BRITISH VIRGIN ISLANDS

IN THE COURT OF APPEAL

HCVAP 2007/027

BETWEEN:

ALFA TELECOM TURKEY LIMITED

Appellant

and

[1] CUKUROVA FINANCE INTERNATIONAL LIMITED
[2] CUKUROVA HOLDINGS AS

Respondents

Before:

The Hon. Mr. Denys Barrow S.C	Justice of Appeal
The Hon. Mr. Hugh Rawlins	Justice of Appeal
The Hon. Ms. Ola Mae Edwards	Justice of Appeal (Ag.)

Appearances:

Mr. Stephen Smith QC, Mr. Robert Levy and Mr. Oliver Clifton for the Appellant
Mr. Kenneth MacLean QC, Ms. Arabella di Iorio and Mr. James Nadin for the Respondents

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2008: January 29;
April 22.

Commercial law – loan to company - secured by equitable mortgage of shares - European Community Directive – financial collateral arrangement – new remedy of 'appropriation' - Equity – equitable mortgage – destruction of equity of redemption – English law – regulations to give effect to directive – principles of interpretation.

Alfa Telecom Turkey Limited (Alfa) and Cukurova Finance International Limited (CFI) and Cukurova Holdings AS (CH) executed a Facility Agreement dated 28 September 2005 ("the Secured Facility"). Pursuant to this facility Alfa, as lender, agreed to provide to CFI, as borrower, a secured dollar term loan facility in the sum of US$1,352,000,000. Repayment of the Secured Facility was secured by four Deeds of Charge ("the Share Charges") in respect of certain shares ("the Charged Shares"). Two share charges dated 25 November 2005 were governed by BVI law ("the BVI Share Charges") pursuant to which CFI charged in favour of Alfa all present and future

shares in Cukurova Telecoms Holdings Limited (CTH) and CH charged in favour of Alfa all present and future shares in CFI. Two share charges dated 28 September 2005 and 25 November 2005 were governed by English law ("the English Share Charges") pursuant to which (respectively) CFI charged in favour of Alfa all present and future shares in CTH and CH charged in favour of Alfa all present and future shares in CFI. The terms of the two English Share Charges are identical in all material respects. Clause 9.3 of each of them provides as follows: "Financial Collateral Arrangement … To the extent that this Deed constitutes a 'financial collateral arrangement' (as defined in the Financial Collateral Arrangements (No 2) Regulations 2003 (the "Regulations") the Lender shall have the right (at any time after the Charges become enforceable to appropriate any Charged Asset which constitutes "financial collateral" (as defined in the Regulations) ("Financial Collateral") in or towards satisfaction of the Liabilities in accordance with the Regulations."

The power of appropriation was a newly created remedy in English law. On 25 November 2005, pursuant to the Share Charges as security, CH and CFI delivered to Alfa's solicitors the share certificates in respect of the Charged Shares and share transfer forms executed in blank. Alfa's security interest in the Charged Shares under the Share Charges is noted in the share registers of CFI and CTH respectively with express reference being made to the English Share Charges and the BVI Share Charges.

On 16 April 2007 Alfa wrote to CFI alleging that CFI had committed a number of Events of Default (as defined in the Secured Facility), that such Events of Default were incapable of remedy and that, as a result, the loan was being accelerated by Alfa. In its letter of 16 April 2007 Alfa demanded immediate payment of the balance of the loan plus interest. CFI denied that any Events of Default had occurred or that Alfa was entitled to accelerate the loan. On 16 April 2007, Alfa commenced Action 72 in the BVI seeking an order requiring repayment of the Secured Facility and Action 73 in the BVI seeking orders requiring Alfa to be registered as holder of the Charged Shares.

On 16 April 2007, Alfa presented the share certificates and transfer forms for the Charged Shares (completed in Alfa's name) to CFI's and CTH's registered agent in the BVI. Alfa said that it did so in order to perfect its security. Alfa was not registered as the shareholder of the Charged Shares in the registers of CFI and CTH. Those shares remain registered in the names of CH and CFI, respectively.

At 3.50 pm on Friday 27 April 2007, CH and CFI issued Stop Notices before the BVI Court Registry in relation to the Charged Shares. These Stop Notices were addressed to CFI and CTH, respectively and directed that they not register any transfer of shares in the company or pay any dividends until the expiry of 14 days after notice was given to CFI and CH that this was to be done.

At shortly after 4pm on 27 April 2007, Alfa's Solicitors faxed letters dated 27 April 2007 to CFI's registered agent in BVI and CH. Each of these letters stated, amongst other things, as follows:

> "Under clause 9.3 of the abovementioned Share Charge, ATT has the right, at any time after the charges have become enforceable, to appropriate the shares covered by the Share Charge pursuant to the Financial Collateral Arrangements (No 2) Regulations. As a result of the Events of Default referred to above, the charges have become enforceable. On behalf of ATT, we therefore give you notice that ATT is hereby exercising its right to appropriate the shares referred to in the Share Charge with immediate effect. …".

Pursuant to an Order of the BVI High Court dated 3 September 2007, a series of questions were ordered to be determined by the Court by way of preliminary issue. These questions fell under two broad heads, namely: (i) Does Alfa have a power of appropriation over the Charged Shares pursuant to clause 9.3 of the English Share Charges and the Regulations?; and (ii) If Alfa has a power of appropriation, and if the conditions precedent to the exercise of such power were satisfied, did Alfa effectively exercise the power by sending letters dated 27 April 2007 to CFI and CH respectively, by which Alfa asserts that it appropriated the Charged Shares? The Court was assisted by expert evidence adduced by both parties (Lord Millett for Alfa and Professor Cranston, now Mr. Justice Cranston, for the Cukurova parties).

