Security Interests (Jersey) Law 2012

The Security Interests (Jersey) Law 2012 (the "Law") came into full force on 2 January 2014. The Law significantly reforms the way in which security may be taken over Jersey intangible movable property and will enhance the remedies that are available to a secured party on default.

The prior law

The prior law which governed the taking of security over Jersey intangible movable property is the Security Interests (Jersey) Law 1983, as amended (the "1983 Law"). The 1983 Law has served its purpose well and allowed security to be taken over a range of Jersey intangible movable property (such as shares in a Jersey company, units in a Jersey property unit trust, bank accounts maintained in Jersey and contracts with Jersey obligors). Indeed, since 1983, there has only been one significant case litigated before the Jersey courts concerning the construction of the 1983 Law. The absence of further litigation is indicative of the success of the 1983 Law in facilitating secured financing transactions.

Under the new Law, it will only be possible to take security in accordance with the provisions of the Law. However, the 1983 Law will continue to govern all security interests taken before the Law came into force (with some exceptions). For a period, there will therefore be a "dual" security regime in Jersey - one governed under the 1983 Law and the other governed under the new Law.

The need for more flexibility

Whilst the 1983 Law has enabled many secured financings to be successfully concluded, the 1983 Law had certain practical limitations. In particular, the following specific limitations can be mentioned:

- There is a view that the 1983 Law cannot be used to structure an "English style" third party charge. Under this arrangement, the grantor of the security interest does not assume any personal liability for the indebtedness of the borrower but merely charges certain property as security for the indebtedness of the borrower. The view is that the 1983 Law is not that flexible and that a security agreement needs to secure a liability of the grantor albeit that such liability can be a guarantee liability. Therefore, in circumstances where security is not being taken directly from the borrower but from a third party (such as the parent company of the borrower), there was a need to interpose a technical guarantee (so that the third party guarantees the indebtedness of the borrower and the security then secures that guarantee obligation). The guarantee would typically be limited recourse in nature (so that the secured party could have no recourse against the guarantor other than in respect of the collateral). Whilst this could all be accommodated from a drafting perspective, this was an unnecessary complication in taking security from non-borrowers.

- Under the 1983 Law, the security agreement must contain provisions regarding the obligation, payment or performance of which is to be secured, sufficient to enable it to be identified. This led to a view that it may not be possible to have an "all monies" security (i.e. a security interest securing all monies owed under any arrangement between the grantor and the secured party whatsoever). Instead, there is
a view that the security agreement should only secure the obligations under specified agreements.

- The 1983 Law cannot be used to take English debenture style security over all present and future intangible movable property of the grantor. One of the formalities under the 1983 Law is that the security agreement must contain provisions regarding the collateral sufficient to enable it to be identified. Also, in the case of security constituted by assignment, there is a view that it is not possible to transfer property which is not yet owned by the grantor.

- Under the 1983 Law, the only remedy that a secured party has on default is to exercise a power of sale in respect of the collateral. A secured party may want a wider range of default remedies.

- Under the 1983 Law, where the security is constituted by assignment, express notice in writing has to be given by or on behalf of the secured party to the person from whom the assignor would have been entitled to claim the collateral. In some situations, however, the grantor may not wish to disclose to that person the fact that the grantor has granted security.

- In order to take security over shares, under the 1983 Law, the secured party (or some person on its behalf) may either take possession of the share certificates or become the registered shareholder. In some cases, a company is not obliged to issue share certificates. For example, an open-ended investment company need not issue share certificates if its articles of association do not require a certificate to be delivered on every occasion when shares of the company are allotted or transferred. In the absence of share certificates, a secured party may only take security by becoming the registered shareholder but this may be unattractive for a number of reasons (for example, potential concerns as to liability from being the registered owner of the shares and potential concerns as to consolidation from an accounting perspective).

