

## Group Briefing

### July 2017

# True Sale and Re-Characterisation Risk: Welcome Clarity

The Irish High Court decision in [Bank of Ireland -v- Eteams International Ltd \[2017\] IEHC 393](#) provides welcome clarity for those involved in structured finance and invoice discounting transactions in Ireland.

Until now, when analysing whether a transaction involves the sale of an asset, or the creation of security over that asset (i.e. whether the transaction is a 'true sale'), regard has been had to the principles set out by the English courts (starting with *Re George Inglefield Ltd*).

Having examined those principles in considerable detail, the High Court has now held that the "settled train of authority...commencing with *Re George Inglefield Ltd*..." represents "good law" in this area.

This decision is a particularly welcome one for capital markets practitioners in the context of the opinions and advices that are regularly provided in structured finance transactions.

#### BACKGROUND

*Bank of Ireland v Eteams* involved a debt purchase agreement entered into in 2007 between Bank of Ireland and Eteams International Limited, a provider of translation services. Eteams went into liquidation in 2013 and the nature of the debt purchase agreement was disputed. Bank of Ireland claimed that the agreement was an invoice discounting arrangement, whereas the liquidator appointed to Eteams claimed that it was a charge that should have been registered with the Companies Registration Office within 21 days of its creation (and was void in light of that non-registration).

#### RE-CHARACTERISATION RISK

The High Court acknowledged that the question of whether a sale could be re-characterised as a registrable charge ('re-characterisation risk') has been the subject of a large body of caselaw in England.

The High Court specifically considered the decisions in *Re George Inglefield* [1933] Ch. 1, *Olds Discount Co. Ltd. v John Playfair Ltd* [1938] 3 All E.R. 275,

*Chow Yoong Hong v Choong Fah Rubber Manufactory* [1962] AC 209, *Lloyds & Scottish Finance Ltd. v Cyril Lord Carpets Sales Ltd. & Ors* [1992] BCLC 609 and *Welsh Development Agency v Export Finance Co. Ltd* [1992] BCLC 148.

#### KEY PRINCIPLES FROM ENGLISH CASES

The key principles from the above English cases are as follows:

- » *Sham?* If a document masks the true intent of the transaction, the Court must have regard to the true position and to the substance of the agreement as a whole.
- » *Raising Funds:* There is "nothing improper or wrong" in raising funds by selling assets, instead of borrowing on the security of those assets.
- » *Differences between Sale and Charge:* The essential differences between a sale and a charge are (per Romer LJ in *Re George Inglefield*):
  - *return of the asset:* in a sale, the seller is not entitled to get the asset back by

repaying the purchase price to the buyer but with a charge, the chargor (unless the charge has been enforced) is entitled to get the asset back once it repays its debt to the chargee. There may, however, be circumstances in which a transaction will still be regarded as sale, even if the seller has a right to get the asset back in certain circumstances;

- ***selling the asset at a profit:*** with a charge, if the chargee sells the asset for more than it is owed by the chargor, it must pass the surplus back to the chargor, but if a buyer on-sells an asset and makes a profit, the buyer does not have to account to the seller for that profit;
  - ***selling the asset at a loss:*** with a charge, if the chargee sells the asset for less than it is owed by the chargor, it is entitled to recover the balance from the chargor, but if a buyer on-sells an asset at a loss, it has no entitlement to recover the shortfall from the seller.
- » ***What, not why:*** A Court should look at what agreement the parties entered into (i.e. a sale agreement) rather than why the parties entered into that agreement (i.e. to raise money).
- » ***Court should not impose an unintended agreement:*** A Court should not impose upon the parties a type of transaction that was completely different to what they had agreed (i.e. a Court should not decide that the parties entered into a charge over an asset

if the parties had agreed that the asset would be sold).

» ***Discounting is not lending:***

While invoice discounting (both commercially and economically) may not be very different from lending money and charging interest, discounting is not treated as lending and the discounted asset is not treated as having been charged.

The Irish courts had not previously considered this chain of English authority in detail although in *Carroll v Bourke* [1990] 1 IR 481 (to which the High Court also referred in this case), the High Court had looked at *Re George Inglefield Ltd* when holding that a document should be looked at in its entirety, and held that parties cannot apply a particular label to a document in the hope of characterising it as something that it is clearly not.

#### HIGH COURT DECISION

The High Court held that the chain of English authority was “*good law*” and that it should be followed in this case.

Noting that there was no suggestion that the debt purchase agreement in this case was a sham, the High Court held that it was a purchase and sale agreement, and not an agreement to lend and take a charge.

Notably, the High Court also held that the following points were not relevant when determining whether the agreement gave effect to a sale or a charge:

- » whether or not risk was transferred from seller to buyer under the agreement;
- » whether the underlying debtors

were given notice of the agreement; and

- » the fact that the agreement contained a boilerplate provision that, if ownership of the asset failed to transfer to Bank of Ireland for any reason, Eteams was to hold that asset on trust for Bank of Ireland.

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