CVL4025
THE LAW OF GUARANTEES

The European Law Students' Association

MALTA

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ACKNOWLEDGMENTS

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Law of Guarantees

Dr. Kurt Xerri.

19th April 2023

Lecture 1.

- The Law of Guarantees

Lecture Series on Ranking of Creditors

Lecture 1	19 April	Introduction & Hypothecs I
Lecture 2	26 April	Hypothecs II
Lecture 3	3 May	Privileges I
Lecture 4	10 May	Privileges II
Lecture 5	17 May	Revision Session

- CVL 4025

- We will have four lectures. This is a short lecture series which meant to compliment the lectures which we had with Dr Patrick Galea. What we will be doing in these four lectures is practically concentrate/focus on the practical application to what Dr Galea covered. So, the schedule of lectures is the following. We will have the coming four weeks, with the aim of finishing on the 10th of May. The lecture of the 17th of May is not yet cancelled. We will not rush so; one would be able to understand the material and concepts that will be discussed.

  - Key Contractors Limited (Key) has made a number of property investments over the years. The company's searches reveal the following notes of hypothecs and privileges registered against it:

  - (1) 1991 - Favour A (Lender) - €50,000 Loan - GH and SH on property in Cospicua

  - (2) 1997 - Favour B (Lender) - €70,000 Loan for purchase - GH, SH & SP on property in Attard

  - (3) 2005 - Favour C (Lender) - €100,000 Loan for purchase - GH, SH & SP on property in Naxxar

  - (4) 2006 - Favour D (Contractor) - €50,000 Cost of works and materials - SP on property in Naxxar

  - (5) 2007 - Favour E (Lender) - €100,000 Loan for construction - GH, SH & SP on property in Naxxar

  - (6) 2012 - Favour F (Lender) - €200,000 Loan - SH on properties in Cospicua and Attard

  - (7) 2020 - Favour G (Purchaser) - €120,000 - GH in support of warranty of peaceful possession granted for sale of property in Valletta

  - Besides the abovementioned properties Key also owns another property in Paola.

  - Key eventually transferred the property in Cospicua to Island Real Estate Limited.

  - Despite the stable property market, Key is currently facing certain financial difficulties which are unsettling its creditors.

  - Advise Key Contractors Limited in view of the below:

- Lenders C and E are contemplating the foreclosure of their respective loans. Moreover, Lenders C and E have come in possession of evidence that the material which Contractor D supplied to Key was not used on the property in Naxxar but on another project elsewhere.

- Purchaser G has recently discovered that the property that he was sold by Key has a defective title, and is now fearing that the GH is not adequately securing any potential claims he might have against Key.

- Lender F is growing increasingly impatient with Key's partial defaults and wants to consider its options.

- Lender H, towards whom Key does not have any commitments yet, is willing to grant some financial breathing space to Key, however it wants to secure, at the least, a first ranking on the property in Paola.

- Lender B has recently discovered that the SP was only registered three months after the purchase of the property. Lender B is concerned about whether this oversight might affect his ranking, particularly in the case of the sale of the Attard property.

- This is last year's past paper. This is also what your exam will look like. This almost invariably since the format does not change. It looks very complicated. By the end of today's lecture, you will be able to answer some of the questions of the past paper.

- In this case, you were meant to advise a construction company. The developer had certain charges enrolled on his property. Practically, he has difficulty in facing the prospect of bankruptcy. We have to give advice. But by the end of today's lecture, you will be able to answer two questions. This is just to let you know where we are heading and what we are aiming towards. We will come back to this.

  - What security mechanisms enable the granting of credit?

- We have Security Mechanisms under the Law of Guarantees. Another way of calling 'guarantees 'is 'securities'. They are used interchangeably. There is no difference between 'guarantees 'and 'securities'. During the previous weeks, we have gone over the main function of a guarantee or of a security. We are ensuring that the creditor at the end of the day, will get paid.

  - Let us take the above example of a young couple. They just had a baby. They want to purchase a home. Let us say that the price of that property is of €200,000. They do not have €200,000 in cash.

- What will happen? They will take a loan. Take the position of a banker or the lender. You are assessing their credit and whether it makes sense as a bank, to grant this loan or otherwise. You are going to carry out this assessment. The couple makes it through.

- However, one needs to question on what happens if one of the members of the couple ends up without a job? If you lend €200,000 to this couple so they could purchase the property. As we said before, as a creditor, my main interest is to make sure that I will at the end of the day, get my money back. I did the credit assessment. I can lend them money. But is it sufficient for a banker? It is not sufficient. In fact, a possible solution for the banker is to see the credit worthiness test. This refers to whether they are in a stable employment and the potential for earning money in the future. This couple is able to satisfy this test. They have also set up a down payment and so, they seem to have everything in order.

- However, for the bank this is not enough. Should s/he end up without a job, there we face the possibility of default. So, I cannot simply trust the fact that there is a situation which will remain like that indefinitely. Therefore, I need further guarantees. The further guarantee could be represented by that of having some sort of tie/link with the property.

- How can I form a real reliable guarantee as a bank? The couple purchased the property. What happens with regards to the ownership? It is my interest as a bank to retain ownership? Or does the ownership pass on to the couple? The ownership passes on to the couple. But if the ownership completely passes on to the couple, I lose the property. The bank can ensure itself that it will be paid back. In fact, whilst the ownership transfers to the couple (i.e., the customers of the bank), what the bank could do is to do a hypothec in its favour. Hypothec does not apply in transfer of ownership. It means however that should the couple default and I should I be made to foreclose the loan, the case of foreclosure is beyond a remedial action and is completely desperate. What can I as a bank attempt to do? Why do I want to keep a link with the property? I can have the property sold and through the proceeds of the sale, recover the amount which is situated to me. This process must happen through a judicial sale.

- The same thing goes with a construction company. Say you own a construction company and you need to file a project. You take a loan from the bank to build a number of blocks of apartments. But the bank needs to be ensured that if the company defaults, it will still be paid back. So, what the bank does is to constitute a hypothec over the property which the construction company is going to acquire for its own purposes.

- This is sort of the basic understanding of what is going on and what we will be talking about. Of course, things are going to get a bit more complex but we will come to that.

  - “the law of securities is intimately linked to credit to which it adds security: there is no credit without security and there is no modern economy without credit ... securities, therefore, constitute a major legal instrument at the service of the market economy”

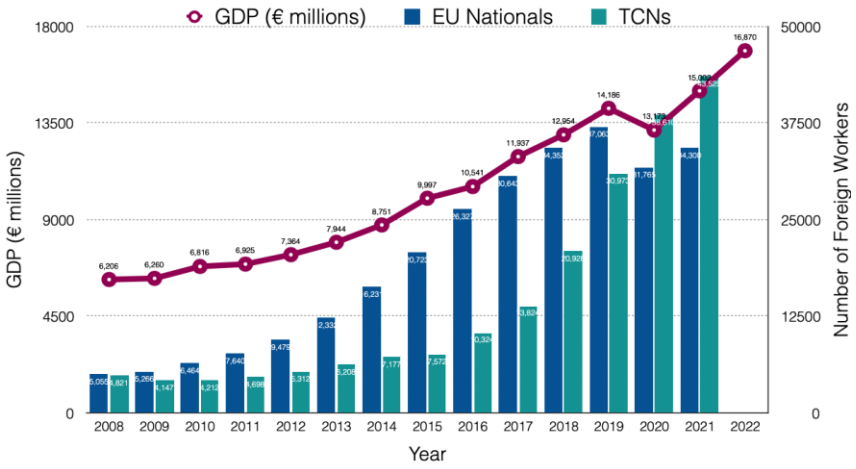
  - Y. Picod, Droit des sûretés, Presses Universitaires de France, 2008, p. 1

- What is the significance of the law of guarantees? Why law of guarantees is important because ultimately, guarantees/securities enable credit and it is the ability of that credit, which at the end of the day, makes it possible for the economy to prosper. At the basis of everything, securities enable credit that in turn then, elements the economy. The law of securities is intimately linked to credit to which it has security.

- If the bank did not have the possibility of hypothecating a property in its favour, it could probably and get twice over whether to grant the financing or not. These securities are enabling the bank or facilitating the situation of the bank to grant money. Through the grant of that money, that I can purchase a house, start my company or start my construction project.

- These are only three examples.

