

HindSight

Newsletter of Rosling King LLP

Consumer Credit Your loan agreement *is* unenforceable

On a commercial view, the Consumer Credit Act 1974 and the raft of regulations that followed represent a complicated series of hoops through which lenders must jump in order to recover from borrowers. In recent times, borrowers have seen the legislation as a convenient system of complex rules that could enable them to walk away from their debts. A cottage industry has, therefore, developed around this legislation with claims management companies promising debtors that their loan agreements are unenforceable or that they need not clear the balance on their credit card.

Although the Consumer Credit Act 1974 was designed to protect consumers, it can be baffling in its complexity to the public and lenders alike. This means that complicated and often judicially untested arguments raised on behalf of borrowers in connection with relatively low debts can present expensive and difficult challenges for lenders to deal with and the result is often a horse trade between the two regarding how much, if anything, the borrower must repay. This clearly has a commercial impact.

Changes in the Law

The law changed in 2007 with the advent of the Consumer Credit Act 2006, which amended the existing legislation and widened the net of regulation between consumers and lenders. Borrowers can now refer any complaints to the Financial Ombudsman Service (“FOS”) if they relate to an agreement entered into after 6 April 2007. The upshot of this is that lenders must ensure they have a complaints handling policy and that it meets the minimum standards set by the Financial Services Authority.

The £25,000 limit

Previously, only loans of less than £25,000 were regulated. This limit no longer applies and credit agreements for sums over £25,000 will be regulated, with the exception of mortgages; commercial loans and/or loans to high net worth individuals. The abolition of the limit reflects growing levels of consumer debt: people are, or at least, were borrowing more money. However, the new rules say that if an agreement originally made prior to 6 April 2007 is varied, for example, by the provision of a further advance after 6 April 2007, the varied agreement would supersede the previous agreement and the new rules would apply.

“It’s just not fair”

One of the most controversial changes in the law is the new concept of an “unfair credit transaction”, which empowers consumers (and also the Office of Fair Trading under Part 8 of the Enterprise Act 2002) to challenge a wide range of contract terms and lender practices if they can establish that an “unfair relationship” exists between the lender and the borrower. It also gives the Courts sweeping powers to examine every aspect of a lender/borrower relationship. This applies to all agreements and not just those that are regulated (except for mortgages). However, the legislation does not specify what an unfair relationship is, despite the entire relationship being subject to assessment (including all dealings before, during and after the contract is made) even if the contract was made prior to the change in the law. This has been left for the Courts to decide.

In the recent County Court case of *MBNA –v– Thorius*, heard on 8 September 2009, a borrower used the new unfair relationship provision to challenge successfully the enforceability of a loan agreement where payment protection insurance (“PPI”) had been sold to her when she took out a loan. In this case, the bank sold a PPI policy to a borrower alongside a loan but did not inform the borrower that it was receiving commission payments from the PPI insurer, the Court held that the policy had been unfairly imposed and there was an unfair relationship between the borrower and the bank. In this case, the borrower’s debt was written off and the bank was ordered to pay back the insurance premiums with interest. This is clearly a live issue and is likely to be raised by many borrowers in the future, particularly as the provision has retrospective effect and would apply to credit agreements entered into before April 2007. All dealings including meetings, telephone calls and emails should, therefore, be documented by lenders in case a borrower alleges unfairness.

The demise of PPI

According to the FOS, PPI was the single most complained about financial product in the first half of this year. The Financial Ombudsman upholds about 80% of consumer complaints about PPI. The Competition Commission has now banned the sale of PPI alongside credit cards and loans. From 2010, banks and retailers making an offer of a loan or credit card must wait a week before they

can sell PPI to a borrower and single-premium PPI (where the cost of the premium is added to the debt so that a borrower pays interest on both) is to be outlawed.

The Financial Services Authority (FSA) has also begun a wide ranging review of the sale of PPI on secured loans, including mortgages and credit cards. It will introduce new rules to ensure that PPI complaints are handled properly and redress is paid where appropriate and has very recently ordered banks to reopen 185,000 previously rejected PPI complaints to assess whether the decisions they made were fair. The FSA feels that too many complaints have been rejected by the banks only to be overturned by the Ombudsman. The FSA estimates that this will result in up to £195 million being paid in compensation to consumers.

What next?

The penalties for falling foul of consumer credit legislation can be severe, and for older credit agreements, failure to comply with the strict provisions on form and content can render those agreements ‘irredeemably unenforceable’ which means that a lender cannot take enforcement action to recover a debt from a borrower. Numerous decisions made at County Court level in the borrower’s favour have been appealed by lenders and we are beginning to see a trickle of High Court and Court of Appeal decisions and authority to guide the industry. The Court of Appeal’s recent decision in favour of the lender in the case of *Southern Pacific Personal Loans Ltd – v – Walker* [2009], in which this firm successfully acted for Southern Pacific Personal Loans Ltd, may signal a hardening of approach by the higher Courts to challenges brought by borrowers to the enforceability of regulated loan agreements.

