurobond trust deed) would read as follows:

> All moneys received by the Trustee under this Trust Deed (including any moneys which represent principal, premium or interest in respect of Bonds or Coupons which have become void under Condition [ ] (*Prescription*)) shall be held by the Trustee upon trust to apply them (subject to Clause [ ] (*Investment of de minimis amounts*)):
>
> FIRST in payment or satisfaction of all remuneration, costs, charges, expenses and liabilities then due and unpaid under Clauses [ ] (*Remuneration*) and [ ] (*Indemnity*) to the Trustee;
>
> SECONDLY in or towards payment *pari passu* and rateably of all principal, premium (if any) and interest then due and unpaid in respect of the Bonds and the Coupons; and
>
> THIRDLY in payment of the balance (if any) to the Issuer (without prejudice to, or liability in respect of, any question as to how such payment to the Issuer shall be dealt with as between the Issuer and any other person).

(e) Various covenants are given by the issuer to the trustee, primarily regarding the keeping of accounts and the provision of certificates and financial information to the trustee. However, it is usual to provide that the trustee is entitled to assume that no event of default or breach of covenant has occurred until it has express notice thereof.[18] Once the trustee has notice, it is obviously under a duty to

[16] The 'interests' of the holders in this context are their contractual entitlements under the securities to be paid in full and on time, together with any ancillary rights designed to provide protection for their entitlement to receive timely payment (such as security or, in the *Acciona* case, the right to appoint a representative to the issuer's board to control the issuer's expenditure), but not extraneous factors (such as market price, ratings, etc): *Law Debenture Trust Corporation plc v Acciona SA* [2004] EWHC 270.

[17] Subject, it would seem, to the duty of the trustee at least to consider whether to issue the certificate: see **12.19**. For an example provision, see **5.19**.

[18] For an example provision, see **12.28**.

(b) Where conflict of interest and duty permissible

12.25 There are two situations where the trustee may legitimately place itself in a position where its interest and its duty may be in conflict:

(a) where the holders consent, so long as they are given full information on all the material circumstances and of the exact nature and extent of the trustee's interest;[61] or

(b) where the conflict is authorised by the trust deed.[62] The holding of investments in the issuer, the entry into other business transactions with the issuer and the holding of trusteeships under other issues of the issuer are all usually expressly authorised,[63] but there are a number of limits on the effectiveness of such authorisations:
   (i) notwithstanding the authorisation, the presence of the conflict may make it more difficult for the trustee to prove that it acted with the requisite standard of care;[64]
   (ii) the authorisation itself may be struck down, particularly as it is in effect 'imposed' on investors who may be relatively unsophisticated and usually do not have an opportunity to participate in its preparation;[65] and
   (iii) notwithstanding the authorisation, the presence of the conflict may make a court less willing to relieve the trustee from liability for breach of trust under s 61 of the Trustee Act 1925.[66]

[61] See especially *Boardman v Phipps* [1967] 2 AC 46; *Lindgren v L & P Estates Ltd* [1968] Ch 572; *North and South Trust Co v Berkeley* [1971] 1 WLR 470 at 484–485; *New Zealand Netherlands Society 'Oranje' Incorporated v Kuys* [1973] 2 All ER 1222; *Fullwood v Hurley* [1928] 1 KB 498. The trustee cannot merely disclose that it has an interest: *Imperial Mercantile Credit Association v Coleman* (1873) 6 HL 189; *Dunne v English* (1874) 18 Eq 524; *Costa Rica Railway Co Ltd v Forwood* [1901] 1 Ch 746 at 761 per Vaughan Williams LJ. As to obtaining such consent by majority resolution of the holders, see **Chapter 16**.

[62] See *Re Llewellin's Will Trusts* [1949] Ch 225; *Boardman v Phipps* [1967] 2 AC 46; *Brown v IRC* [1965] AC 244; *New Zealand Netherlands Society 'Oranje' Incorporated v Kuys* [1973] 2 All ER 1222; *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd* [1986] 3 All ER 75. See also Mowbray (1996) 10(2) TruLI, pp 49–50. Cf *Re Drexel Burnham Lambert UK Pension Plan* [1995] 1 WLR 32 at 43.

[63] For an example provision, see **12.28**.

