serle**speak**

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Lessons from Lehman: Extended Liens

JUDGMENT IN THE LATEST DIRECTIONS HEARING IN THE LEHMAN ADMINISTRATION WAS HANDED DOWN IN NOVEMBER 2012.

The decision focused on the custody agreements setting out the terms on which Lehman Brothers Europe International Ltd ("LBIE") assumed responsibility for the safekeeping and administration of assets for its clients. Some of LBIE's custody agreements contained provisions ("extended liens") whereby the client purported to grant a "lien" securing debts owed not just to LBIE but also to other "Lehman Brothers entities". Four points of significance emerge from the judgment at [2012] EWHC 2997 (Ch).

First, the case demonstrates that "liens" in custody agreements will readily be re-characterised as floating charges when a traditional lien would make little commercial sense. The client had argued that the expression "general lien" was a term of art giving rise to a contractual lien, which could not bite on intangible property. The judge rejected that argument, concluding that the parties were unlikely to have intended to create security rights of a type covering little or none of the property typically held by the custodian under the agreement.

Secondly, the case refines the definition of a charge. The client had relied upon various classic definitions of a charge, expressed in terms of conferring security for the payment of debts owed to the chargee. The judge concluded that it was not inherent in the nature of a charge that the chargee must be, or be a trustee or fiduciary for, the creditor. All that is necessary is that the chargee must have a specifically enforceable right to have the property appropriated to the payment or discharge of the relevant debt or other obligation.

Thirdly, the case deals with the duties of the chargee under a charge that constitutes security for debts owed to persons other than the chargee. The court rejected the argument of the representative creditor affiliate ("314 CA") that the charge gave rise to a trust or fiduciary duty in favour of LBIE's affiliates. Applying the test of necessity, the court concluded that there was no need for LBIE to have owed such duties to its affiliates. Before the unexpected collapse of the Lehman group, LBIE would have acted in the interests of the group without any need for legal duties affecting its rights as chargee.

Finally, the case deals with the applicability of the Financial Collateral Arrangements (No. 2) Regulations 2003 ("FCAR"). This is important in the context of custody agreements because any charge created will frequently be (as in this case) a floating charge, and as such generally voidable if not registered, unless qualifying as a "financial collateral arrangement" under FCAR. The judge broadly agreed with the decision of Vos J in *Gray v GTP Group Ltd* [2011] 1 BCLC 313, rejecting the argument of the Administrators and 314 CA that the requirement in FCAR for the collateral-taker to be given "possession or control" could be satisfied simply by the charged property being held in the name of the collateral-taker. This conclusion was reached despite analysis of the travaux préparatoires to the Financial Collateral Directive (not reviewed in *Gray*), which provided support for the conclusion that the framers of the directive had not contemplated a requirement of the kind now firmly established in the interpretation of the Directive and FCAR by English courts. The judge's conclusion on this point remains relevant notwithstanding the clarification of the definition of "possession" introduced into FCAR, as from April 2011, by Regulation 4 of the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010, because on the Administrators' argument the amended definition would still have been narrower than was required by the Directive.

314CA has sought permission to appeal.

DAVID BLAYNEY acted as senior junior for LBIE's Administrators.

Welcome to this new edition of Serlespeak, this time covering topics in commercial litigation. In my lead article I discuss the ship owner's predicament where the ship's cargo is the subject of competing claims and a letter of credit has been issued for the benefit of the seller. David Blayney writes on the nature and effects of extended liens in the context of the collapse of Lehman Bros. Later in the edition David Drake examines the extent to which consumer protection legislation can be applied in a commercial context, whilst Tim Collingwood discusses the different approaches of offshore jurisdictions to the liquidation of investment funds. Finally, Dan McCourt Fritz reviews the enforceability of conciliation clauses.

Dominic Dowley QC

The hidden perils of letters of credit

WHAT IS A SHIPOWNER TO DO WHEN THERE ARE COMPETING CLAIMS TO A CARGO ON BOARD HIS VESSEL?