Lenders face a new landscape in the aftermath of the credit crunch. Hard pressed borrowers, who were happy to borrow money when times were good, spurred on by the current High Court challenges to the fairness of current account overdraft charges and the FSA clampdown on the level of credit card default charges, are taking it upon themselves to test lenders’ resolve. This feeling has been seized upon by a burgeoning industry of claims management companies who promise to rid consumers of their debts and the widening and fortification of consumer credit legislation means that there is no sign of a truce in the battle between lenders and borrowers in the foreseeable future.

To make recoveries from third parties lenders will have to deal with allegations of bad lending practice

As the full effects of the worldwide recession are being felt and lenders are attempting to establish the extent of their liabilities and look for routes of recovery, professionals such as surveyors, solicitors, brokers and accountants are facing claims to recover the losses. During the property market fall in the 1990s Rosling King recovered substantial sums for its lender clients from professionals who were held to have been responsible for the losses. We are doing so again. Naturally Defendant firms then and, of course now, look to limit their client's liability. One area where they will do this is to look for issues of contributory negligence and failure to mitigate by the lender. Press comments as to "reckless lending" help to fuel the fire of such defences.

Lenders should expect the issues to be raised will relate to loan to value (LTV) ratios, self certification loans, non-status lending, delays in the repossession or sale and sales at allegedly unduly low prices.

The PI insurers for professionals sued will request the release of lender's underwriting files, arrears, possession and marketing files for review, looking for evidence of contributory negligence or bad lending.

Some surveyor's claims may be "capped" by the principles laid down in *South Australia Asset Management Corp v York Montague Limited* ("SAAMCO"). Particularly where a loss is large, contributory negligence or failure to mitigate claims will in practice not have much effect as those losses are taken off the total loss figure which more often than not had no effect on the cap. Sometimes, however, on smaller losses the discount does affect the cap.

It should be remembered that it may well be possible in some cases to argue that the basis of the claim being brought by the lender may

avoid entirely any consideration of the lender's lending practices. This is because in some instances claims are brought on grounds other than negligence. One example of this was the well known case of *Target Holdings Ltd v Redferns* in which the lender showed that the solicitor in that case had been guilty of breach of trust. Again the case of *Nationwide Building Society v Balmer Radmore* confirmed that where a solicitor was found to have breached his fiduciary duty he was liable to the lender and claims that the lender contributed to it were not relevant. Care should, therefore, be given as to the basis on which any claim is brought and negligence is not necessarily the right basis in all circumstances.

New issues might even be raised by PI insurers defending professionals and no doubt new ideas will be explored to try to reduce the amount of the claims being recovered. However, there are now well established principles which allow lenders to make successful claims even if in some cases the amount recovered is reduced because of the lender's own actions.

Lenders are going to have to be prepared again to provide their solicitors with all the necessary information, documentation and evidence, in relation to the loan transactions where losses have occurred. Lenders should also expect, and be able to respond to, scrutiny from insurers seeking justification for lending decisions and actions taken. Lenders, however, should not be afraid of pursuing claims where they are properly handled and where the claims brought are good ones. It has to be remembered that amongst the allegations of bad practice in lending on the rising property market there are many clear claims against professionals who did not carry out their job properly and comply with their duties to the lenders.

Don't be late or you will miss that Very Important Date

As with the economic downturn of the nineties, the number of professional negligence claims being brought by lenders is expected to increase substantially. Given the number of potential claims that lenders may have against their professional advisers, such as solicitors or valuers, it is important that they act quickly to avoid those claims falling outside of the relevant limitation period and being time-barred. There are also a number of practical reasons why lenders should not delay issuing a claim. These include acting before a valuer goes into administration, to place the valuer's professional indemnity insurer on notice of a potential claim and obtaining documents from solicitors before they shut down and their files may be difficult to find.

Professionals owe their clients duties of care concurrently under contract and tort and, therefore, a claim for negligence may be brought under either or both these areas of law. Under the Limitation Act 1980 (the "1980 Act"), a claimant has six years from the date on which the cause of action accrued to bring a claim in contract or tort. A claim is brought for limitation purposes when the Court receives the claim form (*Barnes v St Helens* [2006] EWCA Civ 1372).

Bearing in mind that potential claims do take some time to investigate properly, it is best not to wait until just before the expiry of the limitation period before instructing your solicitor. Also, consideration should be given to the Pre-Action Protocol for Professional Negligence which should be adhered to and gives the defendant three months to respond to the Letter of Claim that should be sent out pursuant to the Protocol.

Under contract the cause of action accrues on the date of the breach of contract, with the six year limitation period running from that date. There is no need in contract for damage to have been caused. This means that if you are considering pursuing a valuer or solicitor, under contractual principles, you may have only 6 years from the date of the valuation report or solicitor's certificate of title to bring the claim. You may be able to push that date back by relying on a basic negligence claim as in such a claim the period runs from the date that the damage is suffered.