- Article 5(1) of the 1983 Law contains a simple priority rule. Priority between security interests in the same collateral is determined by the order of creation of security interests relating to the same collateral. However, Article 5(2) of the 1983 Law acknowledges that nothing in Article 5 of the 1983 Law shall prevent the postponement by a secured party of the secured party’s rights. Therefore, the 1983 Law acknowledges that security may be the subject of priority agreements. However, the actual method of achieving such priority could be problematic. For example, if a secured party has assignment security, it would be difficult for a second secured party also to take assignment security over the same collateral (on the basis that it is only possible to assign title to the collateral once). In these circumstances, one solution is for the security to be given in favour of a security trustee who would hold the security on behalf of both the senior creditors and the junior creditors.

- Under Article 2(5) of the 1983 Law, where a bank takes security over a bank account maintained with that bank, it is necessary for the bank to have control over that account. However, control is not defined in the 1983 Law and by analogy with English case law (namely National Westminster Bank plc v Spectrum Plus Limited [2005] UKHL 41, [2005] 2 AC 680), concerns might arise as to the validity of the security in circumstances where the account is not operated as a blocked account.

- There is a view among some Jersey practitioners that similar concerns could arise where security over a bank account is taken by assignment and the assignor has the freedom to deal with the account before the occurrence of an event of default. It could be argued that the ability to deal with the account is inconsistent with the very nature of the assignment and that therefore the assignment constitutes a sham and should be re-characterised accordingly.

- Where security has been constituted by the taking of possession of certificates of title, the security will be discharged if the secured party (or a person on the secured party’s behalf) ceases to have possession of the certificates of title. The secured party is therefore exposed to the risk of accidental loss or destruction of the certificates of title.

The key features of the Law

The key features of the Law may be highlighted as follows:

- A simplified concept of what constitutes a security interest is established under the Law. It is possible to create a “security interest” in the relevant collateral (without having to specify any specific method of creation, for example, by possession of certificates of title, by control or by assignment).

- It is possible to take “debenture style” security over all of a company’s present and
future intangible movable property.

- The Law establishes a clear set of priority rules. A secured party will enjoy more certainty as to how security will rank against competing interests.

- The Law introduces a security registration system. This will be a modern system of security registration. It will be on-line and will be fully automated.

- The Law significantly extends the enforcement powers of the secured party. In addition to the ability to sell the collateral, the secured party will have the right to appropriate the collateral and to take a range of ancillary actions (including the exercise of any rights of the grantor in relation to the collateral).

The intangible movable property to which the Law applies
The Law applies to a range of specific types of intangible movable property listed in Article 4 of the Law as well as any other intangible movable property which is situated in Jersey. This will therefore include shares in a Jersey company, units in a Jersey property unit trust, deposit accounts maintained in Jersey and contracts where the contractual obligor is a Jersey company or individual.

It will not be possible to take new security over any Jersey intangible movable property otherwise than in accordance with the Law.

Outright assignment of receivables
The Law also applies to the outright assignment of receivables. Such assignments are not security assignments but absolute assignments. The aim of these provisions is to promote the financing of Jersey receivables (such as the factoring of a company’s debtor book). The Law seeks to regulate the perfection and priority of outright assignments of Jersey receivables. In particular, in order to have a perfected outright assignment of a Jersey receivable, the assignee will need to register such assignment on the public register established by the Law.

Excluded interests
The Law states that it does not apply to certain interests.

One class of interest is a lien, or other encumbrance or interest in movable property created by any other enactment or by the operation of any rule of law.

Another excluded interest is any right of set-off, netting or combination of accounts. This is a helpful exclusion. There are academic debates as to whether a right of set-off gives rise to a form of security interest. In this context, a bank would often have a right of set-off in respect of an account maintained with the bank meaning that the bank could set-off its liability to pay the balance on the account to the bank’s customer against the liability of the customer to repay indebtedness owing to the bank. In essence, the customer’s asset (being the balance on the account) is used to discharge the customer’s borrowings. However, the Law confirms that it has no application to such rights of set-off.

Excluded transactions
The Law also contains a list of transactions and provides that the Law does not apply to any interest created or provided by those transactions. Such excluded transactions include the following:

- a sale coupled with a repurchase; and
- stock lending or securities lending.

By way of brief explanation, a sale coupled with a repurchase (known as a “repo”) is a sophisticated financial instrument by which "Party A" sells securities for cash to "Party B" and "Party A" agrees to repurchase the securities at a later date for a price equal to the original sale price and with an additional payment equivalent to interest.