The experts agreed in relation to all of the issues except the question, whether Alfa had, by its letters of 27 April 2007, effectively appropriated the Charged Shares given that it did not thereby become the legal owner of the Charged Shares. On 16 November 2007, the BVI High Court handed down its judgment on the preliminary issues and answered that question in Cukurova's favour holding that "Alfa did not validly appropriate the Charged Shares by sending these letters as the legal title to the Charged Shares remain [sic] vested in the Cukurova entities". Alfa appealed that finding of the judge.

Held: Allowing the appeal with costs to Alfa in the appeal and in the court below: the judge was wrong to hold that Alfa did not validly appropriate the Charged Shares by sending the letters of 27 April 2007. Accepting the suggested definition that to appropriate meant to keep the collateral as absolute owner, this did not require an equitable mortgagee to acquire the legal title to the Charged Shares. It was sufficient for the equitable mortgagee to become the absolute owner of the equitable interest in the Charged Shares, which was the interest that had been mortgaged and had passed, by way of security, to the equitable mortgagee. The accepted objective of giving a meaning that could be uniformly applied in all member states to a European Commission Directive and an English regulation incorporating a directive into English law, was qualified by what was practical. The Regulations expressly gave the power of appropriation, if the parties so agreed, to the holder of an equitable mortgage of collateral. It was sufficient for the equitable mortgagee to form the intention to appropriate, or to keep as absolute owner, the collateral. The forming of that intention, coupled in this case with notification of appropriation to the equitable mortgagor, was effective to appropriate the collateral. (The appeal was accordingly allowed, with costs to Alfa on appeal and in the court below.)

Cases referred to:

Director General of Fair Trading v First National Bank PLC [2001] UKHL 52; [2002] 1 AC 481

Marleasing SA v La Commercial Internacional de Alimentacio SA Case C-106/89

Pfeiffer v Deutsches Rotes Kruez [2004] ECR 1-8835

JUDGMENT

[1] BARROW, J.A.: This appeal is from the judgment of Joseph-Olivetti J[1] deciding, on the trial of a preliminary issue; whether as a matter of English law an equitable mortgagee had effectively exercised the power of appropriating collateral given as security for a loan. Appropriation is a remedy newly created by a European Union Directive[2] (the Directive) and incorporated into English law by the Financial Collateral Arrangements (No. 2) Regulations 2003[3] (the Regulations). Counsel advised that there has been no decision from the English courts on the exercise of the remedy. The judge decided, after hearing the testimony of two experts, a retired member of the Judicial Committee of the Privy Council, Lord Millet and former English Solicitor General, Professor Cranston, that the lender had not effectively appropriated the security.

Agreed Statement of Facts

[2] The parties were able to agree on a statement of facts found at the trial and it will be helpful to reproduce this statement wholesale, employing the internal headings and paragraph numbering of the document, rather than to paraphrase it.

1 ...

Parties

2 Alfa Telecom Turkey Limited ("Alfa") is a private company incorporated in the BVI. It is a wholly owned subsidiary of the Alfa Group, which is a conglomerate based in Russia.

3 Cukurova Finance International Limited ("CFI") is a private company incorporated in the BVI. It is a wholly owned subsidiary of Cukurova Holding AS ("CH"), a

[1] BVI Claim No. 072 of 2007 and Claim No. 119 of 2007 (judgment delivered 16th November 2007).
[2] Directive 2002/47/EC
[3] Statutory Instrument No. 3226 of 2003

private company incorporated in Turkey. Both companies are part of the Cukurova group of companies, which is an industrial group based in Turkey.

4 Cukurova Telecoms Holdings Limited ("CTH") is a private company incorporated in the BVI.

5 CFI is registered as the shareholder of 51% of the shares of CTH and Alfa is registered as the shareholder of 49% of the shares of CTH.

6 Shares in CFI or CTH are not listed on any exchange or market or publicly traded.

7 CTH holds a 52.91% shareholding in Turkcell Holding AS ("Turkcell Holding"), a company incorporated in Turkey.

8 Turkcell Holding's main asset is a 51% shareholding interest in Turkcell Iletisim Hizmetleri AS ("Turkcell"), the largest mobile telecommunications company in Turkey. Turkcell's shares are quoted on the Istanbul and New York Stock Exchanges.

9 Shares in CTH are of particular value as a result of CTH's substantial indirect shareholding in Turkcell.

The Agreements

10 Alfa, CFI and CH executed a Facility Agreement dated 28 September 2005 ("the Secured Facility") pursuant to which Alfa, as lender, agreed to provide to CFI, as borrower, a secured dollar term loan facility in the sum of US$1,352,000,000.

11 Repayment of the Secured Facility was secured by four Deeds of Charge ("the Share Charges") in respect of certain shares ("the Charged Shares"):

(1) Two share charges governed by BVI law ("the BVI Share Charges") dated 25 November 2005 pursuant to which:

(a) CFI charged in favour of Alfa all present and future shares in CTH then or in the future owned by CFI or in which CFI then or in the future had an interest.

(b) CH charged in favour of Alfa all present and future shares in CFI then or in the future owned by CH or in which CH then or in the future had an interest.

(2) Two share charges governed by English law ("the English Share Charges") dated 28 September 2005 and 25 November 2005 pursuant to which (respectively):

(a) CFI charged in favour of Alfa all present and future shares in CTH then or in the future owned by CFI or in which CFI then or in the future had an interest;

(b) CH charged in favour of Alfa all present and future shares in CFI then or in the future owned by CH or in which CH then or in the future had an interest.