In the leading case of *Nykredit Mortgage Bank plc v Edward Erdman Group Ltd* [1997] UKHL 53 the House of Lords considered the question of the date when the claimant bank's cause of action arose for the purposes of calculating interest on damages. However, the legal principles apply directly to the law on limitation and tort. In *Nykredit*, the lender had relied upon the defendant's negligent overvaluation of a property, to lend to a borrower, who defaulted on the loan immediately.

The Court had to look at the issue of damage and suggested that a lender should look at a basic comparison between (a) the amount of money lent plus interest and (b) the value of the borrower's covenant and the true value of the property. When this basic comparison first throws up a loss, damage occurs.

In certain cases the limitation may be extended further beyond six years for tort claims. Under section 14A of the 1980 Act, there is an additional limitation period of three years from when the claimant had the knowledge required to bring an action, including the identity of the defendant. This is subject to a long-stop date of 15 years from the date of the negligent act or omission. Absolute protection is afforded by the 1980 Act in cases of fraud and deliberate concealment. Under section 32(1) of the 1980 Act, if the action is based upon fraud or any relevant fact to the claimant's right of action is deliberately concealed, the limitation period will not begin until the claimant has discovered the fraud or concealment.

So, you may be able to 'push back' the date for limitation purposes but you cannot rely on this and you should ensure that any potential or actual losses are picked up and consideration is given to any possible route of recovery at an early stage.

Additionally, the parties may be able to suspend time by entering a standstill agreement, however, these need to be clearly drafted otherwise the claim may be time-barred nevertheless (*Investors Compensation Scheme v West Bromwich Building Society* [1997] UKHL 82).

Currently, there is a draft bill which is being considered by the government which is looking to revise the law on limitations, but this is some way off becoming new law.

Time keeps on slipping ...

In short, lender clients need to be alive to the limitation periods of any potential claims and the need to act on a potential claim as soon as possible. There may be some cases where the limitation period may be extended, but these will not apply to all potential claims. As mentioned, there are a number of practical considerations to consider also, including the time it will take to investigate a claim properly, the time it will take to work through the Pre-Action Protocol and the need to notify defendants and their insurers as soon as there is a potential claim. Lenders should ensure that they instruct solicitors as soon as they consider there to be a potential claim so that good claims do not fail for being brought out of time.

Pursuing defendants resident outside England and Wales

The current economic environment has had significant impact on credit availability and cash flow throughout the business community. One knock-on effect of this which is becoming increasingly apparent is that businesses are now much more inclined to litigate when faced with losses occasioned as a result of breaches of contract or professional negligence. Different and difficult issues may, however, arise where the breaching or negligent party is domiciled in a jurisdiction other than that of England and Wales, particularly, the question of in which jurisdiction legal proceedings should be commenced.

All forms of commercial contracts frequently provide an express jurisdiction clause enabling the parties to agree, at the outset of their contractual relationship, which country's, or countries', courts are to have jurisdiction to hear disputes which may arise out of that contract. The inclusion of an express jurisdiction clause will remove the uncertainty and inconvenience generated by jurisdictional disputes between parties which can result in additional costs and delay to the progression of proceedings.

If, however, no effective jurisdiction clause has been incorporated into the parties' legal relationship, the correct forum for the resolution of any dispute must be determined in accordance with the rules of private international law and, in particular, in accordance with the rules set out in the Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (the "Brussels Regulation").

The general rule of the Brussels Regulation is that is that persons can only be sued in the courts of the Member State in which they are domiciled. This rule is, however, subject to a number of exceptions, the most pertinent being: -

- *Matters relating to contract*

In matters relating to contract, the defendant can be sued in the courts of the place of performance of the obligation which has given rise to the dispute. Within the United Kingdom the position is identical: where the defendant is domiciled in a part of the United Kingdom other than England and Wales, that defendant may be sued in England and Wales where the contractual obligation which gave rise to the dispute was, or should have been, performed in England and Wales.

The Brussels Regulation provides specific rules governing the jurisdiction to hear disputes arising out of contracts for the sale of goods and for the supply of services. In the case of a contract for the sale of goods, the Brussels Regulation provides that the place of performance of the obligation which gave rise to the dispute will be the place where the goods were, or should have been, delivered. In relation to jurisdiction to hear disputes arising out of a contract for the supply of services, the place of performance of the contractual obligation will be the place where the services were, or should have been, provided.

The Brussels Regulation, however, also makes specific provisions in matters relating to contracts concluded by consumers (defined as persons who concluded a contract with a professional, the purpose of which is outside their trade or business). The Brussels Regulation provides that

where a contract is concluded with a consumer relating to the sale of goods on installment credit terms or is a loan contract, repayable in instalments, in order to finance the sale of goods, the consumer may bring proceedings in either the Member State in which he is domiciled or in the Member State in which his contracting party is domiciled. The contracting party, however, may only bring proceedings against the consumer in the Member State in which the consumer is domiciled.