In contrast, stock lending or securities lending does not involve a sale and repurchase for a money price. Instead, there is a transfer of ownership of securities by "Party A" to "Party B" and "Party B" agrees to retransfer the securities back to "Party A" at a later date and to pay a fee for the loan of the securities.

There are academic debates about whether repos and stock lending transactions give rise to security interests. The Law helpfully confirms that any interests arising from these instruments are outside the scope of the Law.

Subordination agreements
The Law also confirms that a contractual subordination agreement does not create a security interest (unless the agreement expressly provides that it does so). The Law further confirms that a "turnover trust" contained in a subordination agreement does not give rise to a security interest (unless it is expressly provided for by the subordination agreement). Under a "turnover trust", a junior creditor who is paid in breach of the subordination arrangements would agree to
pay the moneys received to the senior creditor and (until so paid) would agree to hold the monies on trust for the senior creditor. There are academic debates about whether subordination arrangements give rise to security interests. The Law provides certainty on this matter. Subordination agreements do not create security interests unless this is expressly provided for in the subordination agreement itself.

Third party security now possible
A security interest may be created to secure the obligation of a third party. Therefore, it will now be possible to take a classic "third party security interest" without the need for the grantor to provide a technical guarantee in relation to the third party's indebtedness.

Freedom to deal
The Law confirms that the attachment of a security interest to collateral is not affected just because the grantor retains, in the absence of a contrary direction from the secured party, the right to deal with the collateral free from the security interest.

In taking security over a deposit account (which is not operated as a blocked deposit account), it is common for the grantor to request the ability to make withdrawals from the deposit account before the occurrence of an event of default. This freedom to deal with the collateral led to concerns under the 1983 Law as to the validity of the security. However, the Law now confirms that such freedom to deal with the collateral will not affect the fundamental validity of the security interest.

A security interest
The Law defines a security interest as an interest in intangible movable property, being an interest that, under a security agreement, secures payment or secures the performance of an obligation. The term "security interest" is therefore a generic term. Under the 1983 Law, focus would be applied as to the manner in which security may be taken (for example, by having possession of the certificates of title to shares, by having control of a bank account or by taking an assignment of the relevant collateral). Under the Law, there is a simplified approach to security interests. A security agreement may therefore just simply state that a security interest is created in the relevant collateral for the purposes of the Law.

Proceeds
The Law provides that where there is any dealing with collateral which has not been authorised by the secured party, the security interest in the collateral will extend to the proceeds of such dealing provided that the proceeds are intangible movable property (such as monies standing to the credit of a bank account). In practice, where there is a consensual sale of a secured asset, the secured party will control the application of the proceeds. For example, the secured party may consent to the sale of a secured asset on the condition that the sale proceeds are paid directly to the secured party and used in or towards discharge of the secured indebtedness. However, the possibility of asserting a security interest in proceeds may be an attractive remedy to a secured party where the grantor has disposed of the secured asset in breach of covenant. In other words, the disposal has not been authorised by the secured party and consequently the secured party may be able to assert a security interest in the proceeds of the unauthorised dealing.

Attachment
The Law sets out rules concerning the attachment of a security interest to collateral.

The concept of attachment describes the requirements that need to be satisfied in order for a security interest to be enforceable against the grantor.

As a general rule, a security interest attaches to collateral at the time when the following three conditions are satisfied:
– value has been given in respect of the security agreement;
– the grantor has rights in the collateral or the power to grant rights in the collateral to a secured party; and
– one or both of the following requirements are satisfied (i) there is possession or control of the collateral by the secured party (or on the secured party’s behalf by a person other than the grantor or obligor) and (ii) the security agreement is in writing, signed by or on behalf of the grantor and contains a description of the collateral that is sufficient to enable the collateral to be identified.

After-acquired property
The Law makes it clear that a security agreement may describe collateral in wide terms and that a security interest may attach to after-acquired property (i.e. future
property). It will be possible to describe the collateral as all the grantor’s present and future intangible movable property. This will therefore enable security to be taken in a way which accords with English practice where a debenture is used to take security over all present and future assets (save that the Jersey security will not cover land or tangible property). This is a significant advantage of the Law.