[64] See *Re Dorman, Long and Co Ltd* [1934] 1 Ch 635; the trustee was a bank that had lent to the company; as trustee it recommended to the holders a scheme of arrangement which benefited it as lender. 'It is idle, I think, to suggest that it is possible for a bank which is owed about one and a half million pounds ... to act impartially in considering such a scheme': per Maugham J at 671.

[65] See *Re Dorman, Long and Co Ltd* [1934] 1 Ch 635; a provision permitting the trustee to act as banker to the company was described by Maugham J (at 671) as 'a most undesirable clause' and 'one which I myself would never have approved, nor, I believe, would the stockholders if they had been told it was to be inserted or had any idea how it might operate'. As a precautionary measure, the authorisations to the trustee are now usually disclosed in general terms in the offering circular. Section 750(1) of the Companies Act 2006 may also be relevant: see earlier.

[66] See, eg, *Re Pauling's Settlement Trusts* [1964] Ch 303 at 339 per Willmer LJ.

(c) Trustees' options where conflict arises

12.26 Where a conflict has arisen, there are generally four alternatives open to the trustee: first, to seek the consent of the holders by means of a resolution;[67] secondly, to resign as trustee (but the trust deed usually expressly provides that the resignation is not effective until a successor trustee has been appointed and approved by the holders); thirdly, to appoint an additional trustee to carry out its functions, if this is permitted by the trust deed; and, fourthly, to delegate its powers and duties, if this is permitted by the trust deed[68] and any applicable provisions of the Trustee Act 2000 are complied with.[69]

Specific duties under the Trustee Act 2000

12.27 In addition to the general duty of care referred to above,[70] the Trustee Act 2000 imposes specific duties in particular circumstances. Of these, the most relevant for corporate trustees are the following:

(a) Whenever the trustee is exercising a power of investment (whether the general power of investment under the Act or a power under the trust deed), it must: have regard to the 'standard investment criteria';[71] review the investments from time to time;[72] and obtain and consider 'proper advice'.[73] These duties cannot be excluded or restricted.[74]

(b) There are restrictions on the terms of appointment of an agent[75] and the delegation of asset management functions.[76] Though it is not totally clear, it is thought that these restrictions do not apply to appointments and delegations under powers in the trust deed (as opposed to those made under the powers in the Act).

[67] As to which, see **Chapter 16**.

[68] Trustees may not, as a general rule, delegate in the absence of authorisation to do so (but see Trustee Act 1925, s 25 and Trustee Delegation Act 1999): see *Snell's Equity* (31st edn, 2005), pp 617–622. Delegation was the solution adopted in 1990 by the trustee of the various issues by members of the British & Commonwealth Group (*Financial Times*, 9 May 1990, p 27; *Re British & Commonwealth Holdings plc (No 3)* [1992] 1 WLR 672 at 674–675). For an example delegation provision, see **12.28**.

[69] See further below.

[70] At **12.11**.

[71] Trustee Act 2000, s 4(1). The 'standard investment criteria' are set out in s 4(3).

[72] Trustee Act 2000, s 4(2).

[73] Trustee Act 2000, s 5.

[74] But the general power of investment under the Act may: ibid, s 6(1).

[75] Trustee Act 2000, s 14.

[76] Trustee Act 2000, s 15.

conjunction with the company and circulating it to the banks, (d) preparing and negotiating with both the company and the other syndicate members the facility documents, and (e) organising the signing arrangements.[2] Where, however, the facility has to be put in place quickly (eg in the case of an acquisition financing), the agreement may well be signed only by a core group of banks (or maybe only one bank), with syndication taking place after signing.

Domestic stock

13.3 The three main ways in which domestic stock is issued are by means of a placing, a rights issue to existing shareholders and takeover offer consideration. The most common is probably the placing.[3] The process is initiated by the company appointing a bank or broker (usually its existing financial adviser) to act as its arranger. However, instead of commitments being solicited over a period of time, as with a syndicated loan, the placing takes place during the course of one day, known as 'impact day'. The normal procedure is for the arranger to agree to underwrite the issue at or before 8 am on impact day (by signing the placing agreement),[4] and then to despatch provisional invitation letters (known as 'pre-placing letters') and preliminary offering circulars to the targeted placees at 8 am. The stock is normally offered on the basis of a stated margin over a comparable gilt-edged security, with the issue yield, rate of interest and issue price being determined later in the day (usually at 3 pm), by reference to the then market price of that gilt, once provisional acceptances have been received from the placees. Formal placing letters and final offering circulars are sent the following morning for formal acceptance to those placees who have provisionally accepted. The trust deed will then usually be executed within the next 2 weeks (but in any event prior to formal allotment).

