

Feature

KEY POINTS

- Covenants to pay provide clarity for the lender as to exactly when the lender's powers of security enforcement are exercisable on a borrower default under a loan agreement.
- The act of assigning "all monies" security will generally operate to fix the debts secured by the security to only those debts assigned.
- Express terms are needed for a secured creditor to acquire unsecured liabilities by assignment but such a clause may be challenged on a number of grounds.

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The component parts of the covenant to pay

The covenant to pay clause is a key provision in any English law security document. Express the secured obligation wrongly and you may find that the security fails to secure the obligations intended. Subsequently amend or vary the obligation intended to be secured and you may find that the secured obligation is no longer the obligation outstanding. The purpose of this article is to look at the considerations that go into drafting a covenant to pay clause and to consider the effect of assignment on the efficacy of the security created.

"ALL MONIES" SECURITY OR FACILITY SPECIFIC

A first drafting consideration is whether the security is intended to secure "all monies" owed to the lender (as recipient of the security) or monies due under a defined facility agreement and/or other specific documents. In the world of bank standard forms, the general position is for security to be "all monies". The covenant to pay in negotiated documents is more often limited to specific documents. In the context of a bilateral arrangement, although the knee jerk reaction may be to limit the covenant to secure only sums due under specific documents, it is often more flexible to agree to "all monies" security. The borrower controls its obligations to a lender and under what facilities the liabilities may arise. Taking "all monies" security:

- avoids later concerns as to whether a liability in respect of a future transaction or an amended agreement is secured by the original security;
- provides greater flexibility; and
- reduces the costs of granting supplementary or confirmatory security.

"All monies" security is rarely appropriate in the context of security held by a security trustee. First, if the lenders benefiting from the security trust have agreed that security realisations should be shared pro rata according to their exposures, "all monies" security can result in one or more lenders being prejudiced by another's profligacy. Second, the security trustee may find that the security is securing obligations about which the trustee knows nothing. Generally, absent situations where the lenders benefiting from the security trust and the security trustee are related,

"all monies" security would be undesirable to the security trustee. A security trustee will not want to find the security it holds securing obligations outside the terms of the facility documents pursuant to which it was appointed.

WHAT IS IN A COVENANT TO PAY?

Covenants to pay are of varying lengths. A short "all monies" clause might read:

"The Company will pay to the Lender on demand all present and future monies, debts and liabilities due, owing and incurred by the Company to the Lender in any manner whatsoever."

A longer "all monies" clause might read:

"The Company will pay to the Lender on demand all and any monies, obligations and liabilities which may now or at any time in the future be due, owing or incurred by the Company to the Lender on any current or other account or otherwise in any manner whatsoever (in whatever currency denominated, whether actual or contingent, whether alone, severally or jointly with any other person and whether as principal, guarantor, surety or otherwise and whether or not the Lender was an original party to the relevant transaction) including all interest, commissions, fees and all legal and other costs, charges and expenses which the Lender may charge the Company or incur."

Is longer always better? The next section considers some of the component parts of the covenant to pay.

Covenants to pay usually bind the chargor to pay "on demand". This wording provides clarity as to when the secured debt will be formally due, demand resulting in the lender's powers of security enforcement becoming exercisable (see ss 101(1) and 109 Law of Property Act 1925). Sometimes, the covenant to pay is qualified by the words "when they [the Secured Liabilities] become due". Such qualification is to avoid a committed facility becoming an on demand facility. However, it is unlikely that such words are strictly necessary because a demand is only validly made when the sum is due under the terms of the facility or other principal agreement (*Cryne v Barclays Bank Plc* [1987] BCLC 548, CA).

Express references to interest, costs and expenses etc. Such references are unnecessary if the points are dealt with elsewhere in the document suite (in a Loan Market Association type facility, for example, such references will often not be necessary as the facility agreement will fully deal with the issues). However, there are a number of reasons why such wording is often included; indeed interest is often (but not of necessity) the subject of its own separate clause in a security document. The first reason is that the points may not be dealt with elsewhere. For example, whilst a standard form bank facility letter will include terms setting out the interest position in relation to the facility advanced, it may not deal with interest on other sums owed under other documents. Secondly, if security is to be "all monies", even if interest provisions were included in the facility letter, the security may well survive the term of the particular facility agreement. Third, the wording provides comfort. The courts tend to construe covenants to pay in a restrictive way. *Ashwood Enterprises Ltd and others v The Governor and the Company of the Bank of Ireland* [2014] EWHC 2624 (Ch) demonstrates the importance of clearly expressing what obligations are intended to be secured. In that case the "all monies" security stood up to challenge because it had been expressed in unambiguous terms.

Reference to actual or contingent obligations. If the covenant expressly references

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contingent obligations, it restricts the ability of the chargor to have that security discharged if nothing is currently owing.

