

Book Review

Darragh Connell reviews a recent banking law publication

The Law and Practice of True Sales
 Nick Grandage and Daniel Franks,
 Partners at Norton Rose Fulbright LLP
 1st Ed, Lexis Nexis, 2015
 281 pages, £250.00
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This book provides a useful introduction to the law and practice of true sales. At the outset, the authors acknowledge that the title raises an obvious question in the mind of the uninitiated as to when a sales transaction could be anything other than true? To answer that question, the book considers English law regarding the recharacterisation of sales transactions as something other than an outright transfer such as the creation of a mere security interest.

In the absence of a clear statutory or judicial definition of a true sale, perhaps one of the notable contributions of this book is the provision of the below workable definition to inform the “true sales doctrine” advanced by the authors:

‘A true sale is an arrangement that will be upheld in the insolvency of either the transferor or transferee as a transfer of the beneficial ownership of an asset whereby the ownership of that asset transfers absolutely (and not by way of security) to the transferee and neither remains nor is capable of being clawed back so as to become part of the transferor’s estate.’

The target audience for this work is principally professionals active in the structured finance market. The authors, both partners with Norton Rose Fulbright LLP, adopt a practical approach to an area of law with pronounced commercial importance that has received intermittent consideration to date. The relative paucity of coverage of the law of true sales is mirrored by the limited number of decisions from the English courts expressly dealing with recharacterisation of sales transactions. As the authors point out in chapter 3, most, if not all, of the case law that exists arises in the context where one party (or its liquidator) or a third party creditor saw an advantage in seeking to claim that the proper treatment of a given transaction ought to be different to the way in which the transactional structure has been described.

The leading authority in this area is *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148 which is extensively considered in chapter 6. The effect of the Court of

Appeal’s judgment in that case is that under English law, parties to an agreement are free to choose the form of transaction they wish to undertake and the court will give effect to the intention of the parties, as evidenced by the wording of the documents, notwithstanding that the transaction has a similar economic effect to another arrangement unless either:

- the transaction is a sham on the grounds that it does not truly record the agreement of the parties; or
- the legal rights and obligations which arise pursuant to the transaction are inconsistent with the arrangement being one of sale.

Chapter 8 provides a useful overview of the applicable principles that will be applied by courts when asked to recharacterise a transaction as something other than a true sale. Specifically, the book rejects the misconception that English courts broadly assess the substance of a transaction over its form when asked to recharacterise a transaction. Under English law, the substance of a transaction is ascertained by reference to the intention of the parties. That intention is assessed with reference to the form of words agreed in the contract. Therefore the distinction between substance and form of itself is of little assistance. Similarly, the economic effect or accountancy treatment of a given transaction will be of no relevance to its legal categorisation under English law.

The book notes that the English courts’ approach to true sales is divergent to that in the US where courts weigh up the elements of a transaction including its economic risks and rewards so as to determine its substance. The divergent approach is significant in circumstances where cross-border transactions may give rise to a conflict of laws as noted in chapter 9.

The critical importance of the true sales doctrine is illustrated by the example of a securitisation where a true sale is fundamental to a typical structure since without an effective transfer of the ownership interest in the receivables by the originator of the assets to the single purpose vehicle (SPV), the underlying value of the issued debt securities will be negligible since the principal asset of the SPV is its ownership interest in the receivables being securitised. Likewise, rating agencies will require evidence that there is a true sale such that the originator’s insolvency would not interfere with the SPV’s ability to repay investors in order to attribute ratings to the debt securities issued by the SPV.

From the perspective of a practitioner, the book helpfully considers various mechanisms by which receivables are transferred

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in a securitisation. Thus, chapter 20 scrutinises a securitisation which uses a declaration of trust rather than a legal or equitable assignment to effect the transfer of an ownership interest in receivables to an SPV. This analysis is particularly pertinent where there is little case law relating to a declaration of trust in the context of a true sale. The authors provide an analysis of potentially analogous cases where the courts have been required to determine whether documents which purport to involve trusts should be characterised as charges.

An area where the law in relation to the potential recharacterisation of financing transactions is well developed is the distinction between fixed and floating charges particularly as they relate to charges over debts. To that end reference is made to the well-known decision in *National Westminster Bank plc v Spectrum* [2005] UKHL 41, where a charge was recharacterised as a floating charge owing to its essential characteristics. The authors reject the analysis of previous commentators that the interventionist approach taken by the courts in cases such as *Spectrum* is inconsistent with the doctrine of true sales where primacy is afforded to the parties' intentions as expressed in the contractual documentation.

Nevertheless, the authors do accept that the subsequent behaviour of contractual counterparties can affect the characterisation of a transaction such that a true sale transaction may subsequently be deemed something other than a true sale in light of the conduct of the parties. The rationalisation provided for this anomaly is that any such recharacterisation reflects an alteration in the agreement or the entry into a new agreement superceding the old one. As recognised in chapter 10, this analysis appears problematic when one considers the normal rules of contractual construction. Further, the use of entire agreement clauses in commercial transactional documentation does not readily allow for an ambulatory recharacterisation of a transaction based on subsequent conduct. Ultimately, the authors offer an eminently sensible recommendation to parties involved in structured finance transactions namely, implement the contract as it is drafted and consider the effect of any subsequent operational changes on the potential characterisation of the contract.

The second part of the book focuses upon specific transactions where the true sales doctrine will be of critical practical importance. Thus, there are chapters dealing with a range of transactions including receivables transactions; participation

arrangements; and repurchase transactions involving goods and securities. The authors provide clarification as to the extent that the true sales doctrine operates in respect of specific transactions though experienced practitioners may expect further detail on certain areas such as the sections on the 1995 ISDA Credit Support Annex (English CSA) and on leasing transactions.

In light of recent legislative changes, the apparently intractable problems posed by a contractual prohibition on the assignment of receivables are tackled in detail. This is an issue which will no doubt feature more prominently in future editions of this book given the attempts by the UK government to reform the law so that a clause in an agreement which prohibits the assignment of a receivable will have no effect under English law. Thus, s 1 of the Small Business, Enterprise and Employment Act 2015, in force from May 2015, enables regulations to be made to introduce a ban on certain assignment restrictions. The relevant regulations – The Business Contract Terms (Restrictions on Assignment of Receivables) Regulations 2015 – are currently in draft form.

Whilst statutory intervention in this area will provide a welcome solution to businesses looking to raise finance through the sale of receivables, there are difficulties reconciling the new nullification provisions with the fundamental principle of freedom to contract in commercial transactions. Richard Calnan, another Norton Rose Fulbright partner cited in the acknowledgments to this book, has expanded upon the various uncertainties contained in the draft regulations as identified by the Financial Law Committee of the City of London Law Society ((2015) 3 JIBFL 136–137). The legitimate concerns of the Committee are also cited in this book and it remains to be seen whether the government will heed the growing calls to resolve the ambiguities that exist in the primary and draft secondary legislation.

Overall, the book provides a helpful introduction to the legal principles applicable to the English law of true sales. Practitioners seeking to advise clients on the risks of unwanted recharacterisation of a sales transaction will find this text of considerable practical assistance. The authors are to be commended for providing this practical insight into an area of law with significant commercial importance. ■

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Darragh Connell is a commercial barrister at Forum Chambers, Chancery Lane, London. Email: dconnell@forumchambers.com