

Safe as houses

This month Daniel Priestley, counsel and Christopher Russell, senior counsel and head of litigation at Ogier take a look at the composition of the First Legal Charge. This section of the series is split into two parts. Part two will follow next month.

Cayman Islands' law and practice will almost always require that the contractual terms of a First Legal Charge are set out in three documents.

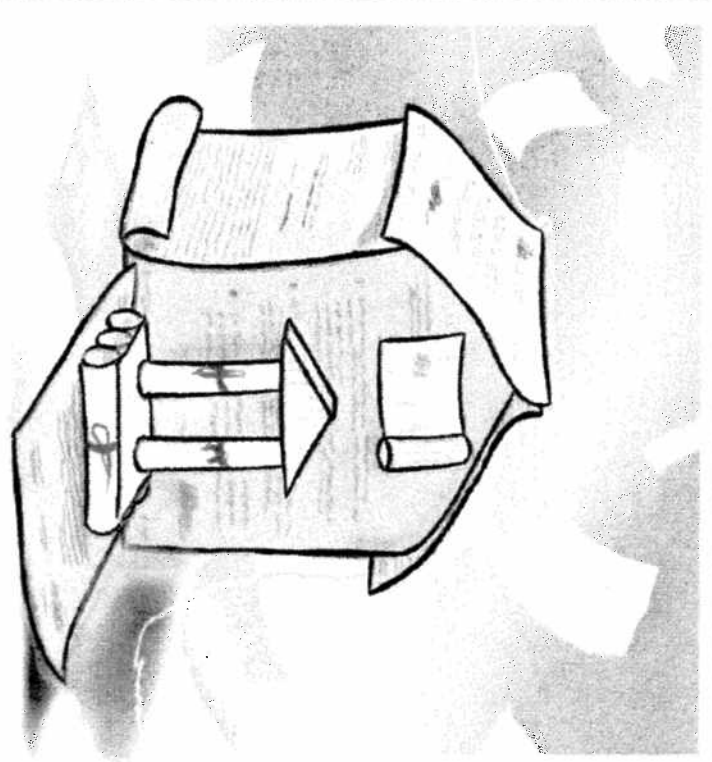
The first is the facility letter agreement, which will usually set out those principal terms of the loan, and which will be of fundamental interest to a borrower.

The second such document is the Land Registry Form RL9. Registration of Land Registry Form RL9 is the essential element in per-

fecting the security over the relevant parcel of land and repeats a few of the principal terms of the loan which, upon registration, will be recorded in the Incumbrances Section and therefore available for anyone to see upon payment of the prescribed fee. There is typically a schedule to Land Registry Form RL9, which, by its drafting, incorporates into the charge, the balance and majority of its terms, most of which are significant, but of lesser practical interest to the borrower.

Finally, some lenders require the borrower to execute a Power of Attorney in a prescribed form which theoretically allows the lender to deal with the property as if it were the absolute owner of it.

However, equity would never allow lenders to exercise unfettered powers over the disposition of secured property, which makes it unlikely that a properly advised lender would take the risks associated with operating



under such a power of attorney.

This type of power of attorney is to be distinguished from the typical power of attorney seen in the schedule to Land Registry Form RL9, which, it should be noted, is usually

limited to ensuring that the asset is properly secured and in connection with realising the security. However, even this somewhat limited power of attorney carries risks associated with

Continued on page 8

Safe as houses

Continued on page 7
its use, which will be discussed in a later instalment in this series in connection with enforcement.

The facility letter agreement

The facility letter agreement will typically set out the following terms: the identity of the parties, the amount of the loan, the purpose of the loan, how and when the borrower may draw down on the loan, the term of the loan, the interest rate applicable to the loan or a formula enabling the ascertainment of the applicable interest rate.

The type of the loan is usually specified, and it is almost always stated to be an "on demand" loan. This expression means exactly what it says, namely, that the loan is repayable to the lender at any time, on demand being made by the lender to the borrower.

There will usually be a commitment fee payable on execution of the facility letter, there will be repayment terms, including prepayment terms, which can attract further fees and, of course, identification of the assets, which will be required to be used as security for the loan. In the context of this discussion, the security will always include some land but there may be other assets over which the lender will require security, such as a life insurance policy and/or an assignment of salary.

The agreement will almost certainly stipulate that the borrower obtain a valuation of the land, and may stipulate that the valuation yield a particular value or more or the agreement automatically terminates. The agreement will almost certainly stipulate that any buildings on the land are insured to their full replacement value and that that insurance is maintained throughout the term of the loan.

Strictly speaking, any breach by the borrower of the terms upon which a loan may have been made is a default. Notwithstanding, the practice here is often to specify certain occasions which will amount to a "default", an example of which might be, say, if the borrower failed to make any payment to the lender within 21 days of the amount becoming due.

As most loans involving residential land are almost always repayable "on demand", there is no need for any default to arise in order for the lender to lawfully require repayment of the loan. Having said this, it is axiomatic that it would not be of benefit to the reputation of any "institutional" type lender to promote the fact that it is in a position to demand repayment of the loan at any time and for no reason, as this would make the lender appear arbitrary and insensitive to the needs of its customers.

Such lenders prefer to emphasise that the lender

will generally allow the loan to run the course of an agreed term unless certain major defaults occur as would justify demanding repayment.

The danger of following this course is that a court may find that the intention of the parties is, in fact, that there must be some form of default before the lender may lawfully demand repayment.

This is the issue that confronted the court in the landmark case of *Williams & Glyn's Bank v. Barnes*. Although the nature of the borrowing in that case was by way of overdraft, the principle which arose from that case applies equally to a loan secured over land.

The presiding judge had the following to say: "Bankers did in and before 1974 regard repayability on demand as a universal or normal attribute of overdrafts, but there is nothing to suggest that they regarded that attribute as overriding an agreement to the contrary. If a usage to that effect existed it would not, in my judgement, be lawful or reasonable... In truth, this custom or usage is no more than a recognition of the rule of law which results from the nature of lending money: money lent is repayable without demand or at the latest on demand unless the lender expressly or impliedly agrees otherwise. In my judgment by the facility letter of January 1974, the bank had agreed otherwise."

Williams & Glyn's Bank v. Barnes turned on the construction of the particular facility letter agreement. Its importance lies in emphasising that the words "on demand" do not override the expressed purpose of the facility. The court will read the facility letter agreement as a whole to ascertain the intention of the parties concerning repayment. If a loan is repayable on demand, the lender must be careful not to include a purpose clause or other provisions which imply some restriction on the lender's ability to make immediate demand for repayment. In particular, as established as a result of the case of *Cryne v. Barclays Bank PLC*, a covenant in a security document (such as a First Legal Charge) to pay on demand will never override the terms of the facility letter agreement under which moneys are advanced.

Finally, the facility letter will usually seek to elicit from the borrower information concerning the identity of any occupiers of the property who are not borrowing, as this is the most common form of an overriding interest. Any such overriding interest must be subordinated to the lender's security interest in the property or the lender may have difficulty in securing vacant possession of the property should the need to realise security over the land arise.

Next month we look at the Land Registry Form RL9

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