12 The terms of the two English Share Charges are identical in all material respects. Clause 9.3 of each of them provides as follows:

"Financial Collateral Arrangement

(a) To the extent that this Deed constitutes a 'financial collateral arrangement' (as defined in the Financial Collateral Arrangements (No 2) Regulations 2003 (the "Regulations") the Lender shall have the right (at any time after the Charges become enforceable to appropriate any Charged Asset which constitutes "financial collateral" (as defined in the Regulations) ("Financial Collateral") in or towards satisfaction of the Liabilities in accordance with the Regulations.

(b) Financial Collateral shall be valued at its Fair Price"

13 Full drawdown by CFI under the Secured Facility of US$1.352 billion took place on 25 November 2005.

14 On 25 November 2005, pursuant to the Share Charges as security, CH and CFI delivered to Alfa's solicitors the share certificates in respect of the Charged Shares and share transfer forms executed in blank.

15 On 25 November 2005, the definition of Fair Price in the English law share charge over CFI's shares in CTH was varied by written agreement of CFI and Alfa.

16 Alfa's security interest in the Charged Shares under the Share Charges is noted in the share registers of CFI and CTH respectively with express reference being made to the English Share Charges and the BVI Share Charges.

17 The Articles of Association of CFI and CTH provide respectively as follows:

(1) As to CFI (Article 6.2) "The transfer of a share is effective when the name of the transferee is entered in the register of members".

(2) As to CTH (Article 6.11) "The transfer of a share is effective when the name of the transferee is entered in the register of members".

The Dispute

18 On 16 April 2007 Alfa wrote to CFI alleging that CFI had committed a number of Events of Default (as defined in the Secured Facility), that such Events of Default were incapable of remedy and that, as a result, the loan was being accelerated by Alfa.

19 In its letter of 16 April 2007 Alfa demanded immediate payment of the balance of the loan plus interest. CFI denies that any Events of Default had occurred or that Alfa was entitled to accelerate the loan.

20 On 16 April 2007, Alfa commenced Action 72 in the BVI seeking an order requiring repayment of the Secured Facility and Action 73 in the BVI seeking orders requiring it to be registered as holder of the Charged Shares.

21 On 16 April 2007, Alfa presented the share certificates and transfer forms for the Charged Shares (completed in Alfa's name) to CFI's and CTH's registered agent in the BVI. AIfa contends that in so doing it was seeking to perfect its security.

22 Alfa was not registered as the shareholder of the Charged Shares in the registers of CFI and CTH. Those shares remain registered in the names of CH and CFI respectively.

23 At 3.50 pm on Friday 27 April 2007, CH and CFI issued Stop Notices before the BVI Court Registry in relation to the Charged Shares. These Stop Notices were addressed to CFI and CTH, respectively and directed that they not register any transfer of shares in the company or pay any dividends until the expiry of 14 days after notice having been given to CFI and CH that this was to be done.

24 At shortly after 4pm on 27 April 2007, Alfa's solicitors faxed letters dated 27 April 2007 to (a) CFI's registered agent in BVI and (b) CH. Each of these letters stated, amongst other things, as follows:

> "Under clause 9.3 of the abovementioned Share Charge, ATT has the right, at any time after the charges have become enforceable, to appropriate the shares covered by the Share Charge pursuant to the Financial Collateral Arrangements (No 2) Regulations. As a result of the Events of Default referred to above, the charges have become enforceable.
>
> On behalf of ATT, we therefore give you notice that ATT is hereby exercising its right to appropriate the shares referred to in the Share Charge with immediate effect. We are currently undertaking the valuation exercise under clause 9.3 of the Share Charge and will revert to you shortly in that regard..."

25 At approximately 4.30pm on 27 April 2007, CFI and CH commenced an ex parte (but on notice to Alfa) application to the BVI High Court for an injunction to restrain Alfa from taking any steps to enforce its security.

26 At approximately 6.45pm on 27 April, the BVI High Court granted an injunction against Alfa, without prejudice to Alfa's assertion that it had appropriated the Charged Shares.

The Preliminary Issues

27 Pursuant to an Order of the BVI High Court dated 3 September 2007, a series of questions were ordered to be determined by the Court by way of preliminary issue. These questions (which are set out at pages 7 to 9 of the judgment of Olivetti J dated 16 November 2007) fell under two broad heads, namely:

(i) Does Alfa have a power of appropriation over the Charged Shares pursuant to clause 9.3 of the English Share Charges and the Regulations?; and

(ii) If Alfa has a power of appropriation, and if the conditions precedent to the exercise of such power were satisfied, did Alfa effectively exercise the power by sending letters dated 27 April 2007 to CFI and CH respectively, by which Alfa asserts that it appropriated the Charged Shares?

28 The Court was assisted by expert evidence adduced by both parties (Lord Millett for Alfa and Professor Cranston, now Mr. Justice Cranston, for the Cukurova parties). The experts agreed in relation to all of the issues set out at pages 7 to 9 of the judgment except question 2(i)(a), namely whether Alfa had, by its letters of 27 April 2007, effectively appropriated the Charged Shares given that it did not thereby become the legal owner of the Charged Shares.

29 On 16 November 2007, the BVI High Court handed down its judgment on the preliminary issues. The Court confirmed the agreed answers given by the experts in relation to all of the issues set out on pages 7 to 9 of the judgment except question 2(i)(a). The Court answered that question in Cukurova's favour holding that "Alfa did not validly appropriate the Charged Shares by sending these letters as the legal title to the Charged Shares remain [sic] vested in the Cukurova entities".

