

## In The Know

### Leveraged Finance Newsletter

By Matthew Cox, Priyanka Usmani, Charles Thomson, Richard Molesworth and Natalie Butchart of Baker McKenzie's London office

## Collateral Appropriation - in a "commercially reasonable manner"

ABT Auto Investments Limited vs.  
Aapico Investment Pte Ltd and Ors  
[2022] EWHC 2839 (Comm.)

A cross-practice group in the London office of Baker McKenzie — led by Restructuring Partner Priyanka Usmani, Disputes Resolution Partner Charles Thomson and Banking Partner Matthew Cox — acted for Aapico and succeeded in their argument that the company validly appropriated shares in a private company under the The Financial Collateral Arrangements (No. 2) Regulations 2003 ("Regulations").

This is the first time that the English courts have had the opportunity to consider the meaning of the term 'commercially reasonable manner' in the context of its use in Regulation 18 of the Regulations, which governs how a collateral taker must value financial collateral that it is appropriating. The judgement is particularly significant because neither the Regulations, nor the EU directive behind them, contains a definition of or direction on what constitutes a 'commercially reasonable manner'.



## Facts of the Case

At its core, the facts of this case are relatively straightforward. As part of a wider joint venture structure, ABT Auto Investments Limited (“**ABT**” or the “**Claimant**”) granted a share charge over shares it held in Sakthi Global Auto Holdings Limited (“**SGAH**” or the “**Third Defendant**”) in favour of Aapico Investment Pte Limited and Aapico Hitech Public Company Limited (collectively, “**Aapico**”, or the “**First Defendant**” and the “**Second Defendant**”, respectively) to secure loans provided by the First and Second Defendants to SGAH.

SGAH failed to fulfil its payment obligations under the loans. Ultimately, Aapico gave notice to exercise its rights, as set out within the share charge, to appropriate the charged shares in SGAH. ABT challenged Aapico’s appropriation of the charged shares and the value that Aapico had ascribed to them, resulting in this case before the English High Court.

It was agreed between the parties that the charged shares constituted financial collateral (as defined in the Regulations) and the share charge and the obligations of ABT (as chargor) thereunder constituted a security financial collateral arrangement (as defined in the Regulations). The right of appropriation clause in the share charge provided that Aapico (as chargee) — upon the security created thereunder becoming enforceable and written notice being given — may appropriate all or any of the charged shares in or towards payment or discharge of the secured liabilities, “subject always to Regulation 18 of the Regulations”. The clause then went on to set out how the chargee was permitted to value the charged shares and expressed that the chargor agreed that the method of valuation provided for was “commercially reasonable for the purposes of the Regulations”.

## The Regulations

By way of background, the Regulations implemented into UK law an EU directive, whose purpose was to ensure that security over certain forms of financial collateral (broadly speaking, cash in a bank account, shares and bonds) was treated consistently throughout the EU, helping to create greater certainty. Regulation 17 introduced into English law the ‘self-help’ remedy of appropriation (where the secured party or ‘collateral

taker’ takes ownership of the financial collateral), requiring simply that the terms of such power be set out in the security financial collateral arrangement (in this case, the share charge); and Regulation 18 sets out the duty for the collateral taker (i.e., the chargee) to value the financial collateral both (i) in accordance with the terms of the security financial collateral arrangement; and (ii) in any event in a ‘commercially reasonable manner’. Neither the EU directive nor the Regulations provide a definition of or direction on what might constitute a ‘commercially reasonable manner’.

## ABT’s claims

ABT, as Claimant, claimed that the valuation of the charged shares did not comply with the requirements under the share charge and/or the Regulations, resulting in a significant undervaluation. As a consequence, the entire appropriation was invalid and legally ineffective, meaning that ABT remained the beneficial owner of the charged shares.

## Court’s key findings

### ▪ Valid power of appropriation

In short, the judge dismissed ABT’s claims in full, finding that the provisions of the share charge conferred a legally valid power of appropriation under Regulation 17.

ABT claimed the power was invalid because the method of valuation provided for was not commercially reasonable or could be exercised in a manner that was commercially unreasonable. ABT made this claim based on the words included in the appropriation clause of the share charge that, in certain circumstances, permitted the chargee to carry out the valuation by “such other process as the chargee may select”.

The judge dismissed this claim, stating that the words did not permit the chargee to act in an “arbitrary or unreasonable manner” as it was expressly stated that the right of appropriation provisions were “subject to Regulation 18 of the Regulations” — providing the necessary protection to the chargor — and the Regulations also provided such protection. In order for the clause to be compliant with the Regulations, it was sufficient that the clause permitted the chargee to carry out the valuation in a commercially reasonable manner.

In addition, he concluded that any non-compliance with a required valuation method would not result in an invalid appropriation; to do so would create uncertainty as to ownership, in this case, of the shares, defeating one of the original intentions of the EU directive and the implementing Regulations. If a court concluded that a valuation had been non-compliant, the remedy would be for the court to substitute a compliant valuation.

▪ **Valuation carried out in a commercially reasonable manner**

The judge rejected the claims that there should be implied terms as to the nature and conduct of the valuation. He also held that the obligation was simply the statutory requirement to conduct the valuation both in accordance with the terms of the share charge and in a commercially reasonable manner, “no more, no less”. In particular, there is no room for the implication of any equitable or other duties associated with the English law of mortgage nor any additional requirement for the collateral taker to act in good faith.

The requirement for the valuation to be conducted in a commercially reasonable manner does import an objective standard into the process, which must be met. This would preclude the chargee from deliberately seeking to create a favourable outcome for itself, e.g., a low valuation, but it was decided that simply stating that its preference or desire would be for a lower valuation was not commercially unreasonable. This fact would have been obvious in itself anyway given the circumstances.

The judge dismissed ABT’s claims in full, finding that the valuation had, in fact, been carried out both in accordance with the terms of the share charge and in a commercially reasonable manner. On the evidence presented in defence, the judge found that the conduct of both Aapico and the valuers had been professional and sought to produce a valuation that was “sufficiently well evidenced and reasoned as to be proof against challenge”.



## Concluding thoughts

The court's findings in this case help to strengthen the value of the self-help remedy of appropriation that was introduced into English law by the Regulations, allowing a collateral taker to take ownership of certain secured assets without the need to turn to the courts.

Lenders and borrowers alike should welcome the greater clarity that the guidance provided by the judge in this case has brought to the application of Regulations 17 and 18 of the Regulations and, in particular, the meaning of the phrase 'commercially reasonable manner'.

Finally, it is worth noting the direction provided by the judge that two valuation experts meet and

produce a joint memo regarding their agreements and disagreements in relation to the valuation of the shares. In the context of the dispute, this greatly assisted the court in crystallising the differences in the expert evidence. From a market practice perspective, one can see the benefit of this approach being taken up and applied in the context of disputed valuations as part of a restructuring plan as a way of reducing the number of issues that a judge needs to consider in complex disputes. The additional time and cost of doing so will need to be balanced with the need to facilitate restructurings in a timely manner while at the same time protecting the interests of all interested parties.

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