'Whether alone, severally or jointly with any other person and whether as principal, guarantor, surety or otherwise' is normally included but on protective grounds. In *Bank of Scotland v Wright* [1990] B.C.C. 663 it was found that 'all sums and obligations due and to become due to you ... in any other way or manner whatever' included obligations under a guarantee the chargor had granted in favour of the lender. Rather than leave the point open to challenge, the better approach is to spell it out.

Frequently, the covenant to pay provides that the chargor will pay any sums due, owing or incurred, on a "current account". Such language is included for the purposes of s 94(2) Law of Property Act 1925 which, in the case of unregistered land, provides that where a mortgage is made expressly to secure 'a current account or other further advances', registration of a subsequent land charge by a second lender to secure further loans does not amount to actual notice of the subsequent charge to the first mortgagee/lender (which it otherwise would do) allowing the first mortgagee/lender to tack further advances to the first mortgage provided it has no actual notice of the subsequent charge. This avoids the need for a (first) lender to have to check against the land charge register before, for example, each utilisation of an overdraft. The tacking rules are different for registered land where tacking is preserved in other ways and so the point is increasingly historic (not least since granting a first legal charge over real property triggers first registration).

DOES AN "ALL MONIES" COVENANT TO PAY CATCH UNSECURED DEBT ASSIGNED TO THE MORTGAGEE?

In *Re Quest Cae Ltd* [1985] 1 BCLC 226 it was determined that the phrase "on any account whatever" in a covenant to pay could only refer to dealings and transactions between the chargor/borrower and the lender. The wording could not be extended so as to capture liabilities of the borrower that were:

- unsecured;
- owed to a third party; and
- subsequently assigned to the lender, so becoming secured at that point.

As a result, and to increase the chance of such obligations and liabilities actually being secured, it is prudent to include the phrase "whether or not the Lender was an original party to the relevant transaction" (or similar) when drafting the definition of secured obligations (where obligations and liabilities of that type are intended to be secured). A word of caution though: a number of text books suggest that such wording might be ineffective to achieve that end. However, for a useful full and more optimistic discussion of the point, see the article by Lexa Hilliard QC in this Journal ([2014] 10 JIBFL 623).

CONTINUING EFFICACY OF "ALL MONIES" SECURITY AFTER ITS ASSIGNMENT

What about when a mortgagee assigns the benefit of "all monies" security to a (previously unsecured) assignee? This is the opposite of the situation described above where an unsecured debt is assigned to the existing holder of "all monies" security. Consideration of the question is particularly pertinent where a lender/assignor assigns a partially drawn bilateral secured loan to a third party and the third party assignee steps into the shoes of the assignor to fund future advances. The issue is avoided in the case of a syndicated loan by the use of a security trust and the security being granted to a security trustee.

In *OBG Limited v Allan* [2001] BPIR 1111, a bank assigned the benefit of certain "all monies" security to a trade creditor of OBG. Security was granted in respect of "all monies" due to the bank and there was the standard wording in the security about references to successors and assigns, qualified by reference to "where the context so admits". The judge held that the assigned security only secured the assigned debt; it did not secure existing or additional monies lent by the assignee to the same borrower. In other words, the act of assigning "all monies" security operates to fix the debts secured by such security to those existing (and assigned) at the time of assignment. It will neither convert previously unsecured debt owed by the borrower to the assignee into secured debt, nor secure future debts incurred by the borrower to the assignee after the date of the assignment. The judge focussed particularly on the equity of redemption and the fact that an assignee takes the security subject to the equity existing at the time of the assignment. The judgment was made on the basis of the facts.

However, what if the "all monies" charge which is assigned has been expressed to include the unsecured liabilities (past, present and future) of the borrower due to the holder of the charge for the time being? The judge did not need to address the question as the charge in the particular case did not contain such wording. He did, however, raise a number of grounds upon which such a clause might be challenged. These included the potential invalidity of arrangements which defeat the *pari passu* distribution between unsecured creditors (in light of the elevation to secured status). Such a charge would also raise questions as to the application of s 859A Companies Act 2006 (relating to the registration of charges), s 245 Insolvency Act 1986 (relating to floating charges) and possibly even s 239 (relating to preferences) if the assignment converts previously unsecured debt during the hardening period.

It is safest to assume that following a security assignment, the principal amount secured by "all monies" security is restricted to the obligations secured to the assignor at the time of assignment (together, I believe, with future accrued interest thereon and costs of enforcement). New arrangements will need to be made to secure new facilities made available by the assignee thereafter.

THE EFFECT OF A FACILITY AMENDMENT OR VARIATION

It is beyond the scope of this article to consider the effect of facility variations in the context of facility specific security. Suffice to say that where a facility is bilateral and the security is true "all monies" (ie, with a broadly drafted covenant to pay as discussed above), the security should secure all liabilities and obligations of a borrower to a lender howsoever the facility is varied, amended, supplemented, restated or replaced. ■

Further reading

- A question of great importance to bankers, and to the mercantile interests of the country [2012] 7 JIBFL 403.
- The uncharted shallows of the prescribed part [2010] 5 JIBFL 278.
- LexisPSL: Banking & Finance: Drafting and negotiating security documents in loan transactions.