In January last year, an oil trader which had purchased a cargo of crude oil from the Republic of Sudan chartered a vessel to load the cargo at Marsa Bashayer. The cargo was loaded and the vessel sailed for Japan where the oil was to be discharged to the order of a sub-purchaser against presentation of the original Bills of Lading to the Owner/Master.

One of the consequences of the separation of Sudan into two states in 2011 was that the new Republic of South Sudan, while having extensive oil resources, had to use pipelines through the Republic of Sudan in order to export that oil. The Republic of Sudan imposed charges for the transportation of the Republic of South Sudan's oil which the Republic of South Sudan considered unreasonably high and, when the Republic of South Sudan declined to pay, the Republic of Sudan, acting under legislation passed for the purpose, seized sufficient of the Republic of South Sudan's oil to cover the charges.

During the vessel's voyage to Japan, the ship's owners ("Owners") received a communication from the Republic of South Sudan to the effect that the cargo of oil on board the vessel was the property of the Republic of South Sudan, having been (as the Republic of South Sudan alleged) wrongly misappropriated by the Republic of Sudan.

Owners thus found themselves in an awkward situation: on the one hand they were on notice from the Republic of South Sudan that the oil on their vessel might have been misappropriated; on the other hand if they did not obey the charterers'

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("Charterers") discharge instructions, they would be in breach of the charterparty. Owners therefore sought relief from the Commercial Court in London. Initially, the relief sought was an interim declaration that Owners were entitled to refuse to deliver the cargo until the Commercial Court had resolved the dispute as to ownership. That, however, would not have helped much, because Owners would have been left with a disputed cargo sitting on board a drifting vessel pending resolution of the matter.

At this point, Charterers got involved in the application to the Commercial Court. The Commercial Court made an order which directed that the cargo be sold to the Japanese sub-purchasers and that the proceeds of sale be paid into Court and held as security for the parties' respective claims ("the Order").

There proved to be certain problems with what at first sight seemed an efficient and sensible way of dealing with the dispute and protecting Owners.

First, the Order did not concern only Owners, Charterers and the Japanese sub-purchaser. It also concerned the Republic of Sudan and the Republic of South Sudan. Since the Order contained provisions about what could and could not be done by way of asserting rights to the cargo and about the seeking of payment for the cargo, it was open to the two sovereign states to object to it on the grounds that, in its relevant parts, it constituted injunctive relief. The effectiveness of the Order also depended, in any event, on the two sovereign states submitting to the jurisdiction of the English Court and it was far from apparent that that would happen.

But there was a further problem, which is likely to arise in any similar case even if there is no involvement on the part of a sovereign state. This concerned the letter of credit issued by a bank on the application of the purchasers/Charterers for the benefit of the seller, the Republic of Sudan. The Order was also addressed to the bank and required that the Bills of Lading should be placed at the disposal of the Court by the Republic of Sudan (again, a problem because of that defendant's sovereign status) or by the bank. This part of the Order was necessary in order to protect Owners from being presented with the Bills of Lading and a demand for delivery of the oil after they had already discharged the cargo in accordance with the Order that it be sold to the sub-purchasers.

By the time of the Order, presentation of the documents under the letter of credit had already been made to the bank. The bank had rejected the documents on the grounds that they were discrepant. The problem arose under Article 16 of Universal Customs and Practices 600. This provides, in broad terms, that where a bank rejects documents as discrepant, it must give the presenter of the documents a notice stating either that the bank is returning the documents or that the bank is holding the documents pending further instructions from the presenter. Article 16 then goes on to say that, if the bank fails to act in accordance with that Article, it is precluded from claiming that the documents do not constitute a complying presentation.

> The bank was in an awkward situation: the bank's compliance with the Order might render it liable

The Order cut straight across Article 16 and now the bank was in an awkward situation: its compliance with the Order would (or, at the least, might) render it liable to the Republic of Sudan under the letter of credit in circumstances where the documents did not comply and the bank might by reason of that non-compliance be unable to seek reimbursement from Charterer/purchaser.

In the event the matter was resolved, so far as the bank was concerned, by an application by the bank to the Commercial Court for a variation to the Order to permit the bank to return the Bills of Lading to the presenter. That application was successful.