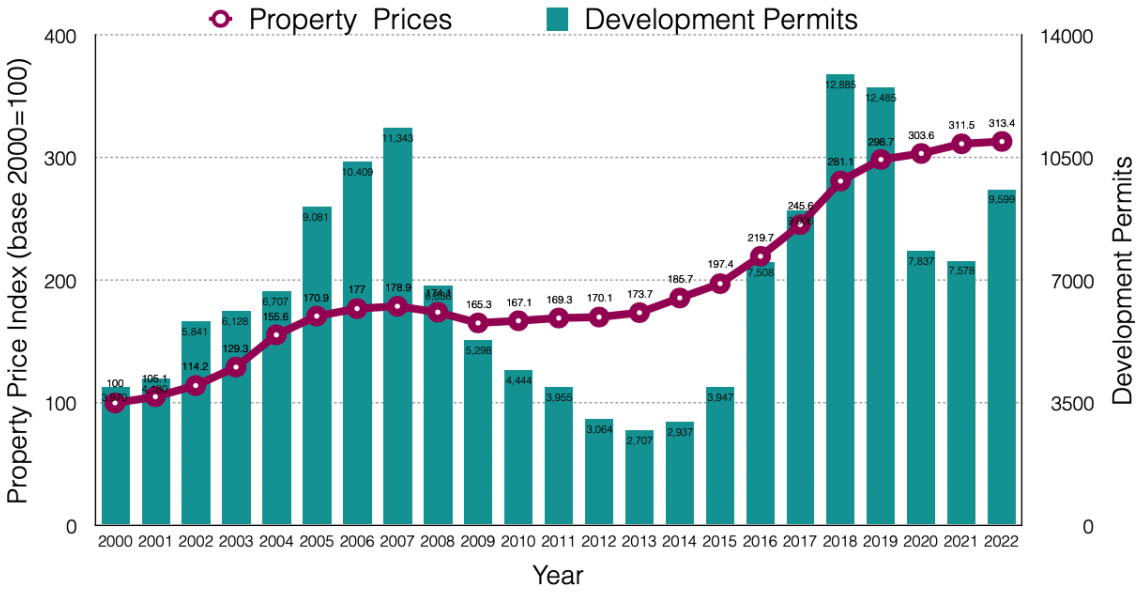
Economic Growth and Number of Foreigners (2008-2021)



Central Bank of Malta, *Real Economy Indicators*: *Prices.*
https://www.centralbankmalta.org/real-economy-indicators

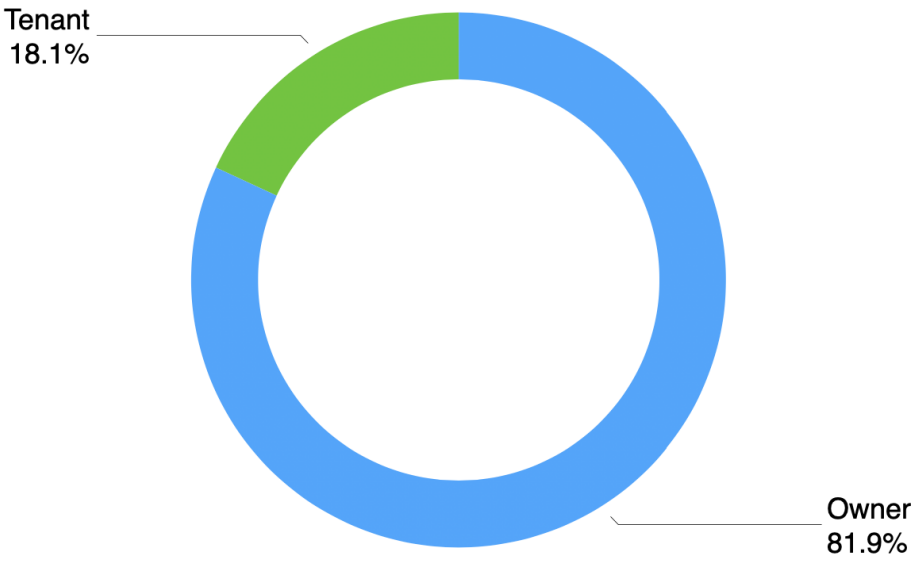
Jobsplus, *Type of Employment of Foreign Nationals (2002-2018)*
https://jobsplus.gov.mt/resources/publication-statistics-mt-mt-en-gb/labour-market-information/foreigners-data
https://jobsplus.gov.mt/resources/publication-statistics-mt-mt-en-gb/labour-market-information/foreigners-

Property Prices and Development Permits (2000-2021)



Central Bank of Malta, *Real Economy Indicators*: *Prices.*
https://www.centralbankmalta.org/real-economy-indicators

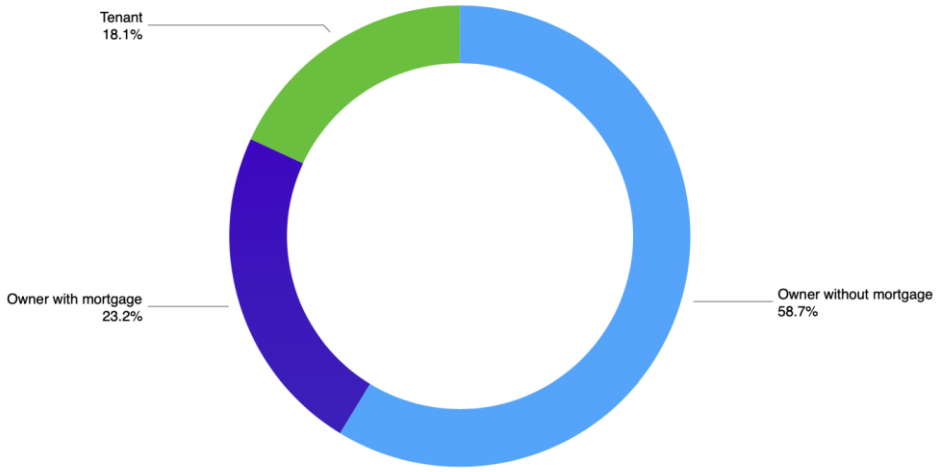
- We went over this slide when we were doing letting and hiring. But practically, as we can see, the property market is very much elevated to the topic we are covering. Why? Property prices and the value of immovable property is very relevant to all this. If you have a situation such as the ones we had in Malta, where the traditional business model in Malta such as HSBC and the Bank of Valletta, being exposed to the property market, it means that the value of property also



Distribution of population by tenure status, type of household and income group - EU-SILC survey
Source of data: Eurostat

affects then, the value of the collateral which the bank holds.

- if you have a situation such as the one one we have here in Malta where the traditional business model, as an example HSBC and Bank of Valletta since it is imposed on the property market, it means that the value of property also effects the collateral which the bank holds, collateral means for example in the example that we mentioned if th bank is going to hypothecate the property in its favour, the



Distribution of population by tenure status, type of household and income group - EU-SILC survey
Source of data: Eurostat

property represents the collateral.

- For the purposes of collateral, take the following example. If the bank is going to hypothecate the property in its favour. The property represents the collateral. The traditional banking model adopted both by Egypt and in Malta, depends very much on the business of home loans. If we take the latest study report published by the Central Bank, we can see that the faster growth loans to households may be reflected stronger growth in lending for house purchases.

> The faster growth in loans to households mainly reflected stronger growth in lending for house purchases (see Chart 2.5). Indeed, mortgage lending grew by 9.6% during 2021, compared with a 5.4% increase recorded in 2020. At the same time, consumer credit and other lending contracted at a slower rate of 4.1%, following a contraction of 6.4% over the year to December 2020.

Chart 2.5
CONTRIBUTIONS TO GROWTH IN LOANS TO HOUSEHOLDS
(percentage points; annual percentage change)

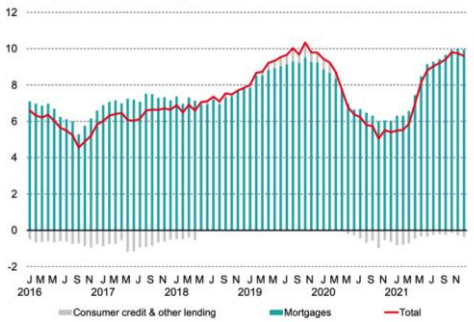


Table 2.2
MFI CREDIT TO MALTESE RESIDENTS
(Annual percentage changes; EUR millions)

	2019 Dec.	2020 Dec.	Dec.	2021 Amount outstanding	Absolute change
Loans to Households	9.8	5.4	9.6	7,010.6	613.7
Mortgages	10.3	6.7	10.9	6,470.7	637.1
Consumer Credit and Other Lending	5.2	-6.4	-4.1	540.0	-23.4

Central Bank, Annual Report (2021)

- So, home loans are represented in major banks, the main product on the basis of which these banks are making profit. Ultimately, as we said before, it is the granting of the credit which is enabling

businesses to thrive/have adequate finance for their project but it is also enabling most households to have their own home.

