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Insights

ENFORCING SHARE SECURITY: APPROPRIATION AND "COMMERCIALLY REASONABLE" VALUATIONS

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The recent case of *ABT Auto Investments Ltd v Aapico Investment Pte Limited and others [2022] EWHC 2839 (Comm)* explores a lender's rights to enforce share security by appropriating shares secured in its favour. The statutory framework for doing this has been in place since 2003 pursuant to the Financial Collateral Arrangements (No 2) Regulations 2003 (the "**FCARs**"), yet this is the first time this has been explored by an English court in any depth.

Share security forms a crucial part of many real estate finance transactions, and appropriation of shares can provide an easy enforcement option for lenders. Sponsors also have a close interest in understanding appropriate valuation mechanisms in this context. Accordingly, this case will bring welcome clarity to funders and borrowers alike in providing guidance on what the FCARs mean by acting in a "commercially reasonable manner" when valuing shares.

FACTUAL SUMMARY

ABT entered into a joint venture with Aapico. It granted guarantees and a charge over shares it held in that joint venture, as security for a loan from Aapico. When ABT defaulted on repayments, Aapico exercised its right to appropriate ABT's shares and obtained a third-party valuation of USD 27m for them. ABT challenged both the appropriation and the value (which was around 30% of the value ABT placed on its shares).

KEY LEGAL POINTS

- Under the FCA Regulations, if the enforcing party wishes to appropriate shares, then the document must provide for them to do so, and they must value those shares in accordance with any methods laid down in the charging document "and in any case in a commercially reasonable manner".
- What is commercially reasonable must be assessed objectively, and will vary from one factual situation to another.

- The methodology used by the valuer must be commercially reasonable. If it is, then an English court will be slow to provide a substitute valuation or award damages, and even slower to seek to unwind the appropriation altogether.
- Involving a third party valuer does not absolve the lender of any further responsibility. Responsibility sits with the lender to value the shares in a commercially reasonable manner. If the valuer does not act in a commercially reasonable manner, the valuation method will not meet the statutory requirements.
- The enforcing party must behave in a commercially reasonable manner towards a valuer when obtaining the valuation. For example, knowingly withholding material information from the valuer, with a view to influencing the valuation downwards, would create a substantial risk of challenge. (On the facts of this case, the court held that nothing material had been withheld, and it was commercially reasonable in the circumstances of an enforcement and a broken-down funding relationship for the valuer not to have access to the company's management.)

KEY PRACTICAL POINTS

First, from a borrower perspective, it is interesting that the court considered this point at all. The charging document stated that valuing the shares in line with a valuation obtained by a qualified independent third party was automatically deemed to be commercially reasonable. The borrower essentially argued, in part, that this process was not commercially reasonable after all. Had a judge simply thrown out this argument altogether, based on the content of the charging document, this would on the surface have been a perfectly rational approach. The judge did not do this. This indicates that if borrowers can challenge an appropriation of shares made by their lenders if they have good reason to believe that its lenders, in fact, have not acted in a commercially reasonable manner in valuing their shares – whatever the credit documents might say to the contrary.

If lenders are enforcing share security and are considering appropriating private unlisted shares, with no ready market or reference point for valuing those shares, then seeking a third party valuation (whilst not being an absolutely essential step) is likely to be a commercially reasonable thing to do. This is, of course, a regular occurrence during the life of a real estate finance facility agreement and would be entirely normal practice prior to appropriating shares. Finally, but perhaps obviously, the lenders must not allow their own commercial interests to pressure or influence the valuer.

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