Eurobonds

13.4 In the case of eurobonds, the issue procedure differs according to whether the issue is in the traditional 'stand-alone' format (ie where the documents are negotiated specifically for that issue) or under an EMTN programme (where most of the documentation has already been negotiated when the programme was established). The majority of issues are now made under EMTN programmes.

[2] On the syndication process, see further Rhodes, *Syndicated Lending* (4th edn, 2004), Chapter 4; Terry, *International Finance and Investment – Multinational Corporate Banking* (3rd edn, 1994), Chapter 7; Fight, *Syndicated Lending* (2004), pp 12–25; Cranston, *Principles of Banking Law* (2nd edn, 2002), pp 54–62.

[3] Stock issued pursuant to a rights issue or a takeover offer is usually ULS or CULS (as to which terms, see **Chapter 3**) rather than secured stock.

[4] In practice, the placing agreement is usually signed the evening before impact day and held 'in escrow' overnight.

(a) Stand-alone issues

13.5 The issue procedure for a traditional 'stand-alone' eurobond issue has three principal phases. The first, as with a syndicated loan, is the pre-mandate phase, during which the company discusses with potential lead managers the type and amount of issue required and then awards the mandate to one particular bank to act as the lead manager.[5] The second phase, the pre-signing phase, involves the lead manager soliciting commitments (on a 'subject to signing of the subscription agreement' basis) from selected financial institutions to form the management group and to underwrite the issue, preparing and negotiating with the company (and, occasionally, the other managers) the subscription agreement and the offering circular, and organising the signing meeting. At the signing meeting, the subscription agreement (which contains the managers' underwriting commitments[6]) is signed and immediately after the signing the offering circular is formally published. The management commitments are solicited during the course of one day, known as the 'launch date'. On the launch date, the lead manager usually contacts by telephone the proposed managers, and then sends invitation telexes or faxes to those institutions which have expressed interest, confirming the oral invitation. Replies are normally required by telex or fax within 24 hours. During the pre-signing phase, also known as the 'selling period', the managers sell the eurobonds to investors, on a preliminary basis subject to allocation by the lead manager and also subject to signing of the subscription agreement. The eurobonds are allocated among the managers by the lead manager immediately before the signing of the subscription agreement.

13.6 The issue structure of a 'stand-alone' eurobond issue used to involve the formation of a management group (who were to 'subscribe or procure subscribers'), an underwriting group (who in effect sub-underwrote the managers' underwriting obligations) and a selling group (who were obliged to assist in the distribution to the ultimate investors, but did not undertake an underwriting obligation). Nowadays, underwriting and selling groups are rare, with the management group obliged to take up the issue to the extent that other investors cannot be found.

[5] It used to be the case that the interest rate and issue price would be agreed between the company and the lead manager immediately prior to the launch date (described below). Such a structure (known as an 'open-priced deal') has now been almost completely replaced by the 'pre-priced deal', in which the interest rate and issue price are agreed as part of the terms of the mandate. A variant of the pre-priced deal is the 'bought deal', in which the lead manager 'commits' to the company as part of the terms of the mandate to purchase all the eurobonds to be issued, irrespective of whether other managers are found.

[6] The practice is that these commitments are undertaken by the managers on a joint and several basis. Cf the position regarding syndicated loans, where the banks contract on a several basis: see **2.17**.

approved for the purposes of s 21 by an authorised person. It should be noted that the restriction will still apply if the communication is made by an exempt person.

13.61 Section 21(8) defines 'engaging in investment activity' as 'entering or offering to enter into an agreement the making or performance of which by either party constitutes a controlled activity ... or ... exercising any rights conferred by a controlled investment to acquire, dispose of, underwrite or convert a controlled investment'.

13.62 An activity is a 'controlled activity'[90] if it is an activity of a specified kind or one which falls within a specified class of activity, and it relates of an investment of a specified kind, or one which falls within a specified class of investment. An investment is a 'controlled investment'[91] if it is an investment of a specified kind, or one which falls within a specified class of investment. The specified activities and investments are listed in Sch 1 to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005[92] (the FP Order).

