

## APPROPRIATION OF SHARES IN BVI COMPANIES UNDER ENGLISH LAW SHARE MORTGAGES

On 5 May 2009 the Privy Council in London handed down its decision in *Alfa Telecom Turkey Limited v Cukurova Finance International Limited* [2009] UKPC 19, drawing a definitive end to the vexed preliminary issue under British Virgin Islands law. The case related to the English remedy of “appropriation” under the Financial Collateral Arrangements (No 2) Regulations 2003 (the “Regulations”) as it applied to shares in British Virgin Islands companies which are subject to an equitable mortgage governed by English law.

The case is the first known judicial decision anywhere on the interpretation of the Regulations, and has generated considerable interest in the European financial markets.

### *Facts*

The relevant facts have been summarised in previous notes in relation to this case, but can be briefly repeated: The applicant, Alfa, had made a loan of approximately US\$1.352 billion to the first respondent, Cukurova Finance. As part of the security package for the loan, share charges had been granted under both English law and British Virgin Islands law over the shares in Cukurova Finance itself and one of its British Virgin Islands incorporated subsidiaries. A default was called under the loan, and Alfa sought to “appropriate” shares in the two British Virgin Islands companies under the English law governed share mortgages by sending letters to the registered office of the chargors and the share issuing companies purporting to exercise the right

of appropriation, but the chargee was never actually entered in the share register as the registered holder of the relevant shares.

## *First instance*

At first instance Joseph-Olivetti J held that although the remedy was available, the mere sending of the letters by Alfa had not effectively exercised the right. Influential in her thinking was that (i) under British Virgin Islands law a person is not recognised as the legal owner of shares until they are registered in the share register; (ii) the Regulations laid emphasis upon the right to “keep” or “retain” collateral, rather than to require the chargee transfer it; and (iii) she felt that some “overt action” was required which vested the legal and equitable rights in the chargee in order to exercise the right - the mere sending of letters was not sufficient, and that actual registration should be required - commenting: “I am not persuaded that to require registration would be that cumbersome to be said to defeat the purpose of the [R]egulations ... to my mind it will lend certainty to a situation as has arisen here.”

## *Court of Appeal*

The Court of Appeal did not agree with Joseph-Olivetti J that to exercise the remedy, one had to become absolute owner of the shares. They preferred the view of Lord Millett (who gave expert evidence for Alfa at first instance) that an exercise of the remedy which did not result in the chargee being registered as the absolute owner had the effect of making it the full beneficial owner of the shares, and reducing the legal ownership to a mere shell. Joseph-Olivetti J had rejected that view on the basis that the Regulations needed to be interpreted in a uniform manner across EU member states, and such an interpretation would be wholly improbable where the vast majority of EU member states did not recognise the concept of equitable title. The Court of Appeal did not agree. It felt that because the Regulations were expressed to apply to equitable mortgages (which are themselves similarly unknown outside of common law systems), this provided a basis for divergence: “It follows inescapably ... that what is required for appropriation in English law must diverge from what may be required in other EU member states.”

The Court of Appeal further added that, following the guidance of Lord Steyn in *Director of Fair Trading v First National Bank plc* [2001] UKHL 52, “[t]he requirement ... that the collateral taker must become the absolute owner of the collateral on appropriation, calls for a pragmatic construction.”

The Court of Appeal further held that pragmatic interpretation required that “full ownership” or “absolute ownership” be construed as meaning full or absolute ownership *of the beneficial interest* in line with the common law on mortgages (see for example *Marshall v Shrewsbury* (1875) LR 10 Ch App 250 at 254), and that no particular difficulty would arise by virtue of a separation of legal and beneficial title on enforcement as this had been the position for years in relation to the law of foreclosure.

### ***Privy Council***

The decision of the Privy Council, delivered by Lord Walker, was the shortest of the three judgments handed down on the preliminary issues (although by this stage a number of the issues between the parties had been agreed, or had not been appealed against). The Privy Council dismissed the appeal, and held that, on the agreed facts, a valid appropriation would have taken place. They agreed with the Court of Appeal that one needed to take a broad and pragmatic view of the wording, and apply that wording in a way which was consistent with the stated aim of creating “rapid and non-formalistic enforcement procedures”. Whilst they had sympathy with the concern of Joseph-Olivetti J at first instance that the Regulations seem to require that the secured party needed to obtain “full ownership” or “absolute ownership” to appropriate collateral, they felt that in this case the term was used in contradistinction to partial ownership (such as a life interest) rather than in relation to legal and equitable title.

The Board took pains to make clear that they did not fully endorse the reasoning used by the Court of Appeal. In particular, they were at pains to stress that they did not agree that only the equitable title to the shares had been charged, or that the remedy of appropriation could be exercised without any overt act at all. They expressed the view that both as a matter of commercial practicality and to be consistent with Article 4.4(a) of the original Directive, some

form of overt act was required, and that the notice sent by Alfa to the Cukurova parties indicating its exercise of its remedies was sufficient for this purpose.

## *Underlying litigation*

The case will now proceed before the British Virgin Islands courts in relation to disputed matters of fact (the Cukurova parties vigorously dispute whether an event of default had occurred at all). Nonetheless, a number of novel legal issues were raised and fully argued over the course of the three hearings (many of which were abandoned by the time the appeals reached the Privy Council, but are summarised in earlier Harneys client notes on this case) means that understanding of this relatively novel remedy has been considerably enhanced during the course of the proceedings.

*If you would like further information on the subject matter of this Guide please contact Colin Riegels at [colin.riegels@harneys.com](mailto:colin.riegels@harneys.com) or your usual contact at Harneys. Alternatively, you can visit our website at [www.harneys.com](http://www.harneys.com)*

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