- *Matters relating to tort*

In matters relating to tort, e.g. professional negligence, the defendant may be sued in the courts of the place where the harmful event which caused the damage or loss occurred, irrespective of where that defendant is domiciled. Again, the position within the United Kingdom mirrors that under the Brussels Regulation: a defendant domiciled in a part of the United Kingdom other than England and Wales may be sued in England and Wales where the harmful event occurred in England and Wales.

The phrase "*place where the harmful event occurred*" has recently been considered by the European Courts and has been determined to include both: -

- (a) the place where the damage or loss occurred; and
- (b) the place where the event which caused the damage or loss occurred.

- *Matters relating to insurance*

In relation to matters relating to insurance an insurer may be sued in the courts of the Member State where it is domiciled or, in the case of proceedings brought by a policyholder, an insured or a beneficiary, in the courts of the Member State in which that claimant is domiciled. In addition, where an insurer is a co-insurer, the Brussels Regulation provides that proceedings may be brought against it in the courts of a Member State in which proceedings are brought against the lead insurer.

Conclusion

In conclusion, where businesses are faced with losses arising out of either a breach of contract or professional negligence on the part of a person domiciled outside England and Wales it is imperative that the terms of the contract governing the legal relationship between the parties are carefully considered so as to establish whether an effective jurisdiction clause has been incorporated into the parties' legal relationship.

If effective provisions as to the jurisdiction to hear disputes arising between the parties have not been included within the contractual terms, legal proceedings for the recovery of loss in matters relating to contract may be commenced in England and Wales against a defendant domiciled outside England and Wales if this is the place where the contractual obligation which has given rise to the dispute was, or should have been performed. For tortious claims, proceedings may be instigated in England and Wales despite the fact that the defendant is domiciled outside England and Wales where either the harmful event or the loss arising from the harmful event occurred in England and Wales.

IT'S MAKE OR BREAK FOR LANDLORDS AND TENANTS

In the current financial climate more and more tenants are looking to negotiate tenant only break clauses into their commercial leases. In this kind of market tenants prefer to negotiate shorter liabilities and avoid the uncertainty of rent review and the potential burden of disposal. In order to protect themselves landlords are best advised to negotiate conditions into the break clause which must be complied with before the tenant can exercise the break.

This article considers various conditions that can be imposed on a tenant in a break clause and goes on to consider compliance with such conditions.

Lease Code Conditions

The Code for Leasing Business Premises in England and Wales 2007 ("the Lease Code") suggests that the only preconditions to a tenant exercising a break clause should be:

1. That the tenant is up to date with payment of principal rent; and
2. That the tenant gives up occupation and leaves behind no continuing subleases.

The requirement to pay all principal rent explicitly excludes any service charge, balancing service charge, insurance or any other payments which may be due under the lease. The Landlord remains entitled to claim these sums. However, the Lease Code stipulates that the break clause should not be made conditional on these sums being paid. The reason for this, as argued by the Lease Code, is that such sums are often the subject of dispute between a landlord and tenant and any dispute of this nature should be dealt with directly and fairly between the parties and a tenant should not be held over a barrel and penalised as a result of any dispute of this nature.

In terms of giving up occupation of the property, all that is required under the Lease Code is that the tenant moves out of the property and does not leave behind any continuing subleases. This condition does not oblige the tenant to remove its trade fixtures and fittings from the premises and, therefore, if these items remained in situ following the tenant's exercise of the break clause, the landlord would be required to rely on the yielding up provisions in the lease following the tenant's exit. This position is not advantageous from the landlord's perspective as the landlord will need to expend money and effort in pursuing the tenant once it has vacated. A far better condition from the landlord's perspective is the requirement for the tenant to give 'vacant possession' of the

property which would include the removal of the tenant's trade fixtures and fittings at the time of exercise of the break.

When negotiating a tenant break clause the landlord should consider these points carefully and bear in mind that although the Lease Code states that these are the only conditions that should be attached to a tenant break, compliance with the Lease Code is not obligatory. However, if a landlord does not intend to comply with the Lease Code, the Lease Code itself suggests that the landlord should justify its reasons for non-compliance to the tenant.

Further Conditions

A landlord may wish to impose further conditions on a tenant's break, such as a condition requiring the tenant to have performed all of its covenants under the lease, or just its repairing covenants, either upon service of the break notice or on the break date.

The likelihood of a tenant agreeing to these conditions in this market is slim, particularly as a tenant could be penalised on exercise of the break for breach of a fairly minor covenant under the lease. However, should a landlord be successful in negotiating these types of conditions both the landlord and the tenant should ensure that the document makes clear the date for compliance of the condition, i.e. upon service of the notice exercising the break or on the break date. Careless drafting has the potential to cause many disputes in a condition of this nature.

