CITY OF LONDON LAW SOCIETY

FINANCIAL LAW COMMITTEE

MINUTES of a meeting held at the offices of Freshfields Bruckhaus Deringer, 65 Fleet Street, London EC4Y 1HS on Wednesday 12 December 007 at 12.45 p.m.

Present: Dorothy Livingston (Herbert Smith - Chair) (DL)

Geoffrey Yeowart (Lovells) (GY)

John Davies (Simmons & Simmons)

David Ereira (Linklaters)

Robin Parsons (Sidley Austin)

Richard Bethel-Jones (Allen & Overy)

Mark Campbell (Clifford Chance)

David Bicknell (Slaughter & May) (in place of Sarah Paterson)

Mark Evans (Travers Smith)

Simon Roberts (Allen & Overy)

Simon Hall (Freshfields Bruckhaus Deringer)

In attendance: Rachael Hoar (Herbert Smith – taking minutes)

1. APPROVAL OF MINUTES AND APOLOGIES FOR ABSENCE

The minutes of the last meeting, which had taken place on 16 September 2007, had been circulated. Any comments to be provided by 16 December or else would be approved.

Apologies for absence were received from James Curtis, John Naccarato, Sarah Paterson, Nigel Ward and Phillip Wood.

2. WORKING PARTIES

A new working party had been formed to consider and respond to a consultation on banking reform. Members of the working party are Dorothy Livingston (Chairman), David Ereira, Richard Bethel-Jones, James Curtis, Will Lawes and Michael Raffan.

An updated list of the Committee's current working parties would be posted onto the CLLS website after the meeting.

3. COMPANIES ACT 2006

3.1 Codification of Directors Duties and board minutes

It was noted that with the coming into force of 3 of the codified directors' duties under the Companies Act 2006 (the **"2006 Act"**) on 1 October 2007, most board minutes relating to

finance transactions now include a general reference to directors' duties. It was noted that different requirements and practices may be needed in relation to companies whose solvency was in doubt.

3.2 **Timing of commencement of remainder of the 2006 Act**

The meeting was reminded that BERR had made an announcement on 7 November 2007 stating that key provisions of the 2006 Act would be delayed because Companies House systems would not be ready in time for an October 2008 commencement. Since then there had been a consultation as to whether provisions which did not require a change in Companies House procedure should be implemented in October 2008 as previously planned.

Post meeting note: BERR announced the implementation timetable for the remainder of the 2006 Act on 13 December 2007. In summary, only those provisions which require a change in Companies House procedure are being delayed until October 2009. See the BERR announcement for full details.

3.3 **Financial Assistance**

It was noted that the following the BERR announcement in November that the commencement of certain provisions may be delayed until October 2009, a further announcement on the timing of the repeal of the financial assistance provisions relating to private companies was awaited.

Post meeting note: The BERR announcement made on 13 December 2007 stated that the repeal will be implemented on 1 October 2008 and the Fifth Commencement Order subsequently published confirmed this.

3.4 **Overseas companies and charge registration**

It was noted that the draft Regulations on Overseas Companies and Charge Registration were shortly expected to be issued by BERR. It was also noted that the timing of implementation of the new provisions had yet to be announced. It was anticipated that the unsatisfactory Slavenburg registration system would disappear when the new provisions were in force and it was very much hoped that implementation of the new provisions would not be delayed. With that in mind, Richard Calnan offered to write to BERR asking them to consider an early implementation of the new system.

Post meeting note: The BERR announcement made on 13 December 2007 stated that the new overseas companies provisions (including the charge registration provisions) would come into force on 1 October 2009. The draft Regulations on Overseas Companies were also issued on 13 December. Comments are requested by 7 March 2008.

4. FINANCIAL COLLATERAL ARRANGEMENTS NO.2 REGULATIONS 2003

4.1 BVI Case – Alfa Telecom Turkey Limited v Cukurova Finance International Limited and others (16.11.07)

It was reported by GY that judgment had been delivered at first instance in the British Virgin Islands ("**BVI**") in *Alfa Telecom Turkey Limited v Cukurova Finance International Limited and others*, which is the first reported case on the Financial Collateral Arrangements (No. 2) Regulations 2003 ("the Regulations"). It concerns whether a power of appropriation had been conferred on Alfa as collateral-taker over shares in a private BVI

company (the main asset of which is a shareholding in a non-EU listed company) and whether that power had been effectively exercised.