13.63 The controlled activities are listed in paras 1–11 of Sch 1, and include accepting deposits, dealing in securities and contractually based investments, arranging deals in investments, managing investments, safeguarding and administering investments, and advising on investments. The controlled investments are listed in paras 12–27, and include deposits, shares or stock (with certain exceptions), debentures, debenture stock, loan stock, bonds, certificates of deposit, any other instrument creating or acknowledging indebtedness, instruments giving entitlement to investments (such as warrants), options, futures and contracts for differences.

13.64 The FP Order provides that 'communication' includes verbal and written communications, television broadcasts and information on web sites.[93] The FP Order also distinguishes 'real time communications' (those made in the course of a personal visit, telephone conversation or other interactive dialogue)[94] from 'non-real time communications' (all other communications, including written communications and e-mails).[95] In addition, a real time communication is treated as 'solicited' if the call, visit or dialogue was initiated or requested by the recipient,[96] but otherwise is treated as 'unsolicited'.[97] These distinctions are relevant (inter alia) for the exemptions described below.

[90] FSMA 2000, s 21(9).
[91] FSMA 2000, s 21(10).
[92] SI 2005/1529.
[93] Article 6.
[94] Article 7(1).
[95] Article 7(2).
[96] Article 8(1).
[97] Article 8(2).

13.65 Even if the communication of the relevant invitational material is prima facie restricted by s 21, a number of exemptions are available (each of which can be relied on in combination with others). Some of the most relevant in the context of issues of debt securities are listed below:[98]

(a) The restriction in s 21 does not apply to any non-real time communication included in listing particulars, supplementary listing particulars, a prospectus or supplementary prospectus approved by the FSA under Part VI of FSMA 2000 or by the competent authority of an EEA State other than the UK (provided the requirements of s 87H of FSMA 2000 are met), or any other document required or permitted to be published by the Listing Rules or the Prospectus Rules under Part VI of FSMA 2000 except advertisements within the meaning of the Prospectus Directive.[99] Consequently, where the securities are to be listed on the London Stock Exchange, the prospectus or listing particulars (once it has been approved by the FSA) may be distributed without causing a breach of s 21.

(b) In addition, the restriction in s 21 does not apply to any non-real time communication relating to a prospectus or supplementary prospectus where the only reason for considering it to be an invitation or inducement is that it: (i) states the name and address of the person by whom the transferable securities to which the prospectus or supplementary prospectus relates are to be offered; (ii) it gives other details for contacting such person; (iii) it states the nature and nominal value of the transferable securities to which the prospectus or supplementary prospectus relates, the number offered and the price; (iv) it states that a prospectus or supplementary prospectus is or will be available (and, if not yet available, when it is to be expected to be); and/or (v) it gives instructions for obtaining a copy of the prospectus or supplementary prospectus.[100]

(c) Certain communications to overseas recipients are exempt. Under art 12 of the FP Order, the restriction in s 21 does not apply to any communication which is either (i) made to a person who receives it outside the UK or (ii) directed only at persons outside the UK.[101]

[98] The exemptions in paras (1), (2), and (5) do not apply to communications relating to 'deposits': FP Order, art 11 and 27. However, if the debt securities have a maturity of one year or more, or satisfy the requirements for the 'commercial paper' exclusion (as to which, see **10.14**), they are not deposits, and the exemptions in (1), (2) and (5) therefore do apply.
[99] FP Order, art 70(1). In addition, where the securities are being issued under a programme for which a base prospectus has been approved (as to which, see para **13.34**), the restriction in s 21 does not apply to any non-real time communication comprising the final terms and complying with the relevant provisions of the Prospectus Directive: FP Order, art 70(1A).
[100] Article 71.
[101] Article 12(1).

(b) Inside front cover

14.79 For Category 1 and Category 2 issues (using TEFRA C or TEFRA D):

> The Notes have not been and will not be registered under the US Securities Act of 1933 and include Notes in bearer form that are subject to US tax law requirements. Subject to certain exceptions, Notes may not be offered, sold or delivered within the United States or to US persons.

(c) 'Subscription and sale' section or equivalent

14.80 This will vary according to the Category into which the issue falls.

(i) For Category 1 issues (using TEFRA C or TEFRA D):

> The Notes have not been and will not be registered under the US Securities Act of 1933 (the 'Securities Act') and include Notes in bearer form that are subject to US tax law requirements. Subject to certain exceptions, Notes may not be offered, sold or delivered within the United States or to US persons. Each Manager has agreed that it will not offer, sell or deliver a Note within the United States or to US persons except as permitted by the Subscription Agreement.
>
> In addition, until 40 days after the commencement of the offering, an offer or sale of Notes within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act.

