

## Taking security over Jersey property

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### Immovables

#### Hypothecs

The encumbrance or charge over immovable property known to Jersey law is a hypothec and is not as such a mortgage.

A mortgage can be defined as a conveyance, assignment, or demise of property as security for the repayment of money borrowed. A hypothec is a "droit reel accessoire", a subsidiary right available to protect a principal obligation. The principal obligation can exist independent of any hypothec but a hypothec cannot exist independently of a primary obligation. If the principal obligation secured by the hypothec is repaid the hypothec ceases to exist and there is a statutory procedure for enforcing the cancellation of hypothecs in such circumstances.

As a hypothec is a right ancillary to the principal obligation it is necessary for the hypothec to be granted by the obligors ("borrower") under the principal obligation. Accordingly if a property is owned by A B and C they cannot create a charge over that property acknowledging a debt in the name of Z although they could provide a guarantee registered as a hypothec over their property. Prior to 1880 the system of hypothecation rendered a man's entire estate as security for all of his transactions. These hypothecs were unquantified in amount so that it was impossible to ascertain the obligations secured against a particular parcel of land. The 1880 law on real property sought to tackle the lack of confidence in immovable property at that time by restoring certainty to immovable property transactions. Hypothecs had to be created for a "somme certaine" and thus were rendered quantifiable. A record of all hypothecs created before the Royal Court had to be effected in the Public Registry. For the first time it became possible to ascertain the extent of the encumbrances (except for legal hypothecs) secured against immovable property belonging to a debtor by looking in the Public Registry.

The 1880 law created three different forms of hypothec: the simple conventional hypothec, the

judicial hypothec and the (less frequently encountered) legal hypothec.

## Simple Conventional hypothec ("hcs")

These hypothecs are created by the express agreement of the borrower and the lender. An hcs is created by contract passed before the Royal Court and copies are held in the records of the Public Registry.

An hcs must be created for a specific amount against a specific parcel of land as fully described within the body of the hcs. It cannot constitute a general charge against all the immovable property in the island of a debtor and must be created against a specific parcel or parcels of land.

An hcs subsists until it has been repaid and can be transferred/assigned by the lender by means of a contract passed before the Royal Court.

## Judicial hypothec ("hj")

These hypothecs are created by act of the court - a "judicial" act. The draftsman of the 1880 law envisaged that these hypothecs would be created at the end of court proceedings when a judgment in a specific amount was given in favour of one of the parties. This is still possible and entails the party who has had a judgment for a specific amount given in his favour asking the court when judgment is given for the resulting act of the Royal Court to be registered in the Public Registry. Registration of an act in this manner gives the judgment creditor a hypothec over all his debtor's immovable property in the island.

The practice evolved of using an hj in non-litigious arrangements and nowadays the vast majority of borrowing arrangements to be secured against immovable property are effected by way of judicial hypothec, one of the reasons being the issue of costs. This is notwithstanding the fact that an hj needs to be re-registered to remain effective against third parties before the elapse of thirty years from its creation.

An hj usually takes the form of a single A4 sheet setting out the borrower's acknowledgement of indebtedness and his consent to the registration of that acknowledgement as an hj. Although the 1880 law envisaged that an hj would encumber all of the debtor's immovable property it is possible to take registrations against one or more designated properties. The acknowledgement of indebtedness is signed by or on behalf of the lender and the borrower and is lodged with the Public Registry on a Friday afternoon. Copies of all acts ("billets") recording the registration of hjs are kept in the Public Registry.

Hjs are more adaptable than hcs when securing more sophisticated facilities such as business loans. In such instances the lender may only require the ability to register if things go wrong. The manner of creating an hj makes it readily adaptable to the holding of security documentation on an unregistered basis.

Further an acknowledgment of indebtedness can acknowledge and secure the payment of an actual or contingent liability. Given the fact that it is now possible to secure a contingent liability it seems that the actual liability need not come into being prior to the registration of the acknowledgement of indebtedness.

There are two standard ways in which the debt comes into being apart from an act of court creating a judgement debt.

The first way is by means of a simple promissory note. Whenever a promissory note is taken the terms of the actual indebtedness or facility should be clearly and fully set out in a facility letter. Most home loans in Jersey are now dealt with in this way. As the terms of commercial loans tend to vary more than home loans, a bespoke facility letter and promissory note provides much of the flexibility that modern lending arrangements require.

The second commonly encountered manner of recording the creation of the debt is by means of the execution of a bond. Although an offer letter is usually also issued, a bond has the benefit of setting out many of the conditions of the advance i.e. that the property be insured, not disposed of or further hypothecated etc.

Whether a hypothec takes the form of an hj or an hcs, stamp duty is payable at the rate of one half of a percent of the capital amount secured, plus a registration fee (currently £80).

Legal fees for the creation and cancellation of an hcs will usually be higher than for an hj.

## Legal Hypothecs

These arise by operation of law and are priorities granted in specific circumstances to protect the rights of certain individuals.

The 1880 law provides that a legal hypothec comes into being against the immovable property of a deceased debtor in favour of his creditors if certain procedural steps are adhered to. Additionally a wife's claim to dower is protected by a legal hypothec coming into being as at the date of the husband's death.

Although legal hypothecs are not registered in the Public Registry, when checking title a competent conveyancer will be put on notice of the possibility of such hypothecs having come into existence. He will make suitable enquiries and if necessary take steps to ensure that such hypothecs do not subsist, or if they do, to ensure that there is appropriate protection in place (i.e. insurance, undertakings to cancel).

