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SCHRIFTENREIHE

DES VERBANDES DEUTSCHER PFANDBRIEFBANKEN

Rechtsfragen der Immobilienfinanzierung in England und Wales

– EIN ÜBERBLICK IN VORTRÄGEN –

BAND 25

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Vorwort

Am 14. und 15. Juni 2004 fanden sich acht Referenten aus London in Berlin zum Länderseminar Immobilienfinanzierung England und Wales zusammen. Dieses Seminar ist Teil der Serie der vdp-Länderseminare Immobilienfinanzierung, die der vdp, im Juni 2004 noch unter seinem alten Namen VDH, regelmäßig für die Fragen der Immobilienfinanzierung in einzelnen Ländern, die für das grenzüberschreitende Geschäft seiner Mitglieder von Bedeutung sind oder sein werden, durchführt.

Die Finanzierung von Immobilien außerhalb Deutschlands hat für die Mitglieder des vdp in den letzten 10 Jahren ständig an Bedeutung gewonnen. Im Jahre 2005 entfielen 69% der Zusagen für die Finanzierung gewerblicher Immobilien auf das Ausland; am Darlehensbestand der gewerblichen Immobilienfinanzierung erreichten die ausländischen Objekte 35,3%.

Der vdp trägt dem seit langem Rechnung und widmet sich den Fragen, die mit dem Geschäft und der Verwendung dieser Finanzierungen für die Pfandbriefdeckung zusammenhängen, intensiv in den Gremien und der Geschäftsstelle. Allein seit 1998 hat der Verband zu Fragen des Auslandsgeschäftes 28 Seminare zu 14 verschiedenen Ländern veranstaltet; darunter sind seit 2003 11 vdp-Seminare Immobilienfinanzierung zu 11 verschiedenen Rechtsordnungen.

Regelmäßig finden solche Seminare an einem einzigen Tage statt. Im Falle von England und Wales (Schottland mit seiner eigenständigen Rechtsordnung wurde in einem eigenen Seminar behandelt) bestand Einigkeit, dass dies nicht ausreichen würde und eine ausführliche Darstellung in zwei Tagen erforderlich sei: Zu groß ist die Bedeutung des englischen Marktes, auf den alleine im Jahre 2005 mehr als 10% aller Zusagen für Hypothekenkredite der vdp-Mitglieder entfielen, und die Mitarbeiter der Mitgliedsbanken haben meist mehr als 10 Jahre Erfahrung mit den Fragen dieses Marktes. Daher musste ausreichend Zeit gegeben werden, um auch vertieft diskutieren und Fragen umfassend darstellen zu können. Wie wichtig die Fragen des englischen Marktes für die Mitgliedsbanken sind, zeigt sich daran, dass sich 46 Spezialisten zwei Tage Zeit nahmen, um ihr Wissen auszubauen und zu vertiefen.

Schon während des Seminars wurde immer wieder der Wunsch geäußert, dass dieser einzigartige Überblick über die Seminarunterlagen hinaus in vollständiger Form schriftlich zur Verfügung stehen sollte.

Der vdp hat dies aufgegriffen und die Referenten waren erfreulicherweise bereit, den Inhalt ihrer Vorträge auch in vollen Text zu fassen. Mit diesem Werk liegt nun ein hervorragender Überblick zu den Rechtsfragen der Immobilienfinanzierung in England und Wales vor.

Die Beiträge wurden in der Sprache aufgenommen, in der sie vorliegen. Wie in dem Seminar wurde meist das Englische, zum Teil aber auch die deutsche Sprache genutzt. Der Kreis der Leser dieses Buches wird in der Regel im deutschsprachigen Raum mit der Immobilienfinanzierung befasst sein, regelmäßig aber auch das Englische beherrschen. Wir haben daher auf Übersetzungen verzichtet.

Die Beiträge wurden mit dem Stand des Jahres 2004 ausgearbeitet, aber zum Teil aktualisiert, sofern sich wesentliche Änderungen ergeben haben; dies betrifft vor allem den Beitrag zu den Kreditsicherheiten von Rod Brown, in den die Rechtsprechung des House of Lords im „Spectrum Plus"-Fall aufgenommen wurde.

Der vdp dankt den Autoren, dafür, dass sie ihr Wissen, ihre Zeit und ihr Engagement zur Verfügung gestellt haben. Sie tragen dazu bei, dass eine wertvolle Arbeitsgrundlage für das Finanzierungsgeschäft, aber auch für Prüfer, Treuhänder und andere Interessierte entstanden ist.

Berlin, Dezember 2006

Dr. Otmar Stöcker Andreas Luckow

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Jane Havergal/Emma Banfield

Land Tenure – Freehold/Leasehold – Registration and Title Issues

Part I: by Jane Havergal

General Introduction

In this talk I will be looking at land tenure in England and Wales (Scotland and Northern Ireland are separate). I will be looking at the following:

- **Estates in Land**
- **Characteristics of a freehold**
- **Characteristics of a leasehold**
- **Long lease compared with a rack rent lease**
- **Title insurance**
- **Legal and equitable interests**

Registered and unregistered land will be dealt with by my colleague Emma Banfield.

1 Estates in Land

- Freehold and leasehold – fee simple or term of years absolute

  When considering charging or acquiring property in England and Wales, a lender needs to be aware that there are two types of property rights or "interests" recognised by English law as legal interests since 1925.

- These are "freehold" and "leasehold".

  The proper term for them is a *fee simple* in the case of a *freehold* and a *term of year absolute* in the case of a lease. The difference is that *freehold* is unlimited in time but a lease is for a fixed term of years.

- Commonhold

  I should briefly mention the concept of commonhold. The Commonhold and Leasehold Reform Act 2002 received Royal Assent on 1 May 2002, and regulations essential to operate the relevant part of the Act are awaited later this year. Commonhold is a new system of *freehold* land ownership. The philosophy behind it is to deal with ownership of premises which are part of a whole and for which the ability to enforce repairing covenants for the parts not owned are necessary. Examples are individual units in blocks of flats, industrial estates and shopping centres. Using a residential example, the concept probably comes closest to the German concept of the *Eigentumswohnung*. Commonhold will probably be most relevant to residential property. Although structures may evolve in due course to use this for commercial property I do not propose to devote much time to it here.

2 Characteristics of a Freehold

So what are the characteristics of a freehold?

- *Right to use the property forever* "Freehold" is probably the more valuable of the two types of title as it gives the right to use the property forever.
- *No fetters on sale* There are usually no fetters on a sale (although factors such as location, market fluctuations, third party rights, restrictions on use, or environmental contamination may impact on investment value). A solicitor needs to opine on title issues and a valuer should be consulted as to effects on value.
- *Value as security* A freehold can also be charged freely i.e. usually without consent by a lender as security for its loan.
- *Chargeable asset* As such freehold is usually a chargeable asset although flaws in the title may exist.

3 Characteristics of a Leasehold

- Exclusive possession

  A "leasehold" interest is a right to exclusive possession of the property for a term of years. As the description "term of years absolute" indicates, this right is limited in time.

- Periodic payment of rent

  It is granted in return for a periodic payment, called "rent".

- Long lease/rack rent lease

  There must be certainty as to the term or length of the lease. The term of a lease may be virtually unlimited, or more limited in time.

  There are therefore two essential categories of leases which I will compare in detail presently, the long lease and the rack rent lease. My talk is aimed principally at the characteristics of long leases. My colleague Ian Silverblatt is dealing in his talk with the rack rent lease, which is more akin to a tenancy agreement.

- Long leases

  A long lease generally begins with a term of from 99 to 999 years, and the rent is low. They share many of the characteristics of a freehold.

- Similarity between long lease and freehold

  Similarity between a "long lease" at a low rent and a "freehold" are:
  - use of the property is virtually unlimited in time
  - on grant or transfer ("assignment") of a "*long lease*" a substantial sum of money, or "premium" is payable.
  - a purchase price, known as a "premium", is payable for grant or assignment, i.e. the lease has a value and is acceptable as security for a loan.

  A *long lease* invariably contains restrictions where a *freehold* may not always do so.

Assuming the rent is low a *long lease* is an investment.

Such a lease will at the end of the day be carved out of a *freehold* and if the rent is low, the valuable interest thereby becomes the leasehold rather than the *freehold* interest. A valuer always needs to advise you if there is a chain of "*long leases*" before reaching the income stream provided by the "*rack rent leases*".

- Rack rent leases

  A rack rent lease is a business lease and its initial term may be anything from 1 to 25-30 years. The rent is a rack or market rent.

- Forfeiture

  The most important difference between a long lease and a freehold is that a lease can be terminated by the landlord. A provision for forfeiture by the landlord for breach of tenant's covenant or non-payment of rent is usual in English leases as mentioned above and not usually omitted. However there are remedies in such case for a lender provided that it serves notice of its charge on the landlord.

  This right must be expressly set out in the lease but it would be unusual not to find it. It is usual for long leases to provide for forfeiture on breach of covenant and on non payment of rent while a rack rent lease should provide for termination on the tenant's insolvency.

- Covenants

  I now turn to the covenants. Leases are not uniform. However long a lease is, under English law it is a contract negotiated between two parties, called a landlord and a tenant. Although there are statutory provisions governing some aspects of the lease, and other issues such as forfeiture are market practice, the parties are generally free to contract.

  As such each lease is different, and in considering a long lease as security, a lender's lawyers and valuers need to check the particular lease carefully to ensure there are no matters which would impact adversely on marketability and therefore value.

  I do not propose to go through every tenant's covenant in this talk, only the important ones. I am additionally focusing on long business leases. There are some differences from rack rent leases and residential leases. I am leaving rack rent leases to my colleague Ian Silverblatt. You will find that a number of covenants in a lease are similar to those in a mortgage and in this a landlord and a lender have similar concerns, namely maintaining the value of the asset. However a tenant has certain statutory rights which a borrower does not enjoy.

- Repair

  A landlord will generally seek to impose a full repairing covenant on a tenant in a long lease of a whole building. If it is a lease of part of a building, it is usual for a business lease to provide for the tenant to repair the interior and the

landlord will repair the exterior and structure recovering the cost by proportionate service charges from the tenants of part. It is not usual in a long lease to reduce the standard of the repair covenant.

- Insurance

  Provision needs to be made for what happens if the building is damaged or destroyed by insured risks. A list of such risks is usual – nowadays it is quite a long list, with a great deal more than fire cover. For example one would look for terrorism while such cover is available, together with three years loss of rent. In a long lease the landlord generally covenants to insure and takes on an obligation to reinstate but if it is a lease of whole it is not unknown for the tenant to be obliged to insure in joint names with an obligation to reinstate. Please note the tenant's repair clause is generally modified by reference to any insurance held.

- Alienation

  Alienation generally In a long lease of a valuable building, it is not unusual for there to be some restrictions. However assignment of part will be prohibited absolutely. A variety of provisions apply in relation to assignments and underletting of whole: either the long lease is freely assignable or assignments are permitted with consent not unreasonably to be withheld. In the case of a long lease assignment at a premium will be acceptable. Underletting may also be regulated whether of whole or of part. Guarantees and other security may be required for an assignment or undertenant plus a direct covenant from the assignee or undertenant.

  English legislation imposes a duty on a landlord to be reasonable where reference is made to any assignment requiring consent of the landlord; i.e. such consent cannot be unreasonably be withheld even if not expressly stated. This is helpful for a long lease.

- Alterations

  It is usual for a tenant to be fettered about what alterations it carries out to the property. Again this is an investment issue for the landlord. There may be an absolute covenant against structural alterations and a qualified covenant in respect of non structural alterations, i.e. landlord's consent cannot be unreasonably withheld. In passing, as in alienation, statute compels a landlord not to be unreasonable in refusing consent to any alteration which constitutes an improvement, where the prohibition is by reference to landlord's consent (if no reference to landlord's consent at all is made, then the prohibition remains absolute).

- Use

  It is usual for the property to be restricted to a particular use. Examples may be the planning use classes, such as B1 (office and light industrial) B8 (warehouse) or uses within A1 (shop use). There may be some limited extension of the use beyond the specific use in question with consent not unreasonably to be withheld. A narrow use is probably reflected in value.

- Determination – Forfeiture

  A provision for forfeiture or reentry by the landlord in the event of breach by the tenant is usual in every lease. However in a long lease, such forfeiture should not be triggered by insolvency of the tenant as to which see below.

  On breach by the tenant, the landlord has the right to sue for damages, but also has the right to reenter, or (more usual if the premises are occupied) to go to court and seek to repossess the premises.

  For breaches other than non payment of rent, the landlord serves a notice. However, some breaches are not capable of being remedied; examples include breaches of covenant forbidding assignment or subletting without consent.

  The remedy for the tenant is to apply to the court for relief from forfeiture, which is at the discretion of the court. The same rights are available to a mortgagee or an undertenant of which the landlord has notice. Clearly it is important that a mortgagee has control of the asset in such circumstances.

  Any break clause on the part of the landlord would be of concern and borrowers need to be restrained from exercising any tenant's break clause. The borrower could not surrender the lease if a charge affects it.

- Rent Review

  A provision for rent review is not usual in a long lease. I will leave it to my colleague Ian Silverblatt to deal with rent review which is an issue for rack rent leases.

4 Long Lease/Rack Rent Lease

4.1 Lease Comparison

Long lease compared with a rack rent lease

- Long lease

  Ground or peppercorn rent

  A nominal rent is always needed for the document to be a lease. Apart from the length of term, rental levels distinguish a commercial "*long lease*" from a commercial "rack rent lease".

  A "*long lease*" is generally at a ground rent, i.e. reflects the cost of renting the ground, without the buildings. The rent may be a peppercorn, a red rose or £1 a year, if demanded. Occasionally investment *long lease*hold properties, as in the City of London, or when granted by local councils, may involve payment to the *freehold*er of a proportion of the rents receivable from the occupational underleases.

  A "*long lease*" at a low rent is generally regarded as an asset and good security for a loan unless there are major flaws in the form of lease.

  Term of 99-999 years

  The term is from 99-999 years.

- Rack rentlease

  Market rent

  A "*rack rent lease*" is at a market rent.

  Rent review

  In a "*rack rent lease*" there is normally provision for rent review on a periodic basis (generally five years), and in accordance with a particular formula based on the provisions of the Landlord and Tenant Act 1954 Part II (the "1954 Act"). Rent will be the best rent obtainable.

  Term

  It is generally for a term of from 1/5 to 25-30 years.

  Generally

  A "*rack rent lease*" is generally more restrictive than a "*long lease*", although "*long leases*" granted by powerful City of London institutions or local councils may be fairly restrictive.

  A rack rent lease is generally not regarded as good security for a loan or as an asset for security purposes, rather as a liability for which a market rent is charged. A mortgage bank will generally see a "*rack rent lease*" as part of the underlying income stream the bank is relying on to service the loan interest payments.

  Of course, if a mortgagee is looking at corporate borrowing where the security is secondary, such as lending to chains of shops or wine bars, a bank may wish to have the ability to take control of the asset despite its flaws.

4.2 Reasons for a Long Lease

You may wonder why a *long lease* is put in place at all. Why does not an owner simply sell a building or a site?

- Control

  It may be an issue of control. London investment properties, even self-contained trophy buildings in the City of London, are often long leasehold rather than *freehold*. The principal factor here is that the ultimate landlord is a long established body which does not wish to lose overall control of what is built and the character of the area. The Crown, the Corporation of London, the City Guilds, the great London estates like the Grosvenor, Cadogan or Portman Estates think in the long term.

- Leases of part

  Enforcement of repair covenant and lease/sublease structures

  It may be because we are dealing with part of a building or estate.

  Firstly a lease of part ensures that there is a mechanism for enforcing repair covenants for those parts of the building or estate not leased to that tenant. It is likely that in a large building there will be a covenant by the tenant to repair

its premises while the landlord covenants to repair structure. The tenant will enforce against its landlord which then enforces as necessary against other tenants of part. A *freehold* interest in part of a building is not considered good security as enforcement of positive covenants to repair against another freehold owners is contractual only and will not run with the land.

Secondly if you are already a leasehold owner of the whole building, there will be an absolute prohibition on transferring or assigning part of that building so your only real option is an underlease. Assignments of part are frowned on and rarely seen because of the technical problems they bring with them. I have seen them principally in old leases of industrial complexes in the North of England – I am not quite sure why this is!

- Flexibility

Leases can confer greater flexibility generally. Let me give you some examples. The leases may develop organically like the first example, or be carefully structured from the start, as in the second example, or be a mixture as in the third example.

Container port and power station Take my first example. This was a container port where the structure grew organically over about four years. First a 999 year lease of land on the Kent coast was granted by British Gas to the original developer for industrial purposes. The original developer granted a sublease of the major part of this property to an operator for use as a container port for a term of 999 years less 3 days. Subsequently the port operator granted a subunderlease of part of the property to another tenant for the purposes of a gas fired power station for a term of 999 years less 6 days. Payments were made in each case.

Shopping centre The second example shows a deliberate leasehold structure. Around the time of the privatisation of the railways in the 1990s a lot of non-operational property was released for development, including a former railway goods yard bordering a former underground station goods yard in London. The two yards formed a perfect site for a shopping centre. The railway board granted a lease of its goods yard to the underground board for 150 years. The underground board granted a lease back to the railway board of both goods yards for 150 years less 3 days. The developer then took a sublease of both yards from the railway board for 99 years. The profit rents from the occupational leases go to the developer which has now, I believe, sold to an investor.

Retail/office building in the West End The third example is a West End of London investment property in the heart of the retail and advertising district near Regent Street. A complicated leasehold structure was set up in the 1950s possibly for tax reasons so freehold headlease and underlease of part are now vested in an investment company. There is an intervening lease to an insurance company sold to a rather troublesome company. The final underlease is the valuable interest and receives income from the occupational tenants. The troublesome company would very much like to get its hands on this underlease but because the freehold and other interests are owned by the investment company

it has not had much success in its attempts to claim there are breaches such as to trigger a forfeiture.

4.3 New Lease or Assignment

- New lease or assignment

  Please note that a borrower will either be offering as security:
  - a new lease, where it is dealing directly with a landlord; or
  - an existing lease by way of assignment from an existing tenant, where the borrower will deal with the current tenant.

- Influence over terms

  You may question the relevance of this but it is an important distinction. Essentially the Bank's lawyers may have more chance of influencing the terms of a lease if a borrower is giving security over a new lease being granted by a landlord than if it is taking an assignment from a tenant.

- Variations

  In the first case, the terms of the lease are still negotiable. In the second case, variations of an existing lease will probably be more difficult to achieve.

  If the existing lease was granted before 1 January 1996, there are additional considerations to take into account, which are dealt with by Ian Silverblatt.

- "rack rent lease"

  A "rack rent lease" is granted as a business lease for a "term" of months or up to 25-30 years. It resembles the German rental agreement, or "Mietvertrag" but should not be confused with a German leasing contract. My partner Ian Silverblatt will be dealing in detail with the rack rent lease, otherwise known as a tenancy agreement, in his talk later today.

  An occupational tenant can again either take an assignment of an existing lease from an existing tenant or be granted a new lease directly from a landlord.

  If an occupational tenant is taking an assignment of an "old lease" granted before 1 January 1996, the borrower will probably seek a direct covenant from that occupational tenant as a condition of granting landlord's consent to assignment. In these cases the original tenant will remain liable for the tenant's covenants throughout the lease even after it has parted with or "assigned" its interest. This is helpful where that tenant has a strong financial covenant.

4.4 Checklist for Taking Security over Leases

It is necessary to have a checklist for taking security over leases as follows:

a) *no absolute prohibition against assignment or underletting* a landlord should not be able to arbitrarily and unreasonably withhold consent to an assignment or underletting. If there are absolute prohibitions this will seriously impact on marketability of an investment property;

b) *no absolute prohibition against charging* the same applies to charging: a landlord should not be able to arbitrarily and unreasonably withhold consent to a charge by the tenant of the lease to a lender;

c) *no forfeiture on insolvency* there should be no provision for termination or "forfeiture" of the lease on insolvency of the tenant. This feature is a characteristic of a rack rent lease, but in a *long lease* is very adverse, as it is precisely when the tenant becomes insolvent that a lender will wish to realise the asset.

d) *check insurance provisions* When a lender takes a charge over a long lease the issue of insurance comes to the fore as the tenant may not be in control of insurance and therefore the asset.

e) check for onerous provisions generally.

Action by bank's solicitors

It is important for a bank's solicitors to check the position in relation to the above three points at an early stage. Even if a borrower is not itself acquiring the lease it will impact adversely on marketability of the lease in the future and the lender will probably wish to seek a variation of the lease in this respect. The bank should also ask its solicitor to verify any unusually onerous covenants on the part of the tenant.

The following matters should be a condition precedent to drawdown:

1) Consent from the landlord to charge and assignment, if needed under the lease. If consent is required, an assignment or underletting without consent is not advisable as the leasehold interest is thereby threatened by forfeiture, i.e. the landlord's right to terminate the lease for breach of covenant by the tenant.

2) Notice of the bank's charge to the landlord. This entitles the bank to notice of any action for forfeiture by way of proceedings taken by the landlord. It does not entitle the bank to be notified of any action by peaceable reentry by the landlord- although in a multilet building it is more likely that the landlord will proceed by way of proceedings in any event. If the lease security has a high value a court is more likely to lean against forfeiture but the risk to the asset remains. A landlord has no duty to enter into obligations to a lender, and so requests for so called forfeiture comfort will not necessarily be successful and are likely to be met with a request for monies in return. Forfeiture comfort is like a step in right: the landlord agrees not to forfeit without giving the lender the right to remedy the breach if remediable or pay a sum of money if not.

Statutory aspects – Liability under leases before and after 1 January 1996

With certain limited exceptions there is a difference between leases (whether long or short) granted before 1 January 1996 and leases granted after that date when the Landlord and Tenant (Covenants) Act 1995 (the "1995 Act") came into force.

The broad effect of the 1995 Act is to reduce tenant liability under leases. Liability of the tenant will therefore be less if a borrower takes a new lease now or an assignment of a lease granted after 1 January 1996 rather than an assignment from an existing tenant of a lease granted before 1 January 1996.

Additionally the Landlord and Tenant Act 1954 gives business tenants security of tenure. You should be aware that the law is changing as at 1 June this year on this aspect. My partner Ian Silverblatt will go into greater detail.

5 Title Indemnity Insurance/Restrictive Covenant Insurance

There are a variety of interests which may adversely affect a *freehold* or indeed a leasehold. In the case of a *freehold* interest, the principal issues which arise are as follows:

a) old rentcharges imposed where the party with the benefit of the rent charge is no longer known/options and rights of preemption

b) old restrictive covenants burdening the property and which may have been breached already

c) no rights of access or paper title to part of the property (which may be built on) plus (possibly) insufficient time in occupation such as to entitle the owner to possessory title.

In the case of a leasehold, the principal issues may be as follows:

a) loss of a landlord to pay rent to

b) an assignment of part where assignee and landlord are no longer to be found.

Insurance cover can be obtained in many cases. It may be restrictive covenant indemnity cover or title indemnity cover. If insurance is put on foot, it will frequently cover the value of the property itself.

Please note that if applying for insurance no approach under any circumstances should be made to the party with the benefit of any of the matters in question, as it will avoid any existing insurance and make future insurance impossible.

If the property is unusable without the matter in question, e.g. access, it is arguable that a bank is lending on the basis of an insurance policy alone so the flaws in title must always be carefully considered with solicitors and valuers in such circumstances.

6 Legal and Equitable Interests

- History

  You may be aware of the English concept of trust and I propose to touch briefly on it here.

  The origins of the idea that an adult should hold on trust for a minor arose in mediaeval times for reasons linked with the feudal system. A modern example of a type of trust is a security trustee holding for a syndicate of banks.

  As from 1925 all rights in land apart from fee simple and term of years absolute mentioned above became equitable rather than legal.

- Valuation

  The importance of a split between legal and equitable interests for you as banks is that value in a property lies in the equitable rather than the legal interest – so

if the equitable interest is not held by the legal owner then little value is left in the legal interest.

- Examples

  1. One example of the split is found where trustees hold property as legal owners on trust for a beneficiary.
  2. Another example is where one party as legal owner has entered into an unconditional estate contract to sell its interest in property to another party.

  In either case, if a third party comes along to buy from the trustees or the original vendor, whether it takes subject to the existing interest depends on whether the party buying subsequently from trustees or vendor in such a situation either knows or ought to know of the existing interest or not. If not, a purchaser takes free of it. If so, the purchaser takes subject to the interest.

  In the first case, if two trustees or a trust corporation sell as trustee, a purchaser is protected as the interests are overreached.

  However, in the second case the same does not apply and if a borrower is on notice that there is an intervening contract it is wise to ensure that the party who entered into the estate contract as purchaser joins into any conveyance or transfer to pass its beneficial interest on.

Conclusion

For your purposes the principal issue is that you should be aware that the interests in land may be split and a certain amount of vigilance is required. In cases where parties have sought to avoid stamp duty on commercial transactions in stamp duty savings schemes, these splits are not uncommon.

I will now hand you over to Emma Banfield to talk about registered and unregistered land.

Talk given by Jane Havergal, Partner
14 June 2004
dbb forum, Berlin

Part II: Land Registration (by Emma Banfield)

This part of the talk deals with the land registration system in England and Wales which has been recently subject to some major reform.

Two systems of conveyancing exist in England and Wales and run parallel with each other – the "registered" and the "unregistered" systems.

7 Land Registration

- Registered land

  If a plot of land is described as "registered", its "title" or ownership is recorded in a register maintained by the Land Registry at a number of District Land Registries around the country. Each piece of land is given a unique title number and the landowner issued with a certificate showing the extent of the land owned, the benefits enjoyed by the land (e.g. rights of way) and the burdens attached to it (e.g. mortgages, restrictive covenants).

- Unregistered land

  In contrast "unregistered land" is land to which title is established by showing documentary evidence in the form of past conveyances and documents. A seller is required to show to the buyer undisputed ownership for 15 years, known as a good root of title.

  Whether land is registered or unregistered depends largely on whether there have been any dealings with the land giving rise to the opportunity to register. Voluntary registration is possible but the trigger factor remains a sale or assignment for value.

  This talk concentrates on registered land.

- Land Registration Act 2002 – the move towards e-conveyancing

  Up until October last year the main legislation in governing land registration was the Land Registration Act 1925. In order to improve and modernise the land registration system and pave the way to electronic or e-conveyancing using the internet, the Land Registration Act 2002 and the Land Registration Rules 2003 came into force on 13 October 2003. The purpose of the legislation is to make the register a more accurate reflection of the state of the title at any one point in time, and to make investigation of land title require the minimum effort.

7.1 Compulsory First Registration

Previously, transactions which attracted compulsory registration were in the main the following:

- Transfers of a freehold;
- Grant of a lease with a term of more than 21 years to run;
- Assignment of a lease having more than 21 years left to run.

The LRA 2002 has reduced the triggering requirement to the:

- Grant of a lease with a term of more than 7 years to run;

- Assignment of a lease having more than 7 years left to run

The reduction in the length of registrable leases is an important change in the law and does mean most commercial leases are now registrable on grant or assignment. The Law Commission's ultimate aim is to make all leases of three or more years subject to registration.

Further triggering events introduced under the LRA 2002 also include:

- Grant or reservation of easements; (including those contained in a lease of less than 7 years)
- Grant of a legal charge over unregistered freehold land or over an unregistered lease that, at the time of the grant of the legal charge, has more than seven years left to run.

7.2 Classes of Title

On application for first registration, the land registry will determine which class of title is allocated to the ownership:

- *Absolute title* – this is as near to perfect as the title can be;
- *Possessory title* – A possessory title is granted where the applicant's title is based on adverse possession or the title deeds have been lost. It is given where the registrar considers that the applicant is in possession of the land and there is no other title under which the land could be registered. The land is subject to all adverse entries existing at the date of registration;
- *Qualified title* – this is very rare in practice and exists where the registrar considers that title can only be established for a limited period or is subject to reservations which cannot be overlooked;
- *Good leasehold title* – where registrar is satisfied that the leasehold title is sound but having no access to the reversionary interest, he is not prepared to guarantee the lease against defects in the freehold title.

Once the land is entered on the register, the state guarantees the authenticity and effectiveness of the title. In certain circumstances where loss is suffered by a defect in the registration system, compensation can be sought.

Both freehold and leasehold land is registerable and as already mentioned it is the "estate" itself which is registerable. In the case of land subject to a lease, there will be one entry on the register dealing with the freehold ownership and there may be one or more entries dealing with the leasehold.

Charge and Land Certificates

Previously under the 1925 Act a charge or land certificate would be issued to the land owner or a mortgagee following registration.

Following the 2002 Act, land and charge certificates are no longer issued and those in circulation no longer have any legal significance.

A title information document is issued on any change to the register, but this document does not constitute a guarantee of title nor is it a legal document. It is merely computer generated document mirroring the title at a given point in time.

7.3 The Form of the Register

The register is divided into three sections:

- *The Property Register* – describes the land itself usually by reference to a plan and notes the type of estate (freehold or leasehold).

  The property register will also give details of any rights which benefit the land such as rights of way. It will also cross refer to superior and inferior titles (i.e. freehold title, or any sub-leases).

  Where the land is leasehold, a brief description of the lease will be given including the original parties, date of lease and term.

- *The Proprietorship Register* – gives the class of title discussed above and the name and address of the registered owner. The Land Registry needs to be advised of any changes in address as this is the address they will use to contact the registered proprietor of any changes to the register.

  This section of the register also shows any restrictions on the title (i.e. if the land is held by trustees for another person) and if any personal covenants were given on the transfer this will be shown in this part of the register.

  Restrictions, principally those which a lender may impose and also to be found at this section of the register and since April 2000, the register includes details of the price paid for the property by the proprietors.

- *The Charges Register* – gives details of any third party rights affecting the title. This could include the burden of an easement and covenants which bind the land i.e. not to use the land for a particular purpose.

  Leases of less that seven years, notices and easements are noted in this section as are details of mortgages together with the registered proprietor of the charge's name and address details.

  Ideally a person dealing with the owners of land should be able to rely on the register to see if there is any limitation on the owner's power. If there is no entry in the registers to suggest the owner's powers are limited, but this is in fact the case, the registered proprietor's powers to dispose cannot be called into question. However the transaction will not be rendered lawful and the owner may be called to account for exceeding its powers (section 26(3) LRA 2002).

7.4 Stamp Duty Land Tax

Before 1st December 2003, a document which effected a land transaction liable for stamp duty was "stampable" i.e. the document itself was sent to the Inland Revenue and the tax paid was impressed on the document.

In addition to the Land Registration reforms, the Stamp Duty regime has also been reformed. Stamp Duty has been replaced with Stamp Duty Land Tax ("SDLT"). This is payable on a "land transaction" whether or not there is a related document. Whereas in the past, some documents were executed outside the UK in order to avoid paying the tax, this is no longer possible. If the land is situated within the UK, then there is a potential liability to SDLT.

SDLT becomes due once a transaction has been "substantially performed" – meaning either 90% of the purchase price has been paid or possession of the premises has been taken.

The Inland Revenue have introduced a 6 page form which must be filed out by hand and submitted to the Inland Revenue within 30 days of completion of the transaction together with the SDLT payable on the transaction. Once this has been processed, the Inland Revenue issue a Land Transaction Return and this must be sent to the Land Registry together with the application for registration. In instances where SDLT is not payable, a "self-certification" form signed by the purchaser, must be sent with the application.

It used to be possible to submit an application for registration to the land registry pending receipt of the "stamped" document back from the Inland Revenue. This is no longer possible.

7.5 Registration

As a result of the LRA 2002, there are an increased number of prescribed forms for use. The Land Registry intends standard forms to become the norm and in due course these will all be electronic forms.

An application for the registration of transfers, charges and other dispositions of registered land must be made on a form AP1.

The application to register must be lodged with the appropriate district land registry within the 30 business days priority period. The priority period runs from the date of the pre-completion search.

Along with the form, the following items need to be sent:

- The transfer, charge or lease effecting the transaction which is being registered, together with a certified copy;
- The appropriate fee;
- Land Transaction Return Certificate or SDLT 60 "self-certification" Form

And in appropriate cases:

- Form DS1 or the use of the END system.

7.6 Open Register and Exempt Documents

One major change under the 2002 Act is that official copies of charges are now publicly available and this rule also applies to charges lodged at the Land Registry prior to October 2003, when the new legislation came into force.

However, where a document contains 'prejudicial information' an application can be made for the document to be designated an "exempt information document" and an edited version of the document excluding the prejudicial information will be publicly available rather than the whole document.

A Landlord may not wish a prospective tenant to be able to obtain the terms which have been negotiated with current tenants.

For a borrower, it may be prejudicial to have the value of the loan (if stated in the mortgage deed) in the public domain and a lender may not wish to have the terms of its loan accessible to the public generally.

An application can be made by either party to a document or by a person affected by the prejudicial information. The Land Registry have indicated that an application will normally be granted if the applicant can show it is not groundless.

In respect of documents lodged with the Land Registry prior to the commencement of the 2002 Act there is a two year transitional period during which time an application for exempt status can be made.

A lender should consider whether any legal charges currently registered contain any prejudicial information, so that an application can be made prior to the document being released to the public domain on 13 October 2005. Obviously the same consideration should be made with current and future documents.

Talk given by Emma Banfield, Solicitor
14 June 2004
dbb forum, Berlin

Rod Brown

UK Real Estate – Conveyancing

This talk is a summary of the process involved in buying UK real estate in England and Wales. Different systems operate in Scotland and Ireland.

The talk assumes that the property being acquired is a freehold property. Additional steps may be required for leasehold properties, e.g. obtaining the landlord's consent to the sale and giving the landlord notice of the assignment of the lease after completion.