Compliance

Compliance with the terms of a break clause will be strictly construed by the Courts and any conditions attached to the right to break must be strictly performed (*Reed Personal Services -v- American Express* [1997] 1 EGLR 229) and time will be of the essence in respect of the time limits contained in a break clause (*United Scientific -v- Burnley Corporation* [1978] AC 904).

A tenant will be prevented from exercising their break clause where there are absolute conditions attached to the break, such as the tenant paying the principal rent and performing and observing its covenants and conditions, if there is any subsisting breach of a covenant or condition at the relevant time, no matter how trivial the breach (*Friar -v- Grey* (1850) 5 Ex 584).

In the case of *Bairstow Eves (Securities) Limited -v- Ripley* [1992] 2 EGLR 47 the lease provided that the property had to be painted in the last year of the term. The tenant had in practice painted the property just before the

beginning of the last year of the term. The Court held that the condition as to compliance with covenants had not been satisfied, despite the fact that there was no material difference between what had been done and what ought to have been done and furthermore that there would only have been nominal damages for breach of covenant.

Conditions may, however, be qualified so that the tenant is required to have either reasonably, materially or substantially complied with its obligations.

Reasonable Compliance

This requires the tenant to have behaved during the tenancy in a way that a reasonably minded tenant might behave and the performance of the tenant over the whole of the term of the lease can be taken into account rather than just the position at the break date or break notice (*Gardner -v- Blaxill* [1960] 1 WLR 752).

Material Compliance

In the case of *Fitzroy House Epworth Street (No. 1) Limited -v- The Financial Times Limited* [2006] EWCA CIV 329) the Court of Appeal confirmed that the test of material compliance was an objective test which must be assessed by reference to the ability of the landlord to re-let or sell the property without delay or additional expense. The Court went on to say that where a provision is absolute then any breach at all will preclude the exercise of the break. However, where a provision is qualified by the requirement that the tenant has "materially complied" with its covenants there is no justification for attributing to the parties an intention that trivial or trifling breaches were permitted.

Conclusion

The current financial climate has already taken its toll on the property market and a great many UK businesses and it seems likely that the number of businesses entering into some type of insolvency process will grow. Tenants are facing difficult trading conditions and some are struggling to keep afloat. This pressure on tenants is forcing them to negotiate harder on new leases and renewals and invariably tenants are requesting shorter terms with break clauses to protect themselves in the event of further financial hardship. The pressure on landlords to agree to break clauses, or face losing a tenant completely, means that the landlord needs to carefully consider the types of conditions they attach to a break clause, to ensure that the landlord is protected as fully as possible from this already disadvantageous position.

CONSTRUCTION OF A CONTRACT

Earlier this year, the House of Lords reaffirmed that evidence of pre-contractual negotiations is not inadmissible for the purpose of interpreting contracts. The less you have to resort to any form of background as an aid to interpretation, the better. The document should so far as possible, speak for itself. The case of Chartbrook Limited v Persimmon Homes Ltd and others [2009] UKHL 38 was Lord Hoffman's final judgment before his retirement.

Facts

In 2001, Chartbrook (C) and Persimmon Homes (P) entered into an agreement for the development of a plot in Wandsworth belonging to C. The structure of the agreement was that P would obtain planning permission, construct a mixed residential and commercial development and sell the properties on long leases. C would grant the leases at the direction of P, who would then receive the proceeds for their own account and pay C an agreed price for the land. The development went ahead but a dispute arose over calculation of the final price. The price owed to C for the residential units was the Residential Land Value (RLV) plus the Additional Residential Payment (ARP). It was interpretation of the ARP clause that caused the problem between the parties. The agreement provided for a minimum guaranteed value in respect of each residential unit, and the ARP was defined as "23.4% of the price achieved for each Residential Unit in excess of the Minimum Guaranteed Value less the Costs and Incentives".

First Instance & Court of Appeal

C's construction was preferred at first instance and by the Court of Appeal. They asserted that to determine the ARP payable, you take the price achieved, deduct the minimum guaranteed value and the costs and incentives, and calculate 23.4% of the result, which totalled approximately £4.5million. P argued the correct interpretation was to deduct costs and incentives to obtain the net price received, calculate 23.4% of that, and the ARP is the excess of that figure over the minimum guaranteed value, which totalled approximately £900,000.

House of Lords

The House of Lords unanimously upheld P's appeal. The leading judgment was given by Lord Hoffman who noted there was no dispute that the principles on which a contract (or any other instrument or utterance) should be interpreted are those set out in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896. The question is what a reasonable person having all the background knowledge which would have been available to the parties, would have understood them to be using the

language in the contract to mean. Although the courts do not easily accept that people have made linguistic mistakes, particularly in formal documents, in some cases the context and background demands the conclusion that something must have gone wrong with the language. In such a case, the law does not require the court to attribute to the parties, an intention which a reasonable person would not have understood them to have had.