The power of appropriation was contained in an equitable mortgage governed by English law. BVI law recognises that a mortgage may be governed by the law of another jurisdiction and provides that in such a case the remedies available to the mortgagee are governed by that other law.

It was common ground between the expert witnesses (Lord Millett for Alfa and Professor Cranston, now Mr Justice Cranston, for Cukurova) that:

- the Regulations apply to shares in private companies and are not limited to shares freely tradeable on the capital markets;
- the Regulations apply even if the collateral-provider, the collateral-taker and/or the issuer of the shares are incorporated outside the EU and the transactions do not involve EU financial markets;
- the English share mortgage constituted a "security financial collateral arrangement" within the meaning of the Regulations and created an equitable mortgage over the shares.

The experts expressed differing views on whether the power of appropriation had been effectively exercised. Professor Cranston considered that regulation 17 of the Regulations must be given an autonomous meaning so that it can be applied uniformly throughout the EU. He suggested that appropriation must therefore result in the collateral-taker becoming the registered holder of the mortgaged shares (where they are directly held, registered, certificated shares), notwithstanding that regulation 17 expressly provides that an equitable mortgagee may appropriate. Lord Millett considered that appropriation can be exercised by giving notice to that effect, whether the mortgage is legal or equitable. In the case of an equitable mortgage, the act of appropriation extinguishes the mortgagor's equity of redemption, vesting full beneficial ownership in the mortgagee and leaving the mortgagor as a bare trustee of the legal title (which in itself has no economic value).

Mrs Justice Olivetti decided that the power of appropriation had not been effectively exercised, since Alfa as collateral-taker had not, as a result of steps taken by Cukurova to prevent registration, become the registered holder of the shares. An appeal by Alfa against this decision is expected [*afternote: an appeal has since been lodged*].

It is also expected that Cukurova will apply to the English courts for permission to commence judicial review proceedings against HM Treasury for an order to quash the Regulations on the alleged ground that HM Treasury acted *ultra vires* when implementing the Financial Collateral Directive into English law [*afternote: an application has since been lodged*].

4.2 Financial Collateral Arrangements Directive

Robin Parsons reminded the meeting that the Committee had sent a paper to the Treasury on this topic at the end of September. There had been no further developments since then.

5. RECENT FIRST INSTANCE CASES ON GUARANTEES

The recent first instance decision in Sabah Shipyard v Republic of Pakistan [2007] EWHC 2602 (Comm) was discussed. It was noted that the case did not concern a normal group

company type guarantee but involved the State of Pakistan. The judge had found that where a guarantee had been given in respect of amounts due under a loan agreement, it did not extend to an arbitral award made against the entity whose obligations had been guaranteed, and the case against the guarantor had to be proved separately. Some doubts were expressed as to whether this case is good law.

Another recent first instance decision was noted, that of *Van der Merwe v IIG Capital* [2007] EWHC 2631 (Ch), but was not discussed in any detail.

6. BANKING REFORM CONSULTATION – PROTECTING DEPOSITORS

DL reminded the meeting that the working party's response to the Banking Reform Consultation had been sent to the Treasury at the beginning of December.

The Committee would watch for further developments.

7. ROME I - APPLICABLE LAW IN CONTRACTUAL OBLIGATIONS

It was reported that a new draft of the Rome I Regulation (applicable law in contracts) had been issued on 29 November and that, largely due to the efforts of the FMLC, this latest draft dealt satisfactorily with the UK's previous concerns and it was therefore possible that UK may opt into Rome I in the future.

The draft was not yet in final form and the Committee would watch for further developments. Timing of implementation of the Rome I Regulation was also unknown as yet.

DL also reminded the meeting that a working party paper had been submitted to the UK Government on 21 September 2007 in response to a feasibility study on the Choice of Law in International Contracts and the Hague Conference on Private International law. The paper had suggested that Rome 1 was sufficient in this area for the EU and that another Convention on this topic would not be best use of Hague resources. There had been no further developments since then.

8. ROME II - APPLICABLE LAW IN NON-CONTRACTUAL OBLIGATIONS

The Committee was reminded that the Rome II Regulation (on the law applicable to non-contractual obligations) will apply from 11 January 2009. It was felt that lenders, arrangers, agents etc may need to consider expanding their contractual choice of law and jurisdiction provisions to cover non-contractual claims e.g. negligence.

