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banking

Administrator removed from pre-pack

The court has removed an administrator of a firm of solicitors who was closely involved in the negotiations for the pre-pack administration on the grounds that it was difficult for him to conduct an independent review in the face of a challenge by major creditors.

In *Clydesdale Financial Services v Smailes* [2009] EWHC 1745 (Ch) a firm of solicitors which specialised in personal injury claims and was financed by Clydesdale had become insolvent. The principal obtained advice from the insolvency practitioner who concluded that the best solution would be a sale of the firm's work in progress, and accordingly a pre-pack contract was entered into with another firm.

The bank objected to the terms of the sale, and in particular the valuation of the work in progress. They argued that the matter required an independent review which would require the removal of the administrator.

The court accepted that there were legitimate concerns that required an investigation by an appropriate office holder, and it would be difficult for the administrator to conduct such an independent review. The court also took into account that the majority of the creditors supported the application. The court also declined to strike out an application by the bank for equitable compensation and damages.■

Responding to mistaken payment

A bank was held liable for monies lost on a mistaken payment. When it received the payment, it became aware of the alleged mistake but failed to take swift action and to raise all relevant enquiries before allowing a customer to withdraw the funds.

In *Jones v Churcher and Abbey National* [2009] EWHC 722 (QB) the claimant made a CHAPS transfer from his account at Lloyds to the first defendant's account at Abbey National. The following day the claimant realised that he had made a mistake and that he should not have paid the first defendant, who had no entitlement to be paid. Thereafter both the claimant and Lloyds repeatedly alerted Abbey and requested the return of the funds. After 12 days had elapsed, and Abbey had asked the first defendant for permission to repay the funds, the first defendant had paid most of the money to a third party, and it was never recovered.

The court held that both the first defendant and the bank were liable for restitution to the claimant for the mistaken payment. Neither defendant could rely on the defence of "change of position in good faith".

The first defendant had paid the money when she knew that she should not have received it, or at least had failed to make adequate enquiry. Abbey had not acted in good faith because it had actual knowledge that Lloyds was asking for the money back, and delayed taking action, despite being told of the error. Steps should have been taken to ring-fence the money pending further enquiry.

The court accepted that that would potentially amount to a breach of mandate, but the court suggested that banks should not be coy about proffering or asking for an indemnity and that the remitting bank should ask the payer for a counter-indemnity if and when he reports the mistake.

The court also dismissed Abbey's defence of "ministerial receipt", which applies to a party who merely handles a mistaken payment, on the basis that the customer, rather than the bank, receives the money.

Comment: The suggested arrangement of an indemnity and a counter-indemnity is clearly something that should be explored in this type of situation, but if the payer is unable to give security for his bank's counter-indemnity, the arrangement is unlikely to be possible.■

Money laundering suspicion – update

In our last newsletter, we reported the first instance decision in *Shah v HSBC Private Bank* [2009] EWHC 79 (QB). In that matter, the bank succeeded in striking out a claim against it for damages for wrongfully forming a suspicion of money laundering which resulted in an authorised disclosure report to SOCA. The court had held that the suspicion need not be rational, subject to the existing case law holding that the suspicion must be "non-fanciful and settled" and not a mere feeling of unease.

The claimant has successfully appealed to the Court of Appeal. It has held that certain issues are arguable and should therefore be determined at a trial. Those issues are:

- whether a bank has a duty to act with reasonable speed in making its report;
- whether a mistake by the bank can vitiate suspicion;
- whether the customer is entitled to information about the suspicion and the reporting after SOCA has indicated that a transaction can proceed or after any investigations have completed;
- whether the bank can prove that its suspicion was "non-fanciful and settled". If applicable, that might involve consideration of reliance on computer generated suspicion; and
- whether damages can be awarded for the "stigma" suffered by the customer.

Comment: The facts of the case appear to be extreme in that the bank's suspicion was highly questionable and the amount of consequential damages claimed is US$331 million. The determination of the claimant to pursue the matter will at least serve to clarify a troublesome area of law and practice. Whether it will finally leave bankers and reporting officers more comfortable or less remains to be seen.■

ISDA clause not a penalty

The early termination provisions in an International Swap Dealers Association (ISDA) master agreement were held not to be a penalty, which would have made them unenforceable.

In *BNP Paribas v Wockhardt* [2009] EWHC 3116 (Comm) the defendants had defaulted under the terms of the master agreement. That allowed the bank to designate an early termination date to determine an amount due under forward transactions. The defendant argued that the early termination and close-out provisions were unenforceable for being a penalty, because they did not provide for a genuine pre-estimate of the loss but for the payment of the same amount on the occurrence of any one of a number of possible breaches which might give rise to different consequences.

The court held that the close-out amount had been calculated using the bank's own standard internal pricing model, which it used in the regular course of its business in pricing and valuing similar transactions. The clause in question did not define a sum, but the method by which the sum was to be determined. In order to decide whether or not the clause constituted a penalty, it was necessary to consider what would have been due to the bank following termination in consequence of the breach. In effect that was the same amount.

The fact that the clause was capable of application to several breaches of different seriousness might, in some cases, indicate that it was a penalty, but that was only one factor.■

Anti-deprivation rule

The anti-deprivation rule operates to prevent a person's property being transferred and taken away from his creditors on bankruptcy or winding up.