Their Lordships held that to adopt C's interpretation would make no commercial sense, taking into account the structure of the agreement, definitions used and financial implications (despite being consistent with ordinary rules of syntax). All that was required was that it should be clear that something had gone wrong with the language and that it should be clear what a reasonable person would have understood the parties to have meant. The appeal was allowed as both these requirements were satisfied. P advanced two alternative arguments of general importance, which were considered. These were that regard should be had to pre-contractual negotiations in construing the agreement and that to the extent that the finalised agreement did not reflect the continuing common intention of the parties at the time of contracting, it should be rectified.

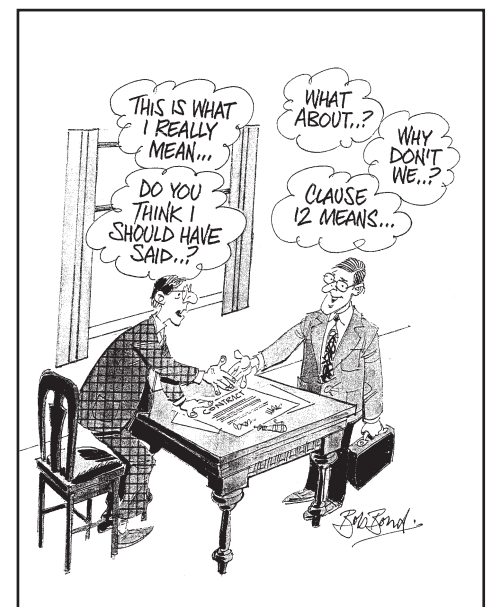
Their Lordships found there was no basis for departing from the established rule that pre-contractual negotiations were not admissible in construing a contract (the exclusionary rule). This rule is justified by the need for commercial certainty. They doubted whether the court could look at the negotiations to consider which one of the many possible interpretations of the clause had been intended. The previous legal authorities suggesting this was permissible, had extended the principle that such negotiations might be admitted to consider what the parties meant by a particular term of art known to them. This principle did not apply to ordinary words or phrases. In addition, the legal test for rectification and admissibility of evidence was reformulated, finding that where a reasonable man regards the common intentions of the parties as not

reflected in the document, a claim for rectification or estoppel might succeed. These are not exceptions to the exclusionary rule, they operate outside it.

Careful Drafting

This decision acts as a useful reminder of the importance of clear and unambiguous drafting. Keep in mind the following tips when entering into any form of agreement: -

- Ensure that all pre-contractual negotiations are included in the final agreement; do not leave anything out if you intend to rely on it.
- Avoid ambiguity by drafting with precision and clarity, reflecting the common intention of the parties.
- Understand every clause and definition used in the final agreement; if in doubt clarify your understanding of the meaning – never sign anything you do not understand.
- Consider how the terms of the agreement will work in practice - do they make commercial sense?
- Remember that an objective approach should be taken to the interpretation of contracts.
- Seek legal advice before the agreement is finalised.



Schemes of Arrangement – what, why, when and by whom?

Schemes of arrangement are a useful method to rescue or restructure companies in financial difficulties (particularly in the context of insolvent insurance companies to ensure an orderly run-off of liabilities). Recently they have also been used successfully to affect debt for equity swaps. A scheme of arrangement is a compromise or arrangement made by a company with its creditors (or any defined class of its creditors) and/or its members (or any defined class of its members). It is a statutory procedure pursuant to Part 26 of the Companies Act 2006, and is often referred to as a Part 26 Scheme. In theory, a scheme could be a compromise about anything which the company and its creditors and/or members may agree to and examples where schemes are used include group reorganisations (for example, to put a new holding company in place), mergers (often as part of a stamp duty saving scheme) and demergers and removing minority shareholders. Schemes of arrangement can also be used to avoid liquidation in place of using the company voluntary arrangement (“CVA”) procedure. They are often used in conjunction with the administration procedure in order to make use of the moratorium on claims to allow time to agree the proposal. The attraction of using a scheme is that they allow the company proposing the scheme great flexibility in defining the class(es) of creditors subject to the scheme. Provided that the required majority of creditors then approve the scheme, and it is sanctioned by the court, the scheme binds all creditors of the company, irrespective of whether they had notice of it. This is one of the main advantages of a scheme of arrangement over a CVA, as a CVA does not bind secured or preferential creditors. The main disadvantage of a scheme is the involvement of the court, which is not required under a CVA and which can make a scheme more expensive.

A scheme of arrangement requires the following steps (outlined in brief detail) to be taken in the following order:

1. application is made to the court by the company (or any creditor, member, liquidator or administrator) including details of a proposed scheme and requesting the court to order a meeting of the relevant class(es) of members and/or creditors (known as a “Court Meeting”);
2. approval of the scheme by the required majorities of the members and/or creditors at the Court Meeting - the relevant majority is a majority in number representing three quarters in value of the members or creditors (or a class of members or creditors, as relevant) who vote (in person or by proxy). The vote must therefore be on a poll;
3. sanction of the scheme by the Court; and
4. delivery of the Order of the court to the Registrar of Companies, upon which the scheme becomes affective.