This did not, of course, resolve the other disputes among the various parties. But this does serve to demonstrate the unforeseen difficulties which may arise when trying to formulate what appears a sensible procedure for dealing with disputed ownership questions, particularly where there is a letter of credit involved.

DOMINIC DOWLEY QC and Justin Higgo represented the bank.

Just a wind up?

THE GLOBAL FINANCIAL CRISIS HAS INFLICTED WIDESPREAD LOSSES ON INVESTMENT FUNDS, WHICH LOSSES HAVE ON OCCASION RESULTED IN DISPUTES BETWEEN PARTICIPATING SHAREHOLDERS/INVESTORS AS TO HOW BEST TO MITIGATE SUCH LOSSES.

These disputes have included whether to liquidate investments, how to effect distributions and who should conduct such processes (generally a choice between the directors of the fund or liquidators appointed by the court). Courts have had to consider the extent to which a minority's contentions and wishes may trump the wishes of the majority of participating shareholders.

One of the key weapons in the arsenal of the minority shareholder seeking to liquidate its investment in a solvent fund is an application for just and equitable winding up. A common allegation is that there has been a "loss of substratum" of the fund (essentially that it can no longer fulfil the purpose for which it was formed or that the carrying on of its business has become, in a practical sense, impossible). The balancing of conflicting commercial interests and attitudes has led to different approaches between jurisdictions. There is a conflict between lines of authority in the Cayman Islands and the British Virgin Islands (in the context of open-ended funds, at least) as to whether the applicant/petitioner must demonstrate that it is impossible to carry on the business of the fund in accordance with the reasonable expectations of shareholders (BVI) or (instead) whether it is sufficient that it is impractical, if not impossible, to do so (Cayman).

In *Euro Value Investment Company I v Greater Europe Deep Value Fund II Ltd* the Royal Court in Jersey was called upon (in two judgments : [2012] JRC 146; [2013] JRC 004) to consider these issues in the context of a closed-ended fund in an application brought by a significant minority shareholder for (among other relief) just and equitable winding up. In respect of the issue of loss of substratum, the Court considered, but did not resolve, the conflict between the two lines of authority referred to above. At the first hearing the Court further held that: (i) the substratum of the fund had been lost (its term of life under its prospectus having expired shortly after the hearing and before judgment was handed down) save to the extent that its formal winding up formed part of the fund's business; (ii) the fund's prospectus

provided that the directors would formally wind up the fund; and (iii) there did not appear to be a sufficient loss of confidence in the directors to oust them from that task. The court adjourned the matter of relief in order to allow the parties to ascertain the views of all shareholders in the light of its findings.

> One of the key weapons in the arsenal of the minority shareholder seeking to liquidate its investment in a solvent fund is an application for just and equitable winding up

At the subsequent hearing, and in spite of a majority of shareholders favouring the liquidation of the investments of the fund by the directors instead of by court-appointed liquidators, the court made an order for winding up and appointed liquidators. Although undoubtedly reached on its facts, the case perhaps ultimately represents a general approach closer to that adopted in Cayman than the apparently more reluctant attitude to impose the effects of the appointment of liquidators demonstrated in the BVI.

TIM COLLINGWOOD acted for the fund in *Euro Value Investment Company I v Greater Europe Deep Value Fund II Ltd.*

> "The generally restrictive approach to the application of the 1999 Regulations can at least be said to promote certainty"

B2B, or not B2B, that is the question

IN OVERY v PAYPAL (EUROPE) LTD THE MERCANTILE COURT HELD THAT IT WAS FATAL TO A LITIGANT'S ABILITY TO INVOKE THE UNFAIR TERMS IN CONSUMER CONTRACTS REGULATIONS 1999 IF THE LITIGANT CONTRACTED TO ANY SIGNIFICANT DEGREE FOR PURPOSES OF BUSINESS (RATHER THAN PERSONAL CONSUMPTION).

Using consumer protection legislation to challenge a business's standard terms as unfair can have a significant impact on a contractual dispute, both substantively and procedurally, and a successful challenge may disrupt the business's relations with (other) customers. But in a commercial context, the opportunities to invoke such legislation are limited. Nevertheless, the past 15 years have seen a succession of cases in which investors and other consumers of financial services in particular have sought to do so, with mixed success.