9. INSOLVENCY RULES MODERNISATION

9.1 Leyland Daf Reversal (Payment of Expenses of winding-up) – Companies Act 2006

It was reported by GY that section 176ZA of the Insolvency Act 1986 (which will reverse the House of Lords' decision in *Leyland Daf* and permit liquidation expenses to be paid out of floating charge assets) is expected to come into force in April 2008. A working party of the Committee had submitted a paper to the Insolvency Service in October, commenting on the draft regulations proposed to implement section 176ZA. It is not yet known to what extent the draft regulations have been amended in the light of comments from interested parties. No further consultation on the proposed regulations is expected.

[*Post meeting note: section 176ZA of the Insolvency Act 1986 (section 1282 of the Companies Act 2006 (Payment of Expenses of winding-up)) will come into force on 6 April 2008 pursuant to the Fifth Commencement Order of the Companies Act 2006.]*

9.2 Consolidation and modernisation of Insolvency Secondary Legislation

GY also reported on the initiative of the Insolvency Service to modernise and consolidate the Insolvency Rules 1986. A joint working party of the Financial and Insolvency Law Committees had submitted comments and suggested amendments to the draft Rules. It is understood that a number of these have been accepted. However, as a legislative reform order will be required to make consequential changes to the Insolvency Act itself, the new Insolvency Rules are not expected to come into force before 1st October 2008.

The Insolvency Service has produced an interim evaluation report on the corporate insolvency provisions in the Enterprise Act 2002 which is available on its website.

9.3 Administration – Insolvency Act Questionnaire

Nothing to report.

9.4 Re-organisation and winding-up of credit institutions – Review of EC Directive 2001/24

DL reported that a working party response to the review of the EC Directive would be sent soon. [*afternote: The Commission's findings were issued in a paper in late December 2007.]*

10. COVERED BONDS CONSULTATION

Robin Parsons reminded the meeting that the working party's response to the Covered Bonds Consultation had been submitted on 17 October 2007. Since then a new draft had been received from the Treasury on 7 December and unfortunately the CLLS suggestions had not been taken up.

RP agreed to circulate the new draft and to liaise with the working party about next steps.

11. TRUSTEE EXEMPTION CLAUSES – SOLICITORS CODE OF CONDUCT

DL reported that the working party on this issue had been unsuccessful in its attempts to have the guidance to the rule on trustee exemption clauses amended by the Law Society and unfortunately there was unlikely to be any value in continuing with the dialogue in this Committee. There is a CLLS Rules Committee that may take the matter further in terms of the need for the Regulator to have regard for the concerns of commercial lawyers operating in international markets.

12. UPDATE ON INTERNATIONAL CONVENTIONS

12.1 Proposal to implement the United Nations Convention on Sale of Goods (the Vienna Sales Convention) – scope of application and FMLC concern regarding carve out in Article 2(d)

Nothing to report. Watch for further developments.

12.2 UNIDROIT Project on Investment Securities

Mark Evans informed the meeting that there was nothing new to report. Watch for further developments.

12.3 UNCITRAL – Draft legislative guide on secured transactions

Nothing to report. Watch for further developments.

12.4 Hague Convention on Choice of Court and Brussels Regulation on Choice of Court

DL reported that the Commission had recently published a lengthy experts report written by 3 German professors which recognized and considered (among other things) the problems arising from the "court first seized rule" in the Brussels Regulation and endorsed the need for the Regulation to be amended.

The report recommended limited exceptions within the Community to the rule of strict priority under Article 27, in particular:

- a restricted exception where the parties concluded an exclusive jurisdiction agreement by way of a short clear cut standard form, in which case the chosen court would be released from the "first seized" rule.

- a very narrow exception where the specific proceedings in the court first seized would be excessively long, such as to breach the parties' rights under Article 6 of the European Convention on Human Rights (which guarantees effective remedies including the conclusion of proceedings in due time);

However, the first of these would be a good deal better than the present position. The report recommended adopting a rule of priority for the apparently chosen court for cases where third country courts were involved. This would enable the Community to accede to the Hague Judgments Convention. There were arguments that a uniform rule as in Hague would be appropriate within as well as without the Community. It was also noted that the report was hostile to unilateral jurisdiction clauses, which are common in cross-border loan transactions.

Despite concerns, the report represented a considerable step in the right direction and the Commission should be encouraged to bring forward amendments to allow parties the opportunity to address the problems of the "court first seized" rule.

13. CLOSE

There being no further business the meeting closed.