

Finance Update

Welcome to Taylor Wessing's June 2006 update summarising what we think are the more interesting recent legal developments in banking and finance.

Banking: Compliance with Freezing Orders

Banks will be extremely pleased to learn that the House of Lords has reversed the decision of the Court of Appeal (reported in the November 2004 update) that a bank owes a duty of care to someone who has obtained a freezing injunction to take care that the funds the subject of the order are not dissipated in breach of the order.

The facts

Customs had obtained freezing injunctions against two companies (which held current accounts with the bank) specifically prohibiting disposal of or dealing with the debtor companies' assets up to a stated amount including in particular any money in identified accounts at the bank. Customs gave notice of the injunctions by faxing copies of the orders to the bank. Soon afterwards, both companies transferred substantial sums from their respective accounts using the bank's "Faxpay" system, by which a customer could send direct payment instructions to the bank's payment centre rather than to the customer's branch. Customs claimed damages for negligence against the bank on the basis that it was unable to enforce the judgments, which it had subsequently obtained against the debtor companies. The bank argued that it had not assumed any responsibility and that in the absence of such assumption of responsibility it had no duty of care to avoid economic loss.

The decision

The House of Lords considered that a third party, such as the bank would be in contempt of court only if it knowingly failed to freeze customer accounts subject to the freezing injunctions and authorised transfers of sums from the accounts after being notified of the court orders. The failure to operate a system for freezing accounts did not mean that the bank was liable to Customs who had obtained the orders. Notification imposed a duty on the bank to respect the order of the court but it did not of itself generate a duty of care to Customs. Having obtained a freezing order and notified the bank, Customs could expect that any responsible bank would respect the order, but it could not rely on the bank doing so. There was nothing that could be regarded as a voluntary assumption of responsibility by the bank for the way in which it would go about freezing the companies' accounts and there was nothing that involved the bank in entering into any kind of relationship with Customs that required it to exercise such care as the circumstances required. In the circumstances, the parties were not in a relationship of proximity and it would not be fair, just and reasonable to hold that the bank owed a duty of care to Customs. Customs had to rely on the court to ensure that the bank did not flout the orders and to punish the bank if it did so.

Comment

This should provide comfort to banks in relation to their compliance with freezing orders. However, in the light of the comment about the court punishing a bank for failing to comply with such orders, banks should not be complacent and must put in place adequate systems to ensure accounts are properly frozen when notice is received.

Customs & Excise Commissioners v Barclays Bank PLC [2006] UKHL 28

Contract: When is a condition precedent satisfied?

In any loan agreement, the availability of the facility is generally subject to the borrower satisfying a number of conditions precedent. Generally the agreement will provide that such conditions have to be in form and substance satisfactory to the bank (or agent in syndicated transactions) but, until now, there has been no real case law to provide guidance as to how 'satisfactory' should be interpreted.

The facts

The claimant was the vendor of a property. The sale agreement provided that the vendor would provide satisfactory evidence to the purchaser that the property was not a listed building within the meaning of s 1 of the Planning (Listed Buildings and Conservation Areas) Act 1990. If satisfactory evidence was not supplied the purchase price was to be reduced, with the balance of £200,000 held in an escrow account. To satisfy the condition the vendor (i) commissioned an expert report that concluded, following consideration of published planning policy guidance and the merits, that the property was not a listed building, (ii) entered into correspondence with English Heritage, the conclusion of which was that the property was not a listed building within the meaning of the Act, and (iii) a statutory declaration made by one of the trustees owning the adjacent premises that prior use of the property had ceased. The parties could not agree whether or not the condition had been satisfied prior to completion so the parties entered into a supplemental agreement which provided that the balance of £200,000, held in the escrow account, would be paid to the vendor in the event of (a) the receipt of permission from the local planning authority that listed building consent was not required, or (b) a final determination by the court that the vendor had provided satisfactory evidence that the property was not a listed building.

After some negotiation (during which the purchaser produced the documentation provided by the vendor), the planning authority concluded that no listed building consent was required. However, the purchaser denied the vendor was entitled to the £200,000 claiming the vendor had failed to provide satisfactory evidence, which it took to mean conclusive evidence that the property was not a listed building.

The decision

The judge found that on the true construction of the agreement, no purchaser, acting reasonably, could have taken the stance adopted by the purchaser. It was clear that the purchaser had adopted a test in respect of the evidence supplied to it that was not required by the agreement. The court was unable to accept that satisfactory evidence, properly construed, meant conclusive evidence. To so find artificially imported an obligation that was not in the minds of the parties when entering the sale agreement. The evidence produced by the vendor was evidence of relevance and quality that the purchaser could have, and had, used to persuade the material planning authority that the property was not a listed building. The vendor had complied with the terms of the sale agreement and was entitled to the £200,000.