Issues for Determination on Appeal

30 The detailed issues Alfa is seeking to have determined on appeal are set out in Alfa's Notice of Appeal. The central issue is whether the judge was wrong to hold that Alfa "did not validly appropriate the Charged Shares by sending [the letters of

27 April 2007] as the legal title to the Charged Shares remain [sic] vested in the Cukurova entities".

The Respective Positions of the Experts

[3] Although courts in this jurisdiction normally determine for themselves, in normal domestic law litigation, the content and meaning of English law without any thought of receiving expert evidence, in this case there was a particular need for expert evidence because the court was called upon to determine as a fact the content and meaning of a novel provision in English law that had its origins in a European Union directive. The experts, Lord Millett and Professor Cranston, both gave written reports and oral testimony. Lord Millett's area of expertise, the judge noted, is equity and he is also well versed in commercial law. While he was a member of the Judicial Committee of the Privy Council he heard appeals from decisions of this court. Professor Cranston's expertise is commercial law. At the time of trial he was Centennial Professor at London School of Economics and has since become a High Court judge in England. Surprisingly, the judge stated, because it was contrary to all initial expectations, the experts agreed on all issues save for the question whether Alfa by its letters of 27th April 2007 effectively appropriated the Charged Shares given that Alfa did not thereby become legal owner of the shares.

[4] On that issue, Lord Millett was of the opinion that, by its letters, Alfa effectively appropriated the Charged Shares. He stated that the Regulations prescribed no formalities for appropriation and the parties themselves prescribed none. In his opinion it was sufficient for Alfa to determine to exercise the power of appropriation and whether it needed to notify the collateral provider was a moot point since notification was given in the instant case. Lord Millett also made the point that, as between the parties themselves, an equitable mortgage is as good as a legal mortgage and the remedies available to an equitable mortgagee are the same as those available to a legal mortgagee. The advantage of taking legal title, he stated, is that it is more effective as against third parties.

[5] Professor Cranston was of the view that Alfa, by its letters, did not effectively appropriate the Charged Shares "because the shares were not registered in its name. Alfa did not

appropriate the Charged Shares at the point it purported to do so because it was not able to treat them as its own to keep or dispose of ..." The judge decided that the Professor's opinion that appropriation must result in the collateral taker becoming registered owner of the shares was correct because it rested on the principle that the Regulations need to be given an autonomous meaning, that is, one capable of uniform application in EU countries.[4] In due course that view will be examined.

The Power to Appropriate

[6] Regulation 17 creates the remedy of appropriation by providing:

> "Where a legal or equitable mortgage is the security interest created or arising under a security financial collateral arrangement on terms that include a power for the collateral-taker to appropriate the collateral, the collateral-taker may exercise that power in accordance with the terms of the security financial collateral arrangement, without any order for foreclosure from the courts."

The Regulations do not define the meaning of 'appropriate', which both experts agreed is a new remedy introduced into English law by the Directive.

[7] Professor Cranston referred to the following suggested non-legal meaning offered by the European Commission in an Evaluation Study of the Financial Collateral Directive:

> "Appropriation essentially means that the collateral taker in an enforcement event may – under certain conditions – keep the assets as its own property instead of selling them."

Both experts agreed, the judge stated, that on appropriation the collateral taker must become the absolute owner of the Charged Shares.[5]

Principles of Interpretation

[8] There is no dispute that the Regulations, which give effect in English law to the Directive, and this new concept of appropriation, are to be interpreted differently from ordinary

[4] See judgment [60]
[5] Judgment [68]. It would have been more accurate to say the experts agreed that the collateral taker must become the absolute owner of the collateral.

English legislation. The English courts have developed special principles for the interpretation of instruments such as the Regulations and the judge referred to three of them. She stated that they were derived from the jurisprudence of the European Court of Justice which English courts accept as authoritative on matters of European Union law.

[9] The first concept to which the judge referred was that of 'autonomous meaning', which expressed the idea that words contained in legislation implementing European Union directives can have a meaning different from the meaning given to those words in national law. Words, phrases and concepts will be given meanings that can be applied uniformly in all member states, the judge stated. The judge cited as an expression of this approach the statement of Lord Steyn in Director General of Fair Trading v First National Bank PLC:[6]

> "32. The Directive is not an altogether harmonious text. It reflects the pragmatic compromises which were necessary to arrive at practical solutions between member states with divergent legal systems. But, despite some inelegance and untidiness in the text, the general principle that the construction must be adopted which promotes the effectiveness and practical value of the system ought to overcome difficulties. And the concepts of the Directive must be given autonomous meanings so that there will be uniform application of the Directive so far as is possible."

[10] The second concept to which the judge referred was the 'Marleasing principle', which gets its name from Marleasing SA v La Commercial Internacional de Alimentacio SA[7]. This case decided that courts in EU member states must interpret their national law so far as possible in light of the wording and purposes of relevant EU instruments. A recent statement of the principle is found in Pfeiffer v Deutsches Rotes Kruez[8]:

> "Although the principle that national law must be interpreted in conformity with Community law concerns chiefly domestic provisions enacted in order to implement the directive in question, it does not entail an interpretation merely of those provisions but requires the national court to consider national law as a whole in order to assess to what extent it may be applied so as not to produce a result contrary to that sought by the directive."

[6] [2001] UKHL 52; [2002] 1 AC 481
[7] Case C-106/89
[8] [2004] ECR 1-8835

[11] The third principle of interpretation the judge discussed was the use of material, called "the travaux preparatoires", as an aid to interpretation. Such material include Commissioners' white papers, Commissioners' proposals, the opinion of the European and Social Parliament, the Council's Common Position and decisions of the European Parliament.