Perfection
The Law deals with the perfection of security interests.

The concept of perfection describes the measures that need to be taken in order to ensure that the security interest is valid as against third parties such as the Viscount, a liquidator and other creditors.

The Viscount is an executive officer of the Royal Court of Jersey and administers certain Jersey bankruptcy proceedings.

The Law has three methods of perfection.

One method of perfection is by the secured party having possession or control of the collateral. However, this is only appropriate for certain classes of intangible movable property.

Another method of perfection is by registering the security interest on the security register (which will be established for the purposes of the Law). The initial registration is effected by submitting a financing statement in relation to the security interest (as to which see below). It is not possible to register security granted by a trustee unless the trustee is a trustee of a prescribed unit trust. However, save for such trustee exemption and one narrow type of security interest which is mentioned below (under the heading of “Registration”), it is possible to perfect all security interests by registration including security interests that may also be perfected by the secured party having possession or control of the relevant collateral.

A further method of perfection is attachment. This method applies where the security interest is granted by a trustee (other than a trustee of a prescribed unit trust). In this situation, the security interest is perfected by attachment of the security interest.

Although a security interest may be perfected, that is no assurance that the security interest will have priority. For example, a security interest may be perfected but rank after an earlier perfected security interest.

The risks of not perfecting the security interest are as follows:
– an unperfected security interest will be subordinate to a subsequent perfected security interest;
– a third party who acquires the collateral for value will take the collateral free of an unperfected security interest; and
– an unperfected security interest will be void against the Viscount, the liquidator and the grantor’s creditors.

Priority
The Law sets out detailed rules as to priority.

As a general rule, a perfected security interest will have priority over an unperfected security interest in the same collateral (regardless of the date of creation).

As regards the ranking of perfected security interests in the same collateral where the perfection has been continuous, the general rule is that priority goes to the security interest in relation to which the first of the following events occurred:
– a financing statement was registered;
– the secured party (or another person on the secured party’s behalf) took possession or control of the collateral;
– the security was temporarily perfected (the concept of temporary perfection relates to only a few security interests under the Law).

Where security interests are perfected by attachment (i.e. security interests granted by trustees (other than a trustee of a prescribed unit trust)), then priority is determined by the order of attachment.

There are detailed provisions in the Law which establish when a secured party may be regarded as having control of the relevant collateral.

The Law has special priority rules where there are conflicting security interests in the same certificated investment security, the same securities account or the same deposit account. In these circumstances, a security interest where the secured party has possession or control of a certificated investment security, control of a securities account or control of a deposit account has priority over a security interest (in the same investment security or account) in respect of
which a secured party does not have possession or control. Where each of the relevant secured parties has possession or control of such collateral, the security interests will rank according to the order in which possession or control was acquired.

There is a special priority rule where a bank takes security over a deposit account maintained with that bank. In these circumstances, the bank’s security interest has priority over any other security interest.

The Law clarifies “tacking” rules. This is the situation where a secured party takes security, subsequent security is then taken by a third party and the first secured party wants to make further advances available but only if those further advances will have priority under the first security interest. The Law stipulates that if a security agreement provides that it secures further advances, then all further advances will have the same priority as other advances.

The Law also makes provision for purchase money security interests. In broad terms, this would cover a situation where a bank lends money to enable a borrower to purchase intangible movable property and the bank takes security over the intangible movable property that it has financed. In this instance, the bank’s security takes priority over other security interests. The basis for this rule is one of fairness. The bank has financed the acquisition of the property and it would be unfair for other secured parties to have priority over that property given that they have not financed the acquisition of such property.

The Law deals with the situation where there might be security over the same collateral pursuant to the 1983 Law and also the Law. In this situation, the security taken pursuant to the 1983 Law has priority.

Priority agreements
The Law provides that a secured party may subordinate the secured party’s security interest to any other interest. However, a transferee of a subordinated security interest will not be bound by the subordination agreement unless at the time of the transfer any one of certain specified conditions is met. One of the specified conditions is that the subordination agreement has been registered pursuant to the Law. It will therefore become common to register subordination agreements which rank the priority of Jersey security interests.