First Stage: The Offer

The first stage of the transaction is when a buyer's offer to purchase a property is accepted by a seller. This does not create a binding contract. Either party is free to withdraw without penalty until contracts have been exchanged.

A problem with this system is that the buyer is at risk of being "gazumped" which is when the seller decides to sell the property to someone else. To reduce this risk it is possible to have a lock-out agreement where the seller agrees not to negotiate with any third party for a specified period of time. In addition, there are solicitors practice rules which requires the seller's solicitor to notify the buyer if the solicitor is asked to deal with another prospective buyer.

Second Stage: Before Exchange of Contracts

Before exchange of contracts, the buyer will investigate the seller' title to the property, carry out searches and enquiries and have a survey and an inspection done.

1. Investigation of Title

(1) ***The seller's duty of disclosure***

The general rule is that a seller is under no duty to disclose material facts to a prospective buyer (the *caveat emptor* or "buyer beware" principle). However as an exception to this principle, the seller is under a duty to disclose to the buyer latent incumbrances and defects in title. A latent defect is one that a prospective buyer could not have discovered by a reasonable inspection of the property.

The duty of disclosure extends no further than what the seller actually knows of or has the means to have knowledge of within reasonable and diligent bounds.

(2) ***Registered land***

The buyer will confirm the seller's ownership of registered land by obtaining up-to-date official copies of the seller's title from the Land Registry.

The buyer will be bound by incumbrances that are not referred to on the title if they are "overriding interests". The buyer will be able to discover the existence of most overriding interests through the other searches and enquiries that are made before proceeding with the purchase.

(3) ***Unregistered land***

The seller will prove ownership of unregistered land by providing summaries or copies of the documents evidencing ownership of the property (this is called an abstract or an epitome of title). For good title to be shown there must be a title document which is at least 15 years old (this is known as a good root of title).

The buyer will be bound by incumbrances that are registered as "land charges" regardless of whether the buyer actually knows about them. The buyer can discover details of any land charges by doing a search at the Land Charges Department.

(4) ***Defects in title***

The buyer's investigation of title may disclose defects in title. If the defect is remediable, the seller should be asked to remove it. If the defect is not remediable, it is usually possible to obtain defective title insurance to cover liability arising out of the defect. Whether this insurance is paid for by the seller or the buyer is a matter for negotiation between the parties.

A defective title insurance policy is a single premium policy so it does not have to be renewed each year. The benefit of the policy usually attaches to the land rather than an individual owner and is therefore available for the benefit of mortgagees and future purchasers and funders.

2. Searches and Enquiries

Because the seller's duty of disclosure is limited to latent defects in title, it is up to the buyer to find out as much as possible about the property before entering into a binding contract. The buyer obtains information about the property by making searches and enquiries.

The following searches are regarded as standard and should be undertaken in every transaction:

(a) ***Enquiries of the local authority***

To discover details of planning policies for the property, road and railway schemes, infringements of buildings regulations and planning legislation and confirmation of whether the property falls within a conservation area. Additional enquiries can be raised regarding public footpaths, pipelines, noise abatement orders and environmental and pollution notices.

(b) ***Search of the local land charges register***

To discover details of planning decisions, compulsory purchase orders, financial charges affecting the property and tree preservation orders (which will impact on proposed developments).

(c) ***Drainage and water enquiries of the water service company***

To discover whether sewers used by the property are maintained by the water company and whether any public sewers run across the property.

(d) ***Commons registration search***

To discover whether the property or any land used for access to the property has the status of a village green or common land. If so, it will be difficult to obtain planning permission to develop that land.

(e) ***Pre-contract enquiries of the seller***

To discover any issues with the property that the seller might be aware of, such as uncertain boundaries, rights of third parties over the property, access, physical condition, utilities and services, notices, disputes and complaints.

In addition to these standard enquiries, it may be appropriate to carry out additional searches depending on where the property is situated. These additional searches may include a coal mining search, other mining searches such as tin, clay and limestone and railway and waterways searches.

In addition, it is a requirement of the Law Society that buyers and mortgagees are advised of potential liabilities associated with environmental issues. In most residential transactions, solicitors will do a basic environmental search with a commercial data provider. However in commercial transactions it is increasingly common for a buyer or funder to carry out more detailed environmental investigations with a specialist consultant.

3. Inspection and Survey

Because the seller is not under any duty to disclose physical defects in the property (these are not defects in title), a buyer will usually arrange for a survey of the property in order to discover any physical problems with the buildings.

The buyer, or his representative, should also inspect the property to look for boundary discrepancies, evidence of third party rights over the property and the existence of non-owning occupiers.

Third Stage: Exchange of Contracts

1. Legal Requirements

The contract for sale must be in writing and must be signed by the seller and the buyer otherwise it will be invalid (s. 2 of the Law of Property [Miscellaneous Provisions] Act 1989).

2. Deposit

No deposit is payable unless the contract expressly makes provision for one. A deposit of 10% of the purchase price is standard practice.

3. The Practice of Exchange

Exchange can take place in person or person but most commonly exchange takes place by telephone and the contract becomes effective as soon as the parties' solicitors agree in the course of the telephone conversation that exchange has taken place. There is a Law Society protocol for exchange on the telephone which should be followed to avoid uncertainties and misunderstandings.

4. Effect of Exchange

On exchange, a binding contract will come into existence, after which time neither party will normally be able to withdraw from the transaction without incurring liability.

The beneficial ownership in the property passes to the buyer but the seller retains the legal title until completion and is entitled to remain in possession and to receive the rents and profits.

The position at law is that the risk in the property passes to the buyer from exchange. This means that the buyer bears the risk of loss or damage. The buyer should therefore insure the property from exchange of contracts. In practice the seller will also want to insure – in case the buyer fails to complete or, where there are occupational leases, to comply with covenants on the part of the landlord to maintain insurance. The contract can provide for the risk in the property to stay with the seller until completion, in which case, the buyer would not have to insure until completion.

The seller has a lien on the buyer's beneficial interest for the balance of the purchase price and if this is not paid in full on completion, the lien attaches to the legal estate in the hands of the buyer.

The buyer has a lien on the seller's legal estate for any deposit paid to the seller in the capacity of agent.

Fourth Stage: Between Exchange and Completion

1. Registration of the Contract

If the seller sells the property to a third party after exchange but before completion, the third party purchaser will not be bound to transfer the property to the buyer unless the contract has been registered (if the seller's title is registered, the contract should be protected by a notice on the title; if the seller's title is unregistered, the contract should be protected by registration of a land charge). However, it is not standard practice to register the contract in all transactions – this is only usually done if there is a long period of time between exchange and completion or if there are doubts about the good faith of the seller.

2. Requisitions on Title

The buyer has a right to raise "requisitions on title", which are essentially queries in respect of title matters which the buyer finds unsatisfactory. The right to raise requisitions can be limited or excluded in the contract. The historical reason for this right is that title used to be deduced after exchange of contracts. However the modern practice is for the seller to show title to the buyer before exchange. The buyer is deemed to have accepted the seller's title by proceeding with exchange so the right to raise requisitions is usually limited to administrative queries relating to the arrangements for completion.

3. Pre-completion Searches

If the seller's title is registered, it is vital that the buyer does a "priority search" at the Land Registry. This will give the buyer a "priority period" of 30 days. During this period, the registration of the buyer as the new owner of the property will take priority over any other application made to the Land Registry. For example, a buyer completes a purchase of property on Monday with the benefit of a priority search. The buyer applies to the Land Registry to be registered as the owner on Friday. However, the seller has purported to sell the property to a third party and the third party puts in an application on Wednesday, before the buyer. Because the buyer has the benefit of a priority search, he will be registered as the new owner not the third party.

If the buyer is obtaining funding for the purchase, the priority search should be carried out in favour of the lender because the buyer can take advantage of this protection. If the priority search is in favour of the buyer, this does not give the lender any protection and a separate search will need to be obtained.

If the seller's title is unregistered, the buyer should update the search already made at the Land Charges Department. The search gives a priority period of 15 working days.

Fifth Stage: Completion

1. The Transfer Document

The transfer document (also called the purchase deed) must be a deed in order to transfer the legal estate in the property to the buyer (s. 52 Law of Property Act 1925).

If the seller's title is registered, the form of transfer is prescribed by the Land Registry (for a simple transfer of whole, the form is called a TR1). If the seller's title is unregistered, the form of transfer is called a conveyance and the parties are free to use their own form.

2. Completion

The contract will prescribe:

- The date and time for completion;
- The place of completion;

- The method of payment of the balance of the purchase price; and
- The time for payment on the day of completion.

3. What Happens

At completion, the balance of the purchase price is paid to the Seller, the transfer document, title deeds and keys to the property are handed over to the buyer, any existing financial charge on the property is discharged and any new charge created by the purchaser to raise money for the purchase is completed.

4. Effect of Completion

If the seller's title is registered, the legal title to the property does not pass to the buyer until the buyer is registered at the Land Registry as the new owner.

If the seller's title is unregistered, the legal title to the property passes to the buyer on completion.

Sixth Stage: Post-Completion Formalities

1. Stamp Duty Land Tax

Before December, 2003, the transfer to the buyer had to be stamped and produced to the Inland Revenue and the buyer had to pay stamp duty.

With effect from 1st December, 2003, the stamp duty regime was replaced by a new stamp duty land tax (called SDLT).

There are some key differences between the two regimes:

- Stamp duty was a tax on documents, whereas SDLT is a tax on transactions. So it is no longer possible to avoid stamp taxes by not using a document (the basis of the "resting on contract" savings scheme).
- Stamp duty was a voluntary tax (although the Land Registry would not register an unstamped transfer), whereas SDLT is a compulsory tax.

SDLT is based on self-assessment. Within 30 days after completion, the buyer must file a "land transaction return" containing a self-assessment of the tax and must pay the tax shown to be due. The Inland Revenue will then issue a certificate that the return has been delivered and the tax paid. This certificate is not conclusive that the return is correct and the Inland Revenue have nine months to enquire into the transaction and require payment of additional tax.

2. Registration of Transfer

If the seller's title is registered, the buyer must apply to register the transfer at the Land Registry within the priority period of the buyer's priority search. The Land Registry will not accept the application without an Inland Revenue certificate that a land transaction return has been delivered and SDLT paid or, if no land transaction return has to be filed (e.g. because there is no chargeable consideration) a "self-certificate" issued by the buyer.

The Land Registry used to issue a title document to the buyer. This was a land certificate or, if the property was charged, a charge certificate. Since October 2003,

the Land Registry no longer issue land or charge certificates. There is no formal title document for the buyer or the buyer's mortgagee to retain.

Conclusion

2003 saw significant changes to the conveyancing practice, with the new Land Registration Act and the introduction of SDLT to replace stamp duty.

Further changes are on the way, most significantly, the introduction of electronic conceyancing. This is still at a very early stage and is to be developed over the next 3 to 4 years. Pilots of various elements have been announced for Q3 2006 and Q3 2007.

April 2006

Jane Havergal

Mortgages

General Introduction

In this talk I will be looking at a mortgage as security for a loan. Rod Brown will be giving you the various structures which may be put in place and details of the types of charge available. My talk is aimed at the fundamental form of property security, which is the legal mortgage, together with ancillary charges and assignments.

My talk is broken into the following headings:

1. **Nature of charges**
2. **Provisions of a mortgage**
3. **Right of redemption**
4. **Due diligence**
5. **Registration**
6. **Perfection of security**

1 Nature of Charges

I am looking at two categories of charge in this section.

1.1 Nature of Charges

The first is a **charge by way of legal mortgage**.

The second is **other charges and equitable assignments**.

There is an element of overlap as you will see.

Please note that in the talk I will be using various definitions of the borrower and lender and I set them out for ease. Other words for a lender are mortgagee and chargee. Other definitions of borrower are mortgagor and chargor.

1.2 Legal Mortgage

In the case of a personal loan, a bank's remedies are contractual only, so only an action for debt can be pursued.

However, as you would expect, in a secured loan, the lender has additional remedies: in addition to the action for debt, it has a direct ability to take over the property security, plus a right to sell it and deduct monies required to satisfy the debt. A further power includes a right to take possession if the mortgagor defaults and foreclose as appropriate.

- Best form of security over land

  Since 1925, a full charge by way of legal mortgage created by way of deed has been the best and strongest form of security over land.

- Form of security Law of Property Act 1925 section 85(1)

  The Law of Property Act 1925 section 85(1) sets out two alternative forms of mortgage. The usual choice nowadays is a charge by deed expressed to be by way of legal mortgage. The other option, a demise for a term of years absolute, or a lease, is not usually adopted.

  In addition to being by way of deed, a mortgage over registered land must be registered at the Land Registry for good title to be conveyed on enforcement. In the case of registered land, a mortgagee is registered as proprietor of a charge and has rights to sell as proprietor of that charge.

  If a first mortgage is taken over unregistered land, as Emma has mentioned this will actually trigger first registration.

  Generally the form of mortgage in English law is borrowed from other legal forms and this will become clearer as I go through.

- Powers of mortgagee Law of Property Act 1925 section 101

  Powers of the mortgagee as contained in the Law of Property Act 1925 section 101 are a power of sale, power to appoint a receiver and other ancillary powers such as a power to insure.

  A mortgagee also has a right to go into possession of the asset and a right to foreclose.

  We will say more about this presently. The charge itself will invariably extend these powers.

  The main point is that if the security has to be enforced, title under a properly drawn and registered legal mortgage can be made quickly and in an uncomplicated way.

  Generally a legal mortgage enables the bank to exercise its remedies without applying to the Court for assistance; but the position differs when an administrator is appointed.

  Two important principles need to be borne in mind.

  1. A legal mortgage must be over a legal estate. I mentioned earlier that there can be a split between legal and equitable interests.
  2. A charge expressed to be by way of legal mortgage will only be effective if the property is owned by the borrower or has been transferred to the borrower at the time the charge is taken.
     A charge, even if described as a legal mortgage, which is over property as yet not acquired will take effect as an equitable charge only and will need to be perfected.
     The case of **Security Trust Co v Royal Bank of Canada [1976] 1 All ER 381** establishes this principle. It is quite a complicated Privy Council case about property in the Bahamas.
     The **conclusion** is broadly that a legal charge over a legal estate overrides an equitable charge over an equitable interest. Meanwhile equitable interests rank according to when they were created.

This is possibly more likely to be important for lenders in a corporate situation than for you as mortgage banks, but if your security expressly includes after acquired freehold and leasehold property, and property is acquired in the future, you as lender need to ensure that the borrower is obliged to put in place a legal mortgage in your favour at the date the legal interest in the relevant property is transferred in order to perfect your security. Until then the interest will be caught but will be equitable only.

- Fixtures and fittings?

  We move to the issue of fixtures and fittings. Are these included in a legal mortgage of property? For the record the definition of property generally includes fixtures and fittings anyway but it is usual to include fixtures and fittings in the description of the property, together with plant and machinery.

  The law of fixtures in England is a complicated matter and the degree to which the fixture forms part of the property is the defining factor.

  The first case you see in 1904, **Reynolds v Ashby & Sons** held that machines on the ground floor of the factory fastened with nuts and bolts were part of the mortgaged property even though strictly speaking, they were removable.

  The second case, **Hulme v Brigham** in 1943 took a different view. Even though heavy printing machines stood on the floor of a factory simply by their own weight and were not easily moveable, they were in principle moveable and therefore held not to be fixtures which formed part of the property but as plant and machinery.

  For this reason, it is usual to include a charge over plant and machinery as well as fixtures.

- Other charges and equitable assignments

  In addition to the legal mortgage, there are other charges which a mortgage or debenture may contain and which Rod Brown will be dealing with in more detail in his talk.

  The general principle is that any matters important for the proper enforcement of security over the property and are indissolubly linked with that should be caught in the security net. It has also historically been seen as a good idea to have a floating charge over assets.

  These include:

  a) specific, or fixed equitable charges over assets;
  b) equitable assignments by way of charge; and
  c) floating charges.

  Dealing first with:

  Fixed equitable charges and assignments by way of security

  When taking a legal mortgage over a property, fixed charges or equitable assignment would also normally be taken over a variety of matters, which can include the benefit of after acquired freehold and leasehold property, rental

income, sale proceeds, agreements, guarantees, licences, claims against third parties arising out of occupational lease documents, building contracts, project agreements, insurance proceeds and policies and the benefit of title insurances. The issue becomes particularly important if this is a development loan.

For the record, as a technical matter, it is thought that in the case of an agreement to do something, or chose in action, only an equitable assignment can be put in place. It is possibly an obscure point for you but should be mentioned. In the case of assignment and sometimes of charge, issues of consent then arise.

Either the agreement may be silent, in which case it cannot always be assumed that the agreement is freely assignable. Or the agreement contains a limited or total prohibition on assignment in which case consent is needed. In the case of development agreements, it is usual to seek that these are assignable at least twice without consent.

Floating charges

A floating charge is a different type of charge. Rod Brown will discuss it in his talk.

Traditionally it has been thought advisable to include floating charges in mortgages and debentures over assets owned by a company to:

1. provide a catch all to supplement the powers of a fixed charge holder; and
2. entitle the lender to notice of appointment of an administrator and/or to appoint an administrative receiver. Please note that for charges entered into after 15 September 2003 administrative receivership is no longer a real option save in very limited cases.

If a company has a number of properties and has given security elsewhere, it may be unable to give a first floating charge. However, you may find that you are offered as security a special purpose vehicle which has no other asset than the property in which case the position is simpler than in the case of a large company with a number of other properties and secured loans. Alternatively the floating charge may not need to be a first floating charge if it is principally aimed at notice of appointment of an administrator.

- General

  Floating charge or fixed charge?

  A fixed charge on property ranks before a floating charge although some charges expressed to be fixed charges are construed as floating charges.[1]

1 A first fixed charge over all the undertaking property of a company is generally construed to be a floating charge and generally case law has viewed as floating charges only accounts duly charged but which may be drawn upon by the borrower.

Rod Brown will be discussing a very recent case which deals with this point, i.e. Spectrum Plus Ltd Re National Westminster Bank plc v Spectrum Plus Ltd [2004] EWCA Civ 670 decided on 26 May 2004.[2]

- Consents

  If consent to charge or assign is needed then as a counsel of perfection this should be obtained as a condition precedent to entry into the relevant charge.

  If we are looking at one valuable asset like a lease of the whole property in the City of London where consent is required, then it would not be normal to proceed without landlord's consent as a condition precedent to a charge by way of legal mortgage. In such case proceeding without consent would not be usual. It could be a big problem for the borrower as it exposes the lease to forfeiture for breach of covenant, and the bank also has potential liability for the tort of inducing a breach of contract.

  However, there are occasions where the asset is not the only asset in the security net and is secondary to the main asset. In such cases there is a school of thought which takes the view that a charge or equitable assignment should be taken first and questions answered later. Clearly it would be dealt with on a case by case basis and would depend very much on the nature of the asset. If the borrower becomes insolvent, a view might prevail that the lack of consent is the least of its problems or breaches.

  The issue of consent to charge arises in the case of floating charges and fixed charges over after acquired property as well. However it is fair to say that in an insolvency situation, crystallisation of a charge will be the least of the parties' worries, i.e. there will be general default.

  If the asset comes in later and is caught by an equitable charge, either

  a) It could be covered by an excluded assets clause, i.e. the asset is excluded but the borrower is obliged to try to get consent and the asset is taken into charge as soon as consent is given OR
  b) it could be charged anyway and the issue of consent pursued after the event.

  Notices of charge and assignment by way of security should be notified to the counterparty in question.

- Property in Scotland

  Property in Scotland can only be effectively charged in Scots form and has to be dealt with separately.

  However the debenture can usefully include a floating charge extending to all property and assets of the company including land in Scotland.

2 The Court of Appeal decided that a specific charge over book debts of a borrower constituted a fixed rather than a floating charge, principally it seems because the book debts in question were directed by the lender to be paid into the borrower's account with the chargee bank.

2 Provisions of a Mortgage

I now turn to the form of mortgage. The intention of today's talk is to examine the form of a mortgage and what needs to be built in. We will be speaking tomorrow about enforcement and the various routes for doing so. The provisions I will be discussing are not exhaustive and intended to give an idea only.

I deal with the provisions as follows:

2.1 Definition of Secured Obligations

- Definition of property
- Charging clause
- Mortgagor's covenants and representations
- Development and investment covenants
- Powers of mortgagee on default.
- Secured obligations

  The secured obligations are fundamental to the charge and need to be set out carefully. An all monies charge is generally used, though usually limited by reference to the loan agreement and security documents.

2.2 Definition of Property

- Description

  The description of the property is very important. It needs to be clearly defined by reference to a title number or a good root of title if unregistered. A plan is not needed for a whole registered title and a plan may be referred to in a conveyance for unregistered land.

2.3 Charging Clause

The Land Registry requires special wording in order to register a legal mortgage over property. The wording is "charges by way of legal mortgage".

Full title guarantee confers statutory comfort including that the party in question has the ability to convey. There may be a slight qualification.

2.4 Covenants

2.4.1 Mortgagors covenants

- *Covenant to pay*. A covenant to pay should be included in any security documents between a lender and a borrower. There are questions as to whether a valid demand can be served upon a mortgagor if there is no liability to pay or how a right to foreclose can arise. The Fifth Schedule of the Law of Property Act 1925 contains statutory precedent mortgages and all of these contain express covenants to pay.

- *Other covenants*. Covenants contained in the legal charge will clearly vary, but certain clauses are fundamental. Arguably covenants in a security document should be restricted to those necessary to protect the security. It is advisable that other covenants or undertakings should be incorporated in the loan agreement or facility letter. De facto the covenants operate as a snapshot and cease to apply on repayment of the lender.

- Some covenants are deemed crucial and the nearest analogy is to a tenant's covenants in a lease. You can see the reasoning, i.e. a landlord and a bank are both looking at an investment yielding a return and do not want the tenant or borrower doing anything which may diminish the value of the asset. A borrower's covenants are therefore aimed at this and are:

  (i) *Repair* a covenant to keep the property in repair;
  (ii) *Negative pledge* Anthony Harris will be dealing with this in his talk on loan agreements. Briefly, it is a covenant on the part of the borrower not to dispose of the property without consent of the lender. This includes charging selling and leasing. This prohibition will probably be qualified in an investment property subject to a variety of leases and by the borrowers obligations to its own occupational tenants. The powers of leasing conferred on a borrower by section 99 of the 1925 Law of Property Act also need to be limited. To stop subsequent charges or dispositions in the case of registered land, there is a useful device called a restriction on the register. This is applied for at the time of the mortgage in order to ensure that no further charges of any type can be registered without the lender's consent. This is an important protection for a first chargee as the Land Registry will not police a negative pledge clause, i.e. a prohibition on further dispositions without a lender's consent contained in the charge itself.
  (iii) *Alterations and use* Covenants not to demolish develop alter or change use without consent are customary. A similar covenant is required to comply with fire regulations and material restrictive covenants and planning consents.
  (iv) *Insurance* My colleague Ian Silverblatt will be dealing with insurance. It is essential to ensure that the assets charged are adequately insured, to include terrorism as well while such cover is available. A covenant to insure in full replacement value against all usual risks with insurers approved by the bank is usual. In a development loan provision also needs to be made for contractor's insurance before completion of the building. The bank should be joint insured, or noted and joined as loss payee. In the case of leasehold property where a landlord insures, the issue may be more difficult to resolve, as Ian will explain.
  A standard mortgage clause is also required so that the mortgagee under such a clause can recover notwithstanding misrepresentations by the mortgagor when he effected the policy.
  (v) *Environmental* It is usual to provide for compliance with environmental laws. For properties built on reclaimed sites the lender will need to be vigilant in relation to environmental matters. Lenders going into possession of the property may face problems.
  (vi) *Observation of lease covenants and regulations payment of outgoings* Covenants are needed in the case of leasehold premises to pay the rent and observe repairing and other covenants in the lease. This is because technically a landlord is entitled to forfeit for breach of covenant as mentioned in my earlier lecture, and relief for a tenant against forfeiture would only be obtained upon remedying a breach. In the meantime, licence to assign may be required and may be held up which would impinge on

marketability of the premises again. Compliance with other obligations is also important. These may include planning obligations and development documents.

(vii) *Further assurance* A covenant for further assurance means that a mortgagee can call upon the borrower to perfect security, as in the case where only equitable interests are held by the borrower and a legal interest is subsequently acquired. Unless such a right is expressly reserved, it will not be implied.

(viii) *To permit inspection* The mortgagee should ensure that a provision entitling it to enter to inspect is included.

(ix) *Title deeds* It has been usual to provide for deposit with the bank of all deeds and documents of title. The position is clearly changing now no charge certificate is issued and paper deeds are not required. Nonetheless where a fixed equitable charge is created over all freehold and leasehold property present and future, property may be acquired subsequent to the date of a debenture. Not only are any relevant deeds required at this stage but a legal mortgage should be provided for over such property at that time (a charge over future acquired property operates as an equitable charge only).

(x) *Unregistered land* In a case of unregistered land, it used to be advisable to ensure that the mortgagor should not register its title without consent of the bank so that the bank can ensure its charge is duly protected on the register. However a mortgage of unregistered land now triggers an obligation to register the property in any event. A mortgagor should also be prevented in the case of registered land from permitting any overriding interest to arise without the consent of the bank.

2.4.2 Mortgagor's development and investment covenants

Here I am looking at the effect on covenants re alterations and letting/management of property.

Specific covenants are required in the case of investment and or development properties.

Simple forms of mortgage for simple property generally prohibit subletting or development of the property without the consent of the bank. Rod Brown will be dealing in more detail on what is done here. However, a mortgage would have to be tailored in the case of a property which is held specifically as an investment subject to occupational leases, or which is being developed. Simple covenants not to sublet or not to alter/develop the property are not appropriate in these cases, as the very purpose of the loan is at odds with the simple prohibition. As such, the use for investment purposes or development is simply a breach of the relevant covenant which would be waived, and there would be no provision for what is to be done in either of the particular circumstances. Similarly a floating charge is helpful to catch documents which may arise later.

Covenants in such cases are as follows:

- Development covenants

  In the case of development property, the mortgagor should:

  1. Proceed diligently with the development
  2. Obtain all necessary consents
  3. Use of materials
  4. Deadline for completion
  5. Warranties

  There should be provision for the mortgagor to proceed diligently with the development up to completion of the works to the satisfaction of the bank.

  He should also covenant to obtain all necessary permissions before commencing development.

  He should covenant not to use or allow use of deleterious materials.

  He should give undertakings to procure completion by a particular date with a longstop date.

  In relation to any building contractor, architect, engineers and other professionals employed in connection with the development, a mortgagor should be required to procure that they enter into warranties in favour of the bank or any receiver and that these warranties contain step in rights should the development be ongoing.

- Investment covenants

  These are

  1. Obligation to enforce covenants in occupational leases
  2. Mortgagee to consent to management matters
  3. Issues where statute protects occupational tenants applying for licence.

  In the case of an investment property which is already sublet, covenants would be required to ensure enforcement of the covenants in the occupational leases. This should also include a provision for consent by the bank to surrenders of subleases.

  It is also usual to include a variety of safeguards for the banks in the management of the property subject to occupational leases, including provisions for bank's consent to rent reviews, licences to assign and licences for alterations.

  In this connection, the bank needs to be aware that there are statutory protections for a tenant when landlord's consent is required to any assignments or sublettings. A landlord cannot unreasonably withhold or delay its consent if consent is expressly required and the mortgagee needs to be aware of this in an English context failing which it may be prejudicing the landlord or even inducing a breach of contract where the provision is expressed.

  Ian Silverblatt deals with issues of how far a bank wishes to police its borrower on management matters in his talk later today.

2.5 Powers of a Mortgagee and a Receiver

The mortgage will deal with:

- *the power of sale*
- *the power to appoint a receiver*

Additionally the bank has power to go into possession as mortgagee and to foreclose.

A mortgage generally deals with various powers granted by the Law of Property Act 1925 and varies the fairly rigid statutory provisions. For example, a mortgage will usually remove statutory grace periods. Under the Law of Property Act, powers are not exercisable until default is made in payment of the mortgage money for three months or interest is unpaid for two months. A mortgage will generally provide that no powers are exercised until a default and upon actual demand. A demand gives the bank a right to waive the default which it will not have if the default clause is automatic. Anthony Harris will be dealing with the events of default and I will leave these issues to Anthony to run through.

2.5.1 Power of sale

Firstly the power of sale. This is a separate power under the Law of Property Act 1925.

It is usual to remove statutory grace periods in the mortgage deed so that the power is immediately exercisable or at any rate after expiry of a grace period whenever an Event of Default under the Loan Agreement occurs.

Otherwise under the Law of Property Act the power is not exercisable until default is made in payment of the mortgage money for three months or interest is unpaid for two months.

If there is a delay in exercising the power of sale we enter into a grey area where a mortgagee may become liable as a mortgagee in possession.

2.5.2 Mortgagee in possession

If a power of sale is deferred for some time and no receiver is appointed this could be construed as going into a possession and this is something to consider if and when a mortgagor defaults.

Banks are historically reluctant to enter into possession given the liability they incur. Case law provides that a mortgagee in possession is liable to account strictly on the basis of managing the property with due diligence. Additionally, the case of Case of **White v City of London Brewery Co [1889]** a mortgagee in possession has to account for not only what he has actually received but for what he might have received but for his own neglect. I will be dealing in more detail with these aspects in my talk on enforcement.

Clearly the clauses in the charge will seek to exclude this but banks historically have avoided taking possession of commercial property and prefer to rely on powers to sell or appoint a receiver.

2.5.3 Receivers and administrators

- Administrators and administrative receivers

  Where a floating charge is in place, an administrative receiver was formerly capable of appointment. However, an administrative receiver has been abolished by the Enterprise Act 2002 for new charges entered into since last year. Now that the new administration regime is in force, of course, this is a limited right as the powers are contractual only unless the charge is old. Administrative receivers cannot be provided for in new charges though they had wide statutory powers under the old insolvency legislation.

  However, the power to appoint an administrator out of court is now generally included in charges as an express option.

- LPA receivers

  Provision is made in the Law of Property Act 1925 to appoint a receiver. However, the powers are very limited and do not include sale.

- Extension of statutory powers of LPA receivers

  A receiver appointed under the LPA needs to be given wide contractual powers. I deal with this in greater detail tomorrow but many express powers are needed.

- Security power of attorney

  The security power of attorney is key when enforcement is put in place. It is a power of attorney which survives liquidation in the case of a bank, although not in the case of a receiver. It will also not survive an administration. Disposals can therefore be effected.

2.5.4 Foreclosure

Although this is an old remedy and enforcement in America is called foreclosure, in England and Wales it is quite unusual. It is done by court proceedings and extinguishes the equity of redemption so that the property becomes the property of the lender. For the reasons set out later, courts do not tend towards this solution.[3]

3 Other miscellaneous clauses include:
Default interest
Costs and expenses
Receivership costs and expenses
Indemnities
Assignment
Consolidation
Release of security and right of redemption

3 Right of Redemption

- Equity of redemption

  The equity of redemption needs to be taken into account whenever secured finance is contemplated as a borrower cannot be tied into a long-term mortgage.

  The borrower always has the right to repay the loan and release the charge if at any time he wishes to pay off the mortgage and refinance. This right is known as the equity of redemption, or a right to buy back the mortgaged land from a lender even after the contractual time for repayment has passed. This right is enforceable in the courts.

  Before 1925, the legal mortgage took the form of an actual conveyance of title and promise by the mortgagee to reconvey the property when repaid. Given a mortgagee has always held the title deeds it was within his power to sell the property if the borrower was in default on the date of repayment. Hence the protection of a borrower arose.

- Clogs on the equity

  It has also been established that there must be no "clogs or fetters" on the equity of redemption.

  The Courts will look at transactions carefully and in certain sets of circumstances give relief to the mortgagor against what the Courts consider to be unfair or even oppressive transactions.

  This should be borne in mind when agreeing and describing fees levied on a borrower for early redemption.

4 Due Diligence

- Conveyancing procedure

  Rod Brown has already addressed the conveyancing process in his earlier lecture. As he says, it is important both for a mortgagee and a purchaser that the conveyancing process is followed.

  A lender will be looking at two potential scenarios. The first will be a purchase by a borrower at the same time as the charge to the lender. The second will be where a borrower already owns the property in which case the mortgagee's position on a conveyancing exercise is similar to that of a purchaser for the first time.

- Importance for a mortgagee

  Generally, it is important for a lender to investigate carefully.

  Firstly the mortgagee does not actually take possession of the mortgaged property.

  Secondly, the mortgagee is not looking to occupy or enjoy the land in the same way as an ordinary purchaser, merely to obtain security for repayment of his loan.

Where security is in the property alone, a mortgagee would generally be looking at freehold interest or a long leasehold interest.

5 Perfection of Security

My colleague Ian Silverblatt will be noting the issues on drawdown, but general actions on completion should include:

5.1 Notices of Charge

Send notices of charge to the landlord which entitles the bank to notice of any forfeiture by proceedings. The notice can seek to extract a promise from the landlord in acknowledging the notice that it will notify the lender of any sort of forfeiture by reentry as well as proceedings. It is questionable whether this can be enforced if the landlord fails to do so as there is a lack of contractual consideration.

5.2 Registration

Failure to register a charge over registered land at the Land Registry will mean that the charge takes effect only in equity and not in law.

Failure to register a charge by a company at Companies House will mean that the charge is void against a liquidator or administrator of the company and against any creditor of the company.

An application for registration of the charge at the Companies Registry and the Land Registry needs to be made where the land is registered and the borrower is a company. In the case of unregistered land, an application for first registration has to be made.

If the charge has to be registered at Companies House, this application will be made first. In view that the application has to be made within the priority period, the application to the Land Registry can initially be made with a certified copy of the charge rather than the original, which can then be forwarded on its return from Companies House.