(ii) For Category 2 issues (using TEFRA C or TEFRA D):

> The Notes have not been and will not be registered under the US Securities Act of 1933 (the 'Securities Act') and may not be offered or sold within the United States or to, or for the account or benefit of, US persons except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.
>
> The Notes are subject to US tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by US tax regulations. Terms used in this paragraph have the meanings given to them by the US Internal Revenue Code and regulations thereunder.
>
> Each Manager has agreed that, except as permitted by the Subscription Agreement, it will not offer, sell or deliver the Notes, (i) as part of their distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the offering and the closing date, within the United States or to, or for the account or benefit of, US persons, and it will have sent to each dealer to which it sells Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, US persons.
>
> In addition, until 40 days after the commencement of the offering, an offer or sale of Notes within the United States by a dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

Subscription agreement

(a) Representations and agreements of the issuer

14.81 Whether TEFRA C or TEFRA D applies has no effect on the representations and agreements of the issuer.

(i) For all issues:

> Neither the Issuer, its affiliates (as defined in Rule 251 under the US Securities Act of 1933 (the 'Securities Act')) nor any persons (other than the Managers) acting on its or their behalf have engaged or will engage in any directed selling efforts (as defined in Regulation S under the Securities Act) in respect of the Notes.

(ii) For a Category 1 issue:

> The Issuer reasonably believes that there is no substantial US market interest (as defined in Regulation S under the Securities Act) in the debt securities of the Issuer.

(iii) For a Category 2 issue:

> The Issuer, its affiliates and any person (other than any Manager) acting on its or their behalf have complied with and will comply with the offering restrictions requirement of Regulation S under the Securities Act.

(b) Representations and agreements of the managers

14.82 This will vary according to the Category into which the issue falls.

(i) For a Category 1 issue (whether TEFRA C or TEFRA D applies):

> Each Manager understands that the Notes have not been and will not be registered under the Securities Act and may not be offered or sold within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Each Manager represents and agrees that it has not offered or sold, and will not offer or sell, any Notes constituting part

with a prescribed procedure. Such a procedure is almost always prescribed in the case of registered debt securities, and usually involves completion of a form of transfer and delivery of it to the issuer's registrar.[70] However, if a purported assignment is ineffective as a result of a prohibition on assignment, it may well take effect instead as a declaration of trust, so long as there is nothing in the contract prohibiting such a declaration.[71]

(b) Rights which, if assigned, result in an increase in the obligor's burden. These are not assignable unless the contract contemplates assignment.[72] This is particularly relevant in relation to tax gross-up or increased costs clauses in loan agreements,[73] and if it is intended that the lenders' interests be assignable the agreement should provide that an assignee can take the full benefit of such clauses.

(c) Rights which are intended to be personal to the assignor. Again, these are not assignable unless the contract contemplates assignment.[74] Rights arising under indemnities (such as tax gross-up

422; McMeel [2004] LMCLQ 483. Curiously, it would appear that a prohibition on assignment does not prevent an assignment where the assignment predates the contract containing the prohibition and operates as a contract to assign future property (*Foamcrete (UK) Ltd v Thrust Engineering Ltd* [2002] BCC 221).

69 *Hendry v Chartsearch Ltd* [1998] CLC 1382; *Barbados Trust Co v Bank of Zambia* [2007] 1 Lloyd's Rep 495. Even where the contract provides that the consent may not be unreasonably withheld, and it is unreasonably withheld (or it would be unreasonable for it to be withheld if it were asked for), there can be no valid assignment until after (i) consent has been granted or (ii) the consent has been asked for and the court has declared that the consent has been unreasonably withheld: *Hendry v Chartsearch*, ibid. See also *British Gas Trading Ltd v Eastern Electricity* (1996) *The Times*, November 29 (upheld on appeal (unreported), 18 December 1996, CA). The standard form of loan agreement recommended by the Loan Market Association provides that assignments and transfers are (subject to certain exceptions) not effective without the consent of the borrower, such consent not to be unreasonably withheld or delayed: for an example of the wording, see the specimen clause at **15.39**.