A straightforward scheme should take around two or three months from the date of application.

One of the most difficult issues is to determine the appropriate class or classes of creditors from which to obtain consent. Failure

to obtain the appropriate consent of each separate class of creditors and/or members will prevent the court from sanctioning the scheme. It is up to the applicant to determine the classes and the court may not give a view or any guidance on who should be included at the application stage but may uphold a challenge to the make up of the class(es) at a later stage. It is therefore important to correctly identify the classes as early as possible and before the Court Meeting(s) to avoid any possible waste of time and costs. Caselaw has confirmed that the class must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest – its is therefore their rights and not their interests which is the governing factor. An analysis is therefore required of the rights to be released or varied under the scheme and the replacement rights (if any) to be given by the scheme. Where a scheme is being proposed as an alternative to a liquidation or administration, the applicant must consider how the respective creditors would have been treated in a liquidation or administration when determining the classes. Therefore, unless you can identify huge dissimilarities in rights, it would seem that all creditors are capable of forming the same class and consulting together.

The courts have in two recent cases approved the use of a scheme of arrangement to implement the restructuring of a company’s debt, by affecting a debt for equity swap between a distressed company and certain of its secured lenders. These cases have enforced the following:

1. a creditor (for example, a mezzanine lender or subsequent charge) who has no economic interest in the outcome of a scheme, because the value of the company’s assets was less than the value of the senior debt so that there is no prospect of any return, has no standing to challenge a scheme;
2. the appropriate basis on which to value the assets of the company was the present going-concern value of the business and not a valuation on a discounted cash-flow basis, which some mezzanine lenders had proposed to support their claim that there was value in their debt;
3. the court will not readily reject a scheme which has been approved by the majority of those participating, unless it does not comply with the statutory requirements or there is some other manifest defect.

In the recent case involving Lehman Brothers International (Europe) (in administration), the Court of Appeal upheld the High Court’s finding that the concept of “creditor”, in the context of a scheme of arrangement, only covers pecuniary claims and not proprietary claims. It is understood that PwC propose to appeal this decision.

Schemes of arrangement are a valuable means for companies to deal with their creditors. Given the financial difficulties many companies find themselves in, and no doubt many more will find themselves in before we are out of this sorry mess, it will be interesting to see just how flexible schemes of arrangement can be.

Paternity leave and pay extensions on the unemployment law horizon

The Work and Families Act 2006 ("WFA 2006") provides for a new right to additional paternity leave and pay affecting those parents of babies due from April 2011 onwards. The extension could see a father's entitlement to leave rise from two weeks to a possible 26 weeks, but only if the mother returns to work with some of her maternity leave entitlement outstanding.

Here we examine the current legislation and the proposed extensions to the existing benefits and how and when the new proposals are to be implemented.

The existing legislation

Since April 2003, employees have been entitled to Statutory Paternity Pay ("SPP") and either one whole week or two consecutive weeks paternity leave. These must be taken within the period of 56 days beginning with the date of childbirth or placement of an adopted child.

Statutory Paternity Leave ("SPL")

SPL is subject to eligibility, length of leave and timing and notice requirements.

Eligibility

For SPL following the birth of a child, the employee must satisfy the following criteria:

1. be continuously employed for a period not less than 26 weeks ending with the 14th week before the weekend the baby is due;
2. be the father of the child, or be married to, the civil partner of or partner of the child's mother; and
3. as the child's biological father, have, or expect to have, responsibility for the child's upbringing, or if not the child's father, have, or expect to have the main responsibility (other than that of the child's mother) for the child's upbringing.

In respect of adoption, the employee must have had a minimum of 26 weeks continuous employment from the week in which the child's adopter is notified of having been matched with an adoptive child.

Leave

Leave can only be taken for the purposes of caring for the child or supporting the adopter.

Timing and notice requirements

Leave must be taken between the date on which the child is born or placed with the adopter and 56 days after that date.

In order to give sufficient notice of intention to take SPL, an employee must confirm in writing with the employer, the expected week of childbirth, the length of SPL the employee intends to take and the date on which the employee wishes to commence their SPL.

Statutory Paternity Pay ("SPP")

Employees who take SPL will be entitled to SPP, subject to the slightly different eligibility criteria. The current weekly rate of SPP is either £123.06 per week or 90% of the employee's normal weekly earnings, whichever is the lesser.

Eligibility

Employees who qualify for SPL will also qualify for SPP, with an additional requirement that the employee needs to be someone on whose behalf an employer is liable to pay Class 1 National Insurance Contributions.