The application for registration must be made within the search priority period already discussed by Rod Brown. If the application is made after the end of the search period, the chargee will take subject to any application lodged by a third party before the chargee's application. This can be disastrous so it is important this be done in good time.

5.3 Restrictions

In registered land, the chargee will also often apply for registration of a restriction along side registration of the charge.

Under the LRA 2002, the form of restriction must generally be in one of the standard forms and made on form RX1.

The standard form of restriction is that the registered proprietor must not dispose of its interest in the estate without consent of the mortgagee.

5.4 Further Advances

Under the 1925 Act a registered charge secured further advances made by a proprietor of that charge in priority to a later charge only if there was an obligation in the

first charge to do so and that obligation was noted on the register. This remains the same under the 2002 Act.

If there was no obligation or the obligation was not noted on the register, then upon an application being made to register a subsequent charge, the Land Registry had to give notice of that application to the first chargee.

Now the Land Registration Act 2002 provides that

the proprietor of a registered charge may make a further advance on the security of the charge ranking in priority to a subsequent charge if it has not received notice of the subsequent charge from the subsequent chargee (section 49(1) LRA 2002).

There is no provision for the Land Registry to notify existing chargees of application of registration of later charges. Instead notice must be sent by the subsequent chargee to the prior chargee's address for service on the register so it is important to keep this information up to date.

Finally, if the parties agree before entering into the registered charge that it will secure a maximum amount and this agreement is noted on the register, then the prior charge will secure a further advance in priority to any subsequent charge so long as the total amount secured by the prior charge does not exceed the figure agreed and noted. This is helpful for development loans.[4]

Talk given by Jane Havergal, Partner
14 June 2004
dbb forum, Berlin

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4 Third party security and transfers of security.

Rod Brown

Taking Security

Overview

- Structures of property finance
- Types of security
- Ranking

Structures of Property Finance

Property financing is the financing or refinancing of the acquisition and/or development of real property assets where the lender concerned looks principally to the value of the assets concerned and the cash-flow generated from those assets as its source of payment of interest and repayment of principal.

Property financing is generally "limited recourse" and can be divided into "development" property financing and "investment" property financing.

Development Financing

Development financing is the provision of financing to purchase and build a property. The lender may be asked to consider this in circumstances where tenants for the property have already been found or where they are to be found during the course of the development.

The usual risks for the lender are:

1. completion risks:

   (a) cost overruns (the development costs more than anticipated);
   (b) time overruns (the development takes longer to complete than anticipated).

   These risks are normally dealt with by some form of shareholder support e.g. additional equity, cost overrun guarantees or interest guarantees.

2. market risks: if tenants are not tied in prior to commencing the development, the market for the particular property or property generally is not as anticipated when tenants are required.

3. investment financing risks: these are the risks associated with investment financing referred to below.

Investment Financing

Investment financing is finance for an existing property (i.e. already built) with existing tenants (i.e. the leases are in place).

The usual risks for the lender are value and cashflow related as follows:

1. value: this is the lender's exit – the lender requires repayment of principal within a specified time frame and can only achieve it via a sale (voluntary or forced) or refinancing of the property.
2. cashflow:
   (a) a tenant risk – the cashflow is the rental income from tenants of the property needed to service the interest and perhaps partially reduce the principal – if the tenant is unable to pay (e.g. liquidation) the cashflow is affected;
   (b) if circumstances arise where the tenant is not obliged to pay (e.g. breach of occupational lease by lessor or destruction of property) the cashflow is affected.
3. an interest risk: rental income, subject to reviews etc., is generally fixed whilst interest expense may be floating for all or part of the term.

These risks are generally addressed in the loan documentation.

Limited Recourse Financing

Introduction

As noted, both development financing and investment financing tend to be done on a limited recourse basis. Limited recourse financing is about the allocation of risks between the person behind the investment (in most cases the parent company) and the lender.

From the parent's point of view the property concerned is only one asset of a number – the parent is only willing to risk its initial equity injection so does not want the non-performance of the one property to lead to the collapse of the group as a whole.

From the lender's point of view, having decided that the property concerned will provide the lender all it requires (payment of interest and fees and repayment of principal), it wants to ensure that no other creditor will compete for recourse to the property – i.e. the lender wants to ensure the property is adequately "ring fenced".

Limited recourse structuring

The limited recourse feature of the financing can be achieved either contractually or legally.

Contractual limited recourse is the situation where the lender lends directly to the parent (who has any number of assets) but agrees that the lender may only look to the property concerned and related assets for servicing and repayment.

Legal limited recourse is the situation where the parent incorporates a special purpose vehicle (SPV) to which the lender lends to finance the acquisition and/or development of the property – the lender may only look to the SPV for servicing and repayment.

A number of factors may determine the choice of structure:

- contractual limited recourse makes it difficult to ring-fence the property financed assets from actions of other creditors.
- another disadvantage with the contractual structure is that generally the lender will be required to act (i.e. enforce its security) even though the particular property to which the lender has recourse may, on its own, remain perfectly viable.
- there will be circumstances where contractual limited recourse is the only option – often because of the legal status of the parent (e.g. a fund that is not authorised to create subsidiaries).
- the SPV structure is simpler than contractual limited recourse because instead of defining which assets the lender has recourse to and which it does not, with an SPV the lender has recourse to all its assets.
- before the Enterprise Act 2002, a big advantage of the SPV structure was that if the parent's group faced financial difficulties, the lender could appoint an administrative receiver of the SPV to ensure control of the assets of the SPV did not fall into the hands of an administrator or liquidator of the parent's group. Following the Enterprise Act 2002, there are only limited circumstances when a lender can block an administration by appointing an administrative receiver.

Nature of the SPV

The two principal determinants as to the nature of the SPV are tax and security.

1. Tax:
   (a) from a VAT and corporation tax (other than capital gains tax) point of view there is probably little difference between whether the SPV is tax resident in the UK or not;
   (b) a non-tax resident SPV will not be liable for capital gains tax or advance corporation tax so that if the group to which the SPV belongs is in a tax paying position, there are advantages in the SPV being non-resident for tax purposes;
   (c) to be non-resident the SPV will need to be incorporated and controlled from offshore – there are various mechanisms for achieving offshore control even for an SPV subsidiary of a UK company;
   (d) in determining whether the SPV should be established with non-resident tax status, the parent needs to consider the potential tax advantages against the actual costs – e.g. foreign control and foreign legal opinions.
2. Security: the lender will want to obtain a fixed and floating charge over all the assets of the SPV so in any case where the SPV is other than a UK incorporated company, one needs to consider its capacity to provide the appropriate security.

Types of Security

Fixed security over property

The best form of fixed security (i.e. over a specific piece of land) for a lender is a legal mortgage. Historically, a legal mortgage would take the form of a conveyance of the land to the lender subject to a proviso for re-conveyance on repayment of the debt. In some cases, the land would be leased to the lender (known as a "mortgage by demise or sub-demise").

A mortgage differs conceptually from a charge in that with a mortgage, the land allocated as security is transferred to the lender subject to an obligation to re-convey the land back to the chargor when the debt is repaid. With a charge, the land allocated as security remains with the chargor. However, this conceptual difference has little practical significance since legislation in 1925 allowed a legal mortgage to be created either by demise or sub-demise or by a "charge expressed to be by way of legal mortgage". The mortgagee had the same powers, protections and remedies whichever method is used.

The modern method of creating a legal mortgage (whether of freehold or leasehold land) is almost always by a charge by way of legal mortgage. Mortgages by demise or sub-demise are not used in practice. This reality is recognised in the Land Registration Act 2002 which provides that in relation to registered land, a legal mortgage may only be created by a charge by way of legal mortgage.

A mortgage or a charge may also be equitable. This can happen in the following situations:

1. There is an agreement to create a legal mortgage. This must comply with section 2 of the Law of Property (Miscellaneous Provisions) Act 1989, namely, it must be in writing, incorporate all the expressly agreed terms and be signed by or on behalf of each party.
2. There is an intention to create security but the formalities for the creation of a legal mortgage have not been complied with, mainly because it was not created by deed or because the mortgage was created over registered land but not registered.
3. It is the express intention of the parties to create an equitable mortgage or charge e.g. the mortgage is of an equitable interest in land.

How does an equitable mortgage/charge differ from the legal mortgage/charge?

As long as the mortgage or charge is by deed, the lender will still have the statutory powers of sale and to appoint a receiver and the other ancillary powers contained in the Law of Property Act 1925, Section 101 and these powers would normally be extended by the charge itself. The lender could also protect the priority of the mortgage or charge by registering a notice at the Land Registry (for registered land) or a land charge at the Land Charges Department (for unregistered land). In the case of registered land, the lender could also register a restriction on the borrower's title to prevent the registration of any dealing with the property without their consent. The important difference between a legal charge and an equitable charge is the rules on priorities which I will come on to a little later.

Floating charges

A floating charge is a charge over a general class of assets rather than a specific property.

The assets secured by a floating charge are described generically, for example, the borrower's trading stock or its undertaking and assets. The group of assets may fluctuate from time to time either through the borrower disposing of them in its ordinary business or through the acquisition of assets of the class described after the floating charge was created (i.e. future or after-acquired assets).

A floating charge will provide that if a specified event occurs, or if the lender takes a specified step, the charge **crystallises**. This means that the floating charge becomes a fixed charge and the borrower can no longer dispose of the assets. Crystallisation typically occurs on specified events of default or events of insolvency of the borrower.

The borrower is free to deal with the assets subject to the floating charge in the ordinary course of business until the floating charge crystallises to become fixed.

A floating charge can be created by a company and a limited liability partnership but not by an individual.

Spectrum Plus

I would like now to spend a little time discussing the recent House of Lords decision in the case of *National Westminster Bank plc v Spectrum Plus Limited* which was decided on 30th June, 2005. This is particularly important for your property lending business in the UK in as much as it goes to the root of whether the charge you take on book debts (and this might potentially include rent payable under occupational leases which will service interest and principal) is categorised as a fixed charge or a floating charge. The emphasis is now on the control over the proceeds rather than how the charge is labelled in the security agreement.

Let me give you some background. The uncertainty began in June, 2001 when the Privy Council held that it is not possible to have a fixed charge over book debts and a floating charge over the proceeds of the debts if the chargor has the right to deal with the proceeds in the ordinary course of its business. This was decided in the case of *Brumark Investments; Agnew v Inland Revenue Commissioners* [2001]. The *Brumark* decision concerned a particular form of debenture rather than the standard form of debenture used by many clearing banks following a decision of Mr Justice Slade in the case of *Siebe Gorman & Co Limited v Barclays Bank Limited* in 1979.

In the *Siebe Gorman* case, the debenture in question was held to create an effective fixed charge over the book debts and their proceeds in circumstances where the chargor was required to pay the proceeds of the book debts into an account with the chargee (whether or not those proceeds were subsequently withdrawn). On 15th January, 2004 the Vice Chancellor held, in the first instance decision in the *Spectrum Plus* case, that a charge over book debts in a debenture which was in substantially the same form as the debenture in *Siebe Gorman* was only effective as a floating charge. After this first instance decision, there was considerable uncertainty among

banks, insolvency practitioners and others regarding the construction of charges over books debts in the *Siebe Gorman* form as there were now conflicting first instance decisions in this regard. So it was decided to appeal.

Let me give you the details of the *Spectrum Plus* case, which are very straightforward. The company owned a bank account with an overdraft of £250,000 to provide working capital for the business. By a debenture, the company created a specific charge in favour of the bank over its book debts. The company was obliged to pay the book debts into the specified account with the chargee bank, and was permitted to draw on the account so that its overdraft fluctuated. It was never in credit. The company went into creditors' voluntary liquidation. The liquidators collected in the book debts but refused to account for them to the bank. The bank sought a declaration that the debenture created a fixed charge in favour of the bank and an order for the liquidators to account to the bank for them. Customs and Excise, the Inland Revenue Commissioners and the Secretary of State of Trade and Industry were joined in as parties – if the liquidators were correct, they would be able to get access to the book debts for certain unpaid taxes ahead of the bank.

The Judge at first instance, the Vice Chancellor Sir Andrew Morritt, refused to grant the declaration holding that the charge created was a floating charge. The Crown appealed and in the Court of Appeal, the appeal was allowed and it was held that a charge over book debts created by a debenture, which provided that the book debts were not to be disposed of prior to collection and that on collection were to be paid into a bank account at the chargee bank, created a fixed rather than a floating charge, since the charge by those conditions imposed restrictions on the use of the proceeds of the book debts.

The liquidators appealed to the House of Lords, who overturned *Siebe Gorman* with retrospective effect, holding that this form of words only creates a floating charge. To constitute a fixed charge the chargee bank must exercise a much greater degree of control over the bank account, giving consent to withdrawals.

In reaching their decision, their Lordships found that an essential characteristic of a fixed charge is that assets can be released from the security only with the "active concurrence" of the chargee bank. They agreed that there must be restrictions on the borrower's ability to use the book debts and their proceeds in the ordinary course of business. It is not enough that the debenture prevents the borrower from dealing with the book debts prior to collection. The borrower must be required to pay the proceeds into a properly "blocked" account from which it cannot withdraw any sums without the consent of the chargee bank.

Their Lordships considered that, in assessing the degree of control the chargee bank has over the charged asset, this is a question of substance over form, namely looking to the nature of the arrangement in practice and not simply to what is contractually agreed.

That said, the *Spectrum Plus* decision (and indeed *Siebe Gorman*) makes no reference to security over rental income. In particular, it fails to refer to the line of cases (including the decision of the Court of Appeal in *Atlantic Computer Systems plc* [1992]) where a charge on a portfolio of leases was held to be a good fixed charge notwithstanding that the chargor was permitted to use the rental stream under those

leases until enforcement or notice terminating that permission. There are a number of other cases following this line where charges on specific intangibles such as chattel leases are upheld as fixed securities.

There are a number of possible explanations for why this line of cases should be distinguished. For example:

(a) These charges may be upheld as fixed because the leases do not turn over in the ordinary course of business i.e. they do not fluctuate like book debts.

(b) A better way of phrasing this may be to say that, in the *Atlantic Computers* case, the charge was over identifiable debts (i.e. the rental income) arising pursuant to existing contracts and which should therefore be regarded as present debts whereas, in the case of book debts, the charge is over a class of present and future debts.

(c) In the *Atlantic Computers* case itself, Nicolls L.J. referred to a mortgage of land (including leasehold land) which does not become a floating charge by reason of the mortgagor being permitted to remain in possession and enjoy the fruits of the property charged for the time being. However, this case concerned subleases of chattels, not real property and the charge was not simply over the leasehold property – the subleases themselves were charged by the company to the chargee.

(d) In *Arthur D Little Limited (in administration) v Ableco Finance LLC* [2002] (handed down between *Brumark* and the House of Lords decision in *Spectrum Plus*) it was suggested that if the rights over which the chargor has control are of a more incidental nature then the charge might remain fixed. However, this case concerned dividends payable on a share so cannot really be compared to a lease, where the rental payments can make up the entire value in the lease – unless there is clearly a substantial residual value in the lease once the rental payments have been made.

(e) Finally, unlike book debts, a rental payment is a debt which, once paid, does not extinguish the lease.

Although the decision by the Court of Appeal in *Atlantic Computers* is good law, there is some residual doubt, in light of the House of Lords decision in *Spectrum Plus,* that a case with similar facts would be decided in the same way in the future. It is more likely that the emphasis will be on control over the proceeds, with less regard to whom the proceeds are paid and the identifiable or incidental nature of the debt.

A typical security package

On the assumption that the SPV is a UK incorporated company the lender will usually expect:

1. a first charge by way of legal mortgage over the freehold or leasehold property;

2. a first fixed charge over:

   (a) plant and machinery;
   (b) the control accounts;
   (c) the insurances;
   (d) other contractual rights (eg managing agent appointment, contractors/ professional team appointments, collateral warranties);

3. an absolute assignment by way of security of:

   (a) rental income;
   (b) hedging arrangements.

   This is used to ensure the lender has effective claims against the tenants (in the case of rental income) and the counterparty (in the case of hedging arrangements).

4. a floating charge over all other assets of the SPV; and

5. a first fixed charge or legal mortgage over the shares in the SPV.

Ranking

Priority of Mortgages

A mortgagee will usually expect to get its hands on the charged property before any other mortgagee/chargee. The mortgagee therefore needs to know which interests he can ignore because they are postponed to his rights and which interests he must take into account because they have priority to his mortgage.

The rules relating to the priority of mortgages are complicated because there are so many possible situations to consider.

The first important distinction is whether the mortgage is of a legal estate or of an equitable interest.

In the case of a mortgage of an equitable interest, the general rule is "first in time prevails" i.e. the mortgages will rank chronologically according to the date of creation. However, if the mortgage is of a beneficial interest under a trust, a special rule applies – known as the rule in *Derle v Hall*. Competing mortgages of the beneficial interest depends on the order in which notice of the mortgage is received by the owners of the legal estate (the trustees of the trust).

Example

The beneficial interest under a trust is mortgaged to A and then to B. B gives notice of the mortgage to the trustees first. B's mortgage will have priority over A's.

In the case of a mortgage of a legal estate, the priority of a mortgage depends on whether the property is registered or unregistered and whether the mortgage is legal or equitable (this is not the same as the mortgage over an equitable interest which we have just discussed – we are talking about a mortgage of the legal estate but that mortgage can be legal or equitable).

Registered land

Priority of a legal mortgage

As we have seen, the only way to create a legal mortgage of registered land is if the mortgage is substantively registered at the Land Registry.

The priority of legal mortgages depends on the order in which they are entered on the register not on the order in which they are created.

A legal mortgage will take priority over all equitable mortgages created after its date of registration and it will also take priority over earlier equitable mortgages that have not been protected by an entry on the register.

For example, let us take an equitable mortgage to A, a legal mortgage to B and a legal mortgage to C. If A's mortgage is protected by an entry on the register, B and C will be subject to it. If it is not so protected, B and C will take free of it. If B's mortgage is registered first, it will have priority over C's – but if C registers before B, C's mortgage will have priority over B's

Priority of an equitable mortgage

An equitable mortgage over registered land may arise because the formalities for a legal mortgage have not been complied with.

An equitable mortgage will be subject to all earlier mortgages, whether those mortgages are legal or equitable and whether those mortgages have been protected by registration or not.

If an equitable mortgage is protected by a notice on the chargor's registered title, it will have priority over all later mortgages, whether legal or equitable. If the equitable mortgage is not so protected, it will still have priority over a later equitable mortgage, even if that mortgage has been protected by a notice on the chargor's title. However, the equitable mortgage will not have priority over a later legal mortgage – the legal mortgagee will take free of the equitable mortgage.

Taking our example of the equitable mortgage to A, the legal mortgage to B and the legal mortgage to C, let us assume that there is then an equitable mortgage to D. D's mortgage will be subject to all three earlier mortgages, even if the equitable mortgage to A is not noted on the registered title. We have seen that if A's mortgage is noted, it will bind B and C but that if A's mortgage is not noted, B and C will take free of it. However, even if A's mortgage is not noted, it will still bind D.

This is why it is far better to have a legal mortgage than an equitable mortgage – it means that the mortgagee can take free of all earlier mortgages that have not been protected on the register. With an equitable mortgage, there is always an uncertainty about whether the lender will be subject to an earlier unprotected mortgage.

Unregistered land

The key question to determine priority of mortgages in unregistered land is whether a particular mortgagee holds the title deeds to the charged property.

If the mortgagee holds the title deeds and the mortgage is a legal mortgage, the mortgage will have priority over all later mortgages, whether legal or equitable,

unless the mortgagee loses priority through fraud, misrepresentation or gross negligence. If the mortgage is an equitable mortgage, it will only have priority over a later legal mortgage if the later mortgagee had notice on the equitable mortgage. If the later mortgage is equitable, the "first in time prevails" rule applies and the earlier equitable mortgage will have priority (unless lost through fraud, misrepresentation or gross negligence).

If the mortgagee does not hold the title deeds to the charged property, his mortgage is registrable as a land charge (if the mortgage is legal, it is called a "puisne mortgage"). If the mortgage is registered as a land charge, all later mortgages, whether legal or equitable, will be subject to it. If the mortgage is not registered as a land charge, all later mortgages that are registered as land charges, whether legal or equitable, will gain priority over it.

Tacking

Tacking occurs when a first mortgagee makes further advances and claims priority over lenders whose mortgages were created after the first loan but before the further advance.

In registered land, the further advance can be "tacked on" to the earlier charge for the purposes of priority even if a second charge has been created after the first charge but before the date of the further advance in the following cases:

1. If the proprietor of the first charge has not received notice of the subsequent charge from the subsequent chargee.
2. If the further advance is made pursuant to an obligation noted on the register.
3. If the parties to the first charge have agreed that it will secure a **maximum amount** and that agreement is noted on the register – in which case, the first charge will secure a further advance in priority to the subsequent charge even if the further advance is made after the subsequent charge as long as the total amount secured by the prior charge does not exceed the agreed and noted amount.
4. If the intervening chargee agrees.

These rules apply to all charges over registered land i.e. registered charges and charges that are not protected by registration at all or simply noted.

In unregistered land, the further advance can be "tacked on" in three instances.

1. If the lender had no notice of the intervening mortgage at the time of making the further advance.
2. If the intervening lender agrees.
3. If the mortgage imposes an obligation to make a further advance.

April 2006

Ian Silverblatt

Tenancy (Rental) Law and Real Estate Insurance

Introduction

In this talk I will be looking at the situation where you as lender are offered, as security for a loan, a legal charge over commercial property (in England or Wales) owned or being purchased by the borrower, and which is subject to occupational leases.

This should be contrasted with Dr. Havergal's talk this morning, in which she looked at the situation where the borrower holds a long leasehold interest, and Dr. Havergal reviewed the main terms of such a lease. In that situation, the long lease is a valuable asset and is effectively the bank's security.

In this talk, I will be looking at an occupational lease – also called a "rack rent" lease – in other words, a lease granted to the occupier of the property, at an open market rent and generally for a relatively short period – usually no more than 15 years and often as short as 2 or 3 years.

1. I will be looking at the main terms of a commercial rack rent lease including some important points to look out for from the lender's perspective.
2. I will then conclude with a look at real estate insurance, with particular emphasis on tenanted properties.

1 Commercial Occupational Lease

The capital value of a tenanted commercial property (whether an office building, shopping parade, shopping centre or industrial estate) will be affected by several factors, including its size and location. However, just as important are the quality or strength of the tenants, the annual rent roll (i.e. the yearly rent payable by the tenants) and the terms of the occupational leases.

In considering the loan proposal, the lender should look at the individual tenants, their financial situation and rental payment history. The lender should also require its solicitor to look at the terms of the occupational leases and advise as to any effect that they may have upon the value of the security being offered.

To do this, the lender's solicitor will either obtain copies of all of the occupational leases or, alternatively, will review a certificate of title from the borrower's solicitors, setting out the principal terms of each of the leases and identifying where any of them depart from the institutionally acceptable terms.

Principal Terms

Let us now look at some of the principal provisions of a commercial occupational lease, with particular emphasis on those points where a lender should be concerned.

I will be looking at the:

1.1 Tenant
1.2 Lease Term
1.3 Rent and Rent Review
1.4 Repair and Services
1.5 Alterations and User
1.6 Assignment and Subletting and
1.7 Forfeiture

1.1 Tenant

- The tenant named in the lease may not be the tenant in current occupation of the premises. This may be because of a subsequent assignment of the lease, or alternatively, because the tenant has sublet the premises. The precise position should be checked in detail, as should the company numbers of any corporate tenants, to ensure that there have been no name swaps.
- Depending upon the security being offered, the lender may wish to carry out a financial and status check against some or all of the tenants. The lender should also check their rental payment record.
- The lender may also wish to look at any security provided by the tenants, such as a guarantee by a third party or a rent deposit.
  - Depending upon the nature of the transaction, the lender may require the borrower to place all rent deposits in an account with the lender, provided of course that this is permitted under the terms of the rent deposit deed.
  - The lender will also wish to consider whether to require that the rents themselves (although usually not the service charges) are paid into an account with the lender to set against the payments due under the loan facility, either from the start of the loan or, alternatively, upon an event of default.
  - With regard to rent deposits, the rent deposit deed will normally provide that the sum deposited with the landlord belongs to the tenant (to protect the tenant should the landlord go into liquidation), but that the sum is charged to the landlord as security for the tenant's liabilities under the lease and under the rent deposit deed (to protect the landlord should the tenant go into liquidation).
    Under English company law, such charges must be registered at Companies House no later than 21 days after they are created, failing which the charge will be void as against a liquidator of the tenant and if the tenant subsequently goes into liquidation, its liquidator could demand the return of the deposit. It is therefore important for the lender's solicitor to check that all such charges have been registered within the 21-day deadline.
- As regards tenant liability, you heard this morning that a distinction must be made between leases granted before **1st January 1996** and those granted after that date.
  - For all leases granted before 1st January 1996, the original tenant and subsequent assignees will remain liable to the landlord for all liabilities under the lease, including those incurred after they assign the lease, until the term of the lease

expires or the lease is otherwise terminated (for example, by surrender or forfeiture). These leases are often referred to as "Old Leases".
Many in the industry felt that this imposed undue hardship on tenants who had assigned their leases, particularly when the Lease Term was a long one. Accordingly, **the Landlord and Tenant (Covenants) Act 1995** was enacted to reduce this hardship and provides that for leases granted after 1st January 1996 ("New Leases"), the original tenant and subsequent assignees will not remain liable to the landlord for liabilities incurred by their successors in title (***Section 5***) unless the lease requires the tenant to enter into an **Authorised Guarantee Agreement** upon an assignment of the lease (***Section 16***).

– Under an **Authorised Guarantee Agreement**, the tenant effectively acts as guarantor for the obligations of the assignee (i.e its immediate successor) until such time as the assignee assigns the lease with the landlord's consent. The previous tenant cannot be required to guarantee any liabilities owed to the landlord under the lease after a subsequent assignment by his successor and indeed the ***1995 Act*** provides that any attempt by the landlord to require such an (extended) guarantee, will be void.
Perhaps not surprisingly, most commercial leases granted since 1st January 1996 do contain an automatic requirement for the tenant to enter into an **Authorised Guarantee Agreement** with the landlord upon an assignment of the lease.

Whilst it is true to say that tenanted properties with Old Leases are more attractive to investors (and consequently their lenders) than properties with New Leases, nevertheless, this should certainly not discourage a lender from accepting such properties as security for a loan. It is, however, important to appreciate the difference between the two forms of lease.

- Finally in this Section, the lender will have to decide whether it requires the borrower to obtain its consent before granting any further leases at the property and before taking a surrender of an existing lease. Sometimes this will be required for the grant or surrender of all occupational leases; other times only for the grant or surrender of key occupational leases – for example, an anchor tenant in a shopping centre or an office tenant with more than a stated amount of square metres.

  Whilst each lender will decide to what extent it wishes to be involved in "management" matters, the continuity of the income stream will clearly be of paramount importance.

1.2 Lease Term

- The lender will obviously be interested in the length of the term of each of the occupational leases and will normally prefer a longer rather than a shorter term, to ensure stability at the property and hopefully a regular rental income without any lengthy void periods.

- Almost all leases will be granted for a fixed term, but quite often they will contain break clauses permitting either or both parties to terminate the lease early in certain circumstances.

  A tenant taking a lease of more than 5 years may well wish to have the option to terminate the lease early and particularly in the current office letting market

in London, it is common to see tenants demanding break options, either on a fixed date or at fixed periods during the lease.

– *For example, a landlord may offer a new tenant a 9-year lease with break options which can be exercised at the end of the third and the sixth years.*

Alternatively, in certain circumstances a landlord may offer the tenant a "rolling" break.

– *For example, a 5-year lease with a break option for the tenant at any time after the expiry of the third year.*

Break options can also be granted to the landlord, although in the current market this is rare unless the landlord has a specific reason for wanting a break clause – for example, if it is intending to redevelop the building in the near future.

It is therefore vital for the lender to check whether any party (particularly the tenant) has the right to terminate the lease before the contractual expiry date. If the borrower has a break option, the lender will usually require the borrower to obtain the lender's consent before exercising it.

- It is also important to consider the impact of the ***Landlord and Tenant Act 1954***. Under Part II of this Act, tenants in occupation of business premises enjoy security of tenure and are entitled to require the landlord to grant them a new lease of their premises upon the expiry of their previous lease (should the tenants so wish).

  – The 1954 Act gives the landlord only a few statutory rights of objection, principally if he intends to redevelop the building such that possession of the tenant's premises is required; or if he intends to reoccupy the tenant's premises for the purpose of the landlord's business (and has been the landlord for at least five years).
  – The 1954 Act does allow the parties to "contract out" of the tenant's security of tenure provisions by mutual agreement and this is quite common in leases of 5 years or less and in certain circumstances can also be seen in longer leases.
    It is beneficial for a landlord to have short-term leases "contracted out", as this will give the landlord more flexibility when they come to an end. It is also vital for the landlord to ensure that a lease is "contracted out" if it contains a break clause operable by the landlord, since otherwise the exercise of the break clause will merely bring the contractual lease Term to an end, triggering the tenant's statutory right to claim a new lease!
  – After 50 years, the 1954 Act is currently undergoing some modification. Under ***The Regulatory Reform (Business Tenancies) (England and Wales) Order 2003***, which came into force on **1st June 2004**, the method of contracting out a business lease has been simplified. Previously, the parties had to obtain a Court order authorising the contracting out of a lease prior to its grant. However, since 1st June 2004, the parties have been able to deal with the contracting out by way of a formal notice served by the landlord on the tenant and a declaration signed by the tenant in response.

The lender's solicitor should therefore check the Application and Court Order (if obtained pre-1st June 2004) and otherwise the signed notices and declarations (all of which should be kept with the deeds), to ensure that the relevant "contracting out" procedure was carried out properly and that the tenants do not therefore enjoy security of tenure.

1.3 Rent and Rent Review

- Most leases provide for the tenant to pay the rent in advance on the usual Quarter Days. The lender will only be concerned if the lease significantly departs from this.

  The usual Quarter Days are:

  - **25th March**
  - **24th June**
  - **29th September**
  - **25th December**

- In addition to checking the annual rental income of a property and the payment history of the tenants, the lender should also check whether any of the tenants have been granted rent-free periods which have not yet expired. These are often granted to new tenants at the start of their lease as a sweetener to take the lease.

  Rent-free periods often only last for a few months, but depending upon the state of the market, periods can sometimes last for two or more years! It is therefore important for the lender to check whether a rent-free period for a particular tenant is still continuing, as it will have an effect upon the rental income of the borrower, at least until the end of the rent-free period.

- The lender should also check whether there are additional rental provisions such as turnover rents. These are common in shopping centres and require that in addition to a set annual base rent, the tenant must also pay a percentage of its annual turnover. Needless to say, any such provisions should be checked carefully.

  The lender should look not only at the current rents, but also at the provisions in the lease relating to future increases in the annual rent. This is called the rent review.

  Most leases granted for terms of more than 5 years will contain provisions for the principal rent to be "reviewed" at some point during the lease term. Most commonly this occurs at 5-yearly intervals, but it can also be found at 4-yearly or sometimes 3-yearly intervals, depending upon the circumstances.

  – The lender will usually want to ensure that leases granted for more than 5 years contain provisions for the rent to be reviewed at least once every 5 years and for such reviews to be "upwards only" – i.e. to the market rental of the premises at the relevant review date, unless this is less than the passing rent, when there will be no increase (but, crucially, no decrease).
  – At present almost all rent review provisions are expressed to be "upwards only". Unfortunately, the Government is currently pressing the property

industry to adopt "upwards and downwards" rent reviews (i.e. to follow the true state of the market), rather than fixing a potentially artificial rental level in favour of landlords.

To-date, a few property companies have subscribed to ***the Commercial Lease Code 2002*** (which is a voluntary code set up by a number of interested bodies including the British Property Federation, The Law Society and the Royal Institution of Chartered Surveyors) and which advocates landlords offering upwards and downwards reviews (but only in return for a higher initial rent!). Nevertheless, the vast majority of commercial leases still contain "upwards only" review provisions and tenants have shown little interest in paying a higher initial rent in return for an upwards and downwards review.

However, the Government has indicated that it is determined to see upwards and downwards reviews in the near future and that it may well bring in legislation to force landlords to provide for such reviews in their leases. This is a point to bear in mind for the future.

– One final point for the lender's solicitor to check is that time is not "of the essence" in the rent review provisions. If time is of the "essence", this would mean that if the landlord fails to serve his rent review "trigger" notice within the time limits set down in the lease, he loses the right to review the rent until the next review date.

  It is rare for time to be expressly made "of the essence" in rent review provisions, but sometimes this can be implied by certain clauses and it is important for the lender's solicitor to check whether this is the case. If it is, again this is not necessarily a reason for a lender to reject a property, but will be one of the factors taken into account by the lender and its valuer in assessing the viability and value of the property as security for the proposed loan.

1.4 Repair and Services

- A property let to a single tenant will normally contain covenants on the part of the tenant to keep the whole of the property in good and substantial repair, with no services required from the landlord.

- However, a more complicated scenario is found with multi-let properties – for example, a building, shopping parade, or shopping centre, let to several tenants.

  In these situations, it will be usual for:

  (i) each tenant to be responsible for keeping the interior of its unit or premises in good repair;
  (ii) the landlord to be responsible for keeping the exterior, structure and common parts of the building or centre in good repair and for providing various services for the benefit of the tenants; and
  (iii) the costs of the landlord's works and services to be paid by the tenants through a service charge, with each tenant paying a percentage of the total, usually by four, quarterly on-account payments, with power for the landlord to levy a balancing charge if at the end of the year his service charge expenditure has exceeded the on-account payments received from his tenants.