[12] Based on her review of the applicable principles of interpretation the judge concluded that an English court must interpret provisions in English legislation implementing an EC directive so as to conform with the directive and that this required the court to examine the directive to determine its scope and objectives in order properly to construe the implementing legislation. In the judge's view it flowed inexorably from the Marleasing principle that the English court must always have regard to the directive to ensure that the court's interpretation of national legislation accords with the EU measures that the national legislation is seeking to implement.

The Judge's view of Appropriation

[13] After considering the guiding principles of interpretation the judge examined the concept of full as distinct from equitable ownership, types of security arrangements and collateral, and the methods provided for realizing or enforcing security. She considered that

> "The concept of appropriation must be given a meaning to promote the aim of the Directive or in other words a purposive meaning and such meaning must be autonomous, that is, one that can be applied uniformly to all the Member States. Thus, as the Regulations are implementing the Directive, a like meaning must be given to the concept in the Regulations, so we cannot give it a meaning which makes sense only with reference to English principles of property law."[9]

[14] In arriving at the meaning the judge stated it was of "the utmost significance"[10] that both Lord Millet and Professor Cranston agreed that on appropriation the collateral taker[11] must become the absolute owner of the charged shares and the equity of redemption extinguished. Professor Cranston, the judge recalled, opined that this meant appropriation

[9] Paragraph [60]
[10] Paragraph [68]
[11] Paragraph [68]. The reference in the judgment to the collateral owner becoming the absolute owner is a mistake.

s, both legal and equitable, and that the letters of 27 April 2007 did not achieve that result.

[15] Lord Millet, the judge stated, took the view that registration was not necessary as once Alfa determined to appropriate the charged shares the equity of redemption was then extinguished and Alfa became entitled to the 'absolute beneficial ownership' in the charged shares. The judge stated that on her analysis Lord Millett's proposition followed to its logical conclusion necessarily meant that the letters had the effect of extinguishing the equity of redemption. But, the judge noted, while Lord Millett thought it was not necessary for Alfa to become registered owner of the charged shares it was to be remembered that Alfa as equitable mortgagee held the share certificates and signed share transfers and was entitled to perfect its security by obtaining registration. It is not clear what significance the judge was attaching to that fact by mentioning it at this point. The judge did not mention, in this context, although she clearly adverted to it elsewhere, that Alfa had in fact completed the share transfers and had sought to perfect its security by becoming the registered owner of the charged shares but had been denied registration. I will return to this situation later because, in my view, it must have some significance for the court's appreciation of the remedy of appropriation.

[16] The judge considered the argument of counsel for Alfa that Professor Cranston's reasoning and conclusion in his report were flawed because they were based substantially on the Professor's analogy with foreclosure and his mistaken view, which he retracted on reading Lord Millet's report and expressly conceded in cross examination, that a mortgagee must first obtain legal title in order to exercise its remedy of foreclosure. Professor Cranston agreed that the paragraph of his report expressing that mistaken view should be deleted in its entirety.

[17] In the judge's thinking the concession that this view was erroneous did not seriously undermine Professor Cranston's conclusion as the analogy with foreclosure was only part of the basis for arriving at his conclusion. There was a more fundamental basis for the

Professor's conclusion, the judge thought, which she stated as follows and this, it seems to me, is the basis on which the judge decided the issue:

> "As I see it, the fundamental basis for his conclusion has not been affected which is that one must have regard to the objectives of the Directive and interpret the Regulations to give effect to it having regard to the special principles developed by English law for construing UK legislation implementing EC directives and the need to give an autonomous meaning to it."[12]

It bears repeating that by autonomous meaning the judge meant one that was capable of uniform application in EU member states.[13]

[18] From that statement the judge reasoned further, and this, it seems to me, is the ratio of her decision:

> "[73] Both experts agree that appropriation as envisaged by the Directive and the Regulations is akin to sale and foreclosure and that on appropriation the rights of the collateral provider are extinguished and the collateral taker is entitled to keep and treat the security as its own and this must mean that he must attain absolute ownership by the exercise of the right. As the civil law countries of the EU have no concept of equitable ownership this must mean that appropriation must entail the collateral [holder] becoming absolute owner of the security on the exercise of the right not just equitable owner."

Implicitly, the judge thereby concluded, appropriation occurs when a collateral taker becomes the registered owner of the charged shares.

The Legal and Equitable Interests must vest

[19] After reaching that conclusion the judge went on to consider Lord Millet's analysis that Alfa attained all the equitable rights by sending the letters and extinguished the equity of redemption and so obtained absolute equitable title, and the legal title which is outstanding is just a shell. Accordingly, on Lord Millet's view, Alfa was not required to be registered as the holder of the charged shares and so become the legal owner as in equity it has full beneficial ownership and the Cukurova entities are bare trustees. The judge noted that Lord Millet conceded that some rights attached to the charged shares, such as voting

[12] Paragraph [72]
[13] See paragraph [60] Judgment

rights, would have to be exercised by giving the requisite directions to the Cukurova entities. Thus, the judge observed, the Cukurova entities will always be in the picture until Alfa obtains registration or Alfa disposes of the shares. The judge then asked: "On this scenario can Alfa be said to have validly appropriated the shares and obtained full ownership if the legal title is outstanding?" The judge reiterated the point that Alfa would have only equitable ownership and all rights which it claims to have, on appropriation, to treat the shares as its absolute property in this scenario must be exercised through the medium of the Cukurova entities and Alfa would have to depend on Cukurova for compliance. The judge further asked: "Is this what is envisaged by appropriation in the Directive and the Regulations, that is that on appropriation the collateral taker may not have acquired full ownership?"