- Malta's maintained macroeconomic stability in the face of major economic difficulties across the continent was also underlined by the IMF. The fact that the core domestic banking sector is largely funded by resident deposits has been identified as one of the main factors that contained the financial spill over from the euro area although the traditional business model adopted by Malta's main two financial institutions (HSBC and Bank of Valletta) is highly exposed to the property market and collateral in the form of real estate. This risk was found, however, to have been limited by "the very high share of owner-occupied properties, prudent loan-to-value ratios, and fair market valuations". Even at the height of the economic downturn in 2009, in fact, one of the main local banks claimed to have a non-performing loans ratio coming in at less than 4%.

- K. Xerri, "The Impact of Directive 2014/17 in Malta", in M. Anderson et (eds),

- The impact of the Mortgage Credit Directive in Europe, (Europa Law Publishing, 2017).

- In letting and hiring, we were dealing with housing. Securities and guarantees also come into the equation of housing. In fact, we saw that in Malta we have strong proportion of home owners. We have eighty percent of local households who own their own home. Theses show as to why we are a home owning nation. Some romanticise the statistics by saying that we are very hard-working and we are very wise with our investments. The main reason is that banks have always made credit available. This is why we have a high ownership rate. If banks did not make money from local households, local households would not have had sufficient funds to purchase their properties.

- Out of the segment population that owns their home, how many are still indebted to a bank? Therefore, these people own property with mortgage. We have almost eighty-two percent of local households who own their property. Out of home owners, the largest proportion is that of owners owning a mortgage or without a mortgage (i.e., with a loan or without a loan)?

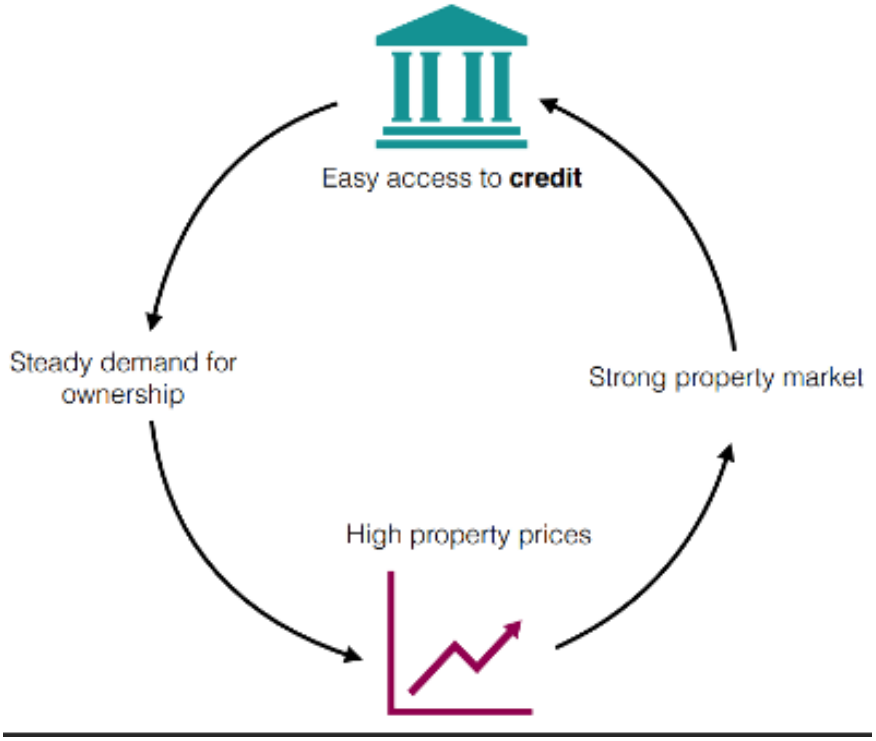
- Fil-verita, it is only the minority. One may assume that it is the majority of households who are indebted. However, in reality it is not. it is only one of every five households who is owning a property and has a loan which still needs to be repaid in relation to that property. This also shows you the roles of lenders mostly in private banking institutions and also securing housing conditions for the

population. It would appear like that for quite a while, we will be having a minor correction in property premises.

- Times of Malta
- Plan ahead, prosper financially with a buy-to-let property
- Property ownership should be regarded as medium-to long-term investment
- Financing your investment
- Your savings today yield very little... if anything at all! Therefore, using your savings to finance or part-finance your rental investment property makes a lot of sense. Banks have a number of loan packages for investors buying rental properties. Using the bank's funds this way helps your money go that much further.

- But what is interesting is that we are now getting mixed messages in that you have obviously the main practice that property market is still encouraging people to invest in property. In fact, there is this article written about prospering financially with a buy-to-let property. So, if you have a property and end up paying your loan, one can take the opportunity by taking another loan by a second property.
  - Times of Malta
  - Endless lending has been fuelling rise in house prices - John Consiglio
  - Over 10 years, house prices have at least doubled
  - How many have asked what role the lenders have played in this rampant rise of house prices? ...
  - It can be strongly argued that the banks 'and others' freedom to lend, almost without any sense of limit or appreciation of what they are doing to society and the economy, has been one proximate cause of the rise in house prices. ...
  - The first and unavoidable reform necessary in the housing market is to stop prices rising. That means reining in the financial institutions that have lent so profusely (not to say recklessly) on mortgages.
- On the other hand, commentators have been trying to cool down the situation. In fact, we had another interesting article where John Consiglio (fellow academic and former banker) is being more cautious whilst saying how many have asked what role the lenders have played in this rampant rise of house prices. In fact, he

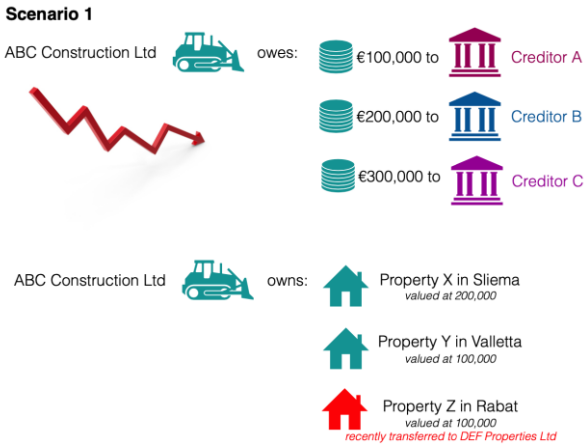
states that if we are to somehow break the stagger price of house prices, the first thing we have to do is regulate the lending of financial institutions.



- Therefore, it is all a vicious circle. Banks who enable easy access to credit. Obviously with who then fuel the demand. The demand then needs to high property prices. High property prices make lending attractive to banks because the collateral also rises in value. The vicious cycle is mainly the reason why we have an increase in property market.

  - 1994. Whosoever has bound himself personally, is obliged to fulfil his obligations with all his property, present and future.

- Article 1994 of the Civil Code tells us that whatever personal obligations I enter into, my property should act as a guarantee to the fulfilment of that financial obligation. In this case, the repayment of the loan.

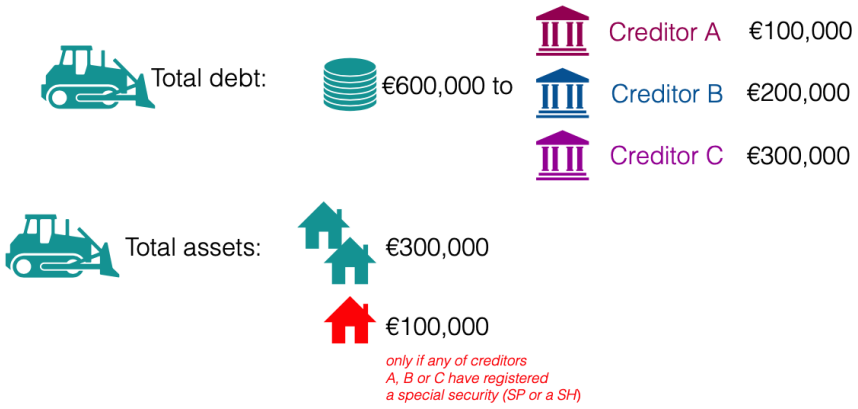


  - This is a practical example.

