

## Briefing Note

### Scots Law Shares Pledges

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#### Background

A Scots law shares pledge requires that the pledged shares are legally transferred to the lender (or more often a nominee company of the lender), with a stock transfer form being signed, share certificate issued and the lender or their nominee company being entered in the company's Register of Members (being the ultimate legal test of share ownership). Although the shares are legally transferred, and any search at Companies House would show the lender or their nominee as the shareholder of the company, the beneficial interest in the shares remains with the pledgor pursuant to the terms of the share pledge agreement. The legal transfer of shares under a shares pledge is made in security only and the shares pledge agreement should provide that voting rights and dividend rights remain with the grantor of the pledge, until an enforcement event occurs.

An example of an enforcement event could be a material breach of the facility agreement, cessation of business or insolvency (all detailed in the share pledge agreement). On an enforcement event the pledge is "perfected" and the voting and dividend rights revert automatically to the lender, or their nominee. The pledge therefore gives the lender a very quick route to divert control over the company if there is a default, unlike the appointment of an administrator under a floating charge – the pledge could be exercised in isolation without appointing an administrator.

#### Standard terms

The drafting in some share pledge agreements can have the effect of creating a personal guarantee by the pledgor to meet the borrower's payments under a facility agreement. If acting for the pledgor this wording should be resisted with the intention being that recourse is limited to the grant of the pledge. Pledges are a continuing security and will continue in full force and effect until satisfaction of all liabilities of the borrower to the lender.

The lender will usually seek warranties from the pledgor, for example, that the shares are fully paid, that the pledgor is the sole legal and beneficial owner of the shares and that the pledgor has not created any other charge over the shares. It is also standard to see a list of negative pledges under which the pledgor agrees not to take certain actions, for example, selling the shares or exercising voting rights in a way which may have an adverse effect on the value of the shares, but it may go further than this to provide for a blanket restriction on any security being granted and this could unintentionally prohibit mortgages over the pledgor's main residence.

If further shares in the borrower are subsequently allotted the terms of the share pledge agreement will often state that these will be held in security for the lender and the pledgor is obliged to grant a further pledge over such shares.

Shares pledges will often include a power of attorney provision whereby the pledgor irrevocably appoints the lender as the pledgor's attorney to execute any document or carry out any act required pursuant to the shares pledge. If acting for the pledgor this provision should be revised in order that the power of attorney is only exercisable on an event of default. Without that revision the power of attorney provisions are potentially quite far-reaching. There is no requirement to register a Scots law shares pledge at Companies House, but it is common place to do so.

### Position in England

Legal charges over shares in English companies do exist and can include the transfer of shares to the lender, by way of legal mortgage, meaning the shares are actually transferred and registered in the name of the lender, or their nominee, as with a shares pledge in Scotland. However, it is also possible to create security over shares by way of an equitable charge in terms of which the shares are not transferred at the outset but the lender seeks to rely on executed transfer forms to be delivered.

### Comment

Share pledges are becoming a common part of security packages required by lenders in Scotland. This is, perhaps, as a result of the restricted powers an administrator has in comparison with receivers. Lenders are actively requiring groups to be structured in a particular way so as to allow a shares pledge to be granted and this has other commercial and tax implications.

Please contact Turcan Connell's Business Law team for more information on shares pledges.

Please note that this briefing note is intended as a short summary of share pledges. No responsibility can be accepted for any action taken in reliance on this note and specialist advice should be taken in every case. Turcan Connell would be happy to provide such advice.

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