[20] In answer to the questions she posed, the judge concluded:

> "[76] It strikes me as unacceptable that in the world of global commerce, a collateral-provider (sic) or lender could appropriate a security by just determining to do so which really amounts to an inner thought process, which is not required to be translated into any overt action. Such a state of affairs would not be commercially reasonable, acceptable or commercially effective especially when one recalls that under the Regulations a collateral taker is not required to give notice. How then will a collateral taker (sic) know that its shares have been appropriated if it gets no notice and if no change on the register is effected? It will simply be left to monitor the actions of the collateral-taker and how can it do so if a mere mental process of the collateral-taker is sufficient to both destroy the equity of redemption and simultaneously vest the full ownership of the shares in it?"

[21] In the judge's view there must be

> "some overt, unequivocal action by a lender which has the effect of both destroying the equity of redemption and of vesting the legal and equitable rights in the security in him for the right of appropriation to be validly exercised. This Alfa cannot do merely by sending a letter in these terms set out in the agreed facts.
> "[77] This construction of the right of appropriation as given by the Regulations in my judgment accords with the objectives of the Directive as it is a concept which can be applied uniformly in all Member States. And, I am not persuaded that to require registration would be that cumbersome to be said to defeat the purpose of the regulations and the Directive as Alpha advanced. To my mind it will lend certainty to a situation as has arisen here. Accordingly, Alfa did not validly appropriate the Charged Shares by sending these letters as the legal title to the Charged Shares remain vested in the Cukurova entities."

Analysis

[22] An analysis of the judge's reasoning reveals that among the major factors on which the judge based her conclusion as to appropriation are the following: (1) Of utmost significance is that on appropriation the collateral taker must become the absolute owner of the charged shares and the equity of redemption extinguished. (2) As the civil law countries of the EU have no concept of equitable ownership, appropriation must entail the collateral taker becoming the absolute owner and not just equitable owner. (3) Appropriation cannot take place by the collateral taker simply determining to appropriate; instead, (4) there must be some overt, unequivocal action by the lender which has the effect both of (i) destroying the equity of redemption and (ii) vesting all the legal and equitable rights in the security in the collateral taker, for the right of appropriation to be validly exercised -- and that action is to become the registered owner of the shares. The judge thought this construction of the right of appropriation, as given by the Regulations, accorded with the objectives of the Directive as it is a concept that can be applied uniformly in all member states.

[23] From that distillation and earlier references in this judgment it is seen that the overarching consideration for the judge was that appropriation must be interpreted in a manner that is capable of uniform application in all member states of the European Union. As earlier stated, the judge reasoned that since the laws of other member states do not contain the concept of an equitable as distinct from a legal estate and do not recognize the different rights that pertain to the different estates, for a collateral taker under English law to appropriate he has to take the same action that a collateral taker in any of the other member states is required to take. That action, on the judge's conclusion, was to become the "absolute owner and not just equitable owner."

The Limits on Uniformity

[24] Uniformity as perceived by the judge cannot be a touchstone for determining the meaning of appropriation because the Regulations expressly provide for – they do not simply permit or accommodate -- the taking of collateral by way of equitable mortgage. The particular

value of an equitable mortgage and, one may infer, the reason why the Regulations provide for equitable mortgages, is explained in Lord Millett's report:[14] an equitable mortgage avoids the disadvantage incident to a legal mortgage of shares by which the mortgagee becomes the shareholder and becomes entitled to receive dividends. Instead, an equitable mortgage of shares results in the situation that is normal where there is a legal mortgage of land, which is that the mortgagor is allowed to remain in occupation of the mortgaged property and to continue to receive the income.

[25] As a starting point, therefore, English law renders uniformity, as the judge understood that concept, impossible in this regard by expressly providing for security for Financial Collateral Arrangements to be given in the form of either a legal or equitable mortgage. In the majority of EU member states there exists no concept of an equitable mortgage so the very existence of this form of security for a Financial Collateral Arrangement in English law is a marker of divergence rather than uniformity, as understood by the judge.

[26] It follows inescapably from that starting point that what is required for appropriation in English law must diverge from what may be required in other EU member states. This is precisely what the judge established by deciding that for appropriation to be effective the equity of redemption must be destroyed and not just beneficial ownership but both legal and beneficial ownership must vest in the collateral taker. These requirements undermine the very foundation of uniformity on which the judge based her interpretation. The equity of redemption exists in English law but does not exist in the law of most other EU member states, as the judge emphasised. How then, can it be a uniform requirement that the equity of redemption must be destroyed for appropriation to be effective? Similarly, it is only in the common law member states, which comprise a small minority, that there exist the concepts of a legal estate and a beneficial interest in property. How can the requirement that they both vest in the collateral taker be a uniformly applicable requirement in EU member states?

[14] At paragraph 16

[27] The requirement, on which the experts agreed, that the collateral taker must become the absolute owner of the collateral on appropriation, calls for a pragmatic construction to be given to the concept of appropriation and not the construction that the same thing must be done in all member states. Uniformity does not require that a concept of ownership that exists in the English legal system must be ignored or devalued in applying the Directive because it does not exist in the legal systems of other EU member states. Rather, uniformity requires that upon the exercise of the power of appropriation the same or a similar result is produced, that is, that the collateral taker becomes the absolute owner of the collateral. Uniformity does not require that the concepts and incidents of ownership must be the same.

[28] Uniformity, it follows, does not justify the conclusion that appropriation cannot take effect in equity alone but that the legal title must also vest for appropriation to be effective. It was never stated as such but that conclusion really amounted to saying that an equitable mortgagee cannot appropriate.

