

Lending to Jersey entities

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| Introduction

Jersey entities have proved popular as vehicles for a wide variety of asset holding structures, such as those holding real property. The modern legal framework and tax neutral regime are attractive to professionals structuring transactions for their clients. As a consequence, lending institutions are frequently requested to put in place credit arrangements for Jersey entities. To protect its position in these circumstances, a lending institution needs to be aware of the material differences that exist between English law and Jersey law.

This briefing is intended to highlight the issues that may be relevant when lending to a Jersey entity, including how security is created under Jersey law, issues relating to corporate benefit and the primary insolvency regimes relevant to Jersey entities.

| Forms of Jersey entities

- Companies

The Companies (Jersey) Law 1991 (the **Companies Law**) is the primary statute relating to Jersey companies. It is derived mainly from the UK Companies Acts and many of the long-established legal principles applicable to companies in the United Kingdom are relevant to Jersey companies. In particular, Jersey law recognises the concept of the company as a legal person, separate to its directors and shareholders. The Companies Law was substantially amended in September 2002 to introduce a wider variety of companies, including companies limited by par value shares, companies limited by no par value shares, companies limited by guarantee and unlimited companies. Cell Companies were introduced in February 2006 taking the form either of protected cell companies or incorporated cell companies. The incorporated cell company was an innovative step in that each of the core cell company and its cells are separate legal entities.

- Trusts

The Trusts (Jersey) Law 1984 (the **Trusts Law**) sets down in statute many of the principles of trusts law that have been established in Jersey and the United Kingdom. Trust concepts, such as the split between legal and beneficial ownership, are commonly put to use in Jersey structures. A notable difference to English law is that, under Article 32 of the Trusts Law, where a third party has entered into a transaction with a trustee of a Jersey trust and that party is on notice that the trustee has entered into such transaction in that capacity, any claim by the third party against the trustee is limited to the trust assets, rather than being, as is the case in England, a personal claim against the trustee but with the trustee having a right to be reimbursed from the trust assets.

- Limited partnerships

A Jersey limited partnership (an **LP**) may be established pursuant to the Limited Partnerships (Jersey) Law 1994 (the **LP Law**) by the execution of a limited partnership agreement (which is not required to be filed) and by filing of the prescribed form of declaration at the registrar of limited partnerships. As in England, an LP is not a separate legal person, but acts through its general partner. The general partner is under an obligation to contribute, without limitation of liability, to the assets of the LP. In contrast, a limited partner will not be liable to contribute more than the aggregate value of money or other property that he has agreed to contribute. If, however, a limited partner involves himself in the management of the limited partnership, he runs the risk of losing such protection. Article 19 of the LP Law sets out the activities that may be undertaken by a limited partner without the loss of limitation of liability.

There are two other forms of limited partnership under Jersey law, being (i) the separate limited partnership (the **SLP**) and (ii) the incorporated limited partnership (the **ILP**). Although many of the requirements for a SLP and ILP follow those for a LP as set out in the LP law, a key difference is that, unlike a LP, both a SLP and an ILP have distinct legal personality, which allow them for example, to contract and hold property in their own name. ILPs are treated under Jersey law as a body corporate while being treated as a partnership for tax purposes. Other features of a ILP are more akin to those of a Jersey company, for example on insolvency and winding-up.

(It is also possible under Jersey law to create unlimited partnerships and limited liability partnerships; however, these are rarely involved in borrowing from UK banks).

Security in Jersey

Where security is being taken over Jersey situated assets, it is recommended that this is created using security governed by Jersey law. For intangible movables (such as shares of a Jersey company or monies in a Jersey bank account), this means complying with the provisions of the Security Interests (Jersey) Law 2012 (the **SIJL**), which came into force on 2 January 2014 and which replaced the Security Interests (Jersey) Law 1983 (the **Old Law**).

Although Jersey law does not itself recognise the concept of a floating charge, it should be noted that under the SIJL, unlike the Old Law, it is possible to secure present and future intangible moveables situated in Jersey, provided that it is possible to identify such assets by reference to the description of the secured assets in the security interest agreement.

It should be noted that Jersey law does not restrict the creation by a Jersey entity of foreign law security over non Jersey situated assets.

The SIJL provides for creation of security by (i) control, (ii) possession and/or (iii) description.

Shares

A security interest in respect of shares of a Jersey company may be created pursuant to the SIJL by:

1. Control: the secured party either being registered as the holder of secured shares or taking possession of the relevant share certificates; and/or
2. Description: the shares which are subject to the security interest are described in the security interest agreement.

The security interest must then be perfected (in order to be enforceable against third parties) either by virtue of the secured party having control (i.e. possession of the relevant share certificate) or alternatively, if the security interest is created by way of description, by way of registration of that security interest on the Jersey Security Interests Register. However, a secured party must be mindful if it is seeking to rely on description and registration of a security interest alone that, to the extent that control security is granted to any other secured party later in time, that security interest will have priority over any earlier non-control security interest. As a result, it is usual practice in Jersey for the secured party to take possession of the relevant share certificates, together with the shares subject to the security interest being adequately described within the security interest agreement and registered on the Jersey Security Interests Register.

