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Standard Clauses in Finance Contracts – Why include them?

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There have been a number of High Court decisions this year which have highlighted the importance of including certain standard clauses in finance contracts. In this webcast, I will discuss the findings in four notable cases from this year – AMC III Purple B.V. v Amethyst Radiotherapy Limited; Chudley & Ors v Clydesdale Bank Plc; Pireaus Bank S.A. v Grand Anemi Ltd & Ors; and Punjab National Bank (International) v Boris Shipping & Ors.

1. Set-off

The right of set-off allows parties who have financial claims against each other to deduct one liability against the other in order to reduce or entirely eliminate the liability. The right to set-off can arise in a number of ways, for example, a legal set-off, where a party can set-off sums claimed against it by way of a counterclaim against the claimant, or an equitable set-off, where a claim and cross claim are so closely connected that it would be inequitable to enforce one without taking the other into account.

AMC III Purple B.V. v Amethyst Radiotherapy Limited

In the Amethyst Radiotherapy case, the lender sought summary judgment against the borrower on a claim for outstanding payments under two loan agreements. The borrower also had claims against the lender which resulted in the commencement of arbitration proceedings against the lender in Cyprus.

The borrower raised several defences, one of which was that it was entitled to make an equitable set-off in respect of the claims that it had made against the lender in the Cyprus arbitration.

However, one of the loan agreements contained a clause stating that *"All payments to be made by the Borrower under the Finance Documents shall be calculated and be made without (and free and clear of any deduction for) set-off or counterclaim".* The Court found that this clause excluded the right of both legal and equitable set-off. The wording in this clause that the payments should be '*calculated and made without… set-off'* meant that it was impossible for the borrower to argue that the payments were not 'due' because they were subject to equitable set-off.

The other loan agreement contained a clause stating that *"Each payment to be made by the [Borrower] under this Agreement will be made in full, without any set-off or deduction."* Again, the Court upheld the clause and found that the use of the word 'any' in this clause meant that both legal and equitable set-off were excluded.

Whilst this decision follows previous decisions relating to no set-off clauses, it is notable that the Court once again upheld the validity of 'no set-off clauses', in this case in the context of a summary judgment application, and that the effect was to exclude both legal and equitable set-off.

2. Contracts Rights of Third Parties

The Contracts (Rights of Third Parties) Act 1999 gives a non-party to a contract (made on or after 11 May 2000) the right to enforce terms of that contract against the parties to the contract. Section 1 of the Act states that a non-party may enforce a contractual term if (a) the contract expressly provides that he may, or (b) the term purports to confer a benefit on him. Section 1(3) of the Act states that the third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description, but need not be in existence when the contract is entered into.

Chudley v Clydesdale Bank

In the case of Chudley v Clydesdale Bank, some investors paid money into an investment company to finance an offshore property development scheme. The investors were not aware that the investment company had signed a letter of instruction with a bank which instructed the bank to open a segregated client account for the scheme. However, the segregated client account was never opened and the money paid to the investment company was paid into another account it held at the bank. Later, the bank made payments out of the account at the investment company's direction. The individuals behind the investment company were arrested for fraud and the company went into liquidation.

The investors later became aware of the existence of the letter of instruction between the investment company and the bank. They argued that the letter of instruction amounted to a contract between the investment company and the bank and that they were entitled to claim the benefit of the contract under the Act. The purported contract did not exclude third party rights.

The Court of Appeal found as follows:

1. There was a binding contract between the investment company and the bank.
2. The investors were entitled to claim the benefit of the letter of instruction under the Act. In accordance with section 1(3) of the Act, the Court found that the reference to "a client account" was an express identification of a class, being clients of the investment company who were investing in the scheme, and that the investors fell within that class.
4. The same term also satisfied the requirements of section 1(b) of the Act that the term purported to confer a benefit on the third party. The purpose of the letter of instruction was to protect investors and the provision for the opening of a segregated client account was clearly intended to benefit such investors by ensuring that their monies were safely held by the bank.
5. The investors could take the benefit of the contract, even though they were unaware of its existence at the time of their investment and when they first sought to recover that investment.

The Act was applied widely in this case indicating the Court's willingness to uphold third party rights in finance agreements. This highlights the importance of including a clause to exclude third party rights under the Act in finance agreements (although care should be taken not to exclude third party rights if there are third parties that actually need to benefit from the Act, such as beneficiaries of indemnities).

3. Irrevocable appointment of agent for service within jurisdiction

Where parties to a finance agreement have agreed upon the jurisdiction of the English courts, in an ideal world, the agreement should contain a clause providing for service of proceedings on a designated agent in England. Service can then be effected on the agent pursuant to CPR 6.11. Whilst there can still be uncertainty surrounding the effectiveness of service of proceedings, the following two cases highlight how useful such a clause can be.

Piraeus Bank v Grand Anemi

In this case, the Bank sued Grand Anemi for over €80m due under a loan agreement and indemnities. The parties agreed for service upon a designated agent in London and service agents had been irrevocably appointed. The Claimant accordingly served proceedings on the Defendant's London agent. However, two weeks later, the agent resigned.

As to the effectiveness of service of the proceedings, the Court held that service was valid despite the agent's resignation, as the appointment of the agent was irrevocable, and that future documents could also be served on the agent.

Thus, a clause providing for the irrevocable appointment of designated agents for service in London can be of great use. In cases where the agent has resigned or the Defendant has withdrawn the agent's authority as a way to try and evade service, service may still be effected upon that agent.

Punjab National Bank (International) v Boris Shipping & Ors

In this case, the Bank brought claims against two offshore companies and their guarantors based in India for failure to repay overdraft facilities when they were due. The guarantees provided for the irrevocable appointment of an agent for service of process within the jurisdiction. However, the Bank chose not to effect service on the agent within the jurisdiction but decided to effect service on all Defendants via the Hague Convention. The Bank considered that the claims were more likely to be brought to the attention of the Defendants if served via the Hague Convention as opposed to service on the agreed agent. About a year later, service had still not been effected on all Defendants.

The Bank sought summary judgment against the Defendants. The application notice for summary judgment was a judicial document to which the Hague Service Convention would also apply. However, given the delay in serving proceedings via the Hague Convention, the Claimant obtained an order for service via an alternative means under CPR 6.15. At the summary judgment hearing, the Court found that the order for alternative service should not have been made because where a contracting state has indicated that it is opposed to service by alternative means (as in this case), only in exceptional circumstances can the English Courts override that, and there were no such exceptional circumstances here. The order for summary judgment was therefore not granted.

Having a clause in a finance agreement which irrevocably appoints an agent for service of process within the jurisdiction means that you may be able to avoid the long, cumbersome and expensive service process under the Hague Convention. In this case, the Claimant had such a clause in the guarantees but chose not to use this method. Had it done so, it is unlikely that it would have ended up in the unfortunate situation in which it found itself.

Conclusion

In conclusion, whilst the clauses discussed above can often be seen as standard clauses inserted at the end of a contract with little purpose, they can sometimes be of real benefit to lenders. They should not be ignored and thought should be given to them when drafting a contract. In particular, with Brexit on the horizon, clauses which provide for service upon a designated agent in England may become significant.