

COLLATERAL MANAGEMENT AGREEMENTS, PLEDGES AND SECURITY: HOW CAN A LENDER PROTECT ITSELF?

Taking security over goods stored with a party which does not have title to them is common in commodities financing. It can give rise to a complex set of contractual and non-contractual rights and liabilities and lenders must be careful to ensure that their security will be available if needed.

In a recent judgment¹, the English Commercial Court held that a lender could recover damages against a collateral manager based on its right to possession to goods, even though a foreign law pledge over the goods was found to be invalid.

¹ *Scipion Active Trading Fund v Vallis Group Limited* [2020] EWHC 1451 (Comm)

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Background

In 2016, under a facility agreement (the “Facility Agreement”), Scipion Active Trading Fund (“Scipion”) granted an uncommitted revolving copper borrowing base facility to Mac Z Group SARL (“Mac Z”), to finance the purchase of copper stock for processing into copper products.

Mac Z as the borrower agreed to enter into a pledge agreement over the goods and products (the “Pledge”) in support of its obligations to Scipion under the Facility Agreement. The Pledge was governed by Moroccan law.

In addition, Scipion and Mac Z entered into a collateral management agreements (CMA) with Vallis Group Limited (“Vallis”). This was governed by English law. Under the CMA, Vallis agreed to act as collateral manager, receiving, storing and holding the stock and products at a storage facility in Skhirat, Morocco (the “Site”). Vallis also agreed to issue warehouse receipts and provide reports to Scipion regarding the total quantity and value of the stock and products at the Site.

In October 2017, Vallis discovered a large discrepancy between the amount of copper it had reported as being at the Site (approx. 2000 tonnes) and the actual amount at the Site (approx. 30 tonnes).

Mac Z failed to perform its repayment obligations under the Facility Agreement and due to the loss of copper from the Site, the balance due to Scipion was left unsecured. Among other steps, Scipion brought a claim against Vallis for a breach of the CMA.

During the trial, Vallis admitted there had been a physical loss of goods from the Site caused by its lack of care in breach of the CMA. However, it argued that the Pledge was invalid under Moroccan law and therefore Scipion had no possessory interest in the lost goods and was not entitled to bring a claim.

Scipion contended that it was entitled to recover from Vallis based on its right to possession as contractual bailor, regardless of the Pledge’s validity.

Decision

The Court held that the Pledge was indeed invalid under Moroccan law but found that Scipion was entitled to recover the value of the lost goods anyway, because of its possessory rights as bailor under the terms of the CMA. Scipion was entitled to damages equal to the value of the lost goods on the date on which they were lost. It had not failed to mitigate its loss by delaying sale or failing to recover a proper value for the goods in another way. This was in part because it was

a finance house rather than a metals trader.

In order to avoid any need to account to Mac Z for a surplus, Scipion capped its claim at the value of the amount it had failed to recover under the Facility Agreement, less the value of certain remaining goods and products.

The Court made the following findings of wider interest:

Bailment relationship between Scipion and Vallis:

In line with earlier cases on CMAs, the Court found that the bailment relationship arose by the original bailor (Mac Z as owner of the goods) bailing the copper to Vallis as the collateral manager, and Vallis as bailee acknowledging the transfer of possession (“attorning”) to Scipion as the new bailor and agreeing to hold the copper on Scipion’s behalf in accordance with the terms of the CMA.

The right to possession and governing law:

Usually, the transfer of movable property (here, the copper) is governed by the laws of the country in which the goods are located (here, Morocco). However, the Court found that when the question is whether a party has a right to possession pursuant to a bailment, that question should be determined by the law governing the bailment. In the case of contractual

bailment, that will be the law of the contract² (here, English law, being the law governing the CMA).

Possessory interest and invalid pledge:

The Court confirmed that substantial damages could be recovered by a person “*who has or is entitled to have the possession of goods*”³ and that this principle applies to a claim by a person who has a right to possession as bailor⁴. Scipion was therefore entitled to claim damages, irrespective of the validity of the pledge.

Contractual bailment and the “*jus tertii*” argument:

Vallis claimed that Mac Z had better title to the goods than Scipion (an argument known as “*jus tertii*”). Vallis accepted that at common law, there is a rule that a bailee is estopped from denying or disputing his bailor’s title. However it argued that this rule was abolished by section 8(1) of the Torts (Interference with Goods) Act 1977. The Court found the Act did not apply to cases of contractual bailment. Vallis’s claim failed.

HFW Comment

This judgment is a reminder of the importance of attornment where security is taken over goods held in storage. Here, where the security which Scipion should have had under the pledge agreement was not available, the success of Scipion’s claim depended on the fact that it could establish that a bailment existed on the terms of the CMA, under which Vallis had attorned to Scipion and agreed to hold the goods on Scipion’s behalf.

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² *Impala Warehousing and Logistics (Shanghai) Co Ltd v Wanxiang Resources (Singapore) Pte Ltd* [2015] EWHC 811

³ *Chabbra Corporation v Jag Shakti (Owners) (The “Jag Shakti”)* [1986] AC 337

⁴ *China-Pacific SA v Food Corp of India (The “Winson”)* [1982] AC 939

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