Taking free
The Law establishes the concept of “taking free”.

This concept concerns the situations in which a third party may acquire collateral free of any underlying security interest. This is different from issues of priority. The priority of security concerns the ranking of two or more security interests. The taking free of security involves a security interest being extinguished.

The general rule is that a purchaser of collateral will acquire that collateral subject to any perfected security interest.

Unperfected security interests are vulnerable. The basic rule is that a person who acquires collateral for value takes the collateral free of any unperfected security interest.

Enforcement
The power of enforcement in respect of a security interest becomes exercisable when (a) an event of default has occurred in relation to the security agreement that created or made provision for the security interest and (b) the secured party has served on the grantor written notice specifying the event of default. Therefore, written notice of the event of default has to be served on the grantor.

A major advantage of the Law is the increased scope of enforcement remedies that a secured party may have. Under the Law, the power of enforcement may be exercised in any of the following ways:
– appropriating the collateral or proceeds;
– selling the collateral or proceeds;
– taking any of the following ancillary actions: (i) taking control or possession of the collateral or proceeds; (ii) exercising any rights of the grantor in relation to the collateral or proceeds; and (iii) instructing any person who has an obligation in relation to the collateral or proceeds to carry out the obligation for the benefit of the secured party; and
– applying any remedy that the security agreement provides for as a remedy to the extent that the remedy is not in conflict with the Law.

The only remedy under the 1983 Law was to exercise a power of sale in respect of the collateral. The Law therefore significantly improves the enforcement remedies which are available to a secured party.
The Law provides that an additional notice has to be given to the grantor and other interested parties not less than 14 days before any actual appropriation or sale. In this context, interested parties are (i) persons who have certain registered security interests and (ii) persons who have given the secured party notice of an interest in the collateral (such as a beneficial interest in the collateral). The purpose of this notice is to alert the grantor and other interested parties that realisation is soon to occur. The grantor may then seek to reinstate the security agreement before realisation and interested parties may seek to redeem the collateral before realisation. However, the Law allows the secured party and the relevant person to contract out of these notice provisions. Further, the Law provides that the notice provisions do not apply to the extent that the collateral is a quoted investment security or the secured party believes on reasonable grounds that the collateral will decline substantially in value if it is not disposed of within 14 days after the relevant event of default.

Redemption
The Law establishes a right to redeem a security interest. This right may be exercised before a secured party appropriates the collateral, enters into an agreement to sell collateral or has otherwise acted irrevocably in relation to the collateral after an event of default.

Reinstatement
The Law provides that the grantor may reinstate a security agreement. Essentially, this concept involves the grantor remedying the event of default and paying associated costs. In this way, the enforcement of the security interest may be prevented. However, the Law allows the parties to agree that the right of reinstatement shall not apply and it is expected that bank standard documentation will negate the ability of a grantor to reinstate the security agreement.

Methods of sale
The secured party may effect a sale of the collateral by auction, public tender, private sale or another method.

The Law confirms that on a sale by the secured party on enforcement, the secured party may purchase the collateral itself. This therefore deals with any concern which existed under the 1983 Law that a secured party cannot purchase secured assets itself on security enforcement.

Duty to obtain a fair valuation or fair price
If the collateral is appropriated, the secured party owes the following duties:
– to take all commercially reasonable steps to determine the fair market value of the collateral as at the time of the appropriation; and
– to act in other respects in a commercially reasonable manner in relation to the appropriation.

If the collateral is sold, the secured party owes the following duties:
– to take all commercially reasonable steps to obtain fair market value for the collateral as at the time of the sale;
– to act in other respects in a commercially reasonable manner in relation to the sale; and
– to enter any agreement for or in relation to the sale only on commercially reasonable grounds.

The duties are owed to the following:
– the grantor;
– any person who has a security interest in the collateral in the following circumstances: (i) a financing statement relating to the security interest has, not less than 21 days before the appropriation or sale, been registered and (ii) the registration is effective at the time of the appropriation or sale; and
– any person (other than the grantor) who has an interest in the collateral and has, not less than 21 days before the appropriation or sale, given the secured party written notice of that interest.

