

Finance Update

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

Guarantees and Mortgages: Check what liabilities are secured

A recent case serves as a reminder to banks and their legal advisers to check that all relevant liabilities are secured when they put together a security package.

The Facts: A company director, Mr. K guaranteed the indebtedness of a group of companies to NatWest under a loan agreement. The maximum amount recoverable under the guarantee was £425,000 plus interest from demand until payment. As security for the guarantee, Mr. K and his wife had executed a legal mortgage over their matrimonial home. The mortgage was limited to £425,000 together with interest from the date of demand and the costs incurred in connection with enforcement of the mortgage. Mr K challenged his liability under the guarantee and applied for an order that the amount secured under the mortgage did not include the bank's costs in enforcing the guarantee. He also sought confirmation as to when interest secured on the mortgage started to accrue as there was a dispute as to when demand had been made.

The Judgment: The judge found that demand under the guarantee on Mr. K alone could not constitute a demand under the mortgage so that the only interest secured on the mortgage was that which had accrued after a later separate demand was made on both husband and wife specifically referring to the mortgage. The judge also considered that the fact that costs had to be incurred in the guarantee proceedings before the bank could go ahead with the process of the enforcement of the mortgage did not make them costs incurred in connection with the enforcement of the mortgage. They were costs incurred in connection with the enforcement of the guarantee and were not therefore secured on the property.

Comment: Although saying nothing new in relation to the law on either guarantees or mortgages, this case shows how careful one must be when drafting security documents so as to ensure that the liabilities one expects to be secured are in fact included. In many transactions, 'Secured Liabilities' includes all obligations under all the Finance Documents so all relevant liabilities should be covered, provided of course the definition 'Finance Documents' has been drafted correctly. However, where limits to liability are agreed one needs to ensure that all parties are agreed where the limit applies. If costs are meant to be on top, have a think about what these costs are likely to be.

ANGELI KOTONOU (2) DEBORAH KOTONOU v NATIONAL WESTMINSTER BANK PLC [2006] EWHC 1021 (Ch)

Investment Property: Service Charges

Jonathan Gaunt QC sitting as a Deputy Judge of the High Court in a recent service charge dispute ended his judgment with a few choice words on landlords and managing agents and their duties in relation to service charges which provide some reminders about how things can go wrong.

"As one who has practiced in the field of landlord and tenant law throughout his career and has seen a deal of service charge disputes, perhaps I may conclude by saying that this case contains many of the typical elements which cause and exacerbate disputes of this kind: first, a managing agent who did not regard it as part of his job to read the lease or give any consideration to whether the items, a contribution to the cost of which he was invoicing, properly fell within the service charge; secondly, a landlord who, despite earlier

misgivings, appears to have decided to include all the costs of his project in the claim for service charges irrespective of the propriety of doing so, placing on his tenants the onus of challenging his demands if they were able to discover and disentangle the calculations on which they had been based; thirdly, a situation where the tenant had been led to expect a certain level of charge and then found himself being charged four times as much with no explanation being offered as to how this state of affairs had come about; leading, fourthly, to the tenant becoming so frustrated and alarmed that he dug in his heels, refused to pay and resolved to take every point going, good or bad, with a view to resisting what he regarded as his landlord's patently unjustified behaviour.

A more potent recipe for expensive and unproductive litigation it would be difficult to devise. Tenants who agree to service charge clauses under which they contract to pay against a surveyor's estimate or an accountant's certificate rely upon the professional people involved performing their roles with professional scrupulousness, diligence, integrity and independence and not in a partisan spirit, supposing their only task to be to recover as much money as they can for the landlord. Experience teaches that such reliance can be misplaced. There are signs that the commercial letting market is beginning to reject the "full recovery" service charge for this reason."

Comment: As was reported in the September update RICS has issued guidance on service charges relating to commercial property so it is hoped that such disputes will become rarer so that the time and money spent disputing service charges is substantially reduced

Princes House Ltd and another v Distinctive Clubs Ltd [2006] All ER (D) 117 (Sep)

Consumer Credit: bank current account default charges

In response to the OFT's statement of principles on the calculation of credit card default charges, the OFT has announced that credit card issuers have agreed to reduce their default charges, the majority by almost half. Many card issuers have stated that they do not agree with the OFT's view of the law and that they believe that their default charges were fair but, in view of the reduction in charges across the market, the OFT has declared itself satisfied that no further intervention is warranted in this area at this time and that this change has brought about substantial benefits for consumers.

In its April statement OFT has stated that it considers that the broad principles in relation to default charges are likely to be relevant to other standard agreements with consumers such as those for bank current accounts. The responses received from the banking industry have generally challenged this belief but the OFT remains of the view that the broad principles do read across to the retail banking area and has decided to undertake further work on the application of these principles to bank current accounts. In the course of this work the OFT will liaise closely with the Financial Services Authority (FSA) and hold discussions with the British Bankers' Association (BBA)

This fact-finding exercise is expected to take between three to six months, at which stage the OFT will consider whether a further detailed investigation of the fairness of individual bank default charges is needed.

To read the OFT statement in full, please go to: <http://www.of.gov.uk/News/Press%20releases/2006/130-06.htm>

Mortgage Regulation: Islamic Finance

The Government has published the secondary legislation necessary to bring home reversions and Ijara home purchase plans into regulation. The changes will ensure that consumers of equity release products and Shari'a law compliant home purchase plans will benefit from the protections afforded by Financial Services Authority (FSA) regulation, and will take effect from 6 April 2007.

Further information

For further information or advice other than in relation to insolvency matters please contact either the person at Taylor Wessing with whom you generally deal or:

Rodney Dukes

E-mail: r.dukes@taylorwessing.com
Tel: +44 (0)20 7300 4189

Paul Harrison

E-mail: p.harrison@taylorwessing.com
Tel: +44 (0)20 7300 4191

Dominic Ross

E-mail: dl.ross@taylorwessing.com
Tel: +44 (0)20 7300 4282

Martin Yells

E-mail: m.yells@taylorwessing.com
Tel: +44 (0)20 7300 4113

Bob Gayford

E-mail: b.gayford@taylorwessing.com
Tel: +44 (0)20 7300 4192

Simon Lovell

E-mail: s.lovell@taylorwessing.com
Tel: +44 (0)20 7300 4605

Peter Shepherd

E-mail: p.shepherd@taylorwessing.com
Tel: +44 (0)20 7300 4141

Akmal Ghauri

E-mail: a.ghauri@taylorwessing.com
Tel: +44 (0)20 7300 4740

Marke Raines

E-mail: m.raines@taylorwessing.com
Tel: +44 (0)20 7300 4181

Graham Wedlake

E-mail: g.wedlake@taylorwessing.com
Tel: +44 (0)20 7300 7157

For further information or advice relating to insolvency and contentious matters please contact:

Alison Goldthorp

E-mail: a.goldthorp@taylorwessing.com
Tel: +44 (0)20 7300 4891

Michael Frawley

E-mail: m.frawley@taylorwessing.com
Tel: +44 (0)20 7300 4849

Nick Moser

E-mail: n.moser@taylorwessing.com
Tel: +44 (0)20 7300 4866

Shane Gleghorn

E-mail: s.gleghorn@taylorwessing.com
Tel: +44 (0)20 7300 4242

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