- In this case, we have ABC Construction Ltd. Basically, ABC Construction Ltd is a construction company. It has been able to expand its business through at least three loan facilities, one granted by creditor ‘A’, another one granted by creditor ‘B ’and another one granted by creditor ‘C’. This situation of ABC Construction Ltd at the moment, is that it owes €100,000 to creditor ‘A’, €200,000 to creditor ‘B ’and €300,000 to creditor ‘C’. So, these are the debts of ABC Construction Ltd.

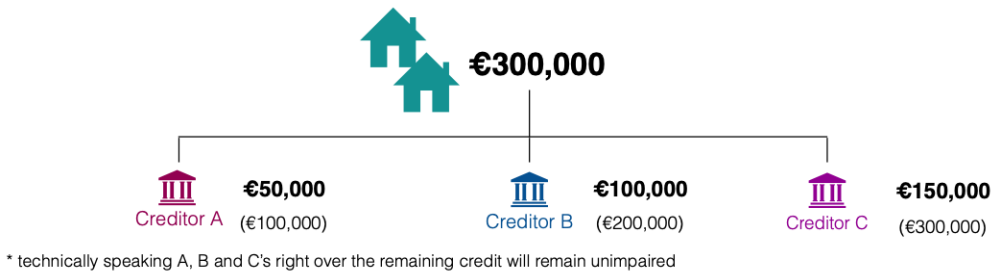
- Its assets, what it owes currently are property ‘X ’in Sliema valued at €200,000 property ‘Y ’in Valletta valued at €100,000 and property ‘Z ’which is valued at €100,000. However, ABC Construction Ltd recently transferred property ‘Z ’to the DEF Properties Ltd.

- Its so happens that ABZ Construction Ltd goes bankrupt. There is no cash left with which to pay the outstanding loans. Now, what is the first thing you can do?



  - If
    Creditors A, B and C are all “simple” or “unsecured” (“krediturikirografarji”) they

are paid pro rata from the proceeds of the judicial sale i.e. (assuming full value



is paid):

- Whose debt should be given preference?
- Creditor A because he was the first to loan money to ABC
- Creditor C because she is owed the greatest amount by ABC
- Creditors A, B and C should be paid pro rata, in proportion to the debt that is owed to each
- This is precisely the problem that a bank would want to avoid. This is a situation that we're going to address during these lectures. What we want to avoid is a situation where despite being owed quite an amount of money I end up in a situation where I have no interest vis a vis other creditors
- These four lectures are about a right of preference over other credits, and we are familiar with the droit de suite.
- This is what happens
  - "[T]he unsecured creditor can only compel the debtor to fulfil his obligation … once the debt is due, the latter may have the debtor's property seized and sold.
  - [H]owever ... the unsecured creditor is not entitled to any right of preference; in other words, all creditors are placed in an apparently equal situation ... The creditor cannot further act on the goods which have left the patrimony of his debtor since the birth of his claim: he therefore has no droit de suite."
  - Y. Picod, Droit des sûretés, Presses Universitaires de France, 2008, p. 2 (emphasis added)
- Shall we come to property 'Z 'or not? one of the possibilities is that they transfer them fraudulently. But let us assume that there was no fraud. Can the creditors

challenge it? It was an outright sale with no fraud involved. We are agreeing that property ‘Z ’does not fall within at the moment of the assets of ABC Construction Ltd. For sure, there are no hypothecs. Neither of the creditors went for the hypothecation of any property of ABC Construction Ltd. We are talking about a situation where the creditors are completely unsecured.

- Once property ‘C ’left the patrimony and the estate of ABC Construction Ltd, then the creditors of ABC Construction Ltd cannot tackle it. This leaves us with a problem. The €100,000 which represent the value of the property cannot be added to our equation. Therefore, we are talking about a situation where the total debt is of €600,000 and the total value of assets is that of €300,000. Creditor ‘A ’ is still owed one hundred thousand, creditor ‘B ’is still owed €200,000 and creditor ‘C ’is still owed €300,000. How are we going to determine who gets paid?

- There is a problem. There are not enough assets to satisfy the outstanding debts that ABC Construction Ltd has vis-à-vis its creditors. They trusted ABC Construction Company blindly. What is going to happen here? We have to decide where does the money go. One is saying that it should go to creditor ‘A ’because creditor ‘A ’was the first one to enter into a financial obligation to offer financing/loan and to grant a loan facility to ABC Construction Ltd. However, another might argue that money should be allocated proportionately in according to the outstanding debt. But there is another argument that given that creditor ‘C ’ is owed the most amount of money, it is creditor ‘C ’who gets to take the €300,000.

- You have three alternatives. We have to choose. We have to discuss. The question is whose debt should be given preference? Where should these €300,000 go? Should we give preference to creditor ‘A ’because he was the first to enter ABC Construction Ltd? Should ‘C ’be given preference as it has a greatest amount? Or should it be given to creditors ‘A’, ‘B ’and ‘C ’proportionately?

- The third alternative is correct. This is precisely the problem that as a bank I would want to look upon. This is precisely that you are going to address these lectures. What you need to avoid is a situation where despite being owed quite a lot of money, I end up in a situation where I have no preference vis-à-vis other creditors. These four lectures are about preference. This is what happens in what you write and describe. If creditors ‘A’, ‘B ’and ‘C ’are all simple or unsecured and so, they did not charge the property with any hypothecs, privileges or with any form of other guarantee. Since they are simple or unsecured creditors, known in Maltese case law as ‘kredituri kirografarji’, they are paid pro rata from the proceeds of a judicial sale.

- So, assume the assets are sold at fair value. What happens is that we take on the debts, add them up, derive proportions compares to each and the final result would be that creditor ‘A ’would get €50,000, creditor ‘B ’would get €100,000 and creditor ‘C ’would get one hundred and €50,000. They all get paid but the claims of either of them is fulfilled entirely. Technically speaking, if ABC Construction Ltd gets back to business and starts making money, their claims could be made unimpaired but it is hardly ever the case in a company which almost goes bankrupt. This is one of the first test to learn especially when you work in banking or with bankers. Banks do not always prevail and this is why, they carry out a risk assessment.

  - Remember the case from the example in Rabat? There is a way through the droit de suite where creditors could still challenge that

- In these lectures, we will be talking about the right of preference which creditors preserve of that service that is, a right of preference over other creditors. Something else we will be dealing with is something which you are already familiar with being the droit de suite. Remember the case of the property in Rabat. Precisely about how it was transferred and could no longer act as a guarantee to the debts owed to creditor ‘A’, ‘B ’and ‘C’. There is a way through the droit de suite by which creditors would still be able to challenge. This is also being said by way of tradition.

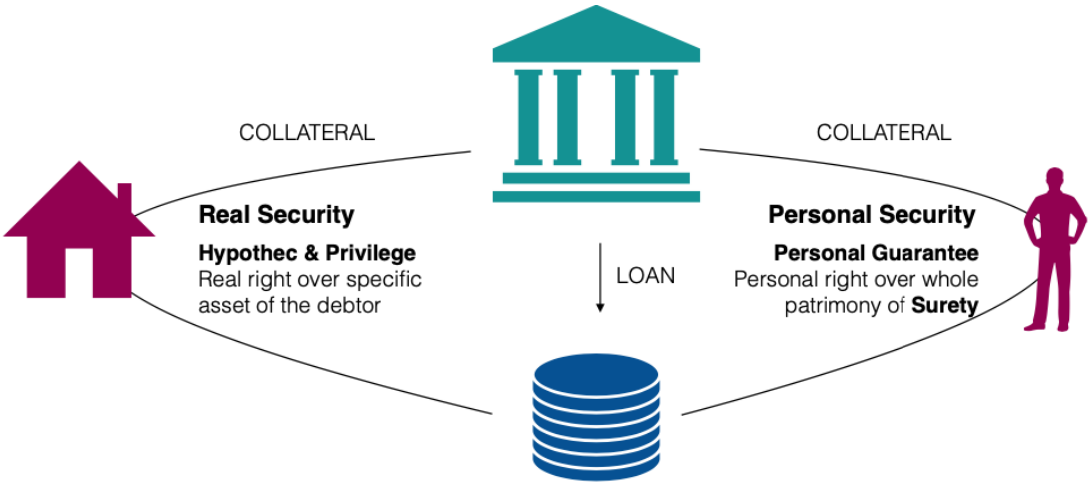
  - Real Security v. Personal Security

  - The accessory right conferred to a creditor by means of security may either be of a personal or real nature.

