Privy Council Rules on the Court's Equitable Jurisdiction to Set the Financial Terms of Relief against Appropriation

Last week the Board of the Privy Council delivered a critical sequel to its previous judgments in connection with the Cukurova Group's attempt to recover shares following an appropriation. The Board held that not only can the court reopen an appropriation and exercise its jurisdiction to grant relief from forfeiture after the event, as per its decision earlier this year, but it can also exercise its jurisdiction to determine the basis and conditions of such relief.

For mortgagors and borrowers in secured transactions, the decision provides a helpful guide as to the breadth and flexibility of equity's ability, after forfeiture, to intervene in their favour and adjust the contractual terms where it would be unconscionable to enforce them strictly.

The Facts

As security for a loan by Alfa Group ("Alfa") to a company in the Cukurova group ("Cukurova"), English law governed share charges were granted to Alfa over Cukurova's shares in a number of BVI companies. The share charges included a clause providing that Alfa had the right, on enforcement, to appropriate the charged shares to satisfy the liabilities under the facility agreement in accordance with the Financial Collateral Arrangements (No. 2) Regulations 2003. When Cukurova defaulted in 2007, Alfa appropriated the shares and thereby gained a controlling interest in Turkcell (Turkey's largest mobile phone company). Within a month of the appropriation, Cukurova tendered the amount due to Alfa in full repayment of the loan. Alfa rejected the tender. Meanwhile, Cukurova held the full amount in an interest earning escrow account until 25 May 2010, ready to repay Alfa. In January this year, the Board held that relief against forfeiture should be available to Cukurova on appropriate terms. In this latest judgment, the Board had to consider the terms, amount and basis of the redemption.

The Issues

- Should the grant of relief in respect of the appropriation be made on the basis that the loan is to be treated as having remained unpaid from the date of appropriation or did the court have discretion to adopt a different approach in exceptional circumstances?
- What was the effect of the tender which was rejected? Should the loan remain outstanding without having regard to the intervening events in connection with the tender?

The Decision

- The majority of the Board rejected Alfa's submission that the court's discretion to intervene in equity is simply to extend the mortgagor's time for repayment in full under the facility agreement and to imposing on Cukurova additional conditions. Alfa had submitted that the debt must be treated as remaining outstanding despite the appropriation of the shares (or as retrospectively revived and outstanding) and that the terms of the facility agreement as agreed between the parties continued to apply. On this basis, Alfa argued that interest must be treated as accruing to date at the default rate in the facility agreement. The majority disagreed.
- The majority held, instead, that the appropriation discharged the debt due and the contractual terms of the facility agreement did not continue to apply. The majority held that where the loan has been discharged in law by the appropriation, a court has discretion to set the terms of the relief (which normally takes account

of the terms of the loan). However, the court is able to take account of circumstances which would make it inequitable or unconscionable for redemption to take place on a basis which treats the loan as if it had remained continuously outstanding.

- In the circumstances, Cukurova's tender of payment and Alfa's rejection of it was of critical relevance in relation to the conditions on which the Board would grant relief. In addition, Alfa had appropriated the shares with the aim of preventing repayment. The Board unanimously held that "equity should respond" where there has been a wrongful rejection by a lender of properly offered repayment during the currency of a loan.

- According to the majority, the discretion of the courts to grant relief which departs from the terms of the contract is not open-ended but is restricted to "exceptional circumstances" where it can be established that not to do so would be "unconscionable". In the circumstances, the majority found that treating the contractual obligation in the facility agreement to repay the debt with default interest as running continuously during the period that Cukurova had placed the funds in the account, despite the satisfaction of the debt by the appropriation of the shares, would be unconscionable.

- However, the minority disagreed. In Lord Neuberger's view, by exercising its equitable power to permit Cukurova to recover the shares, "the court is simply extending the time within which the money due under the mortgage must be paid". Accordingly, in his view, the mortgage should remain in being until the money due has been tendered and accepted. Relief should be granted on terms which are based on the contractual terms in the facilities agreement, despite the appropriation. The minority believed that the majority's departure from this principle on the basis of exceptional circumstances risks leaving the law in a state of uncertainty.

- The minority (following different reasoning from that of the majority) agreed with the majority that no interest was payable for the period Cukurova held the amount tendered in an escrow account. Lord Neuberger stated that, in accordance with existing case law, "if the whole amount due under the mortgage is tendered and refused and then put aside in an account by the mortgagor, the mortgagee is not entitled to interest at the contractual rate while it is in the account, although it can recover the interest actually earned on the amount in the account (less any expenses)."

Comment

The decision of the Privy Council establishes that where equity grants relief after an appropriation has discharged a due debt, the court has equitable jurisdiction to set the conditions of relief. These will try to take close account of the terms of the original loan, but may take account of other exceptional circumstances. Although the decision is quite specific to its facts, it arguably broadens the equitable principles that have developed to mitigate against unjust effects of common law in connection with contracts. The minority of the Board held that such an extension of the court's equitable discretion demonstrates a "*fundamental misunderstanding of the role of equity*" and that equity *"did not provide some sort of cure-all whereby a judge could simply do what seemed just to him in the particular case"*. The minority of the Board referred back to past judgments which expressed concern that "*'[u]nconscionable' must not be taken to be a panacea for adjusting any contract … when it shows a rough edge to one side or the other"*.

Irrespective of the extent to which the equitable principles have been broadened, the decision does introduce an element of uncertainty. For practical business reasons, parties want to ensure that they make express provision for a certain eventuality in their contracts and they want to be certain that these provisions will be enforced by the courts. A courts' discretion not to enforce certain terms of a contract on the grounds that it would be unconscionable does mean that parties will not be certain that the outcome will follow the terms agreed by the parties. The very existence of that discretion also means that knowledge of it can be used as a tool in negotiations.

Although decisions of the Privy Council are not binding on English courts, they are highly persuasive. Given that the dissenting minority considered that the appropriation will not discharge the due debt, there is still some uncertainty for lenders looking to the exercise of a contractual right of appropriation as to the path the English courts will follow.

If you would like to learn more about the issues in this alert, please contact your usual Ropes & Gray attorney, or any of the attorneys listed below.

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