A number have concerned the Unfair Terms in Consumer Contract Regulations 1994 and 1999 (designed to implement Directive 93/13 on unfair terms in consumer contracts), which provide potent weapons for challenging the effectiveness of standard terms on the nebulous grounds that they cause a "significant imbalance" in the parties' rights and obligations under the contract; but these protections may only be invoked by an individual who was acting for purposes "outside his business" (in the language of the 1994 Regulations) or "outside his trade, business or profession" (in the language of the 1999 Regulations). Applying this test can pose problems when, for example, an individual contracts for purposes incidental to the business he or she (part) owns or manages, or for services characteristically provided in a business-to-business context.

Outstanding among the successful challenges are the decision of Longmore J in *Standard Bank v Apostolakis* [2002] CLC 933 and the first instance and Court of Appeal decisions in *Evans v Cherry Tree Finance* [2007] CTLC 220 and [2008] CTLC 117, which concerned, respectively, forex margin trading contracts, and lending secured on commercial premises to allow their purchase.

But doubt was expressed as to the correctness of the Apostolakis decision in *Maple Leaf Macro Volatility Master Fund v Rouvroy* [2009] 1 Lloyd's Rep 475; and in *Overy v PayPal (Europe) Ltd,* unreported, 2nd March 2012, the Mercantile court in Manchester held, first, that it was fatal to a litigant's ability to invoke the protections of the 1999 Regulations if that litigant contracted to any significant degree for purposes of business rather than personal consumption, and, secondly, that what was decisive was the objective appearance to the other contracting party of the litigant's purposes in contracting, rather than the litigant's unexpressed subjective intentions. In doing this, the court followed the approach of the ECJ in *Gruber v Bay Wa AG* [2006] QB 204 in the context of the Brussels Convention's jurisdiction provisions in relation to consumer claims. Furthermore, the court declined

to follow the "predominant purpose" test applied in *Evans v Cherry Tree Finance* in relation to cases where a litigant contracts for mixed business and personal purposes.

The question of what criteria characterize a contracting party's purposes as business purposes rather than personal consumption remains somewhat obscure and controversial after these decisions, in particular in the context of a one-off commercial venture outside a litigant's principal business. But the generally restrictive approach to the application of the 1999 Regulations taken in the *PayPal* decision can at least be said to promote certainty.

DAVID DRAKE acted for the defendant in the *PayPal* case.

Chambers news

Directories

We have had another excellent set of results in the latest Legal 500 directory. As a set we are ranked in the first tier in Civil fraud and Partnership and are highly ranked in 8 other practice areas: Banking and finance, Commercial litigation, Company, Insolvency, Media, entertainment and sport, Private client: trusts and probate, Professional negligence and Property litigation. Individually we now have 116 recommendations; Prof. Jonathan Harris is recommended for the first time and Elizabeth Jones QC, Philip Marshall QC, Andrew Bruce, Daniel Lightman, Jonathan Adkin, Giles Richardson and Thomas Braithwaite all gained new recommendations.

We also continue to be highly recommended in Chambers & Partners. We have 108 individual recommendations. This places us 10th in "sets with most barrister rankings" and 5th in the "recommendations per member" table. As a set we are recommended in 11 practice areas, and only 4 other sets in the country are recommended in more. Highlights among the recommendations include: top ranking as a set in Fraud and Partnership; Alan Boyle QC, Philip Jones QC and Philip Marshall QC being ranked as *"Stars at the Bar"* (only 17 barristers are included in this prestigious category); 4 juniors being included in Offshore for the first time: Nicholas Harrison, Jonathan Adkin, Giles Richardson and Dakis Hagen; a first recommendation for Matthew Morrison in Fraud: Civil; and Lance Ashworth QC's first recommendation in Chancery: Commercial, Commercial Litigation and Restructuring/Insolvency.

Thank you to all our clients for continuing to recommend us so highly.