  - Economic interest: the value of the asset vs the credit-worthiness or financial strength of the guarantor

  - Personal security: a personal right conferred over the whole patrimony of another person acting as guarantor

- Real security: a direct right over a specific asset of the debtor which may be enforced by the creditor to satisfy his claim in preference to other unsecured



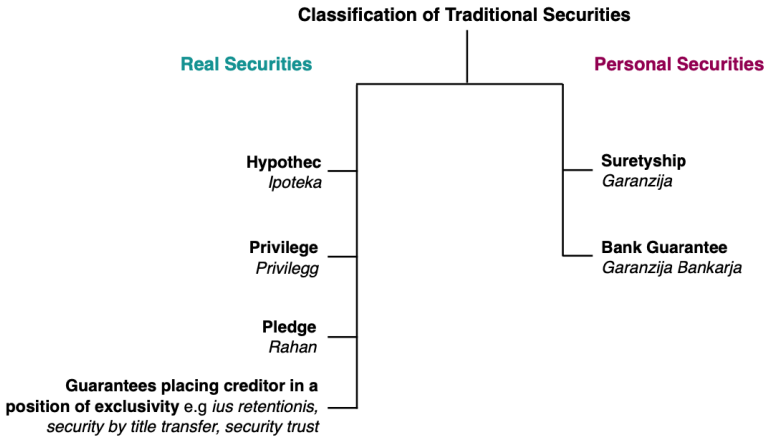
creditors.

- What we are doing in these lectures, is simply applying the theory. In Guarantees, we make a distinction between real security and personal security. In real security, you guarantee the debts through property and real assets. However, when it comes to personal security, you are guaranteeing your debts through the estate of a particular person.

  - For example, I am paying out a loan because I need to purchase a car. The bank needs collateral and therefore, needs a guarantee. Assuming that I am a twenty-six-year-old who has not bought his property yet. Does it make sense for the bank to request a security? I have no assets. It does not make sense. In this case, a real security does not make sense because there is no property that I can challenge. As a bank, I want a guarantee. How can I secure some form of guarantee/collateral? Therefore, what makes sense in this scenario is that I would request the parents or the father or the mother to act as a surety for the person taking out a loan.

- Since we are talking about a surety, a surety is a personal guarantee and not a real one. In the first case we saw of the prospective home owners, who applied for a loan, what do banks normally do in these cases? The banks normally request a real security. What could happen in an ordinary transaction, the couple would purchase the property, the property would pass on to them but the bank would hypothecate in its favour the same property that would have been transferred to the couple.

- So, in this case we are talking about a hypothec and the hypothec is creating a direct link between the property and the bank (i.e., the creditor). In this case, we are talking about a real security. It is real because the guarantee is represented by the property.
- Had it been the case of the twenty-six-year-old who does not own any property and who takes a loan of around €20,000 to purchase a car, the bank would probably go for a personal security/personal guarantee and it would request that the father or the mother or both parents to appear in solidum as the sureties/personal guarantors for the payment that loan. In this case, we are not tying down to one property but we are tying down to the estate of a particular person. In this case, we are talking about a personal guarantee/personal security.
- In our series of lectures, we are going to deal only with real securities. Therefore, we are going to deal with



hypothecs and privileges.

- One might question traditional securities opposed to what? Now that you can appreciate the difference between real and personal securities and have taken a number of examples, another needed qualification before proceeding with the content of the presentation is that we are going to deal with hypothecs and privileges which represent real securities. They are both traditional securities and we are seeing traditional as opposed to contemporary securities.

  - Real Security

  - The subjection of property in such a way as to be entitled to a cause of preference over the proceeds of the sale of such property.

  - A cause of preference is the right to claim payment before all other creditors. To this right which all real securities attribute, is sometimes added what is known as the “droit de suite” i.e. the right to pursue the property subject to the security, whoever may be its owner.

  - The right of preference is available against the other creditors, and the creditor whose right is so secured is preferred to all simple creditors and to all privileged or hypothecary creditors whose causes of preference rank below his.

  - Although hypothecated, the property is left de jure and de facto in the possession of the debtor.

- This we went over.

  - Creditors need solutions which give them added security and without necessarily restricting the transfer of goods and, thereby limiting commerce:

  - “hypothecs and privileges were thus created as a solution to retain the rights of the creditor over things forming the security without dispossessing the owner thereof of the things themselves.”

  - P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, p. 45.

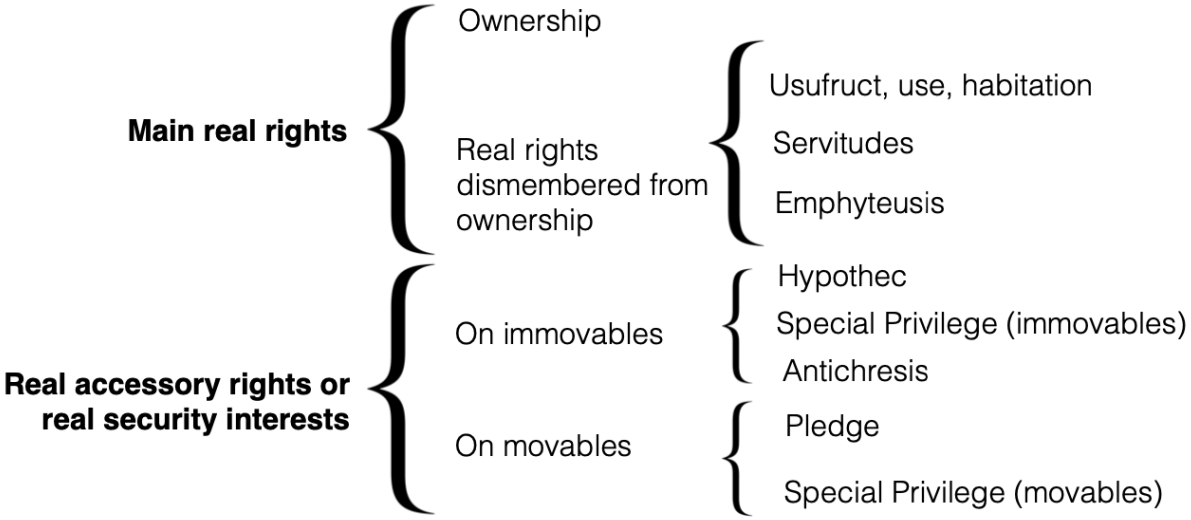
  - “Jura in rem alienam” imply the subjection of the thing, which forms the subject-matter thereof, to the holder of the right, either in respect of its enjoyment or in respect of a particular mode of disposal. Now pledge, privilege and hypothec belong to this second class and are essentially different from all other rights over things belonging to others ... the purpose of pledge, privilege and hypothec [is] the right to dispose of the “res aliena” which they attribute is not an end in itself but as a means whereby compliance with another right is secured and eventually enforced.

- The rights which pledge, privilege and hypothecate guarantee are personal rights or debts.

- V. Caruana Galizia, Notes on Civil Law, The University of Malta: Laws IV Year, 1981 (Reprinted), p. 813

- "... the law of securities forms the umbilical cord between the law of obligations and the law of property"

Classification of real rights



J. Carbonnier, *Droit Civil (Tome 2): Les biens et les obligations*, (Paris: PUF, 2017), 1580

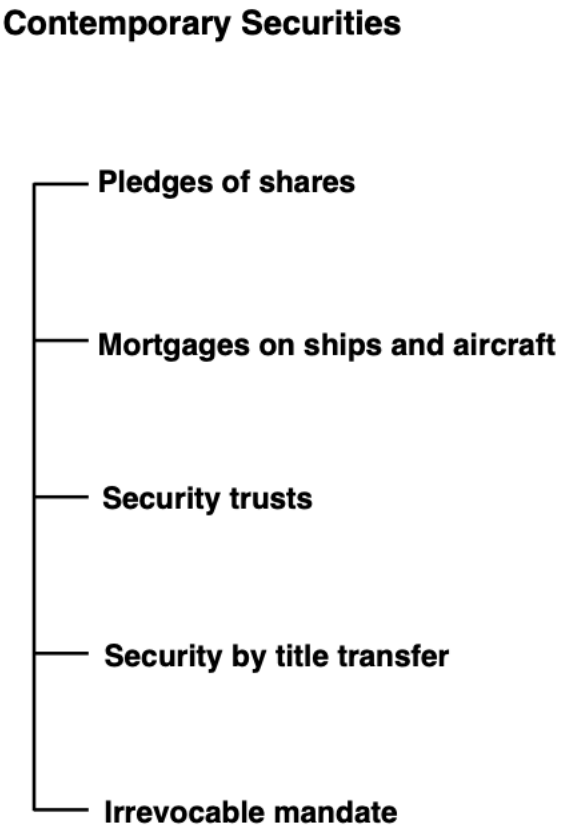
- Y. Picod, Droit des sûretés, Presses Universitaires de France, 2008, p. 12

- "A clear historical development can be seen from land as the prime and most valuable object of property law during feudal times to the growing acceptance of the value of movable property during the period of the Industrial Revolution. Then "decorporealisation" followed: it was more and more realised that not only corporeal, but also incorporeal objects (claims, but also intellectual property) should be recognised as valuable."