It is therefore important for the lender to ensure that no shortfall in recovery is likely – i.e. that the borrower cannot be required to carry out any repairs or services for which he cannot recover 100% of the costs from the tenants. Otherwise, the value of the security could be affected.

- A lender will also be concerned if, as sometimes happens, the lease contains a proviso that the tenant will not be required to keep the property in any better state than it was in when the lease was granted. In this regard, the lease will normally have a Schedule of Condition annexed, providing either in words or by photographs, evidence of its state and condition at that time. It will then be a matter for the lender's valuer to advise of any impact on the value of the security.

1.5 Alterations and User

- The lease will normally limit the alterations or additions which the tenant is allowed to carry out. Structural or other major works will not usually be allowed. Others, such as internal partitioning and non-structural alterations and additions, will often be allowed with the landlord's consent and with a proviso that such consent is not to be unreasonably withheld.

  Save in exceptional circumstances, a lender will have concerns only if, for example, the lease contains no prohibition whatsoever against alterations or additions.

- The use for which the tenant can put the premises is normally strictly regulated under the lease. Often, a specific use will be permitted, with certain alternative uses permitted with the landlord's consent (not to be unreasonably withheld).

  Sometimes, the tenant is allowed to use the premises for any use within a specified Use Class. These are classes of use set out for planning purposes under Town & Country Planning Use Classes Orders.

  – for example, a tenant may be permitted to use the premises for any purposes under Class B1, which covers office and light industrial use; or Class A1, which is retail.

  Obviously, it is important to ensure that the premises have the necessary planning consent for the use permitted.

  A lender will normally be concerned if the lease permits any use (since this can affect the commercial viability – and therefore the value – of the property, particularly if it is a parade of shops or a shopping centre), or if the lease is too restrictive (since this could affect the viability of the tenant's business and thus the landlord's rental income; it could also restrict the rental increase upon review).

1.6 Assignment and Subletting

- Having looked into the financial viability of the current tenants of the property, the lender will want to ensure that the tenants cannot freely assign their leases or sublet their premises without restriction.

It is usual for commercial leases, granted at a market rent, to permit the tenant to assign or sublet only with the prior consent of the landlord, but with such consent not to be unreasonably withheld.

- In any event, statute provides for the landlord to act reasonably where the lease requires the tenant to obtain the landlord's consent to an assignment or subletting (***Section 19 (1) Landlord and Tenant Act 1927***).

  The lender will therefore want to check that the leases do not contain a general permission for assignment or subletting without the need for consent and that they contain an absolute prohibition against assignment or subletting of part (save in certain circumstances where subletting of part may be permissible with the prior consent of the landlord – for example, where a tenant has a lease of several floors of a building).

- In the case of New Leases, the lender will want to check that the leases require each tenant to enter into an **Authorised Guarantee Agreement** with the landlord upon an assignment.

- There are often additional requirements in the lease regarding the tenants' ability to sublet their premises. Ideally, the lease should require subleases to be granted at no less than the open market rent at the relevant time or the rent then passing under the lease (whichever the higher) and also for the subleases to be contracted out of the relevant provisions of ***the Landlord and Tenant Act 1954*** to prevent the subtenants from obtaining security of tenure rights.

- Another important point to note is that under statute, arrears of rent or service charge which are more than six months old cannot be claimed against previous tenants or their guarantors, whether they are liable under an Old Lease or by virtue of an Authorised Guarantee Agreement under a New Lease (***Section 17 Landlord and Tenant (Covenants) Act 1995***).

  – In addition, a previous tenant (or guarantor) who receives a claim from the landlord for sums due under the lease, is entitled upon payment of such sums, to claim from the landlord an "overriding lease" of the premises, under which that tenant (or guarantor) will become the immediate tenant of the landlord and the immediate landlord of the defaulting tenant (***Section 19***). This is designed to allow the previous tenant (or guarantor) an opportunity to recover the sums which they have paid to the landlord, from the current tenants or to seek possession of the premises should this be considered desirable.

- The lender will therefore have to decide whether it requires the borrower to obtain its prior consent before claiming any arrears from previous tenants, since, in certain circumstances, the lender may not wish a previous tenant to be able to claim an overriding lease and thus become the direct tenant of the borrower.

  The lender will also have to decide whether it requires the borrower to obtain its prior consent before consenting to an assignment or subletting of any of the occupational leases. Often, lenders require this control only with regard to significant or important tenants.

It must, however, be borne in mind that even if the legal charge requires the borrower to obtain the lender's consent before consenting to an assignment or subletting of a lease, the borrower will still be subject to the provisions contained in the lease and also to statute, and it is therefore usual for the legal charge to provide that the lender will not refuse consent where to do so would put the borrower in breach of its obligations under the lease.

1.7 Forfeiture

- Almost all commercial leases will contain a clause permitting the landlord to forfeit (i.e. terminate) the lease at any time if the tenant is in breach of covenant, in arrears of rent for more than a certain specified number of days, or if the tenant commits an act of insolvency.
- It is important for the lender to ensure that such provisions are contained in the occupational leases, although it should bear in mind that tenants (and their mortgagees) have a statutory right to claim relief from forfeiture by way of an application to the Court (under ***Section 146 of the Law of Property Act 1925***). The Court has complete discretion as to whether or not to grant relief, but will normally do so if the tenant (or its mortgagee) remedies the breach, if it can be remedied – eg: by the payment of all outstanding sums due.

2 Insurance

An entire talk could be devoted to deal the various facets of real estate insurance, particularly in relation to landlord and tenant matters. Here I have only a few minutes to provide a brief overview of the subject.

2.1 In most commercial leases, the landlord will covenant to insure the building in its full reinstatement value, together with architects' and other professional fees (and related value added tax), together with three years' loss of rent.

It is usually undesirable for the tenant to insure the property, even in a lease of whole, since this would devolve control away from the landlord.

2.2 It is important for the lender to check that the insured risks are adequate (and, if required, include terrorism cover – particularly in the central areas of London); also that the sums insured are sufficient.

2.3 The lender should also check that all of the tenants covenant to reimburse the landlord for their particular share of the premiums and that the various leases are drafted in a way that there should be no shortfall, save perhaps in respect of any vacant premises.

2.4 The leases will normally provide that if the building is damaged by an insured risk such that one or more of the tenants are unable to operate from their premises, those tenants' rents will cease to be payable until the damage has been remedied and occupation resumed, or until the expiry of the loss of rent period (whichever the earlier). Otherwise, the tenants would still have to pay rent even though the building may have burnt down!

Normally, only the principal rent will cease during this period, with the tenant still liable for insurance premiums and any service charges which are incurred. It is important for the lender to check that if the lease provides for

insurance and service charge payments to cease as well, the loss of rent insurance provision should also enable the landlord to insure against loss of three years' service charges and insurance payments.

2.5 It is common for the landlord to insure in its own name but with its various tenants' (and their mortgagees') interests noted on the policy. However, sometimes leases provide for the landlord to insure in joint names with its tenants. This can cause complications, particularly vis-à-vis a lender, should an insurance claim be made, and should be avoided if at all possible.

2.6 The lease should also deal with what is to happen if the building cannot economically or practically be rebuilt (or the damage remedied). The lease should provide that in such circumstances, the lease will terminate and the insurance proceeds will belong to the landlord, since a tenant paying a market rent will normally have no significant financial interest in the building.

Unfortunately, leases are sometimes silent on this issue. This is less favourable for the landlord and its lender, but may not prevent a lender from proceeding with the loan, since general law will normally dictate that the lease will be frustrated and will thus terminate automatically. In such a situation the insurance proceeds will be divided between the landlord and its tenants according to their respective financial interests in the building, with the vast majority (if not the whole) of the insurance proceeds thus belonging to the landlord.

Where the lease is silent on this point, the lender should ask its solicitor to advise.

2.7 A lender will normally wish to have the option, if the property is damaged by an insured risk, to take the insurance proceeds as part of the monies due from the borrower, particularly if the damage is significant and potentially long-term.

It is usual for most legal charges to provide that in such a situation, the lender can call for the insurance proceeds to be used to redeem the whole (or part) of the loan. However, the borrower will still be subject to the terms of the leases, which will normally require the borrower to use the insurance proceeds towards remedying the damage, unless this is uneconomical or impractical.

Nevertheless, provided that the lender ensures that the property is insured at all times in its full reinstatement value, with adequate loss of rent and other safeguards (for which ongoing monitoring is recommended), it will normally want the property to be rebuilt anyway.

2.8 I mentioned earlier that it is undesirable from the perspective of the lender for the property to be insured jointly between the borrower and its tenants. I now turn to the position of the lender and how it may wish to be protected under the policy.

The options generally available are as follows:

- **Insurance in the name of the borrower but with the lender's interest noted on the policy**
  - This is the most basic form of protection for the lender. It means that the lender will be kept informed of any claims under the policy, or of its lapsing. However, it will not, in itself, allow the lender any control over how and to whom the insurance proceeds are paid if a claim is made.
- **Joint insurance in the names of the borrower and the lender**
  - This will give the lender the benefits of having its interest noted (receipt of information etc) and will ensure that following damage by an insured risk, the borrower cannot receive the proceeds and promptly "disappear" with the money! By requiring joint insurance, both the borrower and the lender must consent to the manner in which the proceeds are dealt with. However, this may be impractical, for example if the property is insured as part of the borrower's block policy, covering several properties, or if the property is leasehold and the freeholder insures. It may also be undesirable for the lender, who would still need to obtain the borrower's written consent if, for example, the lender required the insurance proceeds to be used to redeem the loan.
- **Lender as sole/first loss payee**
  - This is the option favoured by several lenders (particularly in high value transactions) and can be applied whether the policy is in the joint names of the borrower and the lender, or in the sole name of the borrower (with the lender's interest noted). With the lender named as sole (or first) loss payee, not only will the lender be kept informed of any claims under the policy, or of its lapsing, but it will have the right to receive any proceeds payable under it which are due to the borrower.
    If at all possible, this option should be required by the lender and an obligation on the part of the borrower to procure such an arrangement should be included in the security documents.

2.9 If at all possible, the lender should also insist upon a **non-invalidation clause** in the policy, by which the insurer confirms that the insurance will not be invalidated by any neglect, misrepresentation, default or misconduct of the borrower or any other insured party.

Equally, the lender should try to secure the written agreement of the insurance company that it will not lapse the policy (for example if premiums are not paid) without notifying the lender and giving the lender time to remedy the default or secure alternative insurance.

If the lender is joint insured (and generally if its interest is noted), the insurer will usually be required to do this anyway, but there is no harm in obtaining such written confirmation, to be absolutely certain.

This is often dealt with as part of the conditions precedent to drawdown of the loan and you will pleased to know that I will be returning tomorrow afternoon to discuss the exciting subject of Conditions Precedent in greater detail.

Conclusion

I hope that this has given you a useful insight into some of the points to be considered by a lender when taking security over tenanted property.

Talk given by Ian Silverblatt, Partner
15 June 2004
dbb forum, Berlin

Anthony Harris

Loan Contracts

A General

1 Introduction

This talk will be a very introductory talk on the English form of Loan Agreement, a specimen form of which you will find in your lecture notes and which I will refer to throughout this lecture. However, I only have just under an hour to give you this talk and as you can appreciate, going through a Loan Agreement, explaining its various clauses, could itself take up a whole day of lectures. Some of you may use Facility Letters instead of a Loan Agreement, but these letters are nothing more than a shorter form of Loan Agreement.

2 Anglo Saxon Form of Loan Agreement

Most of you will be familiar with the German legal system which differs in a material extent to the Anglo Saxon legal system. The Anglo Saxon legal system works on the basis that in documents all areas should be covered and that when a person reads a document from cover to cover, all terms and conditions should be contained in that document. On top of this, however, there is of course statutory law and also, more importantly, case law. Statutory law does affect a number of areas and, in particular, contracts relating to sale of goods but has little impact in terms of commercial lending. There is statutory legislation relating to consumer lending, but the loans that you will make will be secured on commercial property to people acting in the course of business and therefore falls outside this legislation. In addition, however, there is also in England what we call "case law" and that is where Courts have generally applied principles or interpreted provisions in agreements. This in a way is a contrast from the German system where I understand documentation is very short as a person can rely on German law. The Anglo Saxon system also works on the basis that in the case of a contract, both parties are basically free to make up their own terms subject to certain limitations imposed by law. In addition there is no duty on any party to the other to operate on a fair or good dealings basis.

The result of this is that accordingly, Anglo Saxon contracts appear to be very long documents, but contain substantially all the terms of a transaction. I have had to debate with German lawyers as to which form is better and what I do acknowledge is happening is that whilst no German lawyer will admit that the Anglo Saxon form is better than the German form, that because of the influence of the big Anglo Saxon firms including American firms, documentation throughout Europe is becoming more standardised following the Anglo Saxon pattern and is becoming longer.

3 Type of Transaction

The type of transaction that you will normally be concerned with will involve a term loan secured on property and will normally involve a fairly lengthy agreement

because the loan is made to the borrower on the basis that the loan will be repayable over a long period of time and early repayment can only take place in certain limited circumstances. This is in contrast to what we have in England what we term an "overdraft facility", which is a loan made by a bank to a customer, but which is repayable on demand and it is possible for a loan contract relating to an overdraft facility to be on one sheet of paper.

4 Form of Term Loan Agreement

We do not have in England a standardised format loan agreement. There have been attempts by bodies such as the LMA (being the Loan Market Association) to standardise documents but there is certainly as far as I am aware no standard property finance loan document. Nonetheless, there is a sort of practice in the London market that all loan agreements, whilst being drafted differently and containing different wording, are all very much in a similar form and tend to all contain the same clauses although the order of these clauses may be different. Nothing turns on the order in which clauses are contained in a loan agreement.

B General Points on Loan Agreements

1 Borrowers

Notwithstanding that the property will be situated in England, there is no necessity that the borrower is an English legal entity. In fact, from my experience, a significant number of loan agreements have non-English entities, the main reason being for this is that a foreign company selling an investment property will not be subject to UK Capital Gains Tax. This results in English investors setting up foreign entities, but there are anti-avoidance provisions dealing with setting up these entities, which I need not refer to further. However, if the borrower concerned is not a UK entity, then it would be impossible for your English solicitors to check that the company is properly incorporated and of good standing and accordingly, lawyers in the jurisdiction of incorporation of the foreign entity will have to be employed and who will have to carry out all necessary checks and provide a legal opinion.

2 Stamp Duty

As you may be aware, prior to the Labour Government coming into office, whilst there was property duty known as Stamp Duty payable on the transfer of property, the amount involved, which was originally 1% was not a material amount. However, under the Labour Government (which came into office in 1997), the rate of Stamp Duty has significantly increased to now a rate of 4% on properties over £½ million. Stamp Duty has also recently been replaced by Stamp Duty Land Tax but the rates are still the same. Importantly, this causes complexities for the property lender because in a number of cases the loan may take the form of, instead of a property loan a form of acquisition finance to acquire a company that owns the property as in such circumstances Stamp Duty rate is reduced from 4% to ½% (being the rate for acquisition of shares) and this is very attractive. As you may appreciate, the non-payment of Stamp Duty Land Tax at 4% is a serious consideration for any purchaser of property and a significant amount of time is spent in this country in devising structures and mechanism to save Stamp Duty. It is accordingly very

important for property lending banks to assess carefully any proposal put to it which involves any Stamp Duty saving scheme because this can affect who actually is the borrower and there can be security risks depending upon what is trying to be achieved. I should add for the sake of completeness and I am sure some of you have had experience of this type of funding that if a company is acquired that owns property and this property is given as security, then this constitutes what is termed "Financial Assistance", which is not permitted subject however to the borrower being able to go through what we in England term the "white wash" procedure, whereby such Financial Assistance will be permitted provided that certain conditions are complied with (including obtaining what could be an expensive auditors' report) to show that creditors are not unfairly prejudiced by what is intended.

3 Other Permutations

It is possible as part of the loan arrangement for there to be a number of borrowers involved. Furthermore, any property finance can extend to a number of properties. It may also be that the obligations of the borrower are to be guaranteed by a third party and it would be usual for the guarantor to be joined as a party to the agreement. It is also normal going down the traditional property finance route that the borrower is a "Special Purpose Vehicle", which only owns the property or properties which are to be the subject of the finance. This will mean that the bank will obtain security over all assets by way of debenture of the borrower and if the borrower defaults, will be able to take full control over the borrower. If the borrower however owns a number of properties and the bank is only given partial security, then this will have an effect on the bank's enforcement position and this is something that will be dealt with by my colleagues.

C Loan Agreements

I will now turn to the terms of the loan agreement.

I have provided a specimen form and I have tried to make this Loan Agreement as simple as possible. It refers to a single borrower who has a freehold property which is subject to Occupational Leases. It is for an Investment Loan (i.e. the property is let). I have also assumed the property is to be purchased. As I have already mentioned, there are a large number of variations relating to the status of the borrower and property, but these are not material for the purposes of this lecture. However, each circumstance of a loan will be different and that is the main reason why loan agreements need to be tailored to fit the situation.

1 Contents and Interpretation

1.1 Contents Page

I would draw your attention to the contents page of the Loan Agreement which sets out the contents that are contained in the Loan Agreement and you will see there are 31 clauses with a few schedules.

1.2 Interpretation Clause

The way Anglo Saxon documentation is normally drawn is to have either at the front or sometimes at the end (but much more usually at the front) an interpretation clause. This clause contains definitions of all the terms used and I have to tell you from a drafting point of view, it is vitally important that this clause is correct and it can take as long to draft this clause as in some cases to draft the rest of the agreement. In the interpretation clause one should, if possible, include all terms which are defined in the Loan Agreement although of course, it is possible to define terms in certain clauses and refer to them separately especially if they are only used in that clause or occur at a later stage.

1.3 Other Provisions

In addition, there are also a number of interpretation clauses, which include a definition of more general terms. Definitions include a "month" to make sure that in accordance with market practice as one normally is working on a modified business day convention. "Business Day" which in a case of a bilateral agreement involving a German Bank it is usual to tie a business day with the UK and Germany. Important other provisions include those relating to making clear that the Loan Agreement prevails over any other Security Documents and a foreign terms clause whereby if there is a foreign borrower, English expressions will have the analogous meaning in relation to foreign jurisdictions.

2 The Facilities

This clause sets out the amount of the facility to be made available. My draft assumes all money is made available at drawdown. It is normal to limit the facility and this will be the lower of up to the amount agreed or actual cost of the property and related costs, a loan to value percentage or the interest cover compliance amount, which I will refer to later.

The facility clause also contains a purpose for which the loan is being made although it is important to note that the bank is not obliged to ensure that this purpose is being adhered to.

3 Conditions

General

As part of any facility arrangement, a bank will require the borrower to provide a significant number of confirmations, documentation and comfort on other matters and these are set out in the Conditions. The bank's position is that if these conditions are not fulfilled to its absolute satisfaction, then it is not obliged to make the loan. There is however also the possibility that the loan could be made if the conditions are not fulfilled but this will be subject to the borrower having to fulfil any outstanding conditions within a period of time. The problem however is that the bank loses its main leverage once the loan is made. In terms of the conditions precedent, I would refer you to Schedule 1 to the Loan Agreement on page 55, which sets out a number of conditions and which would include the following:

3.1 Establishment

Confirmation that the borrower is duly established and has full authority to enter into the loan agreement. This is of fundamental significance and should be checked

before the loan agreement is entered into. It should be remembered that if a borrower did not have authority to enter into the loan agreement, then this is a major defect because the loan agreement as entered into and all security documents would be invalid. It is therefore very important for the bank's solicitors to check the borrower does have due authority which in the case of an English company a bank's solicitor can easily do, but will have to rely upon a foreign legal opinion in relation to a non-English entity.

3.2 Valuation

It will be usual for a bank to require a valuation of the property. Normally a well-known firm of valuers will be appointed and the bank will specify the basis of a valuation. As you may be aware, the Royal Institution of Chartered Surveyors sets out the definitions and interpretations of valuation in their then current statement of asset valuation practice and guidance note which I believe is also called the "Red Book" and it is normal to value property on the basis of market value or estimated realisation price, the main difference between the two definitions being the time it takes to sell the property. There are also other definitions, which are more restrictive in terms of sale and will likely lead to normally lower valuations.

3.3 Survey

It is not unusual for a bank to require a survey of the property, although this is not essential. In addition, a bank would also require comfort in terms of the environmental position of a property and to ensure it is not in a polluted area or does not contain any polluted materials. Depending upon the location of the property, there may be a formal environmental investigation.

3.4 Ownership of Property

One of the key aspects of the acquisition of property financing is the assumption that the borrower owns the property, which is free from defects. This can be confirmed to the bank in a number of ways. One way is for the bank's solicitors to carry out a full investigation but this is the most expensive way. A sort of halfway house is for the borrower's solicitors to prepare a Certificate of Title (which is in a standardised form I am pleased to tell you) and which gives confirmation in relation to the property and is prepared by the borrower's solicitors. These confirmations however are normally subject to exceptions which are set out in schedules and it will be usual for a bank's solicitors to report to the bank on the form of Certificate of Title. A third way, which is sometimes accepted by the bank, is that if a borrower is acquiring a property, then the bank accepts the Report on Title prepared by the Borrower's solicitors of which it will be a co-addressee. A Report on Title is nowhere near as good as a Certificate of Title and can be qualified and is a much more commercial document from the borrower's perspective.

3.5 Bank Legal Opinion

It is usual for the bank to ask its solicitors to provide a legal opinion on the documentation. This is now very much accepted market practice. I should however caution you in relation to a legal opinion. If a bank's solicitor did not give a legal opinion and any dispute arose in the future, the bank, would, in my view, be entitled to argue that unless its solicitors had advised it to the contrary than it could assume

that the documentation was in acceptable form, and was fully, legally binding, valid and enforceable against the borrower and that the borrower had all the required power and authority to enter into the documents. A legal opinion in most cases will however say this, but will be subject to a number of assumptions and qualifications and if you carefully review these assumptions and qualifications, you will find what I will term the "assumed position" is greatly watered down. A legal opinion is therefore more a shield for the bank's solicitors than protection for the bank. If the borrower is a foreign entity a legal opinion will be required from the foreign lawyers acting for the Bank.

3.6 Other

There will be a number of other conditions precedent dealing with financial information on the borrower, main occupational tenants, confirmation of compliance with money laundering requirements and sufficient funds to complete the acquisition of the property. There will be further conditions precedent dealing with the security to be taken from the borrower such as a debenture, notifications to tenants and confirmation of insurance.

3.7 Property Documents

Lastly, there will be documentation relating to the property such as title information documents, copies of leases and documents dealing with the VAT position of the borrower if relevant.

4 Availability of the Facility

4.1 Notice

Please bear in mind that even if a borrower enters into a loan agreement, it is not obliged to drawdown under the loan facility. This obligation is only confirmed when the borrower serves a drawdown notice, a form of which you will find in Schedule 3 to the Loan Agreement on page 59. If a borrower enters into the loan agreement and did not serve a drawdown notice to draw the loan, then the only liability the borrower would have would be to pay any arrangement fee and the bank's professional costs.

4.2 Timing

If the borrower does serve a drawdown notice, it has to give the bank a certain number of days notice that it requires funding. Bearing in mind you are a German bank as opposed to a UK bank, you may require a period of notice of anywhere between two to five business days in order to fully organise funding. A longer period of time is likely to be required if the borrower is taking funds on a fixed basis as opposed to a floating basis.

5 Interest

5.1 Charging of Interest

Interest on the loan can be charged in a variety of ways. It can be charged by reference to a fixed rate or by reference to a floating rate. If a borrower elects for a floating rate, then the loan will be funded on the basis of LIBOR (being London Interbank Offered Rate) and this rate can be determined in a number of ways. The most common practice now adopted is to use the rate that appears on the Reuters

screen at a certain page, but an alternative way is to actually ascertain the LIBOR rate offered by certain banks which are termed "Reference Banks" or even the rate that is actually offered to the bank itself. Please note that rate can also be ascertained either on the first day of the beginning of an interest period or, alternatively, could be ascertained two business days beforehand which a number of German banks find a more convenient way to tie in with their funding arrangements. It would also be usual if a floating rate is adopted to tie in the payment of interest with the interest payment date stated in the loan agreement. Interest payment dates are the dates on which any interest and any other payment are due by the borrower and these will normally fall after the rental payment quarters contained in Occupational Lease. Rental quarters are as you are aware, 25th December, 25th March, 24th June and 29th September in each year.

5.2 Fixing

An alternative method of funding is for the bank to fund by reference to a long-term fixed rate. The basis of determination of the fixed rate can be stated in the loan agreement and is normally based upon the costs of an interest swap. It is also possible for the loan agreement to give the borrower the choice of whether the loan is funded on a fixed or floating rate.

5.3 Margin and Regulatory Costs

In addition to funding costs, the bank will also charge a margin, which is basically the bank's profit and takes into account the bank's costs and the risk of providing funds to the borrower. The bank will also charge Regulatory costs, these being any costs imposed by the central bank in its home territory or the European Central Bank. I understand the position to be that currently German Mortgage Banks do not have any regulatory costs on lending. This would be different to an English bank that does have regulatory costs and these are determined in accordance with a formula, which is normally attached to the loan agreement. I would add that any branch of a German Mortgage Bank as opposed to a representative office would also be subject to the UK regulatory regime and will have regulatory costs. These costs are, as a matter of practice, normally always passed back to the borrower.

5.4 Interest Costs

Since most loans are likely to be rental income backed, a bank will want to ensure that interest costs are covered by rental income. Rental income is to a certain degree known, but interest costs, which can change in the future unless fixed, are not known. It is accordingly not unusual in a situation where a bank funds a loan by reference to a floating rate for the borrower, to be required to take measures to ensure that its interest costs do not get out of hand. The borrower can be required to enter into derivative arrangements whereby the interest rate is secured (to cover upward changes) or if the borrower does not want to enter into a derivative arrangement, it is not unusual for banks to have drop-lock provisions whereby if certain interest rates are exceeded, then the borrower is required to enter into a fixed rate loan.

6 Repayment

The terms of repayment of a loan have to be negotiated between the bank and the borrower. It is not unusual in relation to property loans for there to be bullet

repayment (i.e. all the loan is paid at the end of the term). However, it is also not unusual for there to be amortisation of the loan and this is usually paid out of available rental income after other expenses have been paid.

7 Prepayment

7.1 Contractual Prepayment

Under an English loan agreement, the borrower has a right to redeem the loan. This is an equitable right. The practice however is rather than for the borrower to rely upon this right, there is normally in the loan agreement a specific prepayment mechanism whereby the borrower will be allowed to repay the loan provided it gives the bank certain notice and prepay the loan in agreed multiples. This is known as contractual prepayment.

7.2 Prepayment Costs

When a loan is prepaid, it is possible to charge the borrower a prepayment fee and further fees if all the loan is repaid such as a redemption fee. There is however in practice a limit on how high any redemption of prepayment fee can be otherwise this will conflict with the equitable rule that the borrower has a right to redeem the loan and there can be no "clog" on the equity of redemption. In addition, the borrower will have to compensate the bank for its breakage costs being its cost of funding. A borrower accordingly is well advised to try and repay a loan at the end of in the case of a floating rate period, the relevant floating rate period. If the borrower is unable to do so and this could occur say in the circumstances of a sale of a property, then the borrower will have to compensate the bank for its loss which is the difference between what the bank would have earned on the amount repaid from the period of repayment to the end of the current LIBOR period less an amount representing the amount recovered and placed on deposit with a prime London bank. If the loan interest rate is fixed by reference to a fixed rate, then the borrower will have to pay the funding breakage costs of the bank which normally would be the unwinding costs of any swap arrangement, but could in other circumstances be treated as early recovery payment and calculated on a similar basis to a floating rate early repayment but also perhaps taking into account early receipt.

The loan agreement should also contain a provision that any amount repaid cannot be re-borrowed.

8 Taxes

8.1 Withholding Tax

In this world there are only two certainties, tax and death.

The tax provision is a very important clause from the borrower's and the bank's point of view. Under English tax law, a UK borrower (which I believe would also extend to an overseas borrower who is funding the payment of interest out of UK source rental income), is obliged to deduct UK withholding tax from any interest payment made to a bank where it is not resident in the UK or not a branch of a non- resident bank. On the basis of a UK tax rate of 20%, if interest of £100 were payable, then the bank would receive £80 with £20 going to the Inland Revenue. Banks however do not accept this position and require the position to be reversed

by a standard grossing up clause which are normally found in all bank loans so that if withholding tax is payable to the Inland Revenue, what would happen is that the borrower would have to increase the loan interest payment to cover the position so that the borrower would have to pay £125 of which £25 is paid to the Inland Revenue and the bank ends up with a net amount of £100. This however increases the interest cost by 25% to the borrower which is totally unacceptable to the borrower and makes such a bank non-competitive with a bank in the UK tax net. Fortunately, this position is saved by the fact that under the UK/German Double Tax Treaty, it is possible for clearance to be obtained from the German/UK Tax Authorities allowing any interest paid on loans by a UK borrower or UK source income to be paid free of withholding tax under an exemption granted under the UK/German Double Tax Treaty.

I believe that a number of you are well aware of the situation and when you set up the loans, you obtain the required exemption forms stamped in advance by the German Tax Authorities and this is then passed on to the borrower to pass on to the UK Tax Authorities. I should also mention for the sake of completeness, although I am not a tax expert, that it is possible for a bank who is making a number of bilateral loans to get pre-tax clearance with the UK Tax Authorities under the Provisional Tax Relief Scheme.

8.2 Indemnity

In addition to the grossing up provision, there is an indemnity provision, which will indemnify the bank if it finds itself subject to any tax (not being withholding tax) in relation to receipt of interest or repayment of the loan. If a bank does in any circumstances make a claim, then it is also usual to include a saving provision whereby if the bank's tax position is worsened but it has made a recovery from the borrower, then if it receives a tax relief anywhere else related to this recovery, then the bank can at its discretion grant the benefit of all or some of this relief back to the borrower.

9 Increased Costs, Illegality and Mitigation

9.1 Increased Costs

Formal provisions are contained in the loan agreement dealing with increased costs. At the time the bank enters into the loan it knows its compliance costs in dealing with the loan in relation to its regulatory and all other authorities. However, loans can be for a long period of time and these compliance costs can change and effectively they can change to such a great deal that the bank's margin could be substantially eroded. Accordingly, there is incorporated in the loan agreement the right for the bank in a situation where there are increased costs, to recover these increased costs from the borrower so that its profit on the loan is not diminished.

9.2 Illegality

It is normal to include in the loan agreement, although it is unlikely to be applied in circumstances of your sort of loan, illegality clauses dealing with where it becomes illegal to continue or make the loan. In such circumstances the loan has to be repaid within the time permitted by law.

9.3 Mitigation

There is also a mitigation provision, which applies in the case where there are tax, increased costs or illegality applies to the effect that the bank and the borrower should try and re-arrange their affairs so that these provisions are mitigated or do not apply.

10 Bank Accounts and Applications of Money

10.1 Rental Income Account

The normal basis of property lending in relation to an investment loan is that the rental income from the property will cover any interest and amortisation due to the bank. In order for the bank to be in as secure a position as possible, the arrangement is set up whereby the lessees under Occupational Leases are required to pay what I term pure rental income, which is essentially the rental income for the occupation of the property exclusive of VAT and management monies into an account which is under the control of the bank. Monies in this account can then be drawn on interest payment dates and used to pay any fees and costs due to the bank and then subsequently interest and any amortisation due. The question is then what happens to any surplus and normally the borrower will want the surplus paid to it though in certain circumstances the surplus is retained for use for further amortisation. A problem that does occur is that if all the surplus is retained in such rental account for amortisation, than the borrower may have a tax problem is that whilst the borrower can get a deduction against rental income against interest, it cannot get a deduction for capital repayment and will have a tax bill but with no funds to meet such bill.

10.2 Management Account

In addition the borrower would normally have a management account. This account although normally charged to the bank will be under the control of the borrower and/or its managing agent. The account will receive all management monies needed to manage the property and VAT monies and VAT is chargeable and will have to be paid to the UK Tax Authorities.

10.3 Application

In a property loan the application of rental monies is something of great significance and there can be in relation to complex property loans where there is not just a senior loan but mezzanine and other funding, a waterfall mechanism whereby the rental income goes in all different directions, but this is really nothing more than a variation of dealing with what happens to surplus rental income as far as the senior lender is concerned.

11 Representations and Warranties

11.1 Nature of Representations and Warranties

A loan agreement will contain from the borrower a significant number of representations and warranties. Before a bank makes a loan it will obviously have done quite significant investigations into the borrower and the property security. In particular, the bank will have received a lot of information, which the bank is relying upon for its evaluation and assumes to be correct. This information received together with other material facts on the borrower, property and loan are confirmed

by the representations and warranties. Whilst the representations and warranties are given at the time the loan agreement is entered into, they are repeated on the drawdown date and on each interest payment date. Accordingly, a number of representations and warranties are continuing representations and warranties and are a way of obtaining information and knowledge of change of circumstances of the borrower. However, if there is a breach of the representations and warranties, then the main remedy of the bank is to call in the loan as an event of default.

11.2 Type of Representations and Warranties

There are a number of warranties, but the main ones would include the following:

11.2.1 Status of the borrower;
11.2.2 Power and authority of the borrower;
11.2.3 Registration of security;
11.2.4 Solvency of borrower;
11.2.5 Confirmation of information supplied, but please note that this warranty is only given at the time the loan agreement is entered into;
11.2.6 Warranty as to audited accounts;
11.2.7 Title to property and environmental matters;
11.2.8 Outstanding litigation;
11.2.9 Ownership of borrower (obviously this is important and will also go into the money laundering aspects that you would investigate before granting the loan to the borrower).