Comment

As with the recent decision regarding the exercise of a bank's opinion in relation to a MAC clause (see *Cai & Ors v Westpac Banking Corporation* [2005] VSC 317 reported in the January Update) it would seem that even if a 'reasonable' is not negotiated into the terms of the contract, the courts will require that parties act reasonably in the exercise of their contractual rights. The case also serves as a reminder to all parties that best practice is to agree what will constitute satisfactory evidence before signing the agreement.

Aldershot Properties Ltd v Hoxdev Ltd [2006] All ER (D) 142 (Jun)

Banking: Capital Adequacy

The European Commission has welcomed the signing by the Council and the European Parliament of the Capital Requirements Directive for credit institutions and investment firms. The Directive introduces an updated supervisory framework in the EU, which reflects the Basel II rules on capital standards agreed at G-10 level. Member States can now focus on transposing and implementing the Directive by the end of this year. To read the press release in full please go to:

<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/797&format=HTML&aged=0&language=EN&guiLanguage=en>

Mortgages: Disclosure

The Consumer Panel has welcomed the publication of FSA research to assess how mortgage disclosure documents have improved since last year's review, which had found wide ranging problems in compliance with the rules. They found that although mortgage information provided by large lenders has improved significantly, and small firms' information is also improving, there are still major concerns about the quality of information being provided by mortgage intermediaries:

- Around a quarter of intermediaries' Key Facts Illustrations (KFIs) contained inaccurate or contradictory information on the fees and charges the customer would have to pay;
- 55% of intermediaries' initial disclosure documents (IDDs) had five or more errors.

In general the research showed that KFIs are still too long. These documents were designed to allow consumers to compare mortgages, but with more than half of the FSA sample over six pages long, this is likely to be difficult for consumers to do.

Mortgages: Mortgage Exit Administration Fees

The Financial Services Authority announced in September 2005 that it was looking into the issue of recent increases to Mortgage Exit Administration Fees ("MEAFs") as some people had argued that these increases were unfair. The FSA has issued a statement setting out what work the FSA has carried out since then and outlining the work it will be doing in the coming period.

In the FSA's May 2005 Statement of Good Practice on 'Fairness of terms in consumer contracts' the FSA explained that a variation clause is less likely to be regarded as unfair if the variation can only be made with a 'valid reason' which is specified in the contract. The FSA are of the view that a 'valid reason' may be one which reflects legitimate cost increases associated with providing the particular service, provided that the change is proportionate.

After examining a number of mortgage contracts, the FSA considered that some were not as clear as they could be in explaining which costs would be charged to the consumer at what time or event in the life of the contract (e.g. default, early repayment or exit), and that it was not clear that increases in MEAFs were proportionate to any increases in associated mortgage exit costs incurred.

The FSA has asked some lenders to consider whether their terms might be unfair, and to provide it with evidence of how decisions to increase their MEAFs were taken. The FSA expects to receive responses in the next month or so and it will make a further statement on this issue in the Autumn.

To read the statement in full please go to:

<http://www.fsa.gov.uk/pages/About/Media/notes/bn021.shtml>

Trade Finance: UCP500 revision

The ICC Banking Commission has announced it is working toward final approval of a revision to UCP 500, the ICC's universally used rules on documentary credits. Three years in preparation, UCP 600, as the new rules will be called, may be completed as early as October and will contain major changes. The current draft, still subject to change, has:

- a leaner set of rules, with 39 articles rather than UCP 500's 49;
- a new section of definitions, containing terms such as "honour" and "negotiation";
- a replacement of the term "reasonable time" with a definite number of days for examining and determining compliance of documents;
- a new provision concerning addresses of the beneficiary and the applicant;
- an expanded discussion of "original documents"; and
- re-drafted transport articles aimed at resolving confusion over the identification of carriers and agents.

Tax: Introduction of Anti Avoidance Rules which might affect certain real estate structured finance arrangements

HMRC have published new draft anti-avoidance provisions aimed at stopping certain structured finance arrangements. The rules are due to be introduced at report stage of the Finance Bill (No. 2), will have immediate effect from 6 June 2006 and apply primarily to sale and leasebacks where the lease is treated as a finance lease in the lessee's accounts.

The new rules will mean that the lessee will only get tax relief on its rental payments to the extent amounts are recorded in the accounts as a finance charge, i.e. on the 'interest' element of the rentals (previously the lessee would have received tax relief for their full rental payments). The finance lessor's position will be unaffected and they will be taxed on the full rentals as under the old rules. The new rules are most likely to affect occupiers rather than property investors, but there might be a knock on effect on property investors. To read further commentary and the rules themselves please go to:

www.hmrc.gov.uk/drafts/avoidance.htm.

Further information

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