- "It is characteristic of the modern approach to property law to allow the acceptance of new objects of property law and to accept new types of property rights. ... A further example is what is sometimes called, "virtual property", such as domain names, an e-mail address or wireless spectrum ... Resulting from

this acceptance of new objects of property law, the question arises whether the traditional rules of property law are perhaps written only for the traditional objects of property law."

- S. van Erp, "Security interests: A secure start for the development of European property law", Maastricht Faculty of Law, Maastricht University.
- Available on: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1297282



- What are contemporary securities? Contemporary securities are presented by and under the Maltese legal system as pledges of shares, mortgages on ships and aircraft, security trusts, security by title transfer and irrevocable mandate. Those deal with mostly intangible and incorporeal property, not all cases because we have immovables. But for those who are interested and is strongly recommended, to go into more detail into contemporary securities, you can next year choose the course on the Laws on Secured Obligations. It is compulsory for

masters in notarial studies however, it is optional for the masters in advocacy. This is part of the law of guarantees.

- 1995. (1) The property of a debtor is the common guarantee of his creditors, all of whom have an equal right over such property, unless there exist between them lawful causes of preference ...
- The law acknowledges the existence of lawful causes of preference
- (although a cause of preference is not necessary for the property to serve as a guarantee for the repayment of a debt)
- Preference entails priority or the right to claim payment before all other creditors. To this right [it] is sometimes added what is known as the “droit de suite” i.e. the right to pursue the property subject to the security, whoever may be its owner
- V. Caruana Galizia, Notes on Civil Law, The University of Malta: Laws IV Year, 1981 (Reprinted), p. 814
- “droit de suite”
- The cause of preference enjoyed by a creditor remains unaffected by any alienation of the property subject to his rights. If the third party in possession of the said property pleads his right of ownership, the creditor, in proceedings for the realisation of the value of the property, may reply: “I am not exercising my right against you but over the property subject to my security, which is in your possession”
- V. Caruana Galizia, Notes on Civil Law, The University of Malta: Laws IV Year, 1981 (Reprinted), p. 815

- Another very important aspect of privileges and hypothecs, on which we will concentrate in our course, is that whilst constituting a guarantee in one’s favour, the debtor himself is not dispossessed of the asset. So, ownership and possession of the asset remain completely in the hands of the debtor. This is important. Why? We made a distinction in the law of guarantees and this will become particularly material next year for those who choose the course on the Laws on Secured Obligations, is that we distinguish between possessory and non-possessory securities.
- In the case of hypothecs and privileges, we are talking about non-possessory securities. Why? The only thing that the bank or any other creditor who hypothecates the property in the case of his or her favour, the secured creditor

reserving in his or her favour is a jura in rem alienam. The only thing s/he is reserving is the right to dispose of the rem alienam that is, the property of another person for the main purpose of compliance with another right which is the right to be secured. This is the most difficult phase in order to secure the repayment of the loan.

- In the second part of this lecture, the idea is to move on to more specific presumptions. We had just a theoretical introduction on hypothecs just to refresh your memory and re-visit the main concepts.
  - 1. HYPOTHECS
  - 2011. (1) Hypothec is a right created over the property of a debtor or of a third party, for the benefit of the creditor, as security for the fulfilment of an obligation.
  - (2) Hypothec is of its nature indivisible, and it exists in its entirety over all the things so charged, over each of such things and over every portion thereof.
- What are hypothecs? As defined under the Civil Code, hypothec is a right created over the property of a debtor or a third party. Here, we have a definition of a jura in rem alienam. It is a right created over the property of a debtor or of a third party for the benefit of the creditor as security for the fulfilment of an obligation.
- As we have previously seen, the French author Y. Picod provided that ‘the law of securities forms the umbilical cord between the law of obligations and the law of property’. Here, you can see the closest link between the law of obligations, nominate and the law of property. We are talking about something which is granted on top of the trust which would have already presumably been to the parties. An example would be of the bank. The bank is trusting the borrower. Is that trust sufficient? No, you need something beyond than that. Beyond the trust, you also need the security.
  - Hypothec from the Greek hupothḗkē meaning subjection i.e. subjection of a thing to the debt.
  - The holder of the right is called the creditor, because he trusts (“credere”) the debtor and his good faith.
  - But good faith is not enough and means were devised to secure the performance of obligations against bad faith or insolvency.
  - Characteristics of the hypothec:
  - it creates a real right over an immovable

- it creates a right of priority in favour of the creditor
- it is a right de suite (when special)
- it is by its nature indivisible
- it constitutes an accessory right
- (connected to the principal right)
- G. Baudry Lacantinerie, P. De Loynes, “Del Pegno, dei Privilegi, delle Ipoteche e della Espropriazione Forzata”, Trattato teorico pratico di diritto civile, (Milano, Francesco Vallardi: 1912:II).

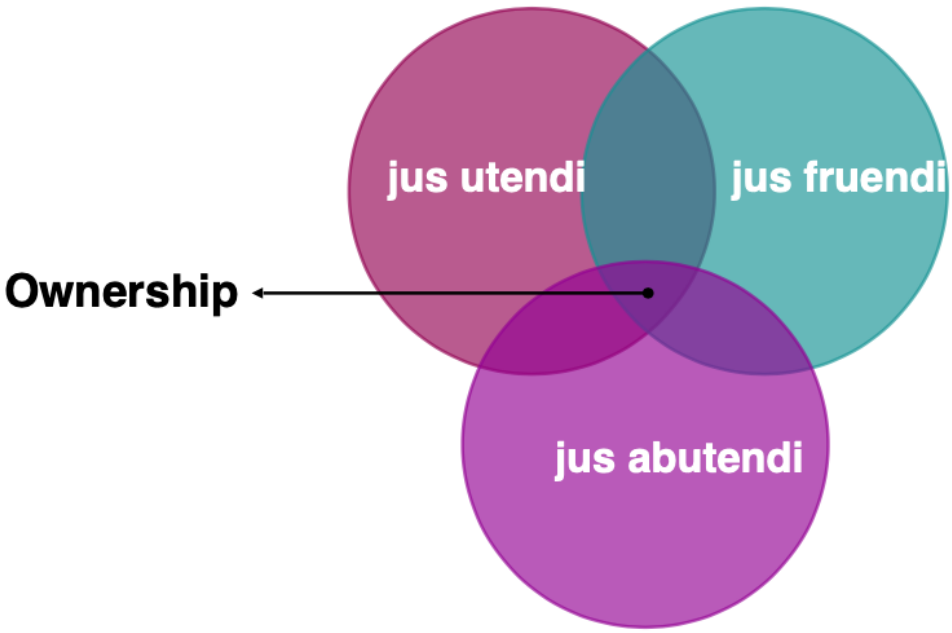
- We are going to discuss the main elements of a hypothec. We are talking of a real right which most importantly, creates the right of priority. This is the keyword when dealing with hypothecs. What is the main function of hypothecs? It is to grant priority over other creditors. Why? Because as we see in the case of ABC Company Ltd, the problems come in essentially when there are competing creditors.
- The issue here is how to determine their rankings. Hypothecs serve the main function of securing a ranking; first ranking, second ranking, third ranking, etc. Then, we are going to deal with the right de suite. When the hypothec is sufficient there is a droit de suite. This is very important but we distinguish between general and special in a few minutes time. But the droit de suite in Italian is easier to understand, it is the ‘diritto di seguito’. Therefore, if there is a diritto di seguito and so, the property is transferred from the debtor to another person, then the hypothec follows the property even despite the transfer.
- The right remains in force even though there has been a transfer. Now it is by its nature indivisible and constitutes an accessory right. Why is it an accessory right? It is contained in the definition. It is an ancillary right and so, cannot exist by itself.
    - For example, if there is no debt to be secured, I cannot constitute a hypothec. As the definition states, you are creating a right as security for the fulfilment of an obligation. Therefore, there must be a fulfilment of obligation as sort of the main principal obligation and then, the hypothec is an ancillary or accessory right. So, there is a connection to the principal right.
    - 1. A hypothec is a real right over an immovable
    - A hypothec gives rights erga omnes (enforceable against any individual)

- Owner is not dispossessed but his power over the property is significantly limited

- If it is a real right, as a characteristic of all real rights, the right of erga omnes is created. This is so exclusively however not for all kinds of hypothecs. So, it gives the right erga omnes only in the case of special hypothecs. We will come to them shortly. What we also said earlier is that the owner is not dispossessed but power over the property is significantly limited.

