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UPDATE

Security over real property – a significant judgment for secured creditors

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The Jersey Court of Appeal in *Jersey Home Loans Limited v Stephen Hill* [2019] JCA 101 has confirmed that costs incurred by a lender may be secured by a judicial hypothec. The decision will be welcomed by secured lenders who will now enjoy better protection in the event of a defaulting loan. Mourant Ozannes acted for the successful lender in this case.

Background – the rights conferred by a judicial hypothec

In Jersey, charges over immovable property are known as hypothecs rather than mortgages.

Hypothecs are usually created by the borrower signing a bond or promissory note in favour of the lender which is then registered by an Act of the Royal Court in the Public Registry (the Jersey Land Registry). The registration will state the capital sum of the loan and whether or not it bears interest.

A hypothec gives the lender certain rights in respect of the secured property if the borrower becomes subject to bankruptcy proceedings including a priority claim to the proceeds of sale of the secured property.

In addition, if the borrower defaults on the repayment of the loan, a lender may look to enforce the hypothec by instituting legal proceedings against the borrower. The legal proceedings may lead to the immovable property of the borrower being subjected to 'dégrèvement' proceedings.

If a dégrèvement is ordered, the creditors of the borrower are given the option to take title to the secured property. The unsecured creditors are given the first opportunity to take title and if they decline, the most recent secured creditor is then given the opportunity to take title and if that secured creditor declines, then the next most recent secured creditor is given the opportunity, and so on. Any creditor who does not accept the property relinquishes its right to become the owner of the property.

Any creditor accepting the secured property in a dégrèvement (called a tenant après dégrèvement) is obliged to pay off all other creditors (if any) with a higher priority claim.

Do legal costs have to be paid by the creditor who accepts the property?

In this case, the borrower's immovable property was subject to dégrèvement. The borrower had an unsecured creditor and her immovable property was subject to two hypothecs. In the dégrèvement proceedings, the unsecured creditor accepted the property. The unsecured creditor therefore became obliged to pay off the two prior hypothecs. The holders of the hypothecs argued that their hypothecs secured not only the repayment of the capital sum and interest owed (as stated in the original registration documents) but also the legal costs they had incurred in seeking to obtain and enforce repayment of their loans against the borrower. However, the unsecured creditor argued that the hypothecs did not secure such legal costs and that he could not be compelled to pay them as a condition of taking over the property.

The decision of the Royal Court

The Royal Court considered the law which regulates the dégrèvement procedure (being the Loi (1880) sur la Propriete Fonciere) and other authorities. The Royal Court held that costs were not secured by the judicial hypothec and that the unsecured creditor could therefore not be compelled to pay the costs of the lenders as a condition of taking title to the property.

The decision of the Court of Appeal

The key elements of the Court of Appeal decision may be summarised as follows:

- The Royal Court had placed emphasis on the purpose of registration in the Public Registry. The Royal Court considered that the purpose of registration was to enable any potential creditor to search the Public Registry and easily ascertain the maximum amount of secured indebtedness. However, the Court of Appeal noted that the 1880 Law had been amended in 2000. Under the amended 1880 Law, there is no requirement that a judicial hypothec must always specify a maximum sum beyond which debts cannot be secured. Therefore, the Court of Appeal considered that it is incorrect to consider that an inspection of the Public Registry must reveal the maximum amount of any secured obligation.
- In terms of whether a stated amount needs to be specified for costs, the Court of Appeal held that it was not necessary. A judicial hypothec may secure an obligation to pay costs even though there is no statement of a specific amount.
- In finding that costs were secured by a judicial hypothec, the Court of Appeal was influenced by an earlier Royal Court judgment concerning interest. In *Re the Remise de Biens of Super Seconds Limited* [1996] JLR 117, the Royal Court held that arrears of interest are accessory to principal and are secured by the same hypothec. The Court of Appeal treated costs in a similar way. In other words, if interest can be additional to the stated principal amount, then there is no reason why costs should be treated any differently.
- The Court of Appeal considered the customary law position before the 1880 Law. It noted that the previous customary law position was that costs were accessory to the principal debt and secured by the same hypothec. Whilst the 1880 Law had reformed Jersey property law, the Court of Appeal held that it had not altered the pre-existing position relating to costs. Therefore, the costs of a lender are accessory to the principal debt and secured by the same hypothec.
- The Court of Appeal noted that the 1880 Law had been amended in 2000. Nevertheless, it held that its judgment applied to hypothecs entered into before and after the year 2000. The date of a hypothec will therefore not affect whether costs are secured.
- The Court of Appeal acknowledged that this may mean that an inspection of the Public Register will not reveal the true level of indebtedness at any particular time. However, the Court of Appeal considered that an intending purchaser, tenant après dégrèvement or creditor would be put on enquiry by the existence of a hypothec and they would therefore need to approach a lender to establish the costs position.
- The Court of Appeal emphasised that in order for costs to be secured, there must be an agreement between the creditor and the debtor that costs are to be secured by the hypothec. However, the Court of Appeal held that there is a presumption that the parties have agreed to secure costs.

Implications

The judgment of the Court of Appeal is to be welcomed by secured creditors as it confirms that costs are secured by a judicial hypothec.

As a matter of practice, the loan documentation between the lender and the borrower should clearly record an agreement that costs are secured by the judicial hypothec.

It is likely that a court will place some limitation on the costs that may be recovered so that the costs must be reasonable in amount and reasonably incurred. Although not relevant to the judgment, secured creditors should already be aware that there is an existing statutory limitation as to the interest that can be claimed in a dégrèvement. Only three years' interest can be secured by a judicial hypothec.

The decision will also be helpful in other bankruptcy procedures where a hypothec is relevant. In a remise de biens (another type of bankruptcy procedure), the secured creditor will be able to insist that its costs are discharged as part of the remise procedure. The Viscount (a court officer who acts as trustee in bankruptcy in a désastre) will also need to pay the secured party's costs out of the proceeds of sale of the secured property as part of its secured claim.

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