What the Regulations intended

[29] It is not clear if the judge fully considered the intention of the Regulations in arriving at her conclusion that appropriation cannot take effect only in equity. Starting with the Directive, conceptually it is difficult to see any reason why the Directive would have intended to make the remedy of appropriation unavailable to an equitable mortgagee. The language of the Directive is understandably inadvertent and neutral as to the divisions of ownership in the English law of property and evinces no intention to provide a remedy in one branch but not the other branch of English property law. As to the Regulations, it is certain they could not have intended to deny the power of appropriation to the holder of an equitable mortgage of shares because the Regulations expressly provide for an equitable mortgagee to appropriate. Further, the experts agreed that the equitable mortgagee in this case was given the right to appropriate.[15]

[15] See paragraph 27 of the Agreed statement of facts, under paragraph [2], above

[30] It is contrary to the express intention of the Regulations, therefore, to interpret appropriation in a way that makes an equitable mortgagee never able, as equitable mortgagee, to appropriate. Such an interpretation would frustrate a major object of the Regulations, by which English law implements the Directive, which was to tailor the concept and operation of Financial Collateral Arrangements to the English legal system -- that for over 400 years has developed and been developed by the concept of equitable ownership. This brings us back to the significance of the failure or refusal of the registered agent to register Alfa as the legal holder of the charged shares so as to perfect its security.

[31] On the judge's view of appropriation the action, or inaction, of the registered agent has been effective to prevent this collateral taker, because it is an equitable mortgagee, from appropriating. In my view, based on the report of Lord Millett, it would be contrary to the very purpose of creating the novel remedy of appropriation, which was to create a self-help remedy that requires no order of the court or other formality for its exercise, to make appropriation by an equitable mortgagee able to take effect only upon the willingness of the collateral provider's registered agent to register the transfer or upon obtaining a court order. If that were the case an equitable mortgage would be practically worthless as security for a Financial Collateral Arrangement because it would make no business sense to take an equitable mortgage as security. That is utterly contrary to the intention of the Regulations.

A Pragmatic Interpretation

[32] An autonomous construction of a word or concept in a Directive does not require, when that construction does not conflict with a construction in regular domestic law, that a concept in domestic law must be ignored or treated as falling outside the scope of a Directive. The guidance given by Lord Steyn in Director General of Fair Trading v First National Bank PLC[16] is apposite: a Directive may not be an altogether harmonious text; it may reflect pragmatic compromises to accommodate different legal systems; and, the general principle is that a construction must be adopted which promotes the effectiveness

[16] [2001] UKHL 52; [2002] 1 AC 481; see paragraph [9], above

and practical value of a given legal system. It is relevant to the earlier discussion on uniformity to note, as well, Lord Steyn's statement, that concepts in the Directive must be given autonomous meanings so that there will be uniform application of the Directive, is qualified by the words, "so far as possible". The view I have expressed that uniformity is not a touchstone or an absolute requirement derives support from that pronouncement of Lord Steyn.

[33] A construction that treats the concept of appropriation as available in equity, no matter that EU law generally knows nothing of Equity, promotes the effectiveness and practical value of the English legal system, which Lord Steyn stated is the general principle of construction. And it seems to be an established principle that an English legal concept which falls outside the conceptual framework of an EU law based Directive should nonetheless be taken as falling within the Directive so as to achieve the purpose of the Directive. Such a construction may be described as "pragmatic" and the respondents' own submissions confirm that it is right for an English court to adopt such a construction.

[34] In the skeleton argument for the respondent, it is stated:[17]

> "(4) The definition of "security financial collateral arrangement" does not literally apply to the English concept of legal mortgages. However, as professor Cranston made clear in evidence, the Courts would treat a legal mortgage as a security financial collateral arrangement despite this definitional inconsistency … The Courts are used to dealing with such issues as European Directives are seldom models of precise drafting and cannot be interpreted in the same way as English statutes … This is common ground … A pragmatic approach to interpretation is therefore required … and this issue would be easily dealt with by the Courts.
> "(5) This is also the view of leading commentators, such as Professor Goode. In his work 'Legal Problems of Credit and Security' (paragraph 6.38) he concludes that although, literally, English law mortgages fall outside the definition in Article 2.1(c) of the Directive, they must be taken to be included." (Emphasis added).

[35] Counsel for the respondents submitted, following this concession, that "this does not require any re-writing or watering down of the concept of appropriation to accommodate mortgages". Clearly it is permissible to interpret the language of a European directive to accommodate a divergent English legal concept. It makes no difference whether such

[17] Paragraphs 96 (4) and (5)

interpretation is called re-writing or watering down or something else; the principle is clear. Even in the face of a 'definitional inconsistency', this example shows, the pragmatic interpretation of the Directive requires a clearly worded definition to be interpreted to include what it does not literally include, because unless that is done the definition would exclude a concept as fundamental in English law as a legal mortgage. In the same way, it seems to me, appropriation "must be taken", in the phrase ascribed to Professor Goode, as including appropriation by an equitable mortgagee of the equitable interest in collateral that has been charged. There is no need to treat the remedy of appropriation as unavailable in equity because the doctrine of equity is unknown to EU law.