12 Financial Information

During the currency of the loan the borrower will go through a number of its financial periods and the bank will want to be kept updated with all financial information on the borrower as is appropriate. In particular, the bank would certainly ask for annual audited accounts within a specific period from its year end. It may also require half yearly and quarterly accounts. Any accounts supplied should be prepared by a reputable firm of auditors and drawn up in accordance with appropriate generally accepted accounting principles.

13 Covenants

I will divide this section into general covenants and then talk briefly about financial covenants.

There are a number of usual general covenants contained in a loan agreement which in particular will including the following:

13.1 Authority

Confirmation of authority.

13.2 Notification

Obligation to notify the lender of major events such as material litigation or of an event of default. Borrowers do not always strictly adhere to this provision especially if there are any difficulties and the bank obviously must be fairly vigilant of its customers.

13.3 Information

Requirement for information on the property given as security should be provided on a quarterly basis. This information in fact is very detailed and really is asking for all changes in relation to the property, which has occurred since the original investigation into the property was carried out to be notified. This way the bank will know exactly what is happening to the property.

13.4 Negative Pledge

One of the key provisions is that the borrower gives certain negative pledges, that it will not carry out certain actions without the bank's consent. These in particular relate to the creation of further security or selling leasing or transfer of its major assets which include the property and rights thereto. In the case of a company it may also relate to payment of dividends or making a distribution to shareholders, but there may well be a carve out that this would not apply if such payment or distribution are paid out of surplus rental income which it is allowed to make.

13.5 Managing Agent

Appointment of a managing agent and change of managing agent. It is also usual to take from a managing agent a Duty of Care Agreement specifically in favour of the bank to ensure the managing agent complies with its obligations.

13.6 Property Covenant

There will of course, since this is a property loan, be specific covenants relating to the property itself. Essentially the bank wants to have fairly good control over any changes or consents relating to the property, but this will firstly be subject to any right of tenants under occupational lease or rights implied as a matter of law and which my property colleagues will mention in greater detail. Furthermore, the borrower should be free to carry out simple administrative matters without involving the bank. However, matters such as changes of major tenants are something that the bank would wish to have control over.

14 Financial Covenants

In a property loan it is quite usual to have certain financial covenants and whilst there are quite a number of different covenants, the main ones that one sees in property loans relate to loan to value and interest cover.

14.1 Loan to Value

A loan to value covenant confirms that the amount of the loan represents a certain percentage of the value of the property. German Mortgage Banks are on the whole fairly prudent and like to see loan to value covenants of 75% or below. A borrower on the other hand would like to gear up as highly as possible and would like to obtain 100% funding if possible. If there is a breach of the loan to value covenant, then it is not unusual to write into the loan agreement what remedies a bank would accept. The usual remedy is to pay down the loan so that the loan to value covenant is complied with or an equivalent sum is deposited in a blocked bank account until the loan to value covenant is remedied.

14.2 Interest Cover

Interest cover covenants as already mentioned are a very important tool for the bank as it wants to ensure that its interest will always be covered by a certain number of times rental income. The higher the cover, obviously the better. In terms of calculating the covenant, the bank will assume that interest is charged at the current rate of interest, but sometimes if the rate is a floating rate, it may wish to impose a fixed term rate which will be higher as the covenant is forward looking. In addition, in terms of rental income, a bank has to take into account the worse case scenario and therefore if there are any break clauses in a lease or downward rent reviews, which is highly unlikely, these will be taken into account. A non-paying tenant's rent will also be disregarded. On the other hand, upward reviews of rent cannot be taken into account unless a review has been agreed or the lease contains a rent review of a guaranteed amount.

It is also possible to add in the loan agreement how a breach of this covenant could be remedied. Again, remedies would include prepayment of the loan but the more usual mechanism is a deposit in a charged deposit account with the bank of a sum sufficient to make up for the rental income shortfall because rental income shortfall may be caused by part or all of the property being vacant (perhaps by insolvency of a tenant) or a tenant being granted a rent free period.

14.3 Other Financial Covenants

There are other covenants that can be incorporated into loan agreements such as yields which are based upon rental value and capital value of the property and also in a case of where the loan is made to the borrower who has a number of other loans, the actual net worth and other financial indebtedness of the borrower may also be covenanted.

15 Default

15.1 Acceleration

The agreement will contain a number of events of default whereby if a default occurs, the bank will be able to accelerate the repayment of the loan and can either demand the loan is immediately repaid or the loan becomes an on demand loan. From the borrower's point of view, a borrower's solicitor will try very hard to make it as difficult as possible for a bank to default a loan as obviously it is of major consequence to the borrower. A loan agreement will contain a number of defaults the main ones which will include the following:

15.2 Event of Default

15.2.1 Non-payment of monies due. This is the most significant and the only variation that is sometimes allowed is if non-payment is due to an error by the paying bank.
15.2.2 Breach of security documents, which are not remedied within a short period of time.
15.2.3 Cross default.
15.2.4 Insolvency of the borrower.
15.2.5 Destruction of the property.
15.2.6 Adverse litigation decisions.

15.2.7 Material adverse change. I would just briefly refer to this last event of default because this is a clause which states that even if a bank has not covered the situation in the preceding large number of events of default, the bank can, if in its reasonable opinion it believes the borrower will be unable to perform its loan, call in the loan. In practice it would be very unusual if the bank would seek to rely only upon this default because normally a borrower would have defaulted under one of the other heads of default. Nonetheless, it is very important to keep in the material adverse change clause because believe it or not, there are certain situations which may not be covered by the other events of default and this gives a bank flexibility. If there were any particular circumstances which a bank knew about at the time it entered into the agreement which could cause it to withdraw the loan, then it is likely that that situation would already have been contained in the events of default.

16 Default Interest and Indemnities

16.1 Default Interest

It is obviously of importance to a bank that the borrower pays its loan on a timely basis. If the borrower fails to pay the loan on the due date, then the borrower has to pay default interest. It is market practice that the default rate of interest varies somewhere between 1-3% over the rate of interest the borrower would normally have paid. If the rate of interest is any greater than that, then the view is taken that this default interest may be a penalty and under English law a penalty is not enforceable.

16.2 Indemnity

This provision would apply if a borrower served a drawdown notice and was unable to fulfil the conditions precedent and the bank in that situation would be entitled to recover all the loss it suffers. More importantly however, the indemnity also applies in a situation where there is a prepayment of the loan which is caused by an event of default as opposed to there being a contractual prepayment. In that sort of situation, a borrower should pay not only the amount that it would have paid if there had been a contractual prepayment, which could include a prepayment fee, redemption fees or any other fees together with breakage funding costs. It is also possible to claim loss of margin which would cover the period from when the loan was repaid until what would have been the repayment date set out in the Loan Agreement. A well advised borrower would normally resist an indemnity allowing a loss of margin to be claimed and the borrower's argument, which actually is a good argument, is that the bank has received its money back early and accordingly the bank has no exposure to the borrower and is not entitled to margin. This is different to what I believe to be the German position that would take the view that an enforced early repayment deprives a bank of the profit it otherwise would have made on the loan if the loan had endured to the repayment date and the loss of margin is therefore recoverable. The normal market practice is that if the borrower does object to this provision to remove the provision.

17 Other Provisions

There are a number of formal provisions in the loan agreement, which I am not going to go through in great detail, but briefly mention to you.

17.1 Currency of Account

There are provisions making it clear that the currency of accounts of the loan is Sterling and there is also of course the possibility that in the future the UK will one day join the Euro. Since the loan agreements go on for long periods of time, this change of currency could occur within the term of the loan. It is accordingly usual to contain a Euro convention clause stating that in the event Sterling is replaced by Euro, then the loan agreement is amended to take into account any necessary changes caused by the change of currency.

17.2 Fees

The agreement will contain provisions for the bank to charge an arrangement fee. This fee will normally be payable on the drawdown date or if drawdown does not take place, the termination date. In addition there will be costs and expenses provisions whereby it is customary in England for the borrower to pay all the bank's professional costs of the loan which will normally extend to solicitors, surveyors and valuers. If the borrower is in default under the loan or requires any changes or amendments to the loan, then again the bank will incur expenses and these are all down to the borrower. It is also usual to include in the loan agreement a provision allowing the bank from time to time to require new valuations of the property at the borrower's expense. Whilst this provision is included, I do not believe that most mortgage banks actually ever elect to obtain new valuations as their funding is normally based on the original valuation and a lower valuation in the future could cause them difficulties.

17.3 Assignment

An agreement will contain an assignment and disclosure provision. This is a provision that may be subject to negotiation, but the best position is the bank is freely able to assign all or any of its rights or participation in the loan to a third party and to disclose information to such potential third party. It is however usual nonetheless to accept a qualification that the borrower's position will not be worsened by the bank transferring the loan to a third party especially if the withholding tax position was to change, which could happen if the transferor was not in a country such as Germany which has a Double Tax Treaty with the UK or is a UK bank for tax purposes.

17.4 Notice

There are provisions dealing with the service of notice and these need to be carefully studied to ensure that they work.

17.5 Law

There is a provision to make it clear that the agreement is subject to English law. It is also usual to include a provision that English courts will have a jurisdiction to determine any matter. It is also quite appropriate to include provisions where there are non-English borrowers allowing jurisdiction to be extended to courts in other jurisdictions where the borrower is resident. Also a non-resident borrower

has to appoint for the UK service of proceedings, a UK service agent. If a UK service agent is not appointed, then in order to serve proceedings on a borrower one has to go through quite a complicated and costly process.

17.6 Third Party Rights

There is incorporated in all UK contracts a provision making it clear that only the parties to the agreement can rely upon the benefit of the contract under the Contract Rights of Third Parties Act.

17.7 Land Registration Act

Lastly we incorporate a provision relating to the Land Registration Act and the recent changes to make it clear that the loan agreement is what is called an "exempt information document". Due to changes in the Land Registration Act, because any Legal Charge over any property will refer to the loan agreement, it is a requirement of the Land Registry that the loan agreement is incorporated as part of the property title. The property title is available for inspection by third parties and a bank and probably a borrower would not want third parties to see the terms of the loan as it may contain sensitive information. It is accordingly useful to include a provision stating that the parties agree the commercial document should, if the Land Registry allows, be treated an as exempt information document.

As you can appreciate the loan agreement is a long document and I have tried to very briefly, in the time allotted to me, go through the specimen loan agreement. It is however quite difficult to deal in such a short time with most of these clauses. I do however hope that you have been able to glean some information from this lecture and I would be more than happy if time permits to answer any questions that you may have.

Talk given by Anthony Harris, Partner
15 June 2004
dbb forum, Berlin

Jane Havergal/Helen Clifford

Enforcement

Part I: Enforcement by Jane Havergal

My colleague Helen and I are dividing this talk into general and insolvency related enforcement of charges.

I will deal with the basic powers under a mortgage.

Helen will elaborate on insolvency related enforcement in her part of the talk linked principally with a floating charge.

There are elements of overlap between the two, as we will explain.

My part of the talk is further divided into two:

1. Duties of a mortgagee on enforcement.
2. Remedies of a mortgagee

1 Introduction

- The mortgagor is in default and an event of default has occurred.
- The mortgagee considers its position.
- What are its remedies?
- What are its duties?

Before moving to remedies which I have already dealt with briefly in my talk yesterday, I will examine what the lender needs to consider when exercising its rights of disposal of the security.

2 Duties of Mortgagee

- Obligations on a mortgagee on a sale were summarised in a case called *Nash v Eads in 1880.* There are two basic principles:

  a) A mortgagee is obliged to conduct a sale properly and sell at a fair value.
  b) A mortgagee should not sell to himself.

  This principally turns on the point at which the sale takes place.

- Should the lender wait?

  As long as a mortgagee takes reasonable care, a mortgagee is not under a duty to wait before selling. This may be an issue where the market is depressed and may recover.

  If we follow the rule in *re Potters Oil Limited (Number 2) (1986)*, we find the principle that a mortgagee's own interest prevails. The mortgagee does not have to hold back from exercising its rights because it might cause loss to the borrower or its unsecured creditors. However, the principle remains that a mortgagee owes a duty to the mortgagor to take reasonable care to obtain a proper price

and to obtain and follow proper professional advice as to the best method of sale.

- Must the mortgagee delay to await a recovery in the market?

  Further illustration of this principle that timing is an issue for the bank is found in the two cases mentioned on the slide.

  Bank of Cyprus (London) Limited v Gill (1980) established that a bank may sell promptly and does not have to wait in the hope of achieving a better price at a later date.

  Cuckmere Brick Co Limited v Mutual Financing Limited (1971) held that a mortgagee was entitled to exercise a power of sale for his own purposes whenever he chooses to do so. He does not have to wait until later to see if a higher price could be obtained. However, in this case too the mortgagee should act in good faith and take reasonable care to obtain the true market value of the mortgaged property at the moment he chooses to sell it.

- Sale to a linked company

  The sale to itself or at any rate a linked company is attractive in certain circumstances where the property market is very depressed and the lender wishes to mothball the property until prices rise. This is the converse of the first situation I have just outlined.

  Sale to a linked company is not unknown in practice but because of the rule that a mortgagee cannot sell to itself, it is for the lender to prove in this case that it is doing everything to conduct a sale properly and sell at a fair value – the burden of proof moves.

  The Court of Appeal held in *Farrar v Farrars (1888)* that a mortgagee can sell to a company in which it is interested provided the company is not a pure nominee and in such case the burden of proof is on the mortgagee to show that all terms and conditions of the sale are fair and proper.

- Sale where there is a conflict of interest

  If the bank or its agents were liable for negligence in connection with the sale, the bank is liable to compensate the mortgagor for any damage suffered by reason of its negligence.

  Tse Kwong Lam v Wong Chit Sen (1983) held (Privy Council) that it was not sufficient simply to accept the highest bid at an auction if there was a conflict of interest. In this case the company was controlled by a party linked with the mortgagee. In such a case it is essential the mortgagee shows that he protected the interests of the buyer by taking expert advice about method of sale, reserve and other steps desirable to make the sale a success.

  The conclusion is that if you want to sell to a linked company in a falling market and mothball the property until values rise, you must be very careful indeed. The burden is on you as bank to establish that the sale price is fair and the sale conducted properly. A bank and a receiver can be liable to the borrower for any

negligence although the bank will not be liable for the negligence of the receiver unless it interferes with the conduct of the receivership.

Professional guidance is crucial on an enforcement as if the agents selling are negligent, the bank may be liable for this negligence. It is important to instruct a substantial firm.

Broadly, where the lender is selling to a linked company and the burden of proof shifts to the lender, two valuations and a period of marketing is advisable before sale to rebut any appearance of negligence.

Development properties are of particular concern on enforcement. Valuation evidence tends towards the view that a half built property may have a negative value and on appointing a receiver a bank should take professional advice as to what best should be done at that stage, i.e. whether it is worth pouring more money into the property or simply "mothballing" it given developments often go wrong in periods of property slump and the market needs to recover before interest is expressed for a half completed development.

3 Remedies of a Mortgagee

We have discussed the four basic remedies of a lender if the property security is by way of legal mortgage and entered into as a deed or under seal:

3.1 LPA 1925

- a power of sale under the Law of Property Act 1925;
- a right to take possession of the asset as a mortgagee in possession;
- a right of foreclosure, which requires an application to the Court and leave of the Court;
- a power to appoint a receiver over the asset under the Law of Property Act 1925.

Helen Clifford will deal with the power to appoint an administrative receiver and administrator.

3.2 Power of Sale and Mortgagee in Possession

I have put these two together as they have quite a close relationship!

- Power of sale

  The power of sale is a separate power under the Law of Property Act section 101.

  As a power of sale is seen as oppressive, a demand should be made by way of notice before a power of sale is exercised or a receiver is appointed.

  Demands should always be served in normal banking hours and time allowed to draw the necessary funds. In practice provision for the occurrence of an Event of Default is made under any well drawn loan agreement.

  A mortgagee of registered land will be a registered proprietor of a charge assuming registration is complete.

As such, the bank itself can sell by the power of sale in its charge, if necessary using the security power of attorney, which survives liquidation (though not administration).

Section 104(1) of the Law of Property Act provides that a mortgagee exercising a power of sale has power to sell free from all other estates over which it has priority but subject to any estates which are prior to it. The same section does not extend to a power of sale by a receiver.

It is usual for there to be no title guarantee upon a sale by a bank or its receiver and for no or minimal answers to enquiries to be given to the purchaser's solicitors. Although purchaser's solicitors invariably complain and resist this, it is not normal to concede. This is because the bank and its receiver will not know what the borrower has done with the property. It is then for a purchaser to make its own enquiries as far as it can and to take the risk. This factor is fed into the forced sale valuation.

However, having made demand and if the bank is then seeking to sell the property by its power of sale and the sale is delayed, the bank enters a grey area where it could be construed as a mortgagee in possession. This is adverse for the bank for the reasons given below.

- Mortgagee in Possession

  Even though liability is excluded contractually a lender will not generally wish to enter into possession of a commercial investment property given potential liability and that a mortgagee in possession may become generally accountable and liable to account in accordance with the case of *White v City of London Brewery Co* (1889).

  For example, if a mortgagee in possession allows a property to remain vacant although it could have been let, it is personally liable to pay the occupation rent. While a mortgage generally seeks to exclude liability this is always a concern.

  The responsibilities as a mortgagee in possession are generally distanced if a receiver is appointed and I comment on that below.

3.3 Foreclosure

Foreclosure is a discretionary remedy and is rarely pursued. Generally, courts are not keen on foreclosure proceedings. The effect of foreclosure is to make the asset the property of the bank. It extinguishes the equity of redemption and so it is seen as a sort of confiscation. As it is a discretionary remedy, it will only be ordered generally by the Court if the loan outstanding exceeds the value of the security. The Court always has discretion to re-open a foreclosure.

Finally please note that on making an order absolute, the effect is that the bank can no longer sue the borrower on its personal covenant to pay and any remedies against the guarantor are likewise barred.

3.4 LPA Receivers

It is still possible to appoint a so called LPA receiver, i.e. one appointed under the Law of Property Act 1925. An administrative receiver under the Insolvency Act 1986 can now only be appointed under historic floating charges i.e. those entered into before 15 September 2003. However, an LPA receiver's powers are suspended upon appointment of an administrator.

An LPA receiver is the agent of the borrower and remains independent of the bank even though it is accountable to it.

- Appointment in writing

  A receiver is appointed in writing.

  Any power of attorney in the debenture will only be valid for a receiver appointed under seal. Please note that the receiver's power of attorney will be revoked by a winding up order or a resolution for voluntary winding up, although the bank's security power of attorney will survive insolvency.

  The appointment must be accepted by the receiver before the end of the business day next following that upon which it was appointed receiver.

  Unless the acceptance is in writing, it must be confirmed in writing within seven days.

  The acceptance must state both the time and date of receipt of the appointment and of acceptance. If the above provisions are not followed, the appointment is of no effect so this is extremely important. The appointment is deemed to be made when the instrument of appointment was received provided all the provisions above are met.

  Upon appointment the receiver should attend at the premises, give notice of his appointment and take control.

- Companies House Registration

  The appointment should be registered at Companies Registry within seven days of the appointment being made. This is the bank's duty but the receivers often register it in practice.

- Notice of Appointment

  Thereafter all letters and other documents must contain notice that a receiver has been appointed and the receiver thereafter should publish notice of his appointment and report to creditors within three months.

  A receiver will thereafter seek to take over all the matters charged.

- Payment and Indemnity

  The rate of payment of receivers is provided for in the Law of Property Act 1925 section 109(6). In the absence of any other rate, the receiver is entitled to 5% of the gross amount of money received by him. In practice, the accountants can adopt an hourly charging rate as 5% is very high. As such, banks should

agree with the receivers before appointing them on the basis on which they will be remunerated.

- Power of Sale?

  The powers of an LPA receiver under the Law of Property Act 1925 are extremely limited. The receiver under the Law of Property Act 1925 has no actual power of sale. Additionally, while a receiver can sell the property under most well drawn charges (it is not contained in the Law of Property Act itself), subsequent mortgages of the property will not be simply overreached by a receiver selling.

  When drafting a charge all the powers of the Law of Property Act 1925 should be included together with those powers conferred on an administrative receiver under the Insolvency Act 1986 Schedule 1.

- Additional Powers

  Upon appointing a receiver, a bank needs to be comfortable that the powers granted to the receiver in the charge are sufficient for him to act. Any well-drawn charge will extend them and Schedule 1 of the Insolvency Act 1986 provides for various powers which are exercisable by an administrative receiver and which can be incorporated by reference.

  A receiver needs to consider carefully the validity of the debenture under which he is appointed as if he acts outside the powers vested in him or the security is invalid, he will be accountable as a trespasser. It is usual for a bank appointing a receiver to provide that receiver with an indemnity to cover his acts.

- Development Property

  Additional powers are important in certain circumstances. Development property will include a number of circumstances where specialist powers are required. It is also a good idea for a debenture of a development property to contain a right to prelet or let the property to occupational tenants.

- When to appoint

  On the pure conveyancing side, it is not unknown for a receiver to be appointed by the bank as a distancing mechanism, and for it to enter into sale agreements with provision in the sale and purchase agreement for the end sale to be by the bank by its power of sale. This is because other interests adverse to a purchaser may have been registered to which the receiver as agent of the borrower takes subject but of which the bank as proprietor of a prior charge sells free. Neither party generally gives any covenants for title.

  As such, it is sensible for the first chargee to sell as mortgagee and overreach subsequent charges. The alternative is for subsequent chargees to release their charges, but this needs to be very carefully dealt with if there are insufficient funds out of the realisation of the property – a stated sum should be paid in order for the release to be issued. By contrast, if a receiver sells, a purchaser has to investigate whether a proper demand was served.

- Points to note

  The practical point on enforcement is that the costs of an administrative receivership have been extremely high and are generally better suited to ongoing businesses where full debentures were taken. If a firm of accountants is appointed, it then generally further delegates a lot of the work to firms of surveyors.

  As such LPA receiverships have sometimes been given to surveyor's firms where the property is small and there are sufficient contractual powers in the charge. However since their power can be suspended by appointment of an administrator, much thought must be given at the point of enforcement.

Talk given by Jane Havergal, Partner
15 June 2004
dbb forum, Berlin

Part II: Other Types of Enforcement, Administrative Receivership, Administration and Winding up by Helen Clifford

I am going to talk about other methods of enforcement in my part of this seminar. I shall be dealing with:

- administrative receivership,
- administration; and
- compulsory liquidation.

These methods are important for lenders like yourselves in two different contexts.

- First of all, the first two rights will be important if your security includes a qualifying floating charge; and
- secondly, they will be important if a third party enforces over say the business and assets of a company where you have appointed a Law of Property Act or other receiver, were planning to appoint an insolvency practitioner yourselves or in the light of that new appointment now feel that you should.
  I will start my talk by giving you a little more background information about the recent developments in insolvency law in the UK before looking in some detail at each of the different methods of enforcement, when they are possible or appropriate and who can appoint. I will also be looking at the advantages and disadvantages of each and then summarising particular problems and issues.

1 Background to the Enterprise Act 2002

1.1 The Enterprise Act 2002 is intended by the present government to promote a rescue culture.

The aim is to promote a more entrepreneurial culture in the UK where companies who have got into financial difficulties can be brought back to good health with protection from individual creditor action where necessary.

It was also felt that the previous regime favoured secured lenders over unsecured lenders such as suppliers. The government wished to minimise the impact of a failed customer on companies who had supplied goods and not been paid. There were also complaints about the cost of insolvency proceedings as has been previously mentioned by my colleagues.

The Act does this primarily by concentrating on administration as its desired route. Administration had existed previously under the Insolvency Act 1986 but had not been used to the extent of other insolvency proceedings. Administration is modelled on Chapter 11 insolvency proceedings in the US.

1.2 What is a floating charge?

Floating charges can be distinguished from fixed charges because:

- they relate to a general class of assets of the company in question;

- that class of assets may change from time to time; and
- it is contemplated that the company will be free to continue carrying on its business in the usual way in relation to that class of assets.

In our context, a floating charge can be used in relation to land that is purchased by the company after the date of a fixed charge or where land is identified as a general class asset but without for example referring to any specific title.

In practice, a lender is highly likely to take security by both fixed and floating charge. The borrowing company may be obliged to execute a fixed charge over any property purchased after the date of the fixed charge as soon as it is acquired. In practice, the lender may take a power of attorney to permit the lender to complete all the formalities. Until the formalities are completed there will be protection given by the floating charge.

1.3 Who can create a floating charge?

A company or limited liability partnership can create a floating charge. Individuals and partnerships cannot.

Some lenders may be unable to be a party to security that includes a floating charge.

1.4 Administrative Receivers and Administrators

1.4.1 What can they do and what are their aims?

- Administrative receivership – this is a remedy for a secured creditor to allow for the realisation of company assets which are subject to security.
- Administration – a procedure under the Insolvency Act 1986 where a company may be rescued or re-organised or its assets realised under the protection of a statutory moratorium or freeze.

These are alternatives to each other. In each case the ideal is obviously to maximise returns by selling the business as a going concern or sell the company's assets.

The appointee – the administrative receiver or administrator must be a licensed insolvency practitioner unlike a Law of Property Act receiver who could be a quantity surveyor for example.

1.4.2 Key Considerations – Can you appoint an Administrative Receiver or an Administrator?

- Check date of security. Is it pre-15 September 2003? If the security post-dates this date then unless one of the limited exceptions apply, you cannot appoint an administrative receiver.
- What does the document state? Is it a fixed charge i.e. one over specific property or does it also contain a floating charge over unspecified assets of the company or business? If there is not a floating charge then you cannot appoint an administrative receiver but you may still be able to appoint an administrator if you are a creditor of the company in question.

- You also need to establish if the floating charge gives security over all or substantially all of a company's assets (on its own or in conjunction with other security).
- What powers are given to the holder to appoint insolvency practitioners?
- Formalities – have all the necessary formalities been completed for the security documents such as registration at Companies House?

2 Appointment of an Administrative Receiver

2.1 Appointment of an Administrative Receiver

Possible for security containing a floating charge dated prior to 15th September 2003.

2.1.1 Exceptions to the general rule:

- Capital Market Arrangements – this is where a party incurs or is expected to incur a debt of at least £50 million during arrangements. In order to qualify as a capital market arrangement the lending must show certain characteristics such as grant of security to a trustee, agent or nominee for a person holding such an investment. It must include step-in rights. Step-in rights mean where the person who provides the finance has certain rights to assume sole or principal responsibility for carrying out the project in certain circumstances, for example, if the project is not being carried out properly.
- Public Private Partnership or Private Finance Initiative where there are step-in rights to take over a particular project. Projects include schemes whereby resources are provided partly by one or more public bodies and partly by one or more lenders or which is designed wholly or mainly for the purpose of assisting a public body and discharging a function. Examples could include construction of roads, hospitals and school.
- Utility Projects – these must also involve step-in rights in order to be exempt. Utility projects include telecommunications services, transport and supply of gas, electricity, water or sewage services and other businesses connected with post, railway and other methods of transport.
- Urban regeneration projects – projects finance in a situation where the project company incurs or is expected to incur a debt of at least £50 million in carrying out the project and there are step-in rights.
- Certain Financial Market Contracts and one or two other limited exceptions.

2.1.2 The administrative receiver is the agent of the company, but his primary role is to seek repayment of the secured debt for their appointee.

2.1.3 A lender can appoint when a company defaults on a loan. Appointments can be made against the directors' wishes and without warning. Typically, the lender will have already appointed an accountant to review the company's affairs and then act on their advice.

- The burden of proof to show the appointment is valid rests with lender. In practice, therefore, the first job of an administrative receiver and their solicitors is to check the validity of the appointment. In most of the cases I have been

involved in this is done at great speed as the administrative receiver is planning to go into the company's premises in a matter of an hour or two!

- There are also certain formalities involved in the appointment such as registration at Companies House. The appointee or their solicitors will typically attend to this.

2.1.4 Statutory powers are given by the Insolvency Act 1986:

- Power to run business and sell it or any part of the assets (except property charged to a party other than the lender who appointed them), enter into contracts, effect insurance.
- Advantages
- He is the appointee of the company but his primary duty is to the lender and the interests of other creditors are not directly relevant.
- and disadvantages for lender
- He must apply to court to dispose of charged property (other than that charged to the lender who appointed him).
- He cannot pursue directors for a contribution to the company's assets for wrongful or fraudulent trading.
- He must cease to act if an administrator is appointed.
- However, he can continue to act if a liquidator is appointed although the relationship between the receiver and a liquidator in that situation is not clear. Incidentally, a very recent House of Lords case has held that if there is concurrence of appointment liquidation expenses do not have to be paid out before any money is paid out to holders of floating charges.
- From a lender's perspective, administrative receivers will require an indemnity from their appointee.

3 Administration

3.1 Appointment of Administrator

- Very specific criteria are used in assessing whether an administrator can be appointed. The administrator must be able to demonstrate that he will be able to achieve one of the following purposes which I list in the order which he must consider:
  - Rescuing the company as a going concern, but if that is not possible then
  - Achieving a better result for the creditors as a whole than if the company were wound up, and if that is not possible then
  - Realising property in order to make a distribution to one or more secured or preferential creditors.

3.2 Who can appoint?

- Lender if his security includes a floating charge and the security includes a statement that the lender can appoint an administrator or an administrative receiver.

- The Company and/or its directors or creditors but if any of these seek to appoint an administrator then they must notify any lender whose security includes a floating charge as soon as reasonably practicable. This means that a lender who does not have a floating charge does have the power to appoint an administrator.
- Any lender who has a floating charge then has the right to intervene and impose the appointment of their own choice of insolvency practitioner as administrator, although the court may refuse to ratify that appointment if it is challenged by another party.
- Appointment can be made via the court but also out of court by the company, its directors and any holder of a qualifying floating charge. Other creditors must always use the court route to appointment.

3.3 Time limits

- In the event that the appointment is out of court the person proposing to appoint an administrator must give the holder of a floating charge a minimum of five business days' notice on a prescribed form of notice.
- If a later ranking qualifying floating charge holder intends to appoint out of court it must give prior ranking holders at least two business days notice on a prescribed form of notice.
- If the appointment is via the court the lender must be notified as soon as reasonably practicable and in any event not less than five days before the date fixed for the hearing.
- The lender has the right to appoint their own choice as administrator within the notice period.
- Court route likely for complex cases, but the vast majority of appointments are now out of court. One would use the court route if there were questions about the validity of the floating charge, but might be sensible if there is a risk of a creditor action to recover valuable assets or any issues relating to possible fraud.
- The procedure for appointment has been substantially simplified and the paperwork required now much easier to comply with. Although we gather that the procedure remains very paper based, one insolvency practitioner I spoke to recently said that the system is now much easier.

3.4 Advantages

- There is a moratorium on creditors meaning that creditors generally cannot take action against the company and the administrator is free to pursue the tasks for which he was appointed with less fear of interruption from creditors. An administrator can be appointed even if there is already a Law of Property Act or administrative receiver or a liquidator in place or there is an outstanding winding up petition in place.
- An administrator can pursue directors for a contribution where they have been wrongfully or fraudulently trading.

- No step can be taken to enforce security without the consent of the administrator or the court.
- A landlord cannot exercise the right of forfeiture by re-entry of premises except with the consent of the administrator or the court.
- The appointment is limited to a year by statute (although administrators can apply to the court for more time if it is needed).

3.5 Disadvantages for Lenders

- The procedure has been called a "collective insolvency procedure" and this effectively means that the lender has less control over what the administrator does.
- Corporation tax on capital gains and income arising during an administration is payable as administration expense in priority to any claim by a floating charge holder. This means that if you expect there to be a substantial gain on a sale of assets then you should consider the appointment of a receiver (where any gains are treated as a liability of the company i.e. as an unsecured debt.)

4 Compulsory Liquidation – Winding up of the Company

It is unlikely that a lender would wish to use this route.

It is more likely to be used by the company itself, its directors or unsecured creditors.

Typical cases would include where a company has significant debts owing to it or for example a dispute with a third party where there was a likelihood of the company receiving substantial damages the liquidator can raise funds to threaten or take court proceedings.

5 Problems and Issues

5.1 The EU Regulation on Insolvency Proceedings

This Regulation relates to cross border insolvencies. It applies in all member states of the Community with the exception of Denmark. It covers winding up and administration but does not cover any receiverships on the basis that these are not collective insolvency proceedings. Financial institutions are not subject to the Regulation as they are covered by a separate regime.

The basic principle of the Regulation is to avoid having numerous sets of insolvency proceedings relating to different assets of a company which may be based in different member states. This means that jurisdiction is given to the courts of the member state within the territory of which the centre of a debtor's main interests is situated.

The presumption is that the place of a company's registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary. There have been a number of court cases which deal with where the main interests of a company are and these have tended to concentrate on where the business and assets of the company are located.

The Regulation is of assistance in situations where a company has a presence or branch or significant assets in more than one member state. In many cases a company wishing to trade in the UK would incorporate a subsidiary and so that subsidiary would be subject to a different set of insolvency proceedings as it is a separate legal entity. However, the English courts have on occasion granted administration orders over an entire group.

The courts of another member state also have jurisdiction to open insolvency proceedings against the debtor but only if he possesses an establishment within that other member state. Such proceedings are restricted to the assets of the debtor in that member state. The proceedings may only be for winding up.

Also the opening of insolvency proceedings does not affect rights in rem which include specifically the right to dispose of assets or have them disposed of and to obtain satisfaction from the proceeds of sale, in particular by virtue of a mortgage. It is not clear whether the appointment of a receiver over such assets would be recognised, although given that the appointment is in effect the exercise of the right in rem, in theory the appointment should be recognised.