In *Perpetual Trustee Co Limited and others v BNY Corporate Trustee Services Limited and others and Butters and others v BBC Worldwide and others* [2009] EWCA Civ 1160 the Court of Appeal had to consider two cases where the rule was said to apply.

The first case involved loan notes which had been issued to investors by a special purpose vehicle which had entered into a swap agreement with

Lehman Brothers. On its insolvency, an investor gave notice of an event of default and required the trustee of the notes to enforce. The relevant agreement contained provisions which, in the event of an insolvency, switched the priority over the assets in the special purpose vehicle between Lehman Brothers and the noteholders, and changed the allocation of certain costs in favour of the noteholders.

The Court of Appeal held that the anti-deprivation rule did not prevent the provisions taking effect as it did not divest Lehman Brothers of any property. It was merely a change in the order of priorities in which the rights were to be exercised in relation to the proceeds of sale of the collateral in the event of default.

There was previous authority that suggested that such provisions would be allowed in favour of someone who could show that the asset in question had been acquired with his money. The rule also did not apply where someone was able to terminate a limited interest, such as a lease or a licence, which he had granted over or in respect of his own property in the event of the lessee's or licensee's bankruptcy.

The second case concerned a joint venture between a Woolworths subsidiary and a BBC subsidiary. When Woolworths went into administration, the BBC gave notice in accordance with the terms of the joint venture requiring Woolworths to sell its shares in the joint venture company to the BBC and thereby terminating a licence agreement.

The Court of Appeal held that the anti-deprivation rule did not apply in that case. The price payable for the shares was market value and could not be

Construction comment

When a construction project is hit by the insolvency of one of the key parties (usually the developer or the main contractor), it is important for a funder to consider what practical, as opposed to purely legal, steps might be available to either save the project or mitigate the possible losses. Whilst a funder may have taken security over the site, the works and the building contract, this will collectively be worth much less than a completed project.

An early concern will be what is actually going on at the site itself. If works are some way along, there will be subcontractors, plant and materials at the site – all of which will be needed if the project is to be completed at all. There will be many competing interests – building sites have few secrets and the subcontractors and suppliers will be concerned about getting paid for their work and materials.

Practical steps should be taken promptly – the site and materials will need to be secured, otherwise they are likely to "disappear", making it more difficult, costly and time consuming to get the project restarted and the works will need to be covered up and protected to ensure that they do not get damaged. It is unusual for funders to accept construction documentation that does not contain provisions allowing them to step in, yet such rights are rarely used in practice – after all, few funders wish to be property developers.

There have been occasions recently, however, where funders have used such rights in innovative ways to persuade important members of the project team, such as the architect and engineers, to stay with the project. If this can be achieved, there are at least two benefits for the funder – the project is more likely to complete within a reasonable timescale and the "construction package" of contracts and warranties will be "cleaner" and more attractive to potential purchasers and tenants when the building is finished.

Such steps have to be carefully taken and good advice is vital to avoid any agreements falling foul of the insolvency laws or the Housing Grants, Construction and Regeneration Act 1996, which applies to most contracts for construction work.

There can be no pretending that an insolvency will not significantly affect a construction project and set back progress and, in all likelihood, the completion date. With a calm outlook and good decision making, however, the worst case scenario of a complete abandonment can often be avoided and, whilst a delayed project may not yield the return that was originally hoped for, some return, at least, might be obtained.■

Hugh Saunders, Fladgate Construction Group objectionable. In any event, the rule would not have applied because the notice was triggered by the insolvency of the Woolworths parent company which pre-dated the subsidiary's own administration.■

Performance bonds

In *Enka Insaat v Banca Populaire Dell'Alto* and *Enka Insaat v Cassa DDI Risparmio DDI Bolzano* [2009] EWHC 2410 (Comm) the applicant applied for summary judgment against two banks pursuant to performance guarantees that they had issued.

The applicant had entered into a contract with a Russian owner for the design and construction of its building. The applicant signed a subcontract with a Russian company to design and install the external façade for a fixed price. The subcontract required the applicant to make advanced payments and also required the subcontractor to put in place certain guarantees by its banks. One of the defendant banks provided an advance payment guarantee and the other provided a performance guarantee.

The guarantees provided that a demand was merely to state that the subcontractor had failed to fulfil its obligations under the subcontract, and that "accordingly" the applicant was entitled to receive payment. In due course, the applicant made such demands under the guarantees, but the banks argued that the applicant did not honestly believe that there was any liability by the subcontractor and that the demands were therefore fraudulent.

The court had to consider whether there was any real prospect that the banks would establish at trial that the only realistic inference was that the applicant could not honestly have believed in the validity of the demands. The court held that the words which obliged the applicant to state "accordingly [*the applicant*] is entitled to receive payment" did not impose on the applicant an obligation either to state expressly or by implication, or to have any reason to believe, that it had suffered damage in the amount claimed or that it was entitled to repayment from the subcontractor for the price paid in advance. The "accordingly" related to the effect of the demand and the statement (rather than the fact) that the subcontractor had failed to fulfil its obligations under the subcontract.

There was no realistic prospect that the banks would establish that the applicant could not honestly have believed in the validity of the demands.■

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