SPP is payable for a period of one or two consecutive weeks, with notice and evidential requirements being the same as those required for leave. Liability to pay SPP falls with the employer. HMRC will be responsible for payment of SPP where the employer is liable for SPP, but has failed to make the payments or if the employer becomes insolvent.

An employer is currently entitled to recover at least 92% of any SPP made from HMRC if the amount of SPP exceeds the amount of tax, NICs and student loan deductions that they are due to pay to HMRC.

Proposed Extensions

Additional Statutory Paternity Leave ("APL")

The current intention is for an eligible employee to be permitted to take a maximum of 26 weeks' APL before the child's first birthday. The right will only accrue where the employee's spouse, civil partner or partner returns to work with some of their maternity/adoption leave untaken. The mother or adopter will also be required to return to work having not exhausted their entitlement to statutory maternity or adoption leave. An employee must of course have been entitled to take ordinary SPL before becoming eligible for APL.

Under the government's proposals, the earliest date upon which APL can be taken is 20 weeks from the date of the birth or placement with the adopter of the child. Where a mother dies as a result of childbirth, a partner will be able to take APL at an earlier point and for a longer time. The proposals state that the minimum period of APL will be two weeks and all leave must be taken in one continuous block.

The contract of employment with the employee will continue throughout APL with any

terms and conditions applying as if they were at work, with the exception of remuneration. All other benefits will continue to apply. There is expected to be some provision made for "keeping in touch days" for those fathers taking APL, whereby an employee may work up to 10 days for the employer without losing their entitlement. A father will have the right to return to the same job on the same terms and conditions as before the APL began.

Additional Statutory Paternity Pay ("APP")

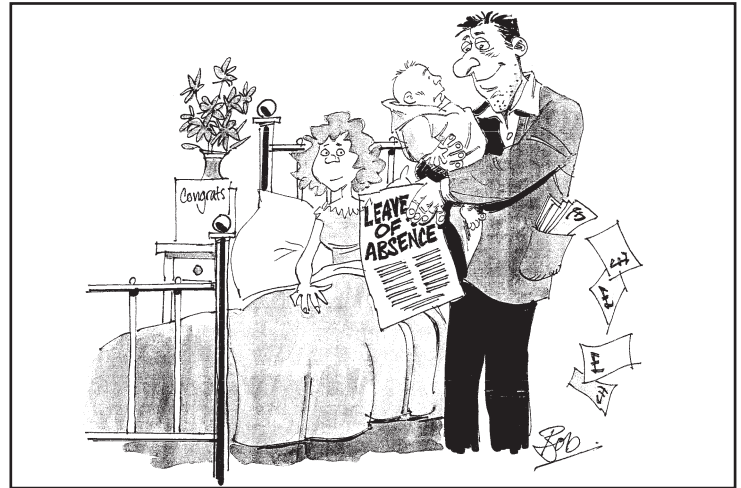
APP will be paid at the same rate and calculated in the same way as SPP and will mirror the existing entitlement. For a father to be entitled to APP, the mother or adopter must have returned to work with some of their maternity payment entitlements remaining. The number of weeks' entitlement to APP will depend on the number of weeks remaining from the mother or partner's entitlement.

Thinking ahead for the employer

The provisions for SPL and SPP under the existing legislation are the statutory minimum and apply as a default. An employer can of course provide enhanced provisions for leave and pay and must decide whether these are to be contractual terms or a non-contractual policy. However, an employee will not be able to exercise their statutory rights in addition to their contractual rights.

Whilst the new rights under the WFA 2006 do not come into force until 2011, employers will need to consider whether to pre-empt the provisions by implementing a more favourable scheme than the current existing legislation. The costs and impact of the scheme can then be measured and appropriate documentation put in place and communicated to employees.

Some employers currently pay above the normal rate during SPL. This may need to be re-considered when APL comes into effect, due to the potentially longer period of leave.



How and when will the proposals come into effect?

In introducing the new proposals, the government is considering using a "light touch" to entitlement, relying on self-certification by the employee. Under these proposals, the employee will provide a signed declaration confirming they have satisfied the criteria for APL. The mother must also sign the declaration providing the date she intends to return to work. An employer can request details of the mother's employer and an employee must notify their employer if the circumstances change. A minimum of eight weeks' notice must be provided, mirroring the notice period for a mother who intends to return from maternity leave early. An employer must confirm the entitlement to APL within 28 days of the employee's notification. The proposal is that the current form for claiming paternity leave and pay should be amended to account for additional entitlements as well.

HMRC will conduct compliance checks on some employees and impose financial penalties for abuse.

The planned implementation date for additional paternity leave and pay has been delayed twice already since its inception. With businesses still feeling the impact of the recession, the question is whether the government will opt to delay the implementation again.

For further information, please contact Ann Ebberson, or the partner with whom you usually deal.

This newsletter has been prepared as a summary and is intended for general guidance only. In the case of a specific problem, it is recommended that professional advice is sought

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