Bank Accounts

A security interest in respect of a Jersey bank account may be created pursuant to the Security Interests Law by;

1. Control:

- (a) The account being transferred into the name of the secured party with the written agreement of the security provider and the account bank;
- (b) The security provider, secured party and account bank agreeing in writing that the

account bank will comply with instructions from the secured party directing the composition of funds in the account;

(c) The account being assigned (by way of security) to the security agent by an instrument in writing to the account bank;

(d) The secured party being the account bank; and/or

2. Description: the account(s) which are subject to the security interest are described in the security interests register.

As for share security, the security would then be perfected by way of control or, if the security is created by way of description, registration of the security interest on the Jersey Security Interests Register. However, as for share security, a secured party must be mindful if it is seeking to rely on description and registration of a security interest alone that, to the extent that control security is granted to any other secured party later in time, that security interest will have priority over any earlier non-control security interest. As a result, it is usual practice in Jersey for the secured party to take control security by one or more of the options (typically (b) and (c)), together with the account(s) subject to the security interest being adequately described within the security interest agreement and registered on the Jersey Security Interests Register.

Contract Rights

Under the SIJL it is also possible to grant a security interest over Jersey situs contract rights, for example a loan either governed by Jersey law or alternatively made to a Jersey established person or entity.

A security interest over such contract rights can only be created by way of description of the collateral in the relevant security interest agreement and consequently must be perfected by way of registration on the Jersey Security Interests Register.

Enforcement

If an event of default (as defined in the security agreement) occurs and notice is given to the security provider specifying the event of default, the power of enforcement arises in respect of the collateral, which is not just limited to the power of sale as under the Old Law but also extends to a power of appropriation and other ancillary actions relating to enforcement.

Where collateral is appropriated or sold, the secured party is under an obligation to determine the fair market value of the collateral at the relevant time of appropriation or sale, act in a commercially reasonable manner and (in respect of a sale) take all commercially reasonable steps to obtain fair market value for the collateral at the time of sale. Upon appropriation or

sale, the secured party is then required to give a statement of account in writing which sets out specified information and then distribute any surplus as specified in the SIJL.

Corporate benefit

Article 74(1) of the Companies Law sets out the fiduciary duties of a director of a Jersey company, providing that he must:

1. act honestly and in good faith with a view to the best interests of the company; and
2. exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

There may be circumstances where a Jersey company is acting in a way which could not reasonably be considered to be in its best interests. This could apply, for example, if a Jersey company is giving an upstream or cross-group guarantee or is giving third party security. Where a counterparty to a contract is on actual or constructive notice that the directors are acting in breach of their fiduciary duty under Article 74(1) of the Companies Law, this may adversely affect enforceability.

However, it is possible to rectify a breach of the directors' fiduciary duties by following the procedure set out in Article 74(2) of the Companies Law. This requires the sanction of all the shareholders and the satisfaction of certain cash-flow solvency tests. The directors of protected cell companies are under an additional duty, when the cell company enters into an agreement in respect of a particular cell, to ensure that the counterparty knows or ought reasonably to know that the cell company is acting in respect of such cell.

Corporate governance

As in England, the directors of a Jersey company have general powers of management, subject to those matters requiring shareholder resolutions pursuant to the Companies Law, the provisions of the articles of association and any special resolutions of the shareholders.

The concept of external ultra vires was abolished by Article 18 of the Companies Law, so that the power of a Jersey company is not limited by anything in its memorandum or articles of association. However, the authority of the directors may be limited, for example, by a restrictive objects clause, and this may affect the ability of a third party to enforce if he is on notice of an excess of authority. It is necessary to review the memorandum and articles to ensure that there are no limits on the directors' authority and also that the procedure for corporate authorisation has been duly complied with.

Financial assistance

The concept of financial assistance was abolished in Jersey in 2008.

Jersey insolvency procedures

The two primary insolvency procedures relating to Jersey companies are as follows:

1. a creditors' winding up under the Companies Law. This is commenced by a special resolution of the shareholders of a company. It follows that a creditors' winding up cannot be commenced by a third party creditor. A liquidator must be appointed to conduct the winding up; and
2. upon the property of the company being declared 'en désastre' under the Bankruptcy (Désastre) (Jersey) Law 1990 (the 'Désastre Law'). In a désastre, Her Majesty's Viscount (a court appointed officer) conducts and administers the procedure. Immediately upon the making of the declaration of désastre, all the property and powers of the debtor vest in the Viscount, who will then conduct the désastre by gathering in the assets of the debtor and, after being reimbursed for his costs and expenses, paying the creditors to the extent possible, in accordance with the statutory provisions. An application for a declaration may be made by a creditor with a liquidated claim of not less than £3,000. The application must be accompanied by an affidavit of the creditor stating that, amongst other things, to the best of his knowledge and belief, the debtor is insolvent. 'Insolvency' is defined in the Désastre Law as being the inability of a debtor to pay his debts when they fall due.

The Companies Law and the Désastre Law contain provisions relating to transactions of an undervalue, preferences, wrongful trading, fraudulent trading, extortionate credit transactions and disclaimer of onerous property in materially similar terms to those that set out in the UK Companies and Insolvency Acts. Mandatory set-off provisions apply on both a désastre and a creditors winding up, in materially similar terms to Rule 4.90 of the UK Insolvency Rules in addition to statutory provisions relating to set-off while solvent.

Conclusion

Much of Jersey law is derived from English law and will be familiar to those involved in lending in the United Kingdom. However, there are issues arising from the material differences between Jersey and English law and this briefing is intended to provide an overview of those differences relevant to an institution lending to a Jersey entity.

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