Awards

At this year's Chambers & Partners Bar Awards David Blayney was named as Banking and Finance Junior of the Year; Daniel Lightman has been included in this year's Lawyer Hot 100; and as a chambers we were nominated for the Chambers of the Year at the British Legal Awards.

Conferences and Seminars

We hosted a very successful conference in Cayman on 29 November. The speakers: (Alan Boyle QC, Dominic Dowley QC, Lance Ashworth QC, Nicholas Lavender QC, John Machell QC, Matthew Morrison, Prof. Jonathan Harris and Sophie Holcombe) were joined by delegates from law firms, trust companies, accounting firms and banks. The conference covered a wide range of issues including: a talk on private trust companies; a case study centered on a family trust dispute; a case study on financial advisors addressing the issues which can arise when trust investments perform badly; a talk on firewall legislation and enforcement of foreign judgments and other offshore jurisdictions; and a panel discussion on fraud and commercial matters.

Our spring seminars and conferences will include a roadshow to Bristol covering Commercial and Property Litigation on 25 February and a trusts workshop in chambers on 27 February. We are sponsoring the Legal Week Trusts and Estates Litigation Conference in Provence on 14 March and we are planning a conference in Jersey in June.

LinkedIn

We have set up 3 discussion groups on LinkedIn to enable Serle Court members and clients to discuss topical issues in Partnership and LLP Law, Fraud and Asset Tracing, and Contentious Trusts and Probate; please join us.

Edited by JONATHAN FOWLES

Conciliation clauses: devoid of meaningful content?

COMPETING POLICY CONSIDERATIONS ARE ENGAGED BY PROVISIONS REQUIRING CONTRACTING PARTIES TO TAKE DEFINED STEPS TO CONCILIATE BEFORE COMMENCING ARBITRAL OR COURT PROCEEDINGS WHEN A DISPUTE ARISES.

The public interest in encouraging disputants to settle their differences without litigating, and the principle that parties should be free to bind themselves to undertake whatever conciliatory process they wish (however eccentric) militate in favour of such provisions being upheld; the tenet enshrined in *Walford v Miles* that agreements to negotiate in good faith are generally unenforceable militates against.

In *Tang and Wong v Grant Thornton International Ltd* [2012] EWHC 3198 (Ch) the claimants, who were former partners in a member of the Grant Thornton International (GTI) group, sought to challenge the jurisdiction of an arbitral tribunal on the grounds that the ADR processes prescribed in the GTI members' agreement (the MFA) had not been followed. The MFA stipulated that (1) any dispute had to be referred in the first instance to the chief executive of GTI, who had one month to attempt to resolve it, and (2) if the dispute had not been resolved within one month of being referred to the chief executive, it be referred to a panel composed of three members of the GTI board, to be selected by the board. The MFA proscribed any party from commencing arbitration in relation to a dispute until the earlier of (a) the panel determining that it could not resolve the dispute, or (b) one month after the dispute being referred to the panel.

The claimants relied on a statement by Colman J in *Cable & Wireless v IBM* [2002] EWHC 2059 that where the court was considering conciliation provisions "a sufficiently certain and definable minimum duty of participation should not be hard to find", submitting that the ADR clauses of the MFA prescribed clear and certain minimum steps which had to be taken in relation to a dispute, and were therefore enforceable. Hildyard J, dismissing the claimants' jurisdictional challenge, rejected this submission, holding that because the content of the dispute resolution processes which the GTI chief executive and board panel had to undertake was not defined in the MFA the ADR clauses were unenforceable.

> "Practitioners should consider whether the provisions adequately identify the processes which those charged with attempting to resolve the dispute should carry out"

In the light of Hildyard J's judgment, when instructed to draft or advise upon ADR provisions practitioners should consider whether the provisions adequately identify not only the people or bodies to whom a dispute should be referred and the timetable for its resolution, but the processes which those charged with attempting to resolve the dispute should carry out. Unless and until *Walford v Miles* is reviewed at the highest level, ADR clauses which do not define the content of such processes will be vulnerable to attack.

DAN McCOURT FRITZ acted with John Machell QC for the claimants in *Tang and Wong v Grant Thornton International Ltd.*