

Appropriation – An Under Used Remedy!

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Lenders will often take security over a borrower's shares, which gives them the option to enforce their security through a sale of shares. However, there is another self-help remedy available to lenders – appropriation.

Appropriation is surprisingly under-used given how effective and simple it is as an enforcement method - it gives lenders the right to become absolute owners of the shares in the borrower, which they can then sell to realise value. Lenders have hesitated to use this remedy in the past because of uncertainty over how to carry out the valuation. However, the recent case of *ABT Auto Investments Ltd v AAPICO Investment Pte Ltd* ('ABT') has clarified a lot of the issues around valuation, making the remedy of appropriation more accessible than ever.

What is appropriation?

Under the Financial Collateral Arrangement (No. 2) Regulations 2003, appropriation is available without the need for a court order, if share security qualifies as a 'security financial collateral arrangement'. For this self-help remedy to be available the security must provide for the power of appropriation and the financial collateral must be valued 'in accordance with the terms of the arrangement and in any event in a commercially reasonable manner'. Until now, it has not been clear exactly what constitutes a 'commercially reasonable manner of valuation'.

The issues in *ABT*

The Court addressed two questions: when is a valuation obtained in a commercially reasonable manner; and what effect does a valuation have on the validity of appropriation?

(1) When is a valuation obtained in a commercial reasonable manner?

- A valuation is obtained in a commercially reasonable manner if the method of valuation can be carried out in a commercially reasonable manner. The actual result need not be commercially reasonable - it is all about the process!
- If a chargee instructs a third party to carry out the valuation, they must also carry out the valuation in a commercially reasonable manner. If they do not, the chargee has not met its obligation.
- Commercially reasonable is judged by an objective standard taking into account the facts of the case. 'Commercially' means in line with 'the reasonable expectations of sensible businessmen'.

- The Court confirmed that the only obligation is for the valuation to be made 'in accordance with the terms of the arrangement and in any event in a commercially reasonable manner'. There is no obligation to act in good faith and, in contrast to when a chargee is enforcing security, no equitable duties apply.

(2) What effect does a valuation have on the validity of appropriation?

In *ABT* the valuation was found to be valid. However, the Court noted that if a valuation was *not* made in a commercial reasonable manner, the appropriation itself would be unaffected, even if the valuation was open to challenge. Lenders do not need to comply with this provision for appropriation to be effective.

Summary

ABT has helped to clarify the meaning of 'commercially reasonable' and has proved just how straight-forward appropriation is. Lenders need not agonise over what constitutes a 'commercially reasonable' valuation, so we may see more use of this remedy in the future. One interesting point raised but not decided in *ABT* is whether a 'commercially reasonable manner' should reflect any special value the collateral may hold for the collateral-taker. That may be decided in a future case but for the time being the focus remains on the process not actual value.