5.2 Which Type of Insolvency Practitioner should you consider appointing?

A Law of Property Act receiver may be the first choice for appointment given the likely costs involved in appointment and assuming that the mortgage grants them wide powers. If there is likely to be a significant capital gain on sale of an asset receivership may be more tax efficient than administration, as I mentioned earlier.

There are, however, potential problems with such an appointment so that unless the mortgage does give wide powers you will not be able to secure a sale of the charged property. It would make sense to appoint an administrative receiver or an administrator so that the property and any other assets can be sold and returns maximised.

The Law of Property Act receiver and indeed other practitioners are also vulnerable to the appointment of other practitioners such as administrators.

If a third party gives you notice of their intention to appoint an administrator It is worth bearing in mind that there are very short deadlines to try to bring in your own appointee. Of course, if your security does not include a floating charge then there is little you can do about the appointment other than to challenge it on the grounds that the statutory grounds for appointment of an administrator have not been established.

The appointment of an administrator means that no receiver can be appointed. Any administrative receiver who is already in office automatically ceases to hold office. A Law of Property Act receiver shall vacate office if required to do so by the administrator. It also means that the court may also restrain the advertisement of a winding up petition and if a petition is on file for compulsory winding up this is automatically dismissed.

Both an administrative receiver and a liquidator can act concurrently in relation to the same company although their exact relationship is unclear and it is obviously better for them to co-operate.

5.3 What should the bank do if it is notified of the appointment of an administrator or other insolvency practitioner?

If the bank receives notice that an administrator is to be appointed and the bank has a valid floating charge then there are very short time limits for the bank to decide whether to nominate its own administrator.

If an administrative receiver is appointed by a third party then the bank should consider whether that appointment is valid and/or whether it should make its own appointment perhaps of an administrator.

If a compulsory winding up petition is presented or granted by the court, consideration should be given to the appointment of an administrator if this is possible.

In some cases, the bank may simply accept the appointment of the office holder.

5.4 Priorities – Preferential and Other Creditors

Preferential creditors must be paid after the monies pursuant to a fixed charge are paid but before any monies due under a floating charge are payable.

They include sums due under certain pension schemes, accrued holiday pay and employee remuneration. In the past the Crown was a preferential creditor and so preferential creditors were much more important than they may be now.

Crown preference for unpaid taxes has been abolished under the Enterprise Act.

For all floating charges dated after 15th September 2003, the prescribed part of any net property not covered by fixed charges will be set aside for unsecured creditors up to a maximum of £600,000. For any dated before this date you do not have to set aside any such amount.

5.5 Particular Problems and Issues

Possibility of the bank being a shadow director. As matters stand this remains more of a theoretical than a practical risk.

In our particular context there is a risk that if a company owns a series of properties and purports to appoint a Law of Property Act receiver over those properties, the appointment could be deemed to be that of an administrative receiver. This is because the appointment is over substantially all the assets of the company in question. If the lender is not entitled to appoint an administrative receiver, then the "appointment" could be held to be void if challenged by another creditor and the administrative receiver and lender liable in conversion for the wrongful appointment.

As I've mentioned previously, the appointment of each office holder has its own advantages and disadvantages. I hope that it is clear that even before an appointment is made careful consideration needs to be given to who should be appointed.

To what extent is an administrative receiver, administrator or Law of Property Act receiver liable to other creditors for negligence, for example, by failing to obtain

a good price for a property? These are issues that remain unresolved but insolvency practitioners and lenders must always be alive to the risk of action being taken.

The role of an administrator is a difficult one. They owe duties to all creditors now and there is much potential for conflict of interest between the interests of the lender and those of other creditors. That is very much an ongoing problem.

Conclusion

In practice, the primary objective of administration, namely to save the company itself, is rarely achieved. Administration usually results in the sale of the business/ assets to a third party, often the management via a new company in much the same way as happened under the previous regime.

As to whether any of the objectives of the Enterprise Act have been met and how effective the new regime is and whether it costs less to implement than the previous regime – it is really still too early to say.

Talk given by Helen Clifford, Solicitor
15 June 2004
dbb forum, Berlin

Anthony Harris

Transfer of Claims and Mortgages and Syndications

My talk covers two subjects, which to a certain degree are inter-related. The first is Syndication of Loans and Transfer of Claims/Mortgages. I will divide up my talk between these two subjects, but I will first deal with Syndication and then Transfers. Please be aware that the subjects that I have been asked to talk about are fairly complicated subjects and I can only very briefly deal in the time allocated to me with these subjects.

Syndication

1 Introduction

Large loans lend themselves to be syndicated amongst a number of banks since a single bank may not on its own be willing or able to advance the whole amount. The essence of syndication is that two or more banks agree to make a loan to a borrower on common terms governed by a single agreement between all parties. The number of banks may be very small and this is sometimes called a "Club Loan" or very numerous and may run into hundreds of lenders. In fact, I see in relation to property lending a number of Club Loans. Loans with numerous lenders would involve multi-national or central banks or countries as borrowers.

2 Arranging of Syndicated Loan

In a syndicated loan there are a number of parties involved and I will set these out:

2.1 Arranger

The function of the arranger is to introduce the borrower to an agent bank and lenders who are able to meet the borrower's commercial requirements and who agree to arrange the loan which may include its underwriting.

2.2 The Agent

The Agent leads the syndicate of banks and is the agent of the banks not the borrower for the purposes of channelling communication between the banks and the borrower. The Agent is involved in the administration of the loan and in a number of cases gives consent or waivers, in some cases after consultation with the lenders but in other cases at the Agent's discretion.

The Agent will be heavily involved in negotiating the loan agreement on behalf of the banks. The Agent is also likely to be one of the lending banks and itself may be taking a substantial part of the commitment. It is not unusual in relation to a loan, in order to move fairly rapidly with a customer that the Agent may be the sole lending bank even though the loan agreement is prepared in syndicated form. This will allow the Agent to subsequently syndicate the loan after drawdown

when there are no pressing time factors. In the unfortunate event of the borrower defaulting, then the Agent's duties become much more onerous and the Agent will be heavily involved in dealing with the loan chairing syndicate meetings and taking steps to enforce all the banks' rights. This can involve the Agent in a significant amount of work and depending upon the loan agreement, the Agent may be able to charge for this work.

2.3 Lending Banks

The Lending Banks are the banks who are actually the banks who are committed to join in the facility and make the required loan to the borrower. Importantly, however, it should be borne in mind that under the terms of a syndicated loan agreement each lender is only severally (i.e. individually) liable for its loan commitment, so that if a committed bank defaulted on its loan commitment, the other banks would not be liable.

2.4 Security Trustee

In a situation where security is given and which will invariably be the case in a property loan, the Agent is normally also appointed as Security Trustee. What will happen is that all security is vested in the Security Trustee as trustee for what will be termed the "Finance Party" in the loan agreement. The Finance Parties will be all the lending banks together with the Security Trustee, Agent and the other relevant parties that may be owed money by the borrower. Importantly, the Security Trustee is acting as trustee for the syndicate of banks and must act in a trustee capacity. The other important aspect of a Security Trustee position is it means that the identity of lenders and other finance parties can change without in any way affecting the security.

3 Information Memorandum

3.1 General

A bank mandated to arrange a syndication of a loan will approach other banks in the market to see whether or not they will be willing to participate. Common practice is for banks who express an interest to be sent an information memorandum giving the financial and other information about the borrower and the property which have been prepared in conjunction with the borrower by the Arranger or the Agent.

The information memorandum can in some cases be a detailed document and in other cases it may be a short document. It is also not unusual to attach to the information memorandum the indicative heads of terms agreed between the Agent and borrower setting out the terms of the loan facility.

3.2 Financial Services/Liability

3.2.1 One issue that does concern an issue of an information memorandum is whether or not the material may be caught by any Financial Service Act legislation in the country in which it is distributed. Another is a potential liability of the borrower and the arranger/agent for misrepresentation and the extent to which the agent/arranger can exclude liability.

3.2.2 Without going into a lot of detail and looking at the UK Financial Services and Markets Act in detail, the accepted view is that this information memorandum is not likely to be caught by the provisions of the Financial Services and Markets Act and even if it did come within the ambit of that legislation, the marketing of it to the participant banks would fall within one of its many detailed and complicated exemptions and exclusion.

3.2.3 A borrower is normally instrumental in preparing the information memorandum especially if it is very detailed and any misrepresentations in the information memorandum due to the borrower, are likely to be caught by being a breach of the warranty and representations as to information in the loan agreement.

3.2.4 As far as the arranger/agent bank is concerned, the position is more complicated. If the arranger/agent bank has acted fraudulently, then the arranger or agent bank would have liability to syndicate members. However, if there is only negligence or inadvertence involved, then the position is a lot less clear. In particular, in any information memorandum there are likely to be a wide exclusion clause limiting and excluding the arranger/agent bank's liability for anything that is inaccurate in the information memorandum and the result of this is that it would be very difficult for a syndicate bank to bring a claim against an arranger or agent bank

3.2.5 I would however expect that you as banks accept this position in any event as a property bank is a sophisticated lender and would have gone through full research, credit and other appraisal before agreeing to be a part of the syndicate.

4 Main Provisions in Syndicated Loan Agreements

A Syndicated Loan Agreement follows the form of a bilateral loan agreement. It however contains a number of provisions dealing with pure syndication and I will refer to some of the most important provisions below:

4.1 Administration of Loan Agreement

As previously mentioned, under the terms of the loan agreement and under the terms of the syndication, the Agent acts on behalf of the lending banks in terms of giving the borrower various consents and waivers in relation to the loan. There are however, nonetheless, certain matters which are very important to a lender and these would in particular include in relation to a property loan, sale of all or any part of a property, changes of occupational lessees and grants of major new leases. In those circumstances, it is important to ensure that the Agent before it grants consent to a borrower it cannot unilaterally do so but will require consent of what is known as the "Majority Banks". Majority Banks can be anything from 50% of all lending banks up to about 75% with the norm being 66⅔%. It is important from your point of view that if you are a syndicate member that important decisions do need majority bank consent. You should however also be aware that notwithstanding certain provisions require a majority bank decision there are nonetheless certain matters in the loan agreement which cannot be changed without unanimous consent of all syndicate members. These matters will normally relate to repayment date of loan, amount of loan, payment of interest, fees and other fundamental terms.

4.2 Sharing of Payment

A common underlying policy of syndication is that each lender should receive pro rata payment and that the borrower should not be able to discriminate between common lenders. It is therefore usually provided that all payments are made to the Agent and it must distribute the receipts pro rata according to the entitlement of the participant banks. Nonetheless there are other ways in which a bank might secure payment of its participation disproportionately to other banks. An example is where a bank may hold a deposit from the borrower which it may set off against its unpaid participation on default against the deposit. It is therefore usual to find in a syndicated loan agreement provisions making it clear that if one bank exercises its right and receives recovery against the borrower, then any recovery received should be shared on a pro rata basis amongst all the banks. There is however one exception to pro rata distribution and that is where legal proceedings are instituted against the borrower and not all the lenders participate in that situation as you can appreciate only the participating banks who take the risk and costs of litigation will participate in any recovery obtained.

4.3 Agent's Duties and Role

One of the most important aspects of a syndicated loan agreement would be the Agent's duties. The important point of an Agent's role, which is of key importance is that an Agent is generally unwilling to undertake risk. It will however receive remuneration in the form of agency fees payable by the borrower, but these are usually fairly modest. The lending banks being almost invariably sophisticated institutions can be expected to look after themselves. The second key feature is that lending banks as I already referred to are generally not willing to delegate large management functions on Agents and wish to take their own decisions. The result is that the Agent's functions are defined precisely and narrow in scope. It also follows that Agent Banks normally seek elaborate protections against risks that otherwise might arise.

The list of an Agent's duties are normally set out in detail in the loan agreement and relates to matters such as the following:

4.3.1 paying agency duties (ie deal with disbursements and receipt of all monies from the lender and the borrower);

4.3.2 documentary duties to deal with all documentation relating to the loan;

4.3.3 receipt of notices – receive all relevant notices relating to the loan;

4.3.4 banking duties – dealing with all banking duties such as fixing of interest rate etc.;

4.3.5 monitoring duties – receiving financial and other information from the borrower and passing it on to the lenders;

4.3.6 default duties – a duty to inform the banks of actual or impending events of default of which it has become aware and take appropriate action;

4.3.7 waiver duties – a power to grant prescribed consent and waivers, in accordance with the terms of the loan agreement.

The documents will make it clear that the Agent's duties are limited and the scope of the Agent's liabilities are exonerated. The Agent is also entitled to be indemnified if it acts in accordance with its duties.

Other provisions in the agency clause makes it clear that any lending bank has carried out its own enquiries, credit appraisals and is well aware of the risk of the situation.

4.4 Resignation

The Agent is normally permitted under the loan agreement to be allowed to resign. A more interesting question is whether or not the Majority Banks are able to remove an Agent. There used to be a time where, particularly in relation to Club Loans where the Agent Bank who would also be a major lender, that there were no provisions allowing the Agent to be removed. However, I have noticed that this practice has changed and it would appear that under Club Loans an Agent can be removed, but this is not actually termed removal but the Agent is asked to resign. This in fact can be more of an illusory right than anything else especially if the Agent holds enough of the facility to block Majority Banks decision.

It is very important to the participants in a syndicate that they are happy not only with the terms of the loan, but also with the Agent administering the facility and the other participants in the loan. In fact one tends to see certainly in relation to German Mortgage Banks that a number of the Club Loans only comprise German Mortgage Banks and other German banks

5 Security Trustee

It is usual in a loan agreement and the related security documents to refer to the position of a Security Trustees, who in most cases would be the Agent although it is possible to have a separate person appointed as security trustee.

It is important to make it clear that in the documents it does actually state that the security agent is holding the security on trust for the finance parties although this position would be implied. Loan agreements do contain provisions relating to the security trustee's position, but basically these are usually exclusion clauses protecting the security trustee in relation to any mishap in terms of holding security.

6 Transfer

One of the key aspects of a syndicated agreement and I will deal with this point in this section sooner rather than later, is that any member of a syndicate is normally able to transfer or sell its commitment to a third party under the terms of the syndicated loan agreement. There can however be limitations on a free transfer and these can include in very limited circumstances where the borrower's consent is required or the borrower may object to the loan being transferred to certain designated banks because it has had fall outs with them in the past. From a lending bank's point of view it is actually fairly important to ensure that the loan is in fact freely transferable and the borrower cannot object to the transfer or cannot at least withhold its consent unreasonably to such transfer. In addition, and a very important aspect of all transfers, is that there must be a wide disclosure provision allowing details of the loan to be disclosed to third parties because even if there is a wide transfer provision, if the bank is not able to disclose details of the loan to a party

it wishes to sell the loan to, then this itself would be an inhibition on the transfer.

The borrower however, is entitled to certain protections in relation to a transfer by a bank to a third party and, in particular, the borrower should be in no worse position following a transfer than before. It is accordingly not unusual to see provisions in an agreement that if the bank does make a transfer, it can only transfer to a bank which is a qualifying bank. As you are aware a qualifying bank is a tax definition and this will be a bank to whom when interest is payable no withhold tax will have to be withheld. Basically, this is a bank within the UK tax net a bank in a country which has a Double Tax Treaty with the UK or a UK building society.

If a transfer is to take place, then the normal requirement is only that the transferor and the transferee complete a transfer certificate which is contained at the back of the loan agreement. Importantly, as far as any transferee bank is concerned, the terms of the transfer contained in the loan agreement and the transfer certificate make it clear that the transferor has no risk or liability in relation to the transfer and that it is up to the new bank to make full enquiries and credit appraisal of the borrower and security.

7 Some other Points on a Syndicated Loan

7.1 Priority Arrangements

Normal transfer of a participation in syndicated loan is usually dealt with by the transfer certificate mechanism in the loan agreement. It is possible in some situations for existing Finance Parties to agree with new lenders that the priority position of the loan will be different. To give an example, there may be £100 million syndicated loan, but in order to get other banks to participate in the facility the Agent and the original lenders may agree that the new bank's participation of say £75 million in a £100 million facility will rank ahead of the remaining £25 million. In a situation such as this, it is necessary for all the finance parties to enter into an inter-creditor agreement setting out the priority position.

7.2 Legal Position

I know that a number of you will have participated in loans and I would presume mainly as a participant as opposed to agent and you have been asked to join in the loan after the loan has originally been drawn down. I would mention that we have acted for a number of clients who ask us on a regular basis to review the legal implications of taking a participation in a syndicate and review the loan agreement and security documents on the bank's behalf. Since a new participant bank has full risk in relation to any arrangement it is very important that the loan documentation is carefully considered. One of the main defects we normally find is that at the time the original loan agreement is set up, the original finance parties will have received certain professional reports from valuers, accountants, surveyors and solicitor, but these reports may not be addressed in such a way that a new participant can rely on such reports or opinions. It is accordingly vital to ensure that all these reports, opinions and valuations are addressed in such a way that a new participant in the facility can rely upon them.

I Will now Turn to Transfers of Claims

1 Introduction

The main methods of granting participation in a loan are as follows:

1.1 Novation

The bank, participant and the borrower agree to novate a proportion of the loan agreement to the participant and I have referred to that above in the syndication section.

1.2 Assignments

This is where a bank assigns a portion of the loan to the participants. This will involve declaration of trust and assignment of proceeds.

1.3 Participation and Risk Participation

This is a situation where the bank agrees to pay to the participant an amount equal to the participant's share of payments received by the bank from the borrower or the participant gives a guarantee to a bank of part of the loan.

There is also securitisation which involves a repackaging scheme of loan facilities which is more complex and will involve the sale of a numerous loans to a special purpose company, which issues debt securities to investors.

I will deal with each of the different methods of transfer below. I should also make it clear that before any transfer of the right of a loan agreement are undertaken, the terms of the loan agreement itself have to be studied to ensure that the transfer is permitted.

Can I however state that the background to any transfer of loan is that there is a fundamental English law principle which a lot of people forget. This fundamental principle is that under English law the benefit of a contract can be assigned but the burden of contract cannot be assigned. Under a loan agreement whilst there will be significant benefits mainly being the right to receive repayment of the loan, there will also however in relation to such agreement be obligations or burdens as well, such as in certain circumstances to provide further facilities or to give indemnities or undertake obligations to the borrower or the Agent.

I will now deal with the main methods of transfer below:

2 Novation

Due to the English law rule referred to above, this is the main method of transfer of the benefit and burden of a contract under English law. For a novation to be effective however, all parties involved have to join in and agree to the transfer. However, very cleverly the syndicated loan agreement deals with the borrower joining in the novation arrangement by effectively getting a pre-consent to such an arrangement under the term of the loan agreement. A novation is by far the best method available to all parties involved in the transfer of a participation in a loan agreement because all parties have clearly defined rights. Furthermore, from a security point of view under the terms of a syndicated loan agreement the security

trustee holds securities for the finance parties from time to time and this will include any transferee.

I can further confirm that under English stamp duty legislation, the transfer by a bank of a loan participation is not subject to UK stamp duty.

A seller should have no liability in relation to the loan once the transfer is completed.

3 Assignment

It is possible instead of doing a novation for a selling bank to assign all its rights and benefits to a purchasing bank. The assignment may be non-notified, which is an equitable assignment or a notified assignment. It would be usual for the assignment to actually be the fully completed English form of legal assignment, which will involve notifying the borrower of the assignment. The main problem with an assignment is whilst it will transfer to the transferee the right to receive payment from the borrower, it will not transfer any of the obligations of the selling bank. This can be covered of course by indemnities in the assignment between the selling and purchasing banks, but the selling bank is not off the hook as far as the borrower and any other parties are concerned under the terms of the loan agreement.

There are also other risks associated with an assignment. If the borrower has rights against the selling bank then, in certain circumstances these rights may still subsist and the purchasing bank will be subject to these although rights such as set-off are normally excluded under the terms of the loan agreement.

There is also the question whether stamp duty is payable on the assignment of the loan which is nothing more than an assignment of a debt. However, Stamp Duty on the sale/assignment of a debt has been abolished.

The security position arrangement would have to be investigated but it should be possible for the benefit of the security to be assigned. It is quite usual in security documents to state that the security is assignable under the same terms as under the loan agreement.

4 Sub-Participation

Under this type of transaction the participant purchases from the selling bank its participation and the selling bank agrees to pay to the participant an amount equal to the participant's shares of receipts that the selling bank receives from the borrower when and if received. In particular, the important point is payments to the purchaser are conditional on the selling bank receiving corresponding amounts from the borrower. This is not such a satisfactory way of participating in a loan because there are a number of disadvantages for a purchasing bank. The purchasing bank has no contractual arrangement with the borrower and accordingly has no ability to enforce the loan. The participant also has a double risk because it is relying on the selling bank passing down any proceeds received to it and also there is the risk of the insolvency of the selling bank as in such a situation the participant would only be an unsecured creditor of the selling bank and would have no direct claim against the borrower. It may be possible to avoid the insolvency risk of the selling bank by charging the loan agreement to the participant, but charging is not generally acceptable to a selling bank. The purpose of such participation will be

to generally transfer the risk of the loan from the selling bank to the participant but without an assignment. It may be that in certain situations assignments may not be possible because of restrictions on assignment or possible stamp duty or withholding tax complications. Furthermore, the participant has the same disadvantages as an assignee in that if the borrower has any claims against the selling bank, these will also be effective against the participant.

There is however no UK stamp duty payable in relation to acquisition of a participation.

5 Risk Participation

This is a situation where no money passes between the participant and the selling bank, but instead the selling bank is given a guarantee by the participant of the payment of the loan. What has happened therefore is that the risk of the loan has been passed from the selling bank to the participant.

6 Disclosure

One important aspect and which relates to the marketability of all loans is that in order for a bank to be able to sell the loan it must be able to freely divulge to any third party full information on the borrower, the loan and documentation. In this regard any disclosure clause in any loan agreement should be carefully looked at and this clause should be as wide as possible. It is not unusual to see very wide disclosure clauses and this relates not only to allowing disclosure to potential transferees, assignees or participants, but also to third parties, credit or rating agencies as well. It would also be usual to take from any potential transferee, assignee or participant a confidentiality letter to ensure that any information given to them is kept confidential especially if they do not at the end of the day decide to participate in the loan.

7 Financial Services and Markets Act

One matter that needs to be considered is whether the selling or buying bank could be caught by UK Financial Services and Markets Act regulations. As you can appreciate, all Financial Services Acts legislation is very complicated and really needs to be very much analysed on a case by case basis. It is however likely that whilst the sale of a loan participation may well be an investment activity within the meaning of the relevant legislation, nonetheless there are exemptions which are likely to apply and means that the selling bank and the buying bank need not be concerned within the UK legislation.

8 Loan Transfer and Capital Assets

One of the main reasons for a loan transfer is to do with the bank's capital adequacy in treatment of the loan and it is important that in relation to a transfer of a loan that the seller transfers all risk in relation to the loan for the purposes of capital adequacy. If the transfer is not a "clean transfer", then the seller may still be treated as the owner of the loan which will attract a risk weight. My understanding that in the case of a novation and an assignment which has been legally affected, then certainly in the UK, although the position may of course be different in Germany, the financial authorities would treat the transfer as an effective transfer of the seller's right and what is known as a clean transfer. A situation where the borrower

is not notified can also be treated as a clean transfer, but this may be subject to conditions and relate to internal controls carried out within the buyer and the seller keeping under careful review the risk, as it remains the lender on record. If the financial authorities are not satisfied on these points, then an assignment may be taken into account in calculating the seller's capital ratio. In the case of a sub-participation, the financial authorities normally recognise the transfer of the amount transferred from the original lender's capital ratio and including it in the sub-participant as a claim on the underlying borrower.

These are a simplification of the financial authorities' rules and based upon notices issued by the Bank of England and/or the Financial Services Authority, but there are other conditions that do need to be satisfied and if this is the intended position that the selling bank dispose of risk, then it has to carefully ensure that all conditions are satisfied.

9 Securitisation

I would very briefly mention securitisation although that is essentially outside the scope of this lecture as this will relate to a block of loans as opposed to individual loans.

Securitisation typically involves an originating bank or other financial institution transferring assets such as mortgage receivables to an insolvency remote special purpose vehicle which finances the acquisition by raising funds against the security of those assets. The method of transfer used includes assignment, novation and sub-participation. The financing techniques used by the special purpose vehicle specifically include public issues, commercial papers, syndicated loan funding or the private placement of loans. Such arrangements are attractive to bank originators as they will, if properly structured, remove the relevant assets from the bank's balance sheet thereby improving the bank's liquidity by relieving it of the requirement to satisfy capital reserves against the risks represented by the loans or other assets in question. The position in relation to the capital adequacy is very similar to that mentioned above.

I hope this talk is helpful to you and I have tried to cover a number of difficult areas.

If time permits, I would be happy to answer questions.

Talk given by Anthony Harris, Partner
15 June 2004
dbb forum, Berlin

Transfer Certificate (Extract)

This clause has been produced for the guidance of delegates at the conference for which it was prepared and is not a substitute for detailed professional advice. No responsibility can be accepted for the consequences of any action taken or refrained from a result of this clause or for the talk for which it was prepared.

29 Transfers

29.1 Transfers

A Bank (a "Transfer Bank") may at any time transfer in accordance with this clause all or any of its rights, benefits and obligations (or any combination of them) under the Security Documents to another bank or other lending institutions (a "New Bank") by delivering to the Agent a duly completed and duly executed Transfer Certificate provided that such other bank or lending institution is a Qualifying Bank.

29.2 Action by Agent

As soon as reasonably practicable after a Transfer Certificate has been delivered to the Agent the Agent shall (unless it has reason to believe that the Transfer Certificate is defective):

29.2.1 sign the Transfer Certificate for itself, the Borrower and each of the other Banks;

29.2.2 send the Borrower a copy of the Transfer Certificate.

29.3 Transfer Certificate to be used except for Bank mergers

No assignment or transfer of any right or obligation of a Bank under this agreement shall be effective unless made by a Transfer Certificate or by any other form of Transfer Document agreed with the Agent.

29.4 Effect of Transfer Certificate

Upon signature of a Transfer Certificate by the Agent with effect from the date of such signature or any later date specified in the Transfer Certificate:

29.4.1 the Transferor Bank's participation is transferred and its Commitment is discharged to the extent provided in the Transfer Certificate;

29.4.2 the New Bank becomes a Bank with the participation previously held by the Transferor Bank and specified in the Transfer Certificate and a Commitment of an amount so specified; and

29.4.3 the New Bank is bound by and entitled to the benefit of all the provisions of this agreement which apply to the Banks generally and to the extent that the New Bank is bound by or entitled to the benefit of those provisions the Transferor ceases to be bound by or entitled to them.

29.5 Further assurance

Each Transferor Bank under a Transfer Certificate agrees with the New Bank under that Transfer Certificate that it shall at the New Bank's expense execute any documents which the New Bank reasonably requires for perfecting in any relevant jurisdiction the New Bank's title under the Transfer Certificate.

29.6 Exclusion

The Transferor Bank and the other Banks do not:

29.6.1 make any representation or warranty or assume any responsibility for the legality, validity, effectiveness, adequacy or enforceability of any of the Security Documents;

29.6.2 have any responsibility for the financial condition of the Borrower or for the performance or observance by the Borrower of the provisions of the Security Documents.

29.7 No recourse to Transferor Bank

Nothing in any Transfer Certificate or this agreement shall oblige a Transferor Bank to accept a re-transfer from a New Bank or support any losses directly or indirectly sustained by a New Bank for any reason whatsoever including failure by the Borrower to perform its obligations under any Security Document.

29.8 Authority for Agent

Each of the Borrower and the Banks irrevocably authorises the Agent to sign any Transfer Certificate on its behalf.

This Transfer Certificate has been produced for the guidance of delegates at the conference for which it was prepared and is not a substitute for detailed professional advice. No responsibility can be accepted for the consequences of any action taken or refrained from a result of this Transfer Certificate or for the talk for which it was prepared.

Form of Transfer Certificate

To: [The Agent]
[The Borrower]

Transfer Certificate

relating to the Loan Agreement (as from time to time amended, varied, novated or supplemented, the "Agreement") dated 2004 whereby a loan facility was made available to [……..] (the "Borrower") by the Banks on whose behalf [……..] (the "Agent") acted as agent in connection therewith. Terms defined in the Agreement shall have the same meaning herein.

1 [Transferor Bank] (the "Bank") (a) confirms that the details which appear in the Schedule hereto under the heading "Commitment" accurately summarise its participation in the Agreement and (b) requests [Transferee Bank] (the "Transferee") to accept and procure the transfer to the Transferee of the portion specified in the Schedule of [its share of the Loan] by countersigning and delivering this Transfer Certificate to the Agent at its address for the service of notices specified in the Agreement.

2 The Transferee hereby requests the Agent to accept this Transfer Certificate as being delivered to the Agent pursuant to and for the purposes of Clause 29 of the Agreement so as to take effect in accordance with the terms thereof on [date of transfer] (the "Transfer Date") or on such later date as may be determined in accordance with the terms hereof.

3 The Transferee confirms that:

3.1 it has received a copy of the Agreement and the other Security Documents together with such other documents and information as it has required in connection with this transaction and that it has not relied and will not hereafter rely on the Bank to check or enquire on its behalf into the legality, validity, effectiveness, adequacy, accuracy or completeness of any such documents or information and further agrees that it has not relied and will not rely on the Bank to assess or keep under review on its behalf the financial condition, creditworthiness, condition, affairs, status or nature of the Borrower, or the value of the Property.

3.2 the information relating to it in the Schedule is accurate.

4 The Transferee hereby undertakes with the Bank and each of the other parties to the Agreement that it will perform in accordance with their terms all those obligations which by the terms of the Agreement will be assumed by it after

delivery of this Transfer Certificate to the Agent and satisfaction of the conditions (if any) subject to which this Transfer Certificate is expressed to take effect.

5 The Bank makes no representation or warranty and assumes no responsibility with respect to the legality, validity, effectiveness, adequacy or enforceability of the Agreement or the other Security Documents or any document relating thereto and assumes no responsibility for the financial condition of the Borrower or any other party to the Security Documents or for the performance and observance by the Borrower or of any other such party of any of its obligations under this Agreement or any other Security Document or any document relating thereto and any and all such conditions and warranties, whether express or implied by law or otherwise, are hereby excluded. The Transferee represents and warrants to the Transferor that it has made its own independent investigation and assessment of the financial condition and affairs of the Borrower in connection with the Facility and this Transfer Certificate and has not relied exclusively on any information provided to it by the Transferor in connection therewith and the Transferee further represents, warrants and undertakes to the Transferor that it shall continue to make its own independent appraisal of the creditworthiness of the Borrower while the Loan is outstanding or its Commitment is in force.

6 The Bank hereby gives notice that nothing herein or in the Agreement (or any document relating thereto) shall oblige the Bank to (a) accept a re-transfer from the Transferee of the whole or any part of its rights, benefits and/or obligations under the Agreement or any Security Documents hereby transferred or (b) support any losses directly or indirectly sustained or incurred by the Transferee for any reason whatsoever including, without limitation, the non-performance by the Borrower or any other party to this Agreement or any other Security Document (or any document relating thereto) of its obligations under any such document. The Transferee hereby acknowledges the absence of any such obligation as is referred to in (a) or (b) above.

7 This Transfer Certificate and the rights and obligations of the parties hereunder shall be governed by and construed in accordance with England law.

The Schedule

Commitment	Portion Transferred
Share of Loan: £	
[Transferor Bank]	[Transferor Bank]
By:	By: .....
Date:	Date: .....
Notice Details:	
Address:	
Fax:	
Telex:	
For the urgent attention of:	

Ian Silverblatt

Drawdown and Disbursement Procedures

Introduction

In this talk I will be looking at the conditions which you, as lender, will want to have satisfied before drawdown of the loan. These are known as **Conditions Precedent**.

I will then conclude with a brief look at the manner in which **the loan monies are transmitted** upon drawdown of the loan.

1. Conditions Precedent

As Anthony Harris explained this morning in his talk entitled 'Loan Contracts, Documentation', even though a borrower and a lender may have entered into a loan agreement, the agreement usually provides that the borrower cannot require the lender to draw down the loan until the borrower has served a drawdown notice and has satisfied the **Conditions Precedent**.

I will now look at some of the common Conditions Precedent, some of which may have been satisfied prior to the date of the loan agreement, others only shortly before drawdown.

1.1 Constitution of the Borrower

In most situations where the borrower is a company, the lender will want to ensure that the borrower is correctly formed and has power to borrow money and enter into the security documents.

The lender should therefore require:

- Certified copies of the borrower's Certificate of Incorporation and Memorandum and Articles of Association;
- A certified copy of the Board Resolution of the borrower, approving the execution, delivery and performance of each security document to which the borrower is expressed to be party and authorising a named person or persons to sign each such security document and authorising any other sealing and completion requirements of the borrower's Constitution; and
- A certificate signed by a duly authorised officer of the borrower, setting out the names and addresses of the persons authorised to sign each security document on behalf of the borrower.
- This procedure should also be followed with regard to any corporate guarantor.

1.2 Financial Status

Provision should be made for receipt by the lender of information regarding the financial status of the borrower and of any guarantors, including:

- Latest audited accounts for the borrower and any corporate guarantor;
- If the borrower is purchasing the property, evidence of the availability of the additional funds required by the borrower and (if applicable) proof that they are not being borrowed;
- Satisfactory bank and other financial references for the borrower, any guarantors and, in some cases, the directors of the borrower and/or of its ultimate beneficial owners; and
- A pro-forma balance sheet for the borrower if accounts are not yet available (e.g.: if it is a newly formed company).

1.3 Valuation and Survey Report

A lender will almost always require a valuation of the property, from a surveyor acceptable to the lender.

