

WHEN A RIGHT TO POSSESSION IS TEN TENTHS OF THE LAW: THE DECISION IN SCIPION V VALLIS

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In a decision which will be of interest to those involved in the commodities sector and warehouse financing in particular, the English High Court has confirmed the principle that substantial damages are recoverable based on the infringement of a bailor's right to possession of property. In *Scipion Active Trading Fund v Vallis Group Limited (formerly Vallis Commodities Limited)*¹ the claimant (Scipion) was awarded damages for lost copper scrap against the defendant (Vallis) as contractual bailor, notwithstanding the fact that Scipion's foreign law pledge over the copper scrap was found to be invalid.

Background

Scipion had provided a US\$10m borrowing base facility to Mac Z Group SARL (Mac Z) which was to be used to finance the purchase and storage of copper stock for processing into copper products in Morocco. To secure full repayment and its performance under the facility agreement, Mac Z purported to provide a pledge over the copper stock and the manufactured products to Scipion. The pledge was governed by Moroccan law.

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At the same time as entering into the borrowing base facility and the pledge, Scipion and Mac Z entered into a Collateral Management Agreement (CMA) with Vallis which was governed by English law. Pursuant to the CMA, Vallis agreed to receive, store and hold the stock and products, issue warehouse receipts, and provide reports to Scipion regarding the total quantity and value of the stock and products at the site. However, after more than a year of acting as collateral manager under the CMA, Vallis discovered a rather large problem – a 1,900mt discrepancy between the level of copper stock it had reported as being at the site and the actual amount which was at the site.

Mac Z failed to repay the amounts under the facility and Scipion's subsequent judgment went unsatisfied.

Scipion contended against Vallis that there had either been a paper loss (ie, tonnage was wrongly recorded in the first place) or a physical loss of copper, but either way Vallis had breached the CMA, as a result of which the balance due under the borrowing facility was unsecured. Accordingly, it brought a claim against Vallis.

In the course of the trial, Vallis admitted there had been a physical loss at the site caused by Vallis' breach of the CMA. However, it contended that pursuant to Moroccan law the pledge was invalid and as a result Scipion had no possessory interest in the lost copper and was not entitled to bring a claim in respect of it. Scipion contended that the pledge was valid but that it was able to sue on the basis of its right to possession as bailor even if the court found that it was invalid. The court found that the pledge was invalid but upheld Scipion's bailment claim and in doing so made several findings:

1. A bailment relationship between Scipion and Vallis arose by the attornment of the collateral manager

It was accepted that there was a bailment relationship between Scipion and Vallis and thus it was not strictly necessary to analyse how that relationship arose. However, the judge expressed the view that in this case, in line with earlier cases concerning CMAs, rather than by direct delivery of goods from Scipion, bailment arose by the original bailor (Mac Z, the owner of the copper) bailing the copper to the collateral manager (Vallis), and the collateral manager as bailee "attorning" (acknowledging a transfer of possession) to the new bailor (Scipion) and agreeing to hold the copper on the bailor's behalf pursuant to the terms of the CMA.

2. The governing law on the creation of a possessory right

The usual rule is that the law of the jurisdiction in which goods are located will govern the transfer of such movable property, even when effected contractually. However, in this case the court confirmed that when the question is whether a party has the right to possession pursuant to a bailment, that question will be governed by the law governing the bailment. Thus, in the case of a bailment on the terms of a contract, as was the case here, the relevant governing law will be the law of the contract. Accordingly, since the bailment was governed by the terms of the CMA, the governing law of Scipion's rights was English law.

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3. Possessory interests are enough to claim substantial damages

Vallis argued that under English law, Scipion had no title to sue if the pledge was invalid as all rights to the property would remain vested in Mac Z. However, the court found that the terms of the CMA were clear that possessory rights vested in Scipion until the facility was repaid, Vallis held the stock for Scipion and Scipion could sue under these rights. The court confirmed that substantial damages can be recovered by a person "who has or is entitled to have the possession of goods"^[2], and that this principle can extend to a claim by a person who has a right to possession as bailor. Scipion was therefore entitled to claim damages, irrespective of the validity of the pledge.

4. The confirmation that a contractual bailee is precluded from relying on a *jus tertii* defence

The court also held that the normal estoppel rule in bailment relationships, which essentially precludes a bailee from arguing that a third party has a better claim to possession than the bailor (sometimes known as a *jus tertii* defence), applied. In doing so, the court rejected Vallis' claim that the Torts (Interference with Goods) Act 1977 abolished the estoppel rule, holding that the Act did not apply to cases of contractual bailment and was limited to tortious claims (such as conversion). As such, Vallis was precluded from arguing that Mac Z had better rights to the copper than Scipion in any event.

5. Primary measure of loss is the value of lost copper plus statutory interest

The court found that the primary measure of loss to Scipion was the value of the lost copper, which was to be valued as at the assumed date of breach. However, this sum was greater than the amounts outstanding under the facility because of the requirement upon the borrower to maintain stock in line with Scipion's 125% coverage ratio. To avoid having to account to the borrower for any over recovery, Scipion limited its claim to the amount payable under its facility including interest.

Credit would be given for the remaining scrap at the storage facility which either had already been sold or would be sold by Scipion. There was a dispute as to the credit that should be given for the remaining copper since its value had fallen between the date of assumed breach and the trial date. The court held that goods which had subsequently been sold should be valued as at the dates that they had been sold, and that any remaining copper should be valued at the date of trial, unless Vallis could show that Scipion had failed to mitigate its loss.

6. The rejection of offers for remaining copper did not amount to a failure to mitigate loss

Various offers had been made for the remaining copper which had been rejected by Scipion. Vallis argued that this constituted a failure to mitigate and that at least one of the offers should have been accepted. However, notwithstanding the unsatisfactory nature of some of Scipion's evidence on this point, the judge did not consider that Vallis had established its case, noting that realisation of the remaining scrap copper (to be extracted from 1,151mt of telecommunications cable) presented Scipion with processing difficulties. The court accepted that Scipion, as a finance house rather than a metals recycler or trader, was not well placed to attend to such processing.

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Takeaways for Finance Parties Involved in Warehouse Financings

- The right to possession is a powerful right and can provide a remedy against a collateral manager even if the underlying security is found to be invalid.
- A bailment relationship will normally arise on the terms of a correctly drafted collateral management agreement and bailees will usually be unable to contend against the bailor that another party has a better title to the goods.

However, readers should not be left with the impression that the validity of a local law pledge is unimportant. In this case it was not decisive. Scipion's right to possession was upheld and Vallis was estopped from contending that Mac Z, Scipion's borrower, had better title because the pledge was invalid.

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In these circumstances Scipion's alternative claim for damages for loss of a chance to secure performance of the facility was not needed. However, the court was far from convinced and considered that the borrower, or possibly third-party creditors, could have taken advantage of the invalidity of the pledge to Scipion's detriment had they known of it.

[1] [2020] EWHC 1451 (Comm)

[2] *Chhabra Corporation v Jag Shakti (Owners) (The "Jag Shakti")* [1986] AC 337

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