  - 1. A hypothec is a real right over an immovable

  - 320. Ownership is the right of enjoying and disposing of things in the most absolute manner, provided no use thereof is made which is prohibited by law.

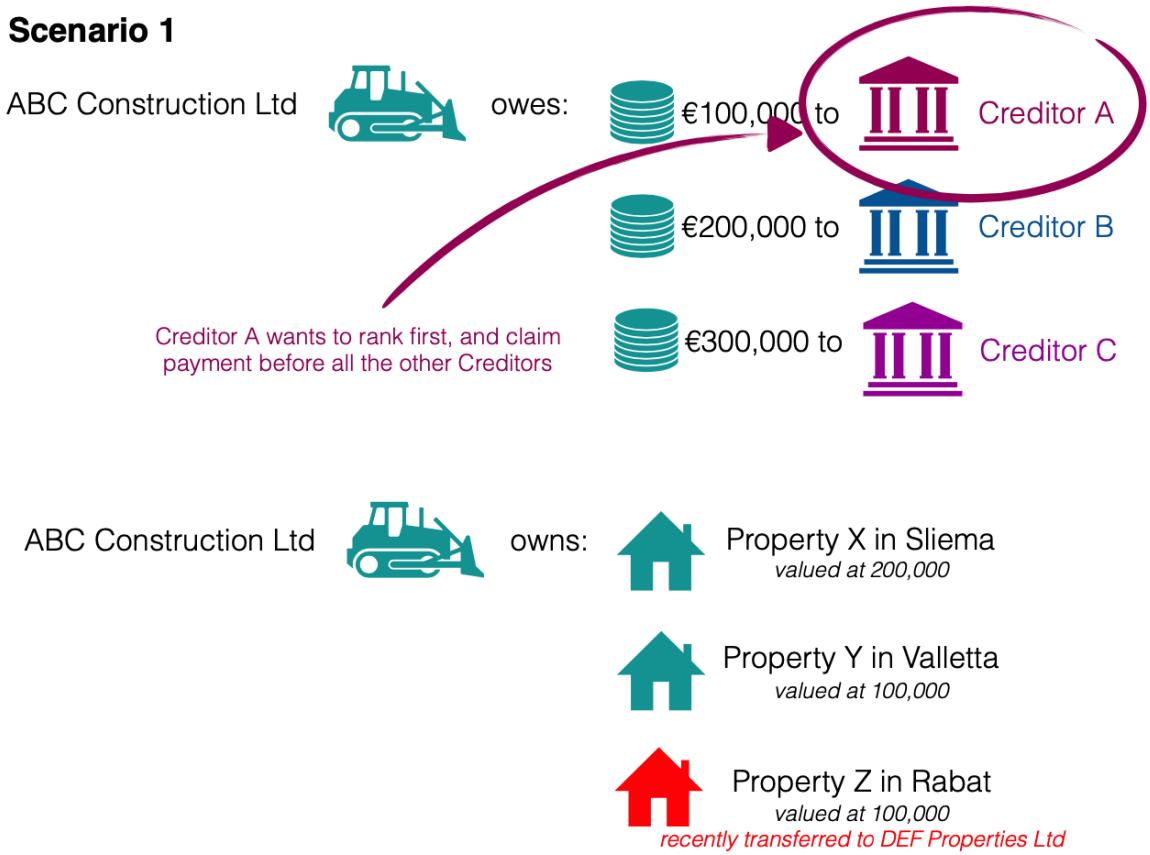


- What property can be hypothecated? A conventional hypothec can only be contracted by persons who are capable of alienating the property. Why is this so? Should all remedies fail and should I have to enforce my hypothec, what should I do? I try to have my property sold through a judicial auction. The sale cannot go through if the person who is bound by the hypothec is not the same person who will be dealing with the law alienating that property. Otherwise, the judicial sale cannot be released because it is not the holder of the title who is transferring the property. A hypothec given to someone who is not capable of alienating the property is practically worthless.

- 1. A hypothec is a real right over an immovable
- SPECIFIC CONDITIONS:
- During the currency of the Home loan facilities, the property, which is specifically hypothecated in favour of the Bank, shall remain in the name of the personal borrowers and will not be subsequently charged in favour of third parties without the Bank's prior written consent. Any breach of this condition shall be deemed to be an Event of Default.
- GENERAL TERMS AND CONDITIONS REGULATING THE FACILITIES
- There shall be an event of default in any of the following:
- ... any circumstance arising which may negatively affect the value or nature of the security held by the Bank or the Borrowers 'financial position.
- 1079. A debtor can no longer claim the benefit of time if he ... has diminished the security which under the agreement he had given to the creditor, or if he has failed to give the security agreed upon.
- What property can be hypothecated?
- 2024. (1) A conventional hypothec can only be contracted by persons who are capable of alienating the property which they charge with such hypothec.
- (2) The property of persons who are not capable of alienating cannot be hypothecated by contract except for the causes and in the form established by law.
- What property can be hypothecated?
- Property has to be in commercium, since if it cannot be sold, it cannot constitute a guarantee (land in public domain is excluded)
- A hypothec can be constituted over property held in common pro indiviso such as between partners or co-heirs. In case of partition, the hypothec would follow the part that would have been gone to the debtor.
- The partition of property made by the heirs of the deceased debtor, do not affect the position of the creditor; the whole property remains subject to the entire debt.

- Of course, the property to be hypothecated, has to be in commercium and one can also hypothecate a share of the property. It is divided or undivided. You have the notes over here.
  - Undivided property can be hypothecated, however, hypothecation depends on partition; creditor cannot seize undivided share of the debtor.
  - F. Laurent, L. Siville, Principi di Diritto Civile, Milano, 1897:XXX.
  - 946. Each co-heir is deemed to have succeeded alone and directly to all the property comprised in his share, or come to him by licitation, and never to have had the ownership of the other hereditary property.
  - 2. A hypothec creates a right of priority
  - The obligations exists independently of the hypothec. The hypothecate merely grants a ranking to the creditor and, if it is special, a droit de suite.
  - This right is, however, subject to the registration of the hypothec; registration determines the rank of the hypothecary creditor.
  - 2011. A conventional hypothec cannot be created except by a public deed
- More importantly, we are concerned with the right of priority. The obligations exist independently of the hypothec. The hypothec mainly grants a ranking to the creditor and if it is special droit de suite. What is the hypothec doing? It is ensuring a ranking to that particular creditor which becomes very important as we said before, is competing with other creditors. The right is subject to the registration of the hypothec. Hypothecs must be registered otherwise they are worthless. Why?