The lender may also want to stipulate in the Conditions Precedent that the report values the property or properties at a date no earlier than, say, three months prior to the date of service of the drawdown notice, and at no less than a certain specified figure.

- It is important that the report and valuation are addressed by the valuer direct to the lender (in case the lender should subsequently need to pursue a negligence claim against the valuer).
- The report may contain certain assumptions, which should be checked by the lender's solicitors. It is also common for the lender to require its solicitors to confirm that they have read the report and valuation and either that they are not aware of any discrepancies or that they have brought any discrepancies to the attention of the valuer, with a copy of the valuer's response to be provided to the lender.
- Depending upon the nature of the property to be charged, the lender may also require a satisfactory building (also known as a structural) survey, again addressed to the lender. This will provide the lender with a much more detailed report on the property.

1.4 Environmental Survey

Depending upon the nature of the property, the lender may require a separate environmental survey.

- The valuation report and any building survey obtained may well contain brief details of an environmental nature. However, for certain properties, the lender may require a more detailed environmental survey, to highlight issues such as:

  (i) The likelihood of contamination at the property caused either by past uses or by the current use: and
  (ii) Whether contamination from neighbouring properties may affect the borrower's property.

  – for example, factory premises are more likely to require this than, say, an office block in the centre of London.

An environmental survey can take several forms, including:

- At the lower end, a **"desktop" search** (effectively a database and records search), which should show the historic uses of the property and of all properties within a 1km radius and will also contain an assessment of risks such as subsidence and flooding.

  Several agencies provide this type of survey, which is relatively cheap (normally between £150 and £250) and takes only a few days to obtain. However, it will provide only a very brief indication as to whether further enquiries are necessary.

- In the middle range would be a **"desktop" search combined with a site visit by an environmental surveyor**.

  This is slightly more expensive (up to £1,000) and takes a little longer to process (up to 2 weeks).

  However, from his visual survey of the property and his search of the available records, the surveyor will produce a more detailed survey which, crucially, will include his recommendations (if any) for further action. The surveyor can also be asked to point out any health and safety or compliance issues, such as any failure to obtain waste transfer notes or the need to transfer certain environmental licences (or the absence of any required licences).

- At the top end is what is often called a **"Phase II" survey**. This is a far more detailed survey and involves intrusive drilling works to obtain soil samples from affected areas or from areas which are likely to be affected by contamination. The samples are then analysed by the environmental surveyor and a detailed report provided with a set of recommendations.

  This type of report is usually instigated only once one of the previously mentioned reports has been obtained, if recommended in the initial report. It can cost several thousands of pounds and can take a few weeks to process. However, if it is recommended in the initial report, the lender will usually wish to see it before proceeding with the loan and will therefore add receipt of a satisfactory Phase II survey to the Condition Precedent.

  In exceptional circumstances, where contamination is likely to be significant, this may well be required even before the lender is prepared to enter into the loan agreement.

1.5 Legal Opinions & Certificates of Title

The lender will almost always require a full report on title, setting out, amongst other matters, the principal terms of the:

- Title to the property;
- Headlease (if the property is leasehold);
- Occupational leases;
- Buildings insurance policy; and

- Searches and planning documents.

  To save duplicating the legal work, this report will often be provided by the borrower's solicitors in the form of a Certificate of Title, addressed to the lender and the lender's solicitors will then provide an overview of the Certificate to the lender.

  If the borrower (or any guarantor) is a foreign company, the lender will also require a legal opinion (addressed to the lender) from a lawyer registered in the relevant jurisdiction.

  However, I will not dwell on these points as they were discussed in greater detail in Mr. Harris's talk this morning.

1.6 Insurance

The lender will require evidence that the property is insured in a satisfactory manner and I mentioned the common forms of protection for the lender in my talk yesterday afternoon.

Common points to be covered in the Conditions Precedent will include:

- Evidence that the requisite insurance cover will be in place no later than the time of drawdown of the loan.
- A letter from the insurance company confirming that the lender is insured jointly with the borrower, or that its interest has been noted, and/or that it is the first loss payee (as appropriate). If possible, the letter should also contain confirmation that the insurer will not lapse the policy without notifying the lender and giving the lender time to remedy the default or secure alternative insurance.

1.7 Occupational Leases

- The lender will usually require evidence that all rents, service charges and other sums due by the tenants under the occupational leases are up-to-date.
- Sometimes, the lender will require the transfer of any rent deposits held by the borrower to an account operated by the lender.
- If the borrower employs a company to manage the property, the lender will often require a certified copy of the Management Agreement between the borrower and the managing agents, together with a (separate) Duty of Care Agreement from the managing agents direct to the lender and satisfactory evidence of the managing agents' professional indemnity insurance cover.
- If the rents are to be paid direct into a bank account operated by the lender, the lender will wish to receive signed notices (usually in a form annexed to the loan agreement) from the borrower addressed to each tenant, directing future payments to be made into this account until otherwise directed by the lender.

  Sometimes this is only required if and when there is an event of default on the part of the borrower. In this case, the signed notices will still be required by the lender as a Condition Precedent, although the lender would then retain them until an event of default occurs (when they would be sent to the tenants).

1.8 Release of Existing Security

The lender will wish to ensure that all existing security is released and discharged no later than drawdown of the new loan. In this regard, it should require the following:

- Deeds of Release in respect of all existing mortgages, debentures and other charges which are to be released.
- Land Registry form DS1 in respect of all mortgages registered against the property at the Land Registry. This form, executed by the current mortgagee, will need to be sent to the Land Registry following drawdown so that the current mortgage entries are removed.
- Often, these documents will not be released by the current mortgagee until the outstanding loans have been repaid, which in turn requires the new lender to release the loan monies. It is therefore common for the lender's solicitor to obtain an undertaking from the borrower's solicitor to supply these documents once the loan monies have been released.

1.9 Pre-completion Searches

- A Land Registry search must be made against all properties registered at the Land Registry. The search will be made by the lender's solicitors or by the borrower's solicitors (in the name of the lender). It is done on Land Registry form OS1 (or OS2 if the borrower is purchasing or mortgaging only part of an existing title). The search will reveal any changes made to the registers of title since the date of the official copy entries last supplied to the lender's solicitors.
- Most importantly for the lender, the search will provide the lender with a protection period of 6 weeks, during which the lender can register the legal charge (and the property transfer if applicable) without any party being able to register an entry in priority to the lender.
- If the property is unregistered, the search to be made is a Land Charges Act Search against the name of the owner of the property and all previous owners usually going back at least 15 years. However, this is very unusual since most properties in England and Wales are now registered.
- This search will protect the lender against subsequent entries provided that the legal charge is completed within the 3-week priority period afforded by the search.
- A company search against all corporate borrowers (and guarantors) incorporated in England and Wales, should also be made, to check that there have been no new registrations at Companies House since the registers were last inspected by the lender's solicitors.
- Lastly, a bankruptcy search should be made against all borrowers or guarantors who are individuals, whether or not resident in England and Wales, to ensure that there are no entries registered against them.

1.10 Security Documents

Before the loan is drawn down, the lender will want its solicitors to have received all the security documents, such as:

- Loan Agreement;
- Legal Charge;
- Debenture; and
- Bank Accounts Charge.

In each case, they must be properly executed by the borrower (and all guarantors), ready for dating upon drawdown of the loan. Some lenders will execute the security documents as well.

1.11 Title Deeds

- As has been mentioned by several speakers, since the implementation of the **Land Registration Act 2002** on 13th October 2003, the Land Registry no longer issues Land or Charge Certificates and they are no longer required in connection with applications to register transfers and legal charges affecting the title.
- Accordingly, whether or not the borrower (or the seller, if the property is being sold to the borrower) still holds the Land or Charge Certificate, this will be of no relevance to the lender (or even to the borrower) and they will no longer be required as part of the title documents to be received upon drawdown of the loan.
- However, where the borrower is purchasing the property, the lender will require delivery of the Transfer deed (usually in Land Registry form TR1, or TP1 if the borrower is purchasing part of a title). This document operates to transfer the legal estate in the property from the seller to the borrower.
- If the property is leasehold, the lender will want to receive the original lease, any documents supplemental to the lease (e.g. deeds of variation, licences to assign or to alter) and (if required under the terms of the lease) licence from the landlord consenting to the transfer of the lease to the borrower and (if required) consenting to the grant of the legal charge to the lender.
- If the property is subject to occupational leases, the lender will want to ensure that it receives all of the counterpart leases and supplemental documents, unless provision has been made for the borrower or its solicitors to retain these documents (held to the lender's order) if, for example, there are many occupational tenants and the original lease documents are required by the borrower in connection with management issues and/or court proceedings against some of the tenants.
- Finally, the lender may also require the borrower to hand over the originals of all searches and planning consents in its possession.

1.12 Stamp Duty Land Tax

This section of my talk deals with the situation where the borrower is purchasing the property, rather than mortgaging a property which it already owns.

Other speakers have already spoken in depth about this subject and the changes brought about by the advent of **Stamp Duty Land Tax**, which replaced Stamp Duty on property transactions with effect from 1st December 2003.

I propose to talk here only about the particular points to be considered by a lender in the nature of **Conditions Precedent**.

- If the transfer is for no more than £60,000[5], or is a transfer for no 'chargeable' consideration, then:
  - no SDLT should be payable and the borrower should sign **Inland Revenue Form SDLT60** (a self-certification form);
  - this form should be handed to the lender's solicitors under the **Conditions Precedent** and they will send it to the Land Registry as part of the application for registration of the transfer and of the legal charge.
- In all other cases (i.e. in most cases), usually where SDLT is payable:
  - the borrower must complete and sign a **Stamp Duty Land Transaction Return (Form SDLT1)**
  - and produce a cheque for the requisite SDLT
  - these must be sent to the Inland Revenue no more than 30 days after the 'effective date' of the transaction, otherwise the Inland Revenue can charge interest and penalty sums
  - Within 5 working days after receipt of these items, the Inland Revenue should issue the **Land Transaction Return Certificate (Form SDLT5)** and which must be sent to the Land Registry before they will register the transfer and the legal charge.
- Often the Form and cheque are handed to the lender's solicitors to process, but sometimes it is more appropriate for the borrower's solicitors to process them, in which case they should undertake to send them to the Inland Revenue immediately following drawdown and to forward the **Land Transaction Return Certificate** to the lender's solicitors when received.

  In any event, the lender should obtain an undertaking from the borrower to pay any additional SDLT due (although such an obligation will usually be contained in the borrower's covenants in the loan agreement).
- Please note that provided that it appears on the face of it that the correct amount of SDLT has been paid, the Inland Revenue will issue the **Land Transaction Return Certificate**. If the Revenue subsequently discovers that insufficient monies have been paid, although it can look to the borrower for the additional sum due, this should not affect registration of the transfer (and legal charge) obtained in the meantime.
- The lender must take extra caution where the property is being transferred:
  - For no monetary consideration or for less than market value – additional SDLT may be payable;

5 On 17 March 2005 an increase in the nil SDLT threshold for commercial property from £60,000 to £120,000 came into effect.

- Between companies within the same "Group" – certain requirements must be met if SDLT is to be avoided;
- Through an SDLT saving scheme – the scheme must be checked by the lender's professional advisors to ensure not only that the correct amount of SDLT (if any) is being paid but also that the structure of the scheme does not prejudice the lender's security; and
- In circumstances where the 'effective date' of the transaction, is more than 30 days before the Inland Revenue receive the **Form SDLT1** and the SDLT cheque – the Inland Revenue can then refuse to issue the Land Transaction Return Certificate until all interest and penalty sums have been paid.
  The "effective date" of a transaction will be determined by the date on which the property transaction is "substantially performed", which was discussed in Emma's talk yesterday morning. Suffice to say that this is a complicated part of the new SDLT regulations and should be considered very carefully by the lender's professional advisors.

• Finally, the old Inland Revenue 'PD' forms (standing for "Particulars Delivered"), which used to be required by the Inland Revenue in connection with the stamping of all property transfers and the grant of some leases, have now been abolished by the new SDLT regulations and are therefore no longer of any relevance.

1.13 Registration

• At the **Land Registry**

- All property transfers and legal charges must be registered at the Land Registry and the lender must ensure that they are registered (usually by its own solicitors) within the 6-week priority period afforded by the Land Registry Search.

Accordingly, as part of the **Conditions Precedent**, the lender should include the following, which will normally be supplied by the borrower's solicitors:

- Land Registry application **form AP1**;
- a cheque for the correct amount of Land Registry scale fees (between £40 and £700 depending upon the purchase price or the loan figure); and
- an undertaking from the borrower to use its best endeavours to deal with any requisitions which may be raised by the Land Registry in connection with the application for registration.

The lender's solicitors will then be able to make the application to the Land Registry, either immediately if no SDLT is payable, or otherwise upon receipt of the Inland Revenue **Land Transaction Return Certificate**.

• At **Companies House**

As I mentioned in my talk yesterday afternoon, under English law (**Section 395 of the Companies Act 1985**), legal charges granted by companies over properties situated in England and Wales, must be registered at Companies House within 21 days after they are granted, otherwise they will be void against a liquidator of the company.

If this time limit is missed, the lender will need to obtain a Court Order to effect registration and even if granted, the lender's legal charge would then rank after any charge registered in the meantime. It is therefore very important not to miss this deadline!

Form 395 is used and a fee of £10 is payable. These are usually dealt with by the lender's solicitors, but some lenders require the borrower's solicitors to supply these items, in which case they should form part of the **Conditions Precedent**.

Please note that this procedure must be followed even if the company is registered outside of England and Wales, although in such case, Companies House will note it in the **Salvenburg Register**.

1.14 Notices

- To the **Landlord** (if the borrower's interest is leasehold)

If the borrower's property interest is leasehold (usually a long lease granted at a low rent), the lender should insist, whether or not it is a requirement of the lease, that notice of the legal charge (and the transfer, if there is one) is formally served on the landlord and that, if at all possible, the landlord's receipt is obtained.

Accordingly, as part of the **Conditions Precedent**, the lender should require delivery of the requisite notice and any registration fee due to the landlord. The lender's solicitors can then serve the notice after drawdown.

1.14.1 To the **Occupational Tenants** (if any)

In addition to any notices to be served on the tenants requiring them to pay their rent direct into a bank account operated by the lender, the lender should ensure that if the property is being purchased by the borrower, the seller must hand over signed letters addressed to all the tenants authorising them to pay all future rents and other sums due under their leases to the borrower or to whoever the borrower directs.

In any event, under **Sections 47 and 48 of the Landlord & Tenant Act 1987**, the borrower will not be able to claim rent or any other sums due under the occupational leases until it has given the tenants written notice of the address to which they should send rent and other payments due under their leases, together with any notices to the borrower.

1.14.2 **Rent Deposits**

If these are being transferred, notice of the transfer should be served on the appropriate tenant and the lender's receipt of such notice should form part of the **Conditions Precedent**.

2. Disbursement Procedures

2.1 On the morning of completion, or sometimes the day before, the lender will usually transmit the loan monies to its solicitors, usually by electronic transfer, for them to hold pending satisfaction of the **Conditions Precedent**, when they will then release the monies.

It is preferable for the monies to be sent in this way rather than direct to the borrower's solicitors, since some of the **Conditions Precedent** may only be satisfied at the very last minute and the lender's solicitors may have to deal with these by way of undertakings from the borrower's solicitors.

Often, during the course of completion, the monies will have to be transmitted via several bank accounts:

Firstly – from the lender to its solicitors;

Secondly – from the lender's solicitors to the borrower's solicitors; and

Lastly – from the borrower's solicitors to the seller's solicitors (on a purchase) or to the outgoing lender (on a remortgage).

As you will appreciate, this can take quite a long time and it is therefore common for the lender's solicitors to be asked to send the monies direct to their ultimate destination.

2.2 This is usually acceptable provided that the monies are not sent out by the lender's solicitors until:

Either – all the outstanding **Conditions Precedent** have been satisfied;

Or – the recipient has undertaken to hold the monies to the lender's order until the outstanding **Conditions Precedent** have been satisfied.

2.3 The lender's solicitors' fees and disbursements will usually be paid by the borrower and there will also be matters such as SDLT and Land Registry fees to consider.

Sometimes these monies are deducted from the loan monies, other times they are paid direct by the borrower (in which case, this should preferably be done before drawdown).

The lender's solicitors will normally produce a Completion Statement shortly before drawdown, showing the amount of the loan to be released by the lender on drawdown and, by way of deduction, all fees, disbursements and other payments which are not being paid direct by the borrower.

Obviously, the lender's solicitors should check that the net loan monies will be sufficient to complete the purchase or the remortgaging, as appropriate.

Conclusion

I hope that this has given you a useful insight into Conditions Precedent and the mechanics of drawdown.

Talk given by Ian Silverblatt, Partner
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dbb forum, Berlin

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Sybille Steiner

Conflict of Laws and Enforcement of Foreign (Esp. German) Deeds and Judgements

A Einleitung

Thema des Vortrags: Welches Recht ist bei internationalen Sachverhalten anzuwenden und wo und wie kann man am besten Ansprüche gegen seinen Schuldner durchsetzen?

Ob und unter welchen Umständen sind eine Rechtswahl sowie eine Wahl der Gerichtszuständigkeit möglich und sinnvoll?

Diese Rechtsgebiete sind extrem komplex und schwierig und können daher nicht umfassend und teilweise auch nur vereinfacht wiedergegeben werden.

B Conflict of Laws

1 Einführung

Unter Conflict of Laws wird die Frage nach der internationalen Zuständigkeit der Gerichte und des anwendbaren Rechts verstanden. Hier muss sehr sorgfältig unterschieden werden. Welches Recht auf einen Vertrag Anwendung findet und welches Gericht für eine Entscheidung über den Vertrag zuständig ist, sind zwei völlig verschiedene Dinge und wird nach ganz verschiedenen Regeln entschieden. Wenn z.B. deutsches Recht auf einen Vertrag Anwendung findet, bedeutet das nicht automatisch, dass auch ein deutsches Gericht für eine Entscheidung über Ansprüche aus diesem Vertrag zuständig ist. Das Gleiche gilt für einen Vertrag nach englischem Recht und englischer Zuständigkeit. Die englischen Gerichte gehen jedoch in der Regel im Falle ihrer Zuständigkeit zunächst von der Anwendbarkeit englischen Rechts aus. Hält eine Partei ein anderes Recht für anwendbar, muss sie dieses plädieren.

Conflict of Laws wird immer dann relevant, wenn in einem rechtlichen Sachverhalt Berührungspunkte mit einem anderen Rechtskreis als dem eigenen bestehen. Man kann und darf sich in einem solchen Fall weder darauf verlassen, dass deutsches Recht und deutsche Gerichtszuständigkeit auf jeden Fall eingreifen, oder dass ausländisches Recht dem deutschen Recht entspricht oder annehmen, dass es mit der Wahl des Wunschrechtes getan ist.

Wenn eine deutsche Hypothekenbank den Erwerb eines englischen Grundstücks finanziert, sind daher immer Aspekte des Conflict of Laws, also des anwendbaren Rechtes und der Frage nach der internationalen Gerichtszuständigkeit zu berücksichtigen.

2 Anwendbares Recht

2.1 Verträge

2.1.1 Für alle Verträge, die nach dem 1. April 1991 geschlossen worden sind, richtet sich die Frage des anwendbaren Rechts nach dem Römischen EWG-Übereinkommen, der Rome Convention über das auf vertragliche Schuldverhältnisse anzuwendende Recht vom 19. Juni 1980, das durch den Contracts (Applicable Law) Act 1990 in das englische Recht umgesetzt worden ist.

2.1.2 Nach der Rome Convention findet das Recht auf einen Vertrag Anwendung, das die Parteien gewählt haben. Die Rechtswahl kann gemäß Art. 3 Abs. 1 der Convention ausdrücklich sein oder muss sich mit hinreichender Sicherheit aus den Bestimmungen des Vertrages oder aus den Umständen des Falles ergeben. Bei Fehlen einer Rechtswahl unterliegt der Vertrag dem Recht des Staates, mit dem er die engsten Verbindungen aufweist.

Das bedeutet, dass es, z.B. in Bezug auf ein Loan Agreement/Darlehensvertrag, grundsätzlich möglich ist, das anwendbare Recht frei zu wählen. Der Vertrag über die Bereitstellung eines Darlehens zum Erwerb einer englischen Liegenschaft kann daher grundsätzlich auch dem deutschen Recht unterliegen.

Sollten Bank und Kunde im Vertrag keine Rechtswahl getroffen haben, so findet nach Art. 4 Abs. 1 der Rome Convention das Recht des Landes Anwendung, mit dem der Vertrag die engste Verbindung aufweist. Gem. Art. 4 Abs. 2 wird vermutet, dass der Vertrag die engsten Verbindungen mit dem Staat aufweist, in dem die Partei, welche die charakteristische Leistung zu erbringen hat, im Zeitpunkt des Vertragsabschlusses ihre Hauptniederlassung hat oder in dem, wenn die Leistung nach dem Vertrag von einer anderen als der Hauptniederlassung zu erbringen ist, sich die andere Niederlassung befindet. Diese Vermutungen können dann widerlegt werden, wenn sich aus den Umständen ergibt, dass der Vertrag eine engere Verbindung zu einem anderen Land aufweist, Art. 4 Abs. 5.

Für einen Darlehensvertrag bedeutet dies Folgendes: Hat keine ausdrückliche Rechtswahl stattgefunden, was eigentlich selten ist, wird wohl in der Regel das Recht des Landes Anwendung finden, in dem die Bank ihre Hauptniederlassung hat bzw. das Recht des Landes, in dem die Niederlassung, die das Geschäft ausführt bzw. das Darlehen verhandelt, ihren Sitz hat. Das könnte in dem ersten Fall zur Anwendung deutschen Rechts, im zweiten Fall möglicherweise zur Anwendung englischen Rechts führen. Allein diese mögliche Unsicherheit, die dadurch auftreten kann, dass eventuell nicht ganz eindeutig ist, wer denn nun das Geschäft ausführt, spricht schon dafür, dass eine ausdrückliche Rechtswahl auf jeden Fall stattfinden sollte.

Fraglich ist, welche Umstände auftreten könnten, die auf eine engere Verbindung zu einem anderen Staat hinweisen. Selbst wenn der Darlehensnehmer in einem anderen Land als die Bank sitzt und dort das Geld in Empfang nimmt, so bleibt es doch weiterhin die Bank, die die charakteristische Leistung erbringt: entweder durch einen elektronischen Transfer des Darlehens aus dem Land der Niederlassung der Bank oder eventuell durch eine Korrespondenzbank im Lande des Darlehensnehmers.

2.1.3. Syndicated Loan

Sollte bei einer Syndicated Loan der unwahrscheinliche Fall eintreten, dass eine Rechtswahl nicht stattgefunden hat, könnte eventuell argumentiert werden, dass eine charakteristische Leistung nicht existiert und dass deshalb die Vermutung nicht greift oder zu ignorieren ist. Für den Fall müsste dann festgestellt werden, zu welchem Staat die engste Verbindung besteht. Dazu müssten alle Fakten in Betracht gezogen werden. Alternativ könnte man möglicherweise auch auf den Staat der Hauptniederlassung der Lead Bank abstellen, wenn man davon ausgeht, dass diese Bank die charakteristische Leistung erbringt.

2.1.4 Guarantee

Bei anderen Verträgen, die im Zusammenhang mit dem Darlehensvertrag abgeschlossen werden, gilt zunächst auch das Prinzip der freien Rechtswahl. Haben diese Verträge eine Rechtswahlklausel, so findet das ausdrücklich gewählte Recht Anwendung.

Gibt es keine Rechtswahlklausel, ist zunächst die Frage zu beantworten, ob die Parteien eventuell implizit eine Rechtswahl getroffen haben. Dazu ein Beispiel: Eine englische Gesellschaft erhält ein Darlehen von der englischen Niederlassung einer deutschen Bank auf der Grundlage eines Darlehensvertrages, auf den ausdrücklich englisches Recht Anwendung finden soll. Als Bedingung für die Gewährung des Darlehens hat der Hauptgesellschafter der Gesellschaft, ein Franzose, eine Guarantee abzugeben. Die Guarantee enthält keine Rechtswahlklausel. Die Gesellschaft zahlt das Darlehen nicht zurück, und die Bank will aus der Guarantee gegen den Gesellschafter vorgehen. Welches Recht findet auf die Guarantee Anwendung? Hier kann man möglicherweise wie folgt argumentieren: Aus den Umständen des Falles, d.h. der Verbindung zwischen dem Darlehensvertrag und der Guarantee, könnte mit reasonable certainty (angemessener Sicherheit) entnommen werden, dass die Parteien wahrscheinlich wollten, dass die Guarantee dem gleichen Recht unterliegt wie die Verpflichtung, die sie absichert, d.h. englischem Recht. Diese Interpretation ist nicht zwingend, sondern jeder Einzelfall auf der Grundlage der individuellen Fakten neu zu beurteilen.

2.1.5 Stellvertretung

Zu der Frage, welcher Stellvertreter einer Gesellschaft/Bank Vertretungsmacht zum Abschluss eines Darlehensvertrages hat, kann man nicht auf die Rome Convention zurückgreifen, da diese die Frage der organschaftlichen Vertretungsmacht bei juristischen Personen in Art. 1 Abs. 2 f. ausdrücklich ausschließt. Anwendbar ist diesbezüglich das so genannte Gesellschaftsstatut, d.h. das Recht am Sitz der Hauptverwaltung. In Bezug auf eine deutsche Bank wäre daher die Frage der Berechtigung der Stellvertretung nach deutschem Recht zu beurteilen.

2.1.6 Vollmacht

Davon zu unterscheiden ist die Frage, nach welchem Recht die Vollmacht zum Abschluss z.B. eines Darlehensvertrages zu beurteilen ist. Der Vorstand wird nicht unbedingt immer selbst unterzeichnen. Hier ist zu unterscheiden: Bestehen vertragliche Beziehungen zwischen dem Vertretenen und dem Vertreter so findet auf diese die Rome Convention Anwendung. Ist das Vertretungsverhältnis aufgrund einer so genannten Power of Attorney/Vollmacht zustande gekommen, ist fraglich,

ob die Rome Convention darauf Anwendung findet. Die Power of Attorney kann als „one-sided instrument, an instrument which expresses the meaning of the person who makes it, but is not in any sense a contract" angesehen werden. Nimmt man diese Interpretation an, finden die Regeln der Rome Convention auf eine Vollmacht keine Anwendung, und es gelten stattdessen die Regeln des Common Law.

Davon zu unterscheiden ist weiterhin die wichtige Frage, ob ein Vertreter die Person, für deren Rechnung er zu handeln vorgibt, wirksam einem Dritten gegenüber verpflichten kann. Dieser Aspekt ist in Art. 1 Abs. 2 f. ausdrücklich vom Anwendungsbereich der Rome Convention ausgeschlossen worden. Als Begründung dafür wurde angeführt, dass in Bezug auf diese Frage das Prinzip der freien Rechtswahl durch die Parteien nicht gelten kann. Stattdessen greifen die Regelungen des englischen Common Law ein, von denen aber niemand so genau zu wissen scheint, wie diese eigentlich aussehen. Eindeutige Regelungen und eine eindeutige und klare Rechtsprechung zu diesem Punkt scheint es nicht zu geben. Man ist sich teilweise noch nicht einmal einig darüber, ob sich ergangene Entscheidungen widersprechen oder nicht.

Zunächst ist festzustellen, dass die Vollmacht nicht automatisch dem Recht des vom Vertreter vorgenommenen Vertrages unterliegt. In Fällen, in denen der Vertreter gar keine Vollmacht zum Abschluss hat, scheint die Frage nach Anscheins- und Duldungsvollmacht nach dem Recht beurteilt zu werden, das dem Vertrag unterliegt, den der Vertreter mit dem Dritten abgeschlossen hat, d.h. im Falle eines Darlehensvertrages nach dem Recht dieses Vertrages. Diese Regelung kann eventuell schwer nachzuvollziehen sein: Wieso sollte, wenn der Vertreter in England gegenüber englischen Parteien tätig wird, z.B. deutsches Recht nur deshalb auf die Frage Anwendung finden, ob der Vertreter den Vertretenen wirksam verpflichtet hat, weil der Vertrag deutschem Recht unterliegt?

Welches Recht auf die Frage anzuwenden ist, ob eine Vollmacht wirksam bestellt worden ist, welchen Umfang sie hat etc., ist auch nicht eindeutig. Normalerweise ist hier wohl auf das Recht des Landes abzustellen, in dem der Vertreter tätig wird oder eventuell auf das Recht des Landes, mit dem die *closest and most real connection* besteht. Es gibt Entscheidungen darüber, dass auf die Frage, ob eine nach deutschem Recht ausgestellte Vollmacht widerrufen werden konnte, englisches Recht anzuwenden war, da mit der Vollmacht in England agiert wurde.

2.2 Unbewegliche Sachen

Ob eine Sache als beweglich oder unbeweglich anzusehen ist, richtet sich nach dem Recht des Lageortes. *All estates interests and charges in or over English land are classified as immovables*. Das schließt *freehold* und *leasehold interests*, *rentcharges* und *interest* eines Hypothekengläubigers ein. Eine Rechtswahl ist nicht möglich. D.h. man könnte theoretisch nach deutschem Recht vereinbaren, dass englisches Land übertragen werden soll, der dingliche Vollzug der Übertragung kann aber nicht durch einen deutschen Notarvertrag stattfinden. Es ist daher auch theoretisch möglich, nach deutschem Recht zu vereinbaren, dass eine charge by way of legal mortgage bestellt werden soll.

Die Bestellung selbst hat aber nach englischem Recht zu erfolgen. In der Praxis ist es schwierig, diese beiden Vorgänge zu unterscheiden, da in England das Abstraktionsprinzip nicht bekannt ist.

Das bedeutet, dass die Regelungen in dem Dokument „Legal Charge" auf jeden Fall englischem Recht zu unterliegen haben. Ist es aber z.B. möglich, eine solche legal charge nach englischem Recht vor einem deutschen Notar zu bestellen und diese Charge dann beim englischen Land Registry registrieren zu lassen? Hierzu sind zwei Anmerkungen zu machen: Zum einen ist bei der Bestellung einer Legal Charge auf zahlreiche Formalitäten zu achten, damit diese wirksam zustande kommt. Wird eine Legal Charge in einem anderen Land als dem bestellt, in dem sie registriert werden soll, können leicht Fehler auftauchen, die dann die wirksame Entstehung der Legal Charge verhindern. Zweitens wird das Land Registry die Legal Charge nur eintragen, wenn alle formellen Bedingungen erfüllt und die richtigen Formulierungen verwendet worden sind. Inwieweit das Land Registry eine deutsche Notarurkunde anerkennen wird, ist ebenfalls fraglich. Es ist daher zu empfehlen, alles was mit der Legal Charge zu tun hat nach englischem Recht abzuwickeln.

In diesem Zusammenhang ist noch zu erwähnen, dass nach englischem Recht die Vereinbarung zur Bestellung einer Legal Charge zur Entstehung einer sog. Equitable Charge führen kann. Ob das allerdings auch bei einer Vereinbarung nach deutschem Recht der Fall sein würde, ist offen.

2.3 Zusammenfassung

Als Ergebnis ist festzuhalten, dass es für Parteien eines Vertrages möglich ist, das anwendbare Recht zu vereinbaren, und dass es aus Gründen der Rechtssicherheit auch zweckmäßig ist, eine solche ausdrückliche Vereinbarung vorzunehmen. Das gilt nicht nur für den Darlehensvertrag, sondern auch für andere Verträge wie z.B. eine Guarantee. Es ist sehr wichtig, sich im Vorfeld zu überlegen, welches Recht auf einen Vertrag Anwendung finden soll, damit der Vertrag entsprechend dem anwendbaren Recht formuliert werden kann.

Wegen der grundsätzlichen Rechtswahlfreiheit bei Verträgen ist es möglich, deutsches Recht zu vereinbaren. Hier sind jedoch Zweifel bzgl. der Zweckmäßigkeit der Vereinbarung deutschen Rechts für den Darlehensvertrag anzubringen. Wie dargestellt, richtet sich die an dem in England belegenen Grundstück zu bestellende Legal Charge nach englischem Recht. Eine Rechtswahl ist diesbezüglich nicht möglich. Es ist daher einfacher, auch den Darlehensvertrag nach englischem Recht abzuschließen, da diese beiden Verträge sehr eng miteinander zusammenhängen.

3 Internationale Zuständigkeit der Gerichte

3.1 Hier geht es um die Frage, in welchem Land geklagt werden kann. Für England und Deutschland findet die Verordnung (EG) Nr. 44/2001 des Rates vom 22. Dezember 2000 über die gerichtliche Zuständigkeit und die Anerkennung und Vollstreckung von Entscheidungen in Zivil- und Handelssachen, die EuGVVO Anwendung, die in England durch den Civil Jurisdiction and Judgments Act 1982, in der Fassung des Civil Jurisdiction and Judgments Act 1991 und den Civil Procedure (Amendment Rules) 2002 umgesetzt worden ist.

Die EuGVVO ersetzt das Brüsseler Übereinkommen über die gerichtliche Zuständigkeit und die Vollstreckung gerichtlicher Entscheidungen, das EuGVÜ. Die EuGVVO gilt in allen Mitgliedstaaten der EG unmittelbar, mit Ausnahme von Dänemark. Im Verhältnis zu den EFTA Staaten gilt das Lugano Übereinkommen, das an das EuGVÜ angelehnt ist. Die EuGVVO gilt für Zivil- und Handelssachen, aber nicht für Steuer- und Zollsachen sowie für verwaltungsrechtliche Angelegenheiten und auch nicht im Bereich Personenstand, eheliche Güterstände, Erbrecht, Insolvenz, soziale Sicherheit und Schiedsgerichtsbarkeit.