Following enforcement, the secured party must prepare (and distribute to relevant persons) a statement of account which essentially discloses the net realization from the enforcement of the security.

If any surplus arises from the security enforcement, the Law establishes rules as to how that surplus should be applied.

Registration
The Law introduces a system of security registration. The initial registration is made...
using a "financing statement" and certain subsequent changes may then be registered using a "financing change statement" (for example, to register a discharge of the security interest).

All security interests may be perfected by registration (save for (i) a narrow type of security interest, being a security interest in favour of an intermediary over investment securities held with that intermediary and which secures the buyer’s obligation to pay for the investment securities and (ii) a wider type of security interest, being a security interest created by a trustee of a trust (other than a prescribed unit trust)). Where a security interest is perfected other than by registration (for example, by possession or control), it could be the case that the secured party has elected not to register the security interest and is looking to rely on an alternative method of perfection.

The security register cannot be regarded as being definitive. It will not give details of any security taken pursuant to the 1983 Law (save for certain exceptions) and it will not give details of any security where the secured party has perfected such security but elected not to register such security.

"The security register cannot be regarded as being definitive. It will not give details of any security taken pursuant to the 1983 Law (save for certain exceptions) and it will not give details of any security where the secured party has perfected such security but elected not to register such security."

The registration system is a fully automated system which is available on-line.

The Law enables a financing statement to be registered before the security agreement is concluded.

A registration will have a limited duration. If a period of registration is provided for in the financing statement, the registration will be effective until the period expires. If no period of registration is provided for in the financing statement, the registration will be effective until the period of 10 years expires. There is a mechanism for the renewal of a registration. The maximum period of registration is 99 years.

As noted earlier in this briefing, it is important for a senior creditor to ensure that any subordination of a security interest is registered (to ensure that any transferee of the subordinated security interest is bound by the subordination).

Where security is registered and the security is subsequently transferred to another person, it is important to register a financing change statement disclosing the transfer. If this is done, then the transferee of the security interest becomes, for the purposes of the Law, the secured party in respect of the security interest.

As regards existing security taken pursuant to the 1983 Law, there is no need to perfect such existing security under the Law.

**Chattels**

The Law only applies to the taking of security over intangible assets. There are proposals to amend the Law to enable security over chattels to be created. Therefore, it is expected that the Law will be amended after its enactment to enable effective security to be taken over Jersey situated chattels.

**Conclusion**

The Law is a significant reform of the security laws of Jersey. It addresses many of the technical problems that existed under the 1983 Law and will greatly enhance the ability of a secured party to take security which will meet with international standards. In particular, the ability to take security over all present and future intangible movable property and the enhanced enforcement options are significant improvements on the previous position.
For further information, please contact:

Jersey

Mark Dunlop  
Partner  
T +44 (0)1534 814720  
E mark.dunlop@bedellcristin.com

Alasdair Hunter  
Partner  
T +44 (0)1534 814270  
E alasdair.hunter@bedellcristin.com

Martin Paul  
Partner  
T +44 (0)1534 814723  
E martin.paul@bedellcristin.com

Tim Pearce  
Partner  
T +44 (0)1534 814663  
E tim.pearce@bedellcristin.com

Simon Hopwood  
Partner  
T +44 (0)1534 814706  
E simon.hopwood@bedellcristin.com

Malcolm Ellis  
Senior Associate  
T +44 (0)1534 814630  
E malcolm.ellis@bedellcristin.com

Antony Clerehugh  
Senior Associate  
T +44 (0)1534 814720  
E antony.clerehugh@bedellcristin.com

London

Bruce Scott  
Partner  
T +44 (0)207 367 8309  
E bruce.scott@bedellcristin.com

© 2011 Bedell Cristin  
The information contained in this briefing is intended to provide a brief update in relation to the topics covered. The information and opinions expressed in this briefing do not purport to be definitive or comprehensive and are not intended to provide legal advice and should not be acted or relied upon as doing so.  
Professional advice appropriate to the specific situation should always be obtained. No responsibility or liability is accepted in connection with the content of any websites to which you may gain access from this briefing.