Appropriation and Absolute Ownership

[36] A pragmatic interpretation of appropriation requires a proper understanding of what is meant by 'full ownership' or 'absolute ownership'. Lord Millett considered those terms to be capable of referring to full or absolute ownership of the beneficial interest. The judge could hardly have decided otherwise because, as the comparison with foreclosure established, it is a settled proposition in English law that an equitable mortgagee may foreclose and become the absolute owner of the beneficial interest while the mortgagor continues to hold legal title.[18] Therefore, the judge's view that it is an undesirable result that there should be a continued separation of the legal and equitable interests in the collateral after appropriation has occurred, is at odds with the legal principle that there can be foreclosure of the equitable interest without at the same time foreclosing the legal estate in collateral. I see no reason why the division of ownership interests in collateral which may continue after foreclosure cannot similarly continue after appropriation.

[37] Further, Lord Millett's opinion that appropriation included becoming "absolute beneficial owner" of the collateral is consistent with the fact that the beneficial interest in the collateral was all that was charged. Therefore, it is all that is required to be appropriated. The acquisition of the legal estate will no doubt be a priority for a collateral taker after it has

[18] Lord Millett clearly states this at paragraph 23 of his report, citing in support Marshall v Shrewsbury (1875) LR 10 Ch App 250 at 254, per James LJ..

appropriated the equitable estate (and thereby extinguished the equity of redemption) but it is not a precondition for appropriation. Where the legal estate is not the collateral, it is not required to be appropriated. As Lord Millet opined, appropriation, in the case of an equitable mortgage, means becoming "absolute beneficial owner" of the equitable title.

To Appropriate means to keep

[38] Counsel for the respondents argued that Lord Millett could give no explanation for his conclusion that Alfa's sending of the letters on 27 April 2007 was sufficient to make it absolute equitable owner of the charged shares, Alfa having then only an equitable security interest subject to Cukurova's equity of redemption. Alfa's only answer, counsel said, is that it became absolute equitable owner of the Charged Shares on 27 April 2007 because its letters were an effective appropriation and destroyed Cukurova's equity of redemption. "But," counsel argued, "its only explanation for why the letters were an effective appropriation is that Alfa thereby became absolute equitable owner – the reasoning is entirely circular. When asked to produce some basis for this theory, Lord Millett could not. He said "I simply rely on the meaning of the word appropriate" [Day 2, 111/13]. That is no basis at all", counsel submitted.

[39] That submission ignores the very full explanation of the meaning of appropriation Lord Millett gave in his report. He did so after explaining the remedies of sale and foreclosure in English law, by which a mortgagee becomes the absolute owner of the proceeds of sale of mortgaged property or of the mortgaged property itself. Lord Millett then stated:

> "26. A major change introduced into English law by the Regulations is to provide for "appropriation" as a new means of realising collateral in the event of default. This is a self-help remedy analogous to foreclosure in that the collateral-provider's equity of redemption and right to redeem are extinguished and the collateral-taker takes the mortgaged property in place of the debt. But it differs from foreclosure … [In] accordance with the requirements of the Directive the Regulations dispense with the need to obtain an order of the court. Appropriation gives the collateral taker an indefeasible interest in the collateral, free from any right on the part of the collateral provider, who is relegated to a right to be paid the amount if any by which the value of the collateral exceeds the amount of the debt."

[40] Lord Millett, as previously mentioned, further explained, "Neither the Directive nor the Regulations prescribe the manner in which the power of appropriation may be exercised, and since the remedy was previously unknown to English law there is no English authority on the question."[19] This was the departure point for Lord Millett's conclusion with which, it will be recalled, the judge had a major difficulty. Lord Millett stated

> "In my opinion, it was sufficient for Alfa to determine to exercise the power; whether it needed to notify the collateral provider is a moot point, as in any event notification was given in the instant case. In the present case Alfa's letters dated 27th April 2007, which gave notice that it was "thereby" exercising the power of appropriation, manifestly gave sufficient notice."

[41] It is a perfectly clear explanation Lord Millett gave why the mental process of forming the intention to appropriate, coupled, in this case, with the action of giving notice, should be sufficient for appropriation to be effective. It is a commonplace in English law that the forming of an intention is in itself sufficient to produce a legal result. In the criminal law the forming of a criminal intent can make an action or an existing fact situation a crime; in land law the intention to possess completes possession; and in the former law of torts an intention to deny the ownership of another constituted conversion. The non-legal meaning of appropriation offered by the European Commission, to which Professor Cranston referred, is that in an enforcement event the collateral taker may keep the assets as its own property instead of selling them.[20] It seems entirely consistent with the Directive that Alfa should be able to achieve the result of keeping the collateral, in this case the equitable interest in the shares, by forming the intention to keep the collateral.

[42] That is all it needed to do because, as Lord Millett stated in his report, the deposit of the share certificates and executed transfers implied a contract to transfer the shares which, being specifically enforceable, passed an equitable interest.[21] Therefore, had this been a case of foreclosure, the equitable mortgagee would have foreclosed that interest. Being, instead, a case of appropriation, the equitable mortgagee has appropriated that interest. It

[19] Paragraph 54 of Lord Millett's Report.
[20] See paragraph [7], above.
[21] Paragraph 1723

formed the intention to keep absolutely the interest that had previously passed by way of security. That is all appropriation requires.

Conclusion

[43] For the reasons I have given I find convincing the opinion of Lord Millett that under English law, by its letters of 27 April 2007, Alfa destroyed the equity of redemption in the collateral and appropriated the beneficial interest in the charged shares. I would therefore allow the appeal. I would award the costs of the appeal and of the trial of the preliminary issue in the court below to Alfa. If the parties do not agree on costs on or before 23rd May 2008, Alfa shall be at liberty to apply to this court within 21 days of that date for costs to be quantified.

Denys Barrow, SC
Justice of Appeal

I concur

Hugh Rawlins
Justice of Appeal

I concur

Ola Mae Edwards
Justice of Appeal [Ag.]