3.2 Die EuGVVO regelt verschiedene Situationen, die eine Zuständigkeit begründen. Es können hier nur die in diesem Zusammenhang relevantesten Zuständigkeiten behandelt werden. In Art. 2 ist die allgemeine Zuständigkeit am Wohnort des Beklagten festgelegt. Nach dieser Vorschrift sind Personen, die ihren Wohnsitz im Hoheitsgebiet eines Mitgliedstaates haben, vor den Gerichten dieses Mitgliedstaates zu verklagen. Art. 5 regelt so genannte besondere Zuständigkeiten, z.B. für Vertragsklagen, Deliktsklagen, Trust-Klagen. Art. 23 befasst sich mit Vereinbarungen über die Zuständigkeit und Art. 22 EuGVVO regelt die ausschließliche internationale Zuständigkeit.

3.3 Art. 22 EuGVVO: Ausschließlicher dinglicher Gerichtsstand

3.3.1 Ist das Gericht eines Mitgliedstaates ausschließlich zuständig, so verdrängt diese Zuständigkeit alle anderen oben genannten möglichen Zuständigkeiten. Das bedeutet, dass eine Zuständigkeit am Wohnort des Beklagten ausgeschlossen ist und die Parteien auch nicht die Möglichkeit haben, eine Zuständigkeit zu vereinbaren, die von der ausschließlichen Zuständigkeit abweicht. Ein angerufenes Gericht hat sich von Amts wegen für unzuständig zu erklären, wenn ein anderes Gericht ausschließlich zuständig ist.

3.3.2 Nach Art. 22 Nr. 1 liegt eine ausschließliche Zuständigkeit für Klagen vor, welche dingliche Rechte an unbeweglichen Sachen sowie die Miete und Pacht von unbeweglichen Sachen zum Gegenstand haben. Für diese Art Klagen sind die Gerichte des Staates ausschließlich zuständig, in dem die unbewegliche Sache belegen ist. Die Formulierung „Klagen, welche dingliche Rechte an unbeweglichen Sachen sowie die Miete und Pacht von unbeweglichen Sachen zum Gegenstand haben“ passt nicht so richtig in die bestehenden Konzepte des englischen Grundstücksrechts. Hier ist jedoch zu beachten, dass nicht jeder Mitgliedstaat eine eigene Definition nach seinem eigenen Recht für den Begriff „unbewegliche Sache“ findet, sondern eine autonome Definition zu finden ist. Zu den unbeweglichen Sachen sind wohl auf jeden Fall Grundstücke zu zählen sowie wohl auch *charges* und *mortgages* an einem Grundstück.

3.3.3 Es ist jedoch zu betonen, dass Art. 22 Nr. 1 gerade wegen seines Ausschließlichkeitscharakters eng auszulegen ist. Den Parteien soll nur in begrenzten Fällen die Möglichkeit der anderen Gerichtsstände genommen werden. Die Ausschließlichkeit des Gerichtsstands der belegenen unbeweglichen Sache wird damit gerechtfertigt, dass dort regelmäßig auf das Recht zurück zu greifen ist, welches am Lageort der unbeweglichen Sache gilt. Hier schließt sich in gewisser Hinsicht der Kreis mit den Regeln über das anwendbare

Recht, nach denen bei unbeweglichen Sachen das Recht des Lageortes gilt und eine Rechtswahl nicht möglich ist.

3.3.4 Die enge Auslegung des Art. 22 Nr. 1 bedeutet, dass das dingliche Recht selbst Gegenstand der Klage sein muss. Es genügt nicht, dass das dingliche Recht an der unbeweglichen Sache von der Klage berührt wird oder die Klage im Zusammenhang mit einem dinglichen Recht steht.

Für eine Klage zur Durchsetzung der Rechte in einer Legal Charge ist daher die ausschließliche internationale Zuständigkeit des Gerichts des Mitgliedstaates, in dem das Grundstück sich befindet, gegeben. Rechte zur Realisierung/Vollstreckung einer Legal Charge an einem englischen Grundstück können daher nicht bei einem deutschen Gericht eingeklagt werden. Ein dinglicher Gerichtsstand nach Art. 22 Nr. 1 ist dagegen nicht gegeben für die Klage aus dem Darlehensvertrag für den Erwerb der englischen Immobilie, da es sich hierbei nur um einen Anspruch im Zusammenhang mit einer Immobilie handelt. In diesem Fall könnte jedoch eine internationale Zuständigkeit des englischen Gerichts aus Art. 6 Nr. 4 EuGVVO gegeben sein.

3.4 Art. 6 Nr. 4 EuGVVO

Art. 6 Nr. 4 sieht vor, dass eine Person, die ihren Wohnsitz im Hoheitsgebiet eines Vertragsstaates hat, auch vor dem Gericht des Mitgliedstaates verklagt werden kann, in dessen Hoheitsgebiet die unbewegliche Sache belegen ist, wenn ein Vertrag oder Ansprüche aus einem Vertrag den Gegenstand des Verfahrens bilden und die Klage wegen dinglicher Rechte an unbeweglichen Sachen gegen denselben Beklagten verbunden werden kann. Das bedeutet, dass sowohl die Rechte aus dem Darlehensvertrag gegen den Darlehensnehmer als auch die Rechte aus der Mortgage vor dem englischen Gericht geltend gemacht werden können, selbst wenn der Darlehensnehmer in Deutschland sitzt und der Darlehensvertrag keine Zuständigkeitsklausel enthält. Enthält der Darlehensvertrag allerdings eine Regelung, wonach ein anderes Gericht als das englische für Ansprüche aus dem Darlehensvertrag ausschließlich zuständig sein soll, greift die Regelung aus Art. 6 Nr. 4 nicht. Es empfiehlt sich somit, die Möglichkeit sowohl aufgrund der Mortgage als auch des Darlehensvertrages bei einem englischen Gericht zu klagen, nicht auszuschließen. Die Regelung greift auch nicht, wenn Kläger und Beklagter aus dem Darlehensvertrag und der Legal Charge nicht identisch sind oder wenn nur aus dem Darlehensvertrag vorgegangen wird. Für eine Zuständigkeit aus Art. 6 Nr. 4 muss die Klage aus dem Darlehensvertrag und das Vorgehen aus der Mortgage gemeinsam erfolgen.

3.5 Art. 23 EuGVVO: Internationale Gerichtsstandsvereinbarungen

3.5.1 In der Praxis wird die internationale Zuständigkeit regelmäßig vereinbart. Die Voraussetzungen für die wirksame Vereinbarung einer gerichtlichen Zuständigkeit sind in Art. 23 EuGVVO geregelt. Voraussetzung ist zunächst, dass mindestens eine der Parteien ihren Wohnsitz in einem Mitgliedstaat hat, was z.B. bei einer deutschen Hypothekenbank der Fall ist. Fraglich ist, ob es ebenfalls notwendig ist, dass der Darlehensnehmer in einem Mitgliedstaat ansässig ist, oder ob Art. 23 auch greift, wenn z.B. der Darlehensnehmer in

den USA wohnt. Die Überprüfung einer Gerichtsstandsvereinbarung hat wohl auch in diesem Fall nach Art. 23 zu erfolgen.

Fraglich kann die Anwendbarkeit des Art. 23 möglicherweise bei reinen so genannten Inlandsfällen sein. Eine deutsche Bank vereinbart in einem Darlehensvertrag mit einem deutschen Darlehensnehmer die Zuständigkeit der englischen Gerichte. In einem ähnlich gelagerten Fall, in dem eine italienische Partei einer anderen italienischen Partei Gesellschaftsanteile an einer deutschen GmbH verkauft hatte, hat das italienische Gericht die Gerichtsstandsvereinbarung zugunsten eines deutschen Gerichtes als nicht wirksam angesehen. Interessanterweise hat das deutsche Gericht dieses in der Parallelentscheidung in Deutschland anders gesehen. Es ist davon auszugehen, dass ein englisches Gericht die oben erwähnte Vereinbarung des englischen Gerichtsstandes zwischen der deutschen Bank und dem deutschen Darlehensnehmer nach Art. 23 bemessen würde, da bei einem Darlehen zur Finanzierung des Erwerbs eines Grundstückes in England zumindest ein internationaler Bezug festzustellen ist.

3.5.2 Eine Gerichtsstandsvereinbarung muss geschlossen werden entweder schriftlich oder mündlich mit schriftlicher Bestätigung oder in einer Form, die den Gepflogenheiten entspricht, die zwischen den Parteien entstanden sind, oder im internationalen Handel in einer Form, die einem Handelsbrauch entspricht, den die Parteien kannten oder kennen mussten und den Parteien von Verträgen dieser Art in dem betreffenden Geschäftszweig allgemein kennen und regelmäßig beachten. Auf alle diese Möglichkeiten hier näher einzugehen, würde den Rahmen dieser Ausführungen sprengen und zu kompliziert werden. Deshalb sind nur die folgenden Bemerkungen zu machen:

Es empfiehlt sich immer, das zuständige Gericht ausdrücklich, schriftlich mit den Unterschriften beider Parteien zu vereinbaren und die zu treffende Formulierung im Vorfeld von einem Juristen prüfen zu lassen. Dabei ist auch zu berücksichtigen, dass die Formvoraussetzungen für eine wirksame Gerichtsstandsklausel nicht nach den jeweiligen nationalen Gesetzen zu prüfen sind, sondern gemeinschaftsrechtlich autonom, damit keine Unterschiede in der Anwendung zwischen den einzelnen Mitgliedstaaten entstehen.

Es ist weiterhin möglich, die Gerichtszuständigkeit ausschließlich oder nicht ausschließlich zu vereinbaren. Es ist auch möglich, die Zuständigkeit von mehreren Gerichten zu vereinbaren oder zu vereinbaren, dass die verschiedenen Parteien bei verschiedenen Gerichten klagen können. Auch bei dieser Art Klauseln kommt es auf die genaue Formulierung an, die deshalb immer vor Unterzeichnung von einem Juristen überprüft werden sollte.

3.6 Art. 5 Nr. 1 EuGVVO: Gerichtsstand für Ansprüche aus Verträgen

Gemäß Art. 5 Nr. 1 EuGVVO kann eine Person, die ihren Wohnsitz im Hoheitsgebiet eines Mitgliedsstaates hat, in einem anderen Mitgliedstaat verklagt werden, wenn ein Vertrag oder Ansprüche aus einem Vertrag den Gegenstand des Verfahrens bilden, vor dem Gericht des Ortes, an dem die Verpflichtung erfüllt worden ist oder zu erfüllen wäre. Diese Zuständigkeit könnte z.B. im Zusammenhang mit

einem Darlehensvertrag relevant werden, der keine Vereinbarung über die Zuständigkeit des Gerichtes enthält und wo die Bank nicht am Wohnort des Beklagten klagen möchte (mit Wohnort im Mitgliedstaat). Es ist hier davon auszugehen, dass ein Darlehensvertrag nicht als Dienstvertrag nach Art. 5 Nr. 1 lit. b EuGVVO anzusehen ist, für den andere Regeln gelten würden. Um die Zuständigkeit nach Art. 5 Nr. 1 lit. a festzustellen, müsste daher geprüft werden, welche Verpflichtung eingeklagt wird (Rückzahlung des Darlehens), welches Recht auf den Vertrag Anwendung findet und wo, nach diesem Recht die Erfüllung der Rückzahlung – Deutschland oder England oder anderes Land – hätte stattfinden müssen. Bei Rückzahlung in Deutschland wäre ein deutsches Gericht, bei Rückzahlung in England ein englisches Gericht nach Art. 5 Nr. 1 lit. a EuGVVO international zuständig. In diesem Zusammenhang wird die Frage des anwendbaren Rechts bei der Prüfung der internationalen Zuständigkeit relevant.

3.7 Zusammenfassung

Wie bei der Frage des anwendbaren Rechts ist es auch bzgl. der internationalen Zuständigkeit der Gerichte innerhalb der vorgegebenen Grenzen möglich, diese zu wählen. Auch wenn die Frage des anwendbaren Rechts von der der internationalen Zuständigkeit in der Regel unabhängig ist, so darf man nicht vergessen, dass es die Gerichte sind, die nach dem anwendbaren Recht entscheiden werden. Es ist daher im Vorfeld zu überlegen, ob es z.B. Sinn macht, einen Darlehensvertrag nach deutschem Recht vor einem englischen Gericht einzuklagen. Ausländisches Recht muss vor einem englischen Gericht plädiert und bewiesen werden, was ein großer Aufwand sein und teuer werden kann. Man muss sich aber auch weiter überlegen, ob es überhaupt sinnvoll ist, einen deutschen Darlehensvertrag zu haben, der zwar in Deutschland eingeklagt werden kann, wo dann aber parallel aus der Mortgage in England vorzugehen ist.

C Anerkennung und Vollstreckung von ausländischen Entscheidungen in England & Wales

1. Einführung

Bei der Frage der Vollstreckung einer Entscheidung geht es in der Regel um die praktische Frage, wo Vermögenswerte des Schuldners liegen und wie man in diese vollstrecken kann. In welchem Kontext könnte dieses für eine deutsche Bank relevant werden? Wie eben dargelegt, ist es möglich, den Darlehensvertrag nach deutschem Recht zu schließen und z.B. gegen einen deutschen Schuldner oder aufgrund einer Gerichtsstandsvereinbarung ein Urteil in Deutschland gegen den Darlehensnehmer aus dem Darlehensvertrag zu erwirken. Der Schuldner zahlt nicht und die Bank beabsichtigt, das Urteil in England zu vollstrecken, da dort Erfolg versprechende Vermögenswerte liegen und/oder der Schuldner in England ansässig ist. Die Frage nach der Vollstreckbarkeit in England könnte sich weiterhin in dem Fall stellen, in dem der Schuldner sich in einem deutschen Notarvertrag der sofortigen Vollstreckung in das gesamte Vermögen unterworfen hat und nun die Vollstreckung aus diesem Titel in England stattfinden soll.

2 Statutory Demand

Wenn ein Gläubiger eine unbestrittene Forderung hat, kann er nach englischem Recht den Schuldner auffordern, diese innerhalb von 21 Tagen zu bezahlen, verbunden mit der Androhung, dass der Schuldner ansonsten zwangsliquidiert wird. Dies ist oftmals eine wirksame Androhung, die den Schuldner zur Zahlung veranlasst. Es sollte gut überlegt werden, ob man als Gläubiger wirklich bereit ist, die Liquidation durchführen zu lassen, da oft am Ende nichts zu holen ist und Kosten verursacht werden.

3 Vollstreckung nach den Regeln des Common Law

Nach den Regeln des Common Law kann ein ausländisches Urteil in England im Prinzip nur mit Hilfe eines neuen Gerichtsverfahrens vollstreckt werden, d.h., es muss eine neue Klage in England auf der Grundlage des ausländischen Urteiles eingereicht werden. Das ist umständlich, und es gibt daher zahlreiche internationale Übereinkommen, die die Anerkennung und Vollstreckung erleichtern.

4 Anerkennung und Vollstreckung in England nach der Verordnung (EG) Nr. 44/2001 (EuGVVO)

Auf Europäischer Ebene regelt die bereits erwähnte Verordnung (EG) Nr. 44/2001 über die gerichtliche Zuständigkeit und die Anerkennung und Vollstreckung von Entscheidungen in Zivil- und Handelssachen (EuGVVO) das Verfahren zur Anerkennung und Vollstreckung innergemeinschaftlicher Forderungen.

4.1 Grundsätzlich werden gemäß Art. 33 EuGVVO alle in den Mitgliedstaaten ergangenen Entscheidungen in den anderen Mitgliedstaaten anerkannt: „Die in einem Mitgliedstaat ergangenen Entscheidungen werden in den anderen Mitgliedstaaten anerkannt, ohne dass es hierfür eines besonderen Verfahrens bedarf.“ Art. 32 definiert die „Entscheidung“ als „jede von einem Gericht eines Mitgliedsstaats erlassene Entscheidung […] ohne Rücksicht auf ihre Bezeichnung wie Urteil, Beschluss, Zahlungsbefehl oder Vollstreckungsbescheid, einschließlich des Kostenfestsetzungsbeschlusses eines Gerichtsbediensteten“.

4.2 Registrierung

4.2.1 Um eine Entscheidung im Vereinigten Königreich vollstrecken zu können, muss sie gemäß Art. 38 Abs. 2 der VO 44/2001 registriert werden. Dazu muss ein Antrag bei dem High Court gestellt werden. Dem Antrag muss das Original der Entscheidung oder eine Ausfertigung der Entscheidung beigefügt werden sowie eine Übersetzung ins Englische, die von einem notary public oder einer anderen „autorisierten Person“ beglaubigt ist oder der eine schriftliche Bestätigung beigefügt ist, dass die Übersetzung korrekt ist. Die beigefügten Dokumente müssen die folgenden Informationen enthalten: Name des Gläubigers und Zustellungsadresse in England; Name des Schuldners und Adresse oder Geschäftssitz, so bekannt; Berechtigung des Gläubigers, das Urteil zu vollstrecken; im Falle eines Urteils, das die Verpflichtung zur Zahlung einer Geldsumme enthält, muss mitgeteilt werden, in welcher Höhe die Urteilssumme unbezahlt ist; die Höhe der aufgelaufenen Zinsen oder die Zinsrate und der Zeitraum, für den Zinsen zu zahlen sind. Es muss weiterhin der Nachweis vorgelegt werden, dass die Entscheidung nach dem Recht des

Staates, in dem sie ergangen ist, vollstreckbar ist, und dass sie dem Schuldner zugestellt worden ist. Im Fall eines Versäumnisurteils ist nachzuweisen, dass das das Verfahren einleitende Schriftstück dem Beklagten ordnungsgemäß zugestellt worden ist. Wo erforderlich, ist nachzuweisen, dass der Gläubiger Prozesskostenhilfe erhalten hat.

4.2.2 Der Antrag zusammen mit den Dokumenten wird beim High Court von einem Master begutachtet. Eine mündliche Verhandlung findet nicht statt. Sind die Unterlagen ordnungsgemäß, werden sie dem Antragsteller mit einem entsprechenden Vermerk des Masters zurück gereicht. Der Antragsteller kann dann damit eine „Formally Sealed Order of Registration" beantragen.

4.2.3 Die Order muss die folgenden Angaben enthalten:

- vollständige Angaben über die Entscheidung, die vollstreckt werden soll, einschließlich des Datums der Entscheidung und des Gerichts, das die Entscheidung getroffen hat;
- Name des Gläubigers und Zustellungsadresse in England;
- Recht des Beklagten/Schuldners, gegen die Registration Order vorzugehen;
- Berufungsfrist (ein Monat, wenn Beklagter in England, zwei Monate, wenn Beklagter nicht in England);
- Feststellung, dass höchstens Sicherungsmaßnahmen, aber keine Vollstreckungsmaßnahmen vor Ablauf der Berufungsfrist durchgeführt werden.

4.2.4 Die Registration Order muss dem Beklagten zugestellt werden. Wenn der Beklagte nicht in England ansässig ist, hat die Zustellung in Deutschland auf offiziellem Wege zu erfolgen.

4.2.5 Öffentliche Urkunden und Prozessvergleiche, Art. 57 und Art. 58 EuGVVO

Art. 57 sieht vor, dass öffentliche Urkunden, die in einem Mitgliedstaat aufgenommen und vollstreckbar sind, in einem anderen Mitgliedstaat auf Antrag vollstreckbar erklärt werden können. Um als öffentliche Urkunde vollstreckt werden zu können, muss diese die Voraussetzungen für ihre Beweiskraft erfüllen können, die in dem Mitgliedstaat, in dem sie aufgenommen wurde, erforderlich sind. Das sind in Deutschland nach der Definition des § 415 ZPO „Urkunden, die von einer mit öffentlichem Glauben versehenen Person innerhalb des ihr zugewiesenen Geschäftskreises in der vorgeschriebenen Form aufgenommen sind". Dabei handelt es sich hauptsächlich um notarielle Urkunden, d.h. die eingangs genannte notarielle Unterwerfung unter die Zwangsvollstreckung könnte nach Art. 57 vollstreckt werden.

Art. 58 sieht die Vollstreckbarkeit von Prozessvergleichen vor. Parteivergleiche sind keine vollstreckbaren Titel.

Bei öffentlichen Urkunden und Prozessvergleichen findet das gleiche Registrierungsverfahren wie für Entscheidungen Anwendung.

4.3 Zwangsvollstreckung

4.3.1 Die Zwangsvollstreckung aus dem Titel findet nach der Registrierung nicht automatisch statt, sondern muss vom Gläubiger beantragt werden. Dazu muss der Nachweis erbracht werden, dass die Registration Order und andere möglicherweise ergangenen Beschlüsse dem Schuldner zugestellt worden sind.

4.3.2 Vor der Durchführung der Zwangsvollstreckung ist es für den Gläubiger ratsam, Informationen darüber einzuholen, ob ausreichend Vermögensgegenstände vorhanden sind, in die vollstreckt werden kann. Man kann z.B. in England einen Bankruptcy search durchführen oder die veröffentlichten Bilanzen etc. einer Gesellschaft einsehen. Diese Maßnahmen werden in der Regel ergriffen, bevor der Prozess der Registrierung eingeleitet wird. Nach der Registrierung ist es möglich, einen Antrag bei Gericht zu stellen, um eine so genannte Order for Information zu bekommen. Dann muss der Schuldner Auskunft über seine Vermögensverhältnisse geben.

4.3.3 Einzelne Vollstreckungsmaßnahmen

Gegen Gesellschaften:

„Execution“

Bei der so genannten „execution“ wird der englische Gerichtsvollzieher beauftragt, Vermögensgegenstände des Schuldners zu beschlagnahmen und im Wege der public auction zu verkaufen.

Verfahren:

Um eine execution durchführen zu können, muss vom Gläubiger ein so genanntes Writ of fieri facias („you may cause it to be done“), kurz Writ of fifa ausgefüllt werden. Die Writ of fifa wird zusammen mit dem Titel, der Registration Order und dem Nachweis der Zustellung bei Gericht eingereicht. Das Gericht versieht die Writ of fifa mit einem Siegel, die dann vom Gläubiger dem Gerichtsvollzieher zur Vollstreckung übersandt wird. Wie auch in Deutschland, können bestimmte Objekte, wie z.B. Objekte des persönlichen Gebrauchs nicht gepfändet und der Drittwiderspruchsklage ähnliche Verfahren eingeleitet werden.

Third Party Debt Orders (früher Garnishee Orders)

Bei der Vollstreckung wegen Geldforderungen kann eine so genannte Third Party Debt Order beantragt werden. Hierbei handelt es sich im Prinzip um eine Forderungspfändung, die auch Bankguthaben etc. erfasst. Ein gemeinsames Bankkonto kann nicht gepfändet werden. Die Third Party muss ihren Sitz oder ihre Niederlassung in England & Wales haben.

Verfahren:

Der Antrag an das Gericht wird ohne Benachrichtigung des Schuldners gestellt. Es gibt zwei Anhörungen. Die erste findet vor einem Richter statt, der bei positivem Ausgang eine Interim Third Party Debt Order erlassen wird. Er wird gleichzeitig den Termin für die zweite Anhörung festlegen, in

der die endgültige Third Party Debt Order erlassen wird und der nicht weniger als 28 Tage nach dem ersten Termin liegen darf. Die Interim Order muss der Third Party mindestens 21 Tage vor dem Termin der zweiten Anhörung und dem Schuldner innerhalb von 7 Tagen nach der Zustellung an die Third Party zugestellt werden. Die Third Party muss dem Gläubiger verschiedene Informationen über die Forderung mitteilen, z.B. Bankkonten benennen und Auskunft darüber erteilen, ob das Guthaben zur Befriedigung der Forderung ausreicht. Nach Erteilung der Final Third Party Order hat die Third Party das Geld an den Gläubiger auszuzahlen.

Charging order over land

Der Gläubiger kann beantragen, dass eine Charging Order an einem Grundstück des Schuldners eingetragen wird. Auch dazu muss ein Antrag bei Gericht gestellt werden, der u.a. einen Entwurf der Charging Order, Einzelheiten über die Urteilsforderung und über das Land, in das vollstreckt werden soll, sowie Namen und Adressen derjenigen Personen zu enthalten hat, denen die Interim Draft Order zuzustellen ist. Dazu gehören alle diejenigen, die vorrangige Sicherheiten an dem Grundstück haben. Über den Antrag wird normalerweise von einem Richter in Abwesenheit der Parteien entschieden, der dann die Interim Charging Order erlässt. Diese Order muss dann bei dem Land Registry oder dem Land Charges Department registriert werden. Auf der Interim Order wird der Termin der Anhörung vermerkt; die Interim Order muss mindestens 21 Tage vorher dem Schuldner zugestellt werden. Nach der Anhörung wird dann die endgültige Charging Order erlassen oder ein Gerichtsverfahren eingeleitet, in dem Einsprüche etc. verhandelt werden.

Wenn eine Final Order erlassen ist, hat der Gläubiger eine Charge an dem Grundstück. Um das Grundstück dann aufgrund der Charge verkaufen zu können, muss ein neuer Antrag an das Gericht auf eine Order for Sale gestellt werden. Bei einem solchen Verkauf haben natürlich früher eingetragene Sicherheiten Vorrang.

Charging Order over Securities

Ein ähnliches Verfahren wie bei der Charging Order für Grundstücke ist einzuhalten.

Winding Up

Dieses Verfahren, welches die Zwangsliquidation einer Gesellschaft zur Folge hat, kann nur gegen eine englische Gesellschaft eingeleitet werden. Es birgt Risiken insofern, als der Liquidator erst die bevorrechtigten Gläubiger bedienen und dann die übrigen Gläubiger pro rata bezahlen wird. Der Gläubiger trägt dabei das Risiko, eventuell nichts zu bekommen.

Vollstreckung gegen eine Person:

Die Vollstreckungsmöglichkeiten entsprechen denen gegen eine Gesellschaft. Statt des Winding Up würden Bankruptcy Proceedings eingeleitet werden,

und das Einkommen kann zusätzlich durch eine Attachment of Earnings Order eingezogen werden.

5 Europäischer Vollstreckungstitel für unbestrittene Forderungen: Verordnung (EG) Nr. 805/2004

Für die Vollstreckung unbestrittener Forderungen findet in den EU Mitgliedstaaten (mit Ausnahme Dänemarks) seit dem 21. Oktober 2005 die Verordnung Nr. 805/2004 vom 21.04.2004 über die „Einführung eines europäischen Vollstreckungstitels für unbestrittene Forderungen" („die Verordnung") Anwendung. Durch diese werden die Voraussetzungen für die Vollstreckung unbestrittener Geldforderungen wesentlich erleichtert. Es wird ein Europäischer Vollstreckungstitel für unbestrittene Forderungen eingeführt, welcher in England das nach der EuGVVO vorgeschriebene Verfahren des *Registration of Title* überflüssig macht. Im Rahmen dieser Ausführungen kann nur auf die relevantesten Bestimmungen der Verordnung eingegangen werden. In England und Wales sind die Vorschriften dem Part 74 der Civil Procedure Rules als Section V beigefügt worden.

5.1 Voraussetzungen für die Bestätigung als Europäischer Vollstreckungstitel

5.1.1. Vollstreckungstitel: Gerichtliche Entscheidungen, Vergleiche oder öffentliche Urkunden

Nach Art. 3 Abs. 1 der Verordnung können gerichtliche Entscheidungen, etwa Urteile, Beschlüsse, Vollstreckungsbescheide und auch Kostenfestsetzungsbeschlüsse, sowie gerichtliche Vergleiche und öffentliche Urkunden über unbestrittene Geldforderungen als Europäische Vollstreckungstitel bestätigt werden.

5.1.2. Unbestrittene Forderung

Zu beachten ist zunächst, dass der Begriff der „Forderung" nach Art. 4 Abs. 2 der Verordnung nur Forderungen auf Zahlung einer bestimmten Geldsumme umfasst.

Unbestritten sind nach Art. 3 Abs. 1 Buchst. a)–d) Forderungen, die der Schuldner während eines gerichtlichen Verfahrens ausdrücklich anerkannt hat, oder denen er im Rahmen eines gerichtlichen Vergleichs zugestimmt hat. Ferner gelten Forderungen auch als unbestritten, wenn der Schuldner ihnen im gerichtlichen Verfahren zu keiner Zeit nach den maßgeblichen Verfahrensvorschriften des Rechts des Ursprungsmitgliedstaates widersprochen hat, oder, nachdem er zunächst widersprochen hat, er zu einer in dem Rechtsstreit ordnungsgemäß anberaumten mündlichen Verhandlung nicht erscheint. Schließlich sind unbestritten auch Forderungen, welche der Schuldner ausdrücklich in einer öffentlichen Urkunde anerkannt hat.

5.1.3 Vollstreckbarkeit im Ursprungsmitgliedstaat

Eine Bestätigung als Europäischer Vollstreckungstitel kann nach Art. 6 Abs. 1 der Verordnung u.a. nur erfolgen, wenn die Entscheidung auch in dem Mitgliedstaat, in dem sie ergangen ist (dem „Ursprungsmitgliedstaat", Art. 4 Nr. 4 der Verordnung), vollstreckbar ist.

5.1.4 Mindestvorschriften für das Verfahren

In Kapitel III Art. 12 bis 19 der Verordnung werden gewisse Mindestvorschriften für das Verfahren festgelegt. Diese Vorschriften beziehen sich insbesondere auf die Zustellung verfahrenseinleitender Schriftstücke und Ladungen zu Gerichtsverhandlungen an den Schuldner, sowie die ordnungsgemäße Unterrichtung des Schuldners über die geltend gemachte Forderung und über die Verfahrensschritte zum Bestreiten der Forderung. Sie sind vor allem dann relevant, wenn ein Versäumnisurteil als Europäischer Vollstreckungstitel bestätigt werden soll.

Sofern der Schuldner der unbestrittenen Forderung ein Verbraucher ist, kann nach Art. 6 Abs. 1 Buchst. d) der Verordnung die Bestätigung als Europäischer Vollstreckungstitel nur erfolgen, wenn die Entscheidung in dem Mitgliedstaat ergangen ist, in dem der Schuldner seinen Wohnsitz hat. Durch diese Vorschrift sollen Verbraucher vor der Vollstreckung ausländischer Entscheidungen geschützt werden, welche sie – möglicherweise versehentlich oder aus Nachlässigkeit – nicht bestritten haben. Dies gilt allerdings nicht, wenn der Verbraucher die Forderung in einem gerichtlichen Verfahren oder in einer öffentlichen Urkunde ausdrücklich anerkannt hat.

5.2 Bestätigung als Europäischer Vollstreckungstitel

Unter den oben genannten Voraussetzungen kann gemäß Art. 6 Abs. 1 der Verordnung eine Entscheidung „auf jederzeitigen Antrag an das Ursprungsgericht als Europäischer Vollstreckungstitel bestätigt werden." Der Antrag kann jederzeit gestellt werden, ist also nicht an eine Frist gebunden. Er kann auch schon bei Einleitung oder während des gerichtlichen Verfahrens vor dem Ursprungsgericht gestellt werden, dies wird bei grenzüberschreitenden europäischen Rechtsstreitigkeiten aus Gründen der Verfahrensbeschleunigung oft sogar ratsam sein.

Die Bestätigung als Europäischer Vollstreckungstitel erfolgt nach Art. 9 der Verordnung auf einem besonders dafür vorgesehenen Formblatt und wird in der Sprache ausgestellt, in der auch die Entscheidung abgefasst ist.

Ist nur ein Teil einer geltend gemachten Forderung unbestritten, kann nach Art. 8 der Verordnung die Bestätigung auch nur hinsichtlich des unbestrittenen Teils ergehen.

Öffentliche Urkunden werden gemäß Art. 25 der Verordnung von der Stelle als Europäische Vollstreckungstitel bestätigt, welche in den einzelnen Mitgliedstaaten dafür bestimmt ist.

5.3 Wirkung der Bestätigung als Europäischer Vollstreckungstitel

Ist eine Entscheidung als Europäischer Vollstreckungstitel bestätigt worden, wird sie gemäß Art. 5 der Verordnung „in den anderen Mitgliedstaaten anerkannt und vollstreckt, ohne das es einer Vollstreckbarerklärung bedarf und ohne dass die Anerkennung angefochten werden kann." Weder die Entscheidung noch ihre Bestätigung als Europäischer Vollstreckungstitel dürfen im Vollstreckungsstaat in der Sache selbst nachgeprüft werden. Unter gewissen Umständen kann aber auf Antrag des Schuldners die Vollstreckung verweigert oder ausgesetzt oder beschränkt werden. Das Verfahren der Anerkennung und Vollstreckbarerklärung vor den Gerichten des Vollstreckungsstaates nach der EuGVVO ist danach nicht mehr erforderlich.

Dies stellt eine wesentliche Erleichterung im Vergleich zu dem Verfahren nach der EuGVVO, welche in England den Registration of Title erfordert, dar.

5.4 Durchführung der Vollstreckung

Der Gläubiger muss den zuständigen Vollstreckungsbehörden des Vollstreckungsstaates eine Ausfertigung des Titels, eine Ausfertigung der Bestätigung als Europäischer Vollstreckungstitel, sowie eine Transkription oder Übersetzung der Bestätigung des Europäischen Vollstreckungstitels übermitteln (Art. 20 Abs. 2 der Verordnung Nr. 805/2004).

Die Vollstreckung wegen der Forderung richtet sich dann nach dem Recht des Staates, in dem vollstreckt wird. „Eine als Europäischer Vollstreckungstitel bestätigte Entscheidung wird unter den gleichen Bedingungen vollstreckt wie eine im Vollstreckungsmitgliedstaat ergangene Entscheidung.“ (Art. 20 der Verordnung). Für die Vollstreckung in England gelten daher die oben gemachten Ausführungen.

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