70 In any event, where the debt security constitutes a debenture (as to which, see **Chapter 17**), the issuer may not register a transfer of it unless a proper instrument of transfer has been delivered to it: Companies Act 2006, s 770(1). The requirement does not apply to an exempt transfer within the Stock Transfer Act 1982 (s 770(1)) or a transmission by operation of law (s 770(2)). Section 770(1) and (2) of the Companies Act 2006 replaces s 183(1) and (2) of the Companies Act 1985 (with no change).

71 *Don King Productions Inc v Warren* [1999] 2 All ER 218; *Explora Group plc v Hesco Bastion Ltd* [2005] EWCA Civ 646 at [104] per Rix LJ; *Barbados Trust Co v Bank of Zambia* [2007] 1 Lloyd's Rep 495. As mentioned above, a mere restriction on 'assignment' will not be construed as restricting declarations of trust (though this reasoning has been criticised by academic commentators).

72 *Tolhurst v The Associated Portland Cement Manufacturers* (1900) Ltd [1903] AC 414 at 423 per Lord Lindley; *Dawson v Great Northern and City Railway Co* [1905] 1 KB 260 at 272 per Stirling LJ; *J Miller Ltd v Laurence and Bardsley* [1966] 1 Lloyd's Rep 90.

73 See **2.11**ff.

74 *Tolhurst v The Associated Portland Cement Manufacturers* (1900) Ltd [1903] AC 414; *Kemp v Baerselman* [1906] 2 KB 604; *Davies v Davies* (1887) 36 ChD 359; *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014; *Southway Group Ltd v Esther Wolff* (1991) 57 BLR 33.

or increased costs clauses) may well be held to be personal to the assignor,[75] and therefore if it is intended that the benefit of such clauses be assignable it is advisable to provide to that effect expressly.

(d) Maintenance or champerty. A chose in action is not assignable if the assignment involves or savours of maintenance or champerty.[76] The modern test involves considering whether the facts of the particular case 'suggest that the agreement in question might tempt the allegedly champertous maintainer for his personal gain to inflame the damages, to suppress evidence, to suborn witnesses or otherwise to undermine the ends of justice'.[77]

The impact of CREST

15.23 In the case of debt securities traded through CREST (the UK's electronic settlement system for shares and certain other securities), an assignment can be effected by means of electronic instructions, without any need for an instrument in writing.

(a) Background

15.24 CREST,[78] which was introduced in July 1996, is operated by Euroclear UK & Ireland Limited[79] in accordance with the Uncertificated Securities Regulations 2001[80] (the 'Regulations'). Its purpose is to 'enable title to units of a security to be evidenced otherwise than by a certificate and transferred otherwise than by a written instrument'.[81]

15.25 The Regulations are not specific to CREST but instead provide in generic terms for a 'relevant system'[82] run by an 'Operator'[83] approved by

75 See, eg, *Peters v General Accident Fire & Life Assurance Corporation Ltd* [1938] 2 All ER 267. Cf *British Union and National Insurance Co v Rawson* [1916] 2 Ch 476.

76 See, eg, *Martell v Consett Iron Co Ltd* [1955] Ch 363; *Re Trepca Mines Ltd (No 2)* [1963] Ch 199; *Laurent v Sale & Co* [1963] 1 WLR 829; *Trendtex Trading Corporation v Credit Suisse* [1982] AC 679; *Giles v Thompson* [1994] 1 AC 142; *R (Factortame Ltd) v Transport Secretary (No 8)* [2003] QB 381. 'A person is guilty of maintenance if he supports litigation in which he has no legitimate concern without just cause or excuse', and champerty 'occurs when the person maintaining another stipulates for a share of the proceeds of the action or suit': *R (Factortame Ltd) v Transport Secretary (No 8)* [2003] QB 381 at 399 per Lord Phillips MR, approving the definitions in *Chitty on Contracts*.

77 *R (Factortame Ltd) v Transport Secretary (No 8)* [2003] QB 381 at 400 per Lord Phillips MR.

78 Which is not an acronym but merely the generic name used to describe the CREST system.

79 A private limited company owned by Euroclear SA/NV, the European securities settlement organisation.

80 SI 2001/3755 (as amended), replacing the Uncertificated Securities Regulations 1995.

81 Regulation 2(1).

82 Defined as 'a computer-based system, and procedures, which enable title to units of a security to be evidenced and transferred without a written instrument, and which facilitate supplementary and incidental matters': reg 2(1).