## Oppositions (or caveats)

Not a hypothec but potentially a way of safeguarding the position of a creditor, enabling a creditor to oppose the passing of a conveyance by his debtor if the latter is intending to sell immovable

property belonging to him.

An opposition may only be lodged with the leave of the Bailiff. An application for leave must be made in writing supported by affidavit. A creditor must be acting in good faith and is not abusing his right to oppose the passing of the contract. If these conditions are not met the creditor may be liable in damages and costs.

## Independent Legal Advice

The requirement that the obligation to be secured should be that of the person granting the hypothec in favour of the creditor can cause difficulties. A classic problem is that of the husband who wishes to borrow money to put into his business where the only substantial asset available is the matrimonial home jointly owned with his wife. It is important in such cases that the lending institution insists that the wife (or any other person who is granting security but who will not benefit, or will not benefit to the same extent as the other party) is independently advised.

Care must be taken to ensure that security documentation is properly executed and that signatures are neither forged nor obtained under duress. Failure to do so may render the security obtained of no value.

## Priority of Changes

A lending institution should exercise care when agreeing to a debtor creating a charge subsequent in time to its own. If a second charge comes into being and there is no clear priority agreement between the creditors the first creditor can find itself in an awkward situation. If the creditor with the first charge has persuaded his debtor to voluntarily sell his property he cannot compel the holder of a subsequent hypothec to release the property from its hypothec. The second creditor might refuse to release the property unless he is paid a substantial element of the sale proceeds to the detriment of the holder of the first charge. If unacceptable the first creditor is left with commencing enforcement proceedings against the debtor, unless an arrangement can be reached with the second creditor.

A lending institution should also exercise great caution if it seeks to create a second charge in its favour behind a States loan whether it be a Housing or Agricultural loan. This is because the relevant statutory provisions governing those loans enable the Public on "foreclosing" to have the property vested in their name free of any subsequent loans. The second (and any subsequent) charge therefore becomes unsecured.

## **Movables**

For the purpose of this briefing we will focus upon loans advanced to buy shares in a company which owns Jersey immovable property. Security can only be taken over shares in Jersey pursuant to a security interest which in turn is taken in accordance with the Security Interests Law.

## Where all of the issued shares are to be purchased

Where a lender is funding the purchase of the whole of the issued shares in a company which owns Jersey immovable property, the shares will be often be offered as a more convenient form of security. Although a security interest over the shares is of value as a "belt and braces", for the reasons outlined below, the shares may provide poor security. There is a risk that where all issued shares are owned by one shareholder that shareholder could undertake commercial activities and incur debts in the name of the company with a consequent impact on the value of the shares. If a lender only has a charge over the shares it stands in no better position than that of shareholder and will be last to be paid out after all secured and unsecured creditors. Therefore it is considered that the most desirable course of conduct is for the lender to take a hypothec over the immovable property supplemented if considered appropriate by a security interest over the shares.

Care is still required when taking a hypothec over the immovable. A company cannot acquire its own shares so the loan must be made to the individual acquiring the shares. In order to obtain a hypothec over the property itself a guarantee will be required from the company in support of the loan. This constitutes financial assistance and can be invalid unless certain Companies Law criteria are met. There is also the question of whether any "cause" similar to "consideration" exists for the company entering into the arrangement. If a company is gratuitously offering security and there is no benefit or justification for the company, the security is liable to be set aside if challenged.

## Where a block of shares is to be purchased

Loans to assist with the purchase of a share transfer flat have tended to be treated differently to the purchase of all of the shares in a property holding company and it is accepted practice to take a security interest over the shares. This pragmatic approach is adopted because companies holding a block of share transfer flats are seen as being non-trading as it is unlikely that the shareholders would allow the company to undertake a trading activity. The risk (albeit small) does, however, still exist.

It is important to examine the articles of association as they establish the rights of the company and its shareholders and the procedure for meetings. The articles (or house rules or regulations made under them) may impose restrictions upon the enjoyment of the flat. For instance there may be restrictions preventing the keeping of pets at the flat, or even preventing children from residing there, which could suppress market value. More importantly some articles contain pre-emption rights and restrictions upon the alienation of shares which will render shares in such companies less desirable as security.

A further consideration for a lender is whether the shares should be issued in the name of the borrower or the lender/its nominee. The first alternative is almost exclusively used nowadays, although there is an undeniable risk that a shareholder could purport to sell his or her shares and defeat the secured interest. This risk is usually minimised by the lender holding the actual share

certificate as well as a signed stock transfer form to force transfer in the event of a default. The second alternative is rarely used; this may be due to factors such as the exposure of the lender to shareholder's liabilities and the resistance of borrowers to their most important investment being in a third party name.

## Assignment of security

The assignment of debt due under a contract is a matter of customary law. Recent case law has confirmed that the consent of the debtor is not required, nor is a debtor entitled to information about the economic basis of the assignment. Once notice is given that a debt has been assigned the original creditor is no longer entitled to payment and the debt may only be extinguished by a payment to the assignee.

There is no provision in the 1880 law covering the transfer of an *hj* or for any alteration in the records of the Public Registry if such a transfer takes place. In fact there is no suggestion in this law that the benefits of an *hj* may be enjoyed by anyone other than the person who obtained the hypothec. There is case law indicating that the Royal Court would adopt a pragmatic approach in a *dégrévement* and permit an assignee to participate in a *dégrévement*, but none specifically confirming that a transferee is entitled to enforcement rights against a third party.

The assignment of claims secured by an *hj* is common in modern financial practice and clarity through legislation or case law would be of considerable comfort. For the present, the conservative approach of bringing a representation to the Royal Court requesting the noting of the assignment in the Public Registry has developed and appears to be a sensible route to follow.

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