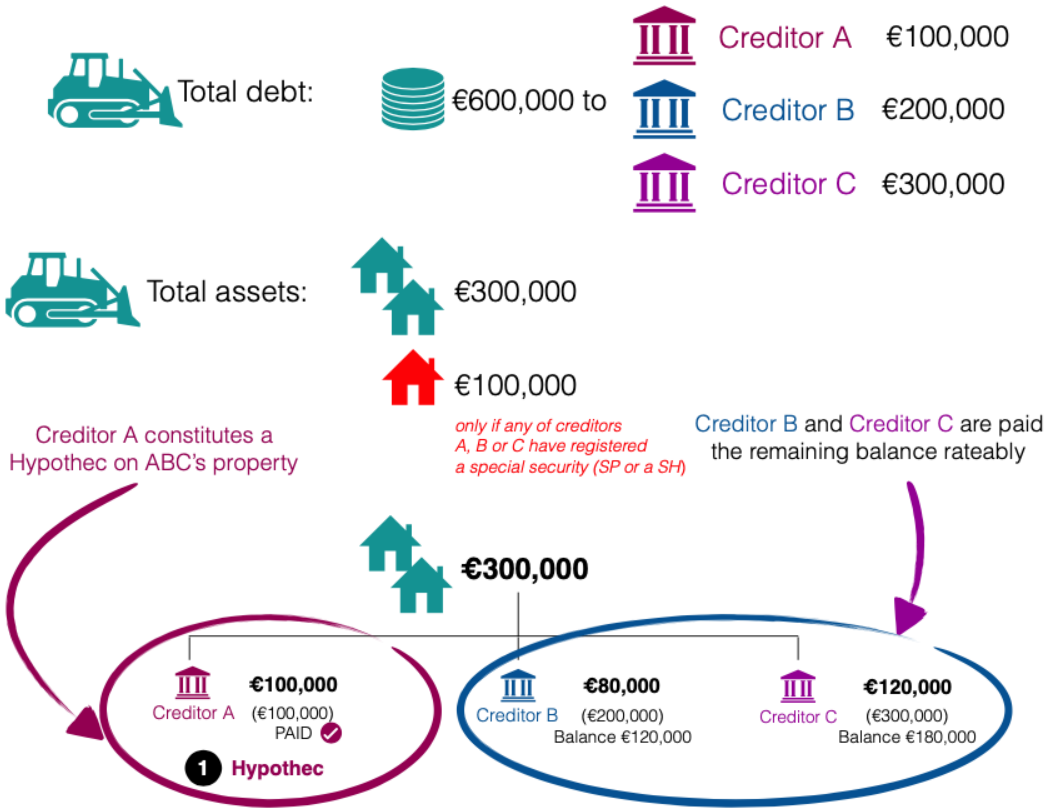
It is the registration that determines the rank of the creditor. The conventional



hypothec cannot be created except by public deed.

- The first scenario is very similar to the initial scenario that we considered with the difference however that, creditor ‘A ’comes to you for advice. Creditor ‘A ’wants to make sure that he ranks first. Take the scenario that we considered, where we had a number of creditors who are owed money by ABC. ‘A ’foretells the situations that is going to be created, a situation which if it is not acted up on, would ultimately mean that he would only receive €50,000 out of the hundred thousand that he is owed. In the first example when we considered the case of ABC Ltd,

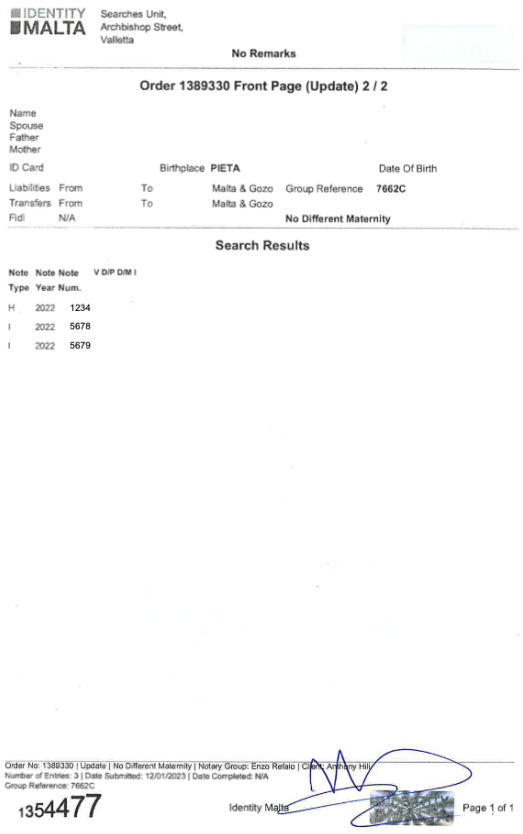
most of you agreed that the creditors will be paid pro rata out of the proceeds of the sale of the properties in Sliema and Valletta.



- What would this mean? It would mean that those €300,000 represented by the value of property in Sliema and the property in Valletta would have to be divided pro rata among the three creditors (i.e., Creditor 'A', 'B 'and 'C'). Pro rata would mean that we are talking about €600,000 and therefore, fifty percent of the total value would go to creditor 'C', thirty percent would go to creditor 'B 'and twenty percent goes to creditor 'A'. In other words, one half goes to creditor 'C 'because the debt owed to creditor 'C 'represents the greater amount out of the entire debt and then, relatively goes to creditor 'A 'and 'B'. At the end, everyone is going to receive fifty percent what was owed.

- However, creditor 'A 'wants to avoid this situation and he wants to make sure that he is paid in preference to the other creditors. What does creditor 'A 'have to do? He has to register a hypothec. What will happen when he registers a hypothec? Out of the proceeds and out of the three hundred euros that are collected from the sales of properties in Sliema and Valletta, what is it going to happen? The first thing that is going to be done is that since he is creating a right of priority through a hypothec, it means that 'A 'will now become a secured creditor while 'B 'and 'C '

will remain unsecured. This means that ‘A ’being the only secured creditor and therefore, his claim is going to be fulfilled



IDENTITY MALTA Searches Unit, Archbishop Street, Valletta

No Remarks

Order 1389330 Front Page (Update) 2 / 2

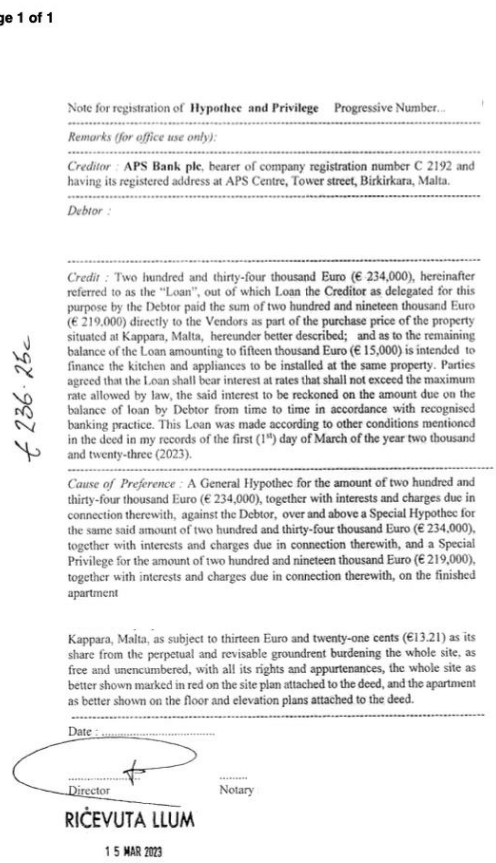
Name
Spouse
Father
Mother
ID Card Birthplace PIETA Date Of Birth
Liabilities From To Malta & Gozo Group Reference 7662C
Transfers From To Malta & Gozo
Fidi N/A No Different Maternity

Search Results

Note Type	Note Year	Note Num.	V D/P D/M I
H	2022	1234	
I	2022	5678	
I	2022	5679	

Order No: 1389330 | Update | No Different Maternity | Notary Group: Enzo Refalo | Client: Anthony Hill
Number of Entries: 3 | Date Submitted: 12/01/2023 | Date Completed: N/A
Group Reference: 7662C

1354477 Identity Malta Page 1 of 1



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Note for registration of **Hypothec and Privilege** Progressive Number...

Remarks (for office use only):

Creditor : **APS Bank plc**, bearer of company registration number C 2192 and having its registered address at APS Centre, Tower street, Birkirkara, Malta.

Debtor :

Credit : Two hundred and thirty-four thousand Euro (€ 234,000), hereinafter referred to as the "Loan", out of which Loan the Creditor as delegated for this purpose by the Debtor paid the sum of two hundred and nineteen thousand Euro (€ 219,000) directly to the Vendors as part of the purchase price of the property situated at Kappara, Malta, hereunder better described; and as to the remaining balance of the Loan amounting to fifteen thousand Euro (€ 15,000) is intended to finance the kitchen and appliances to be installed at the same property. Parties agreed that the Loan shall bear interest at rates that shall not exceed the maximum rate allowed by law, the said interest to be reckoned on the amount due on the balance of loan by Debtor from time to time in accordