LexisPSL Banking & Finance Quarterly Briefing – Q2 2020

In this briefing, the LexisPSL Banking & Finance team looks at two cases which have particular resonance for the new world we find ourselves in.

The first case, *Pathway finance*, looks at the impact of a document being registered at Companies House on the court's approach to remedying mistakes in the document. The second case, *Re A company (injunction to restrain presentation of petition)*, confirms that a court can take a proposed change in the law into account when making its decisions.

Pathway finance – why is it of interest to lenders?

The case *of Pathway finance v Defendants set out in annex 1 to the claim* [2020] EWHC 1191 (Ch) is of interest primarily because it gives guidance as to the court's approach to construction of contracts when the relevant contract is a publicly available document – in this case security accession deeds registered at Companies House.

The increase in defaults under credit documentation means that more mistakes in security and other finance documents are likely to come to light as lenders conduct security reviews to establish their position. Understanding the approach a court is likely to take to these mistakes may assist lenders looking to understand and mitigate their risk in relation to particular credits. In this case, the court made it clear that the impact on third party creditors would be considered when correcting mistakes in security documents.

Pathway finance – what were the facts?

Pathway Finance, as lender, entered into a facility agreement on 16 September 2011 – this was later amended in November 2016 to increase the facility sum from £3m to £180m. The initial borrowers under the facility agreement granted Pathway Finance a floating charge (the Security Agreement) in 2011.

Group companies acceded to the facility agreement as borrowers and to the Security Agreement as chargors at intervals, but in February 2017, the accession deed entered into by a new borrower mistakenly defined the Security Agreement as being dated the 17 November 2016 as opposed to 16 September 2011. This mistake was then replicated in the 86 accession deeds entered into after that.

The claim was not contested but was put before the court for determination due to the possible effects on third party rights. The accession deeds had been filed at Companies House and were therefore publicly available documents – any amendment to the deeds agreed privately between the parties could impact a third-party creditor.

The court was invited to construe the accession deeds as referring to the correct date or, if this was not possible, to rectify the deeds so that they referred to the correct date.

Construction v rectification – which should be preferred?

The court looked at whether the remedies of construction or rectification would be more appropriate in this instance.

Construction can be used to remedy a mistake if it is clear there has been a mistake (looking at both the document and admissible background evidence) and it is clear what correction ought to be made in order to cure the mistake (see *Chartbrook Ltd v Persimmon Homes Ltd [2009] UKHL 38, [2009] 1 AC 1101*).

Rectification is broader – it is a discretionary remedy that can be ordered if: (1) the document fails to give effect to a prior concluded contract or (2) when they executed the document, the parties had a common intention in respect of a particular matter which, by mistake, the document did not accurately record (see *FSHC Group Holdings Ltd v GLAS Trust Corporation Ltd [2019] EWCA Civ, 1361, [2020] 2 WLR 429*).

Interestingly, the fact that the documents were registered at Companies House had an impact, in the court's view, on whether construction or rectification was appropriate.

The court preferred construction as a remedy in this case, as if a publicly available document was rectified but later that rectification was reversed by court order, a third party who relied on the rectified version in the interim could be negatively impacted.

The court also commented that construction will often logically precede rectification. This is because it is necessary to establish an error – or at least a real doubt that there might be an error – before rectification can be ordered by way of equitable relief.

When it comes to publicly available documents that could be relied on by third parties, then, there is a strong argument in favour of selecting construction as a remedy where available. Where the nature of the error is such that construction is unlikely to be available, the court will look in detail at the likely impact of the rectification on third parties before making the relevant order.

How was the court's approach to construction impacted by the documents' registration at Companies House?

The other point that the court looked at was the impact of the accession deeds being publicly available (by virtue of their registration at Companies House) on the court's approach to contract construction.

The ordinary test when interpreting a contract is what a reasonable person with the background knowledge of the parties to the relevant contract, at the time it was made, would have thought it meant. On this analysis, a reasonable person with background knowledge, would have assumed that the 2011 Security Agreement was intended to be referred to.

The question was whether the fact that the accession deeds were public documents limited the relevance of 'background information' when construing the documents. The extrinsic material here was predominantly the existence of a 2011 charge and non-existence of a 2016 charge.

The judge concluded that the court's approach to what weight to give extrinsic material will depend on the nature and circumstances of the particular instrument. The court must identify to whom the document is 'addressed', ie who can be expected to rely on it, and the effect of taking extrinsic material into account on this group. A registrable corporate charge is addressed to third parties looking to extend credit and/or take security from the chargor, so it is the effect on this group that needs to be considered.

Significantly, the judge decided that a third party looking to extend credit or take security would request a copy of the security document and thereby discover the mistake for themselves. The extrinsic evidence, the existence of the 2011 Security Agreement, was therefore admissible as it was available to these third parties. The judge did also note that, in any event, the date of the Security Document would have no impact on third parties.

Pathway finance - what are the practical takeaways?

The decision highlights that lenders who find mistakes in their documents should give careful consideration to whether they pursue construction or rectification in circumstances where both are potentially available.

The court highlighted that construction may be preferred for a security document due to the possible effect of rectification on third parties. However, the case also demonstrates that a court may not admit extrinsic evidence when construing a security document where the evidence is not available to third parties. In some cases, this may prevent the document being construed to reflect the actual intention of the parties.

It is also worth noting that the court considered it the right approach to seek determination from the court, rather than privately amending the accession deeds, given the large sums involved, possible impact on third party rights and directors' duties considerations.

The case is also of interest to those looking to take security. In this case at least, the court thought it was reasonable to assume some due diligence on the part of the third-party creditor and it would be wise, therefore, for lenders to ensure they request copies of all available, relevant documentation before extending credit. If a lender relies on the contents of the documents, having reviewed those available, the court is likely to ensure its rights are protected.

Re a company (injunction to restrain presentation of petition)

The Corporate Insolvency and Governance Bill 2020 (the CIG Bill) is bringing in significant temporary and permanent changes to insolvency legislation.

Paragraph 1 of schedule 10 to the CIG Bill prevents any statutory demand from being used to present a winding-up petition from 27 April 2020 where the statutory demand was served in the period between 1 March 2020 and the later of either 30 June 2020 or one month after the coming into force of schedule 10.

The effect of paragraphs 2 and 5 of schedule 10 is that at the hearing of any petition presented on insolvency grounds after 27 April 2020, it would have to be shown that (i) coronavirus had not had a financial effect on the company, or (ii) the facts on which the petition was founded would have arisen even if coronavirus had not had a financial effect on the company.

Paragraph 4 of schedule 10, in summary, provides that where a petition has already been presented on insolvency grounds between 27 April 2020 and the coming into force of schedule 10, and the court is satisfied that the creditor did not have reasonable grounds for believing that i) coronavirus had not had a financial effect on the company, or (ii) the facts on which the petition was founded would have arisen even if coronavirus had not had a financial effect on the company, then the court may make such order as it thinks appropriate to restore the position to what it would have been if the petition had not been presented.

In the case of *Re A company (injunction to restrain presentation of petition*) [2020] EWHC 1406 (Ch), the company relied on these provisions of the CIG Bill when applying for an injunction to restrain the presentation of a petition by a creditor lessor.

The judge reviewed the relevant case law and decided that when the court was deciding whether to grant relief and, in particular, relief which involved the court controlling or managing its own processes, it could take into account its assessment of the likelihood of a change in the law which would be relevant to its decision.

Assessing that the CIB Bill was likely to become law shortly, the Chancery Division granted the injunction on the basis that coronavirus had had a financial effect on the company before the presentation of the petition. The facts on which the petition would be based would not have arisen if coronavirus had not had a financial effect on the company.

Re a company – what are the practical takeaways?

The case, together with the earlier case of *Travelodge v Prime Aesthetics* [2020] All ER (D) 47 (Jun), provide confirmation that pending legislation can be considered by the courts. This may well have broader implications, for example in relation to the upcoming changes to the law as a result of the UK's departure from the EU.

More narrowly, this case confirms that even prior to the new insolvency legislation becoming law, creditors need to be aware that it is likely to be treated as though it is already law. In fact, the effect of *Re a company* can be seen already in the slightly later case of *Re a company (application to restrain advertisement of a winding up petition)* [2020] EWHC 1551 (Ch) where the facts were similar. In light of the decision in *Re a company*, it was common ground that the court should factor the provisions of the CIG Bill into the exercise of its discretion.

In practice, this means that lenders should exercise caution in accelerating debt on the basis of an event of default triggered by the presentation on insolvency grounds of a winding up petition which falls in the relevant time period. The effects on particular documents will need to be examined on a case by case basis, but there is certainly an argument that an event of default, even if triggered by the presentation of a petition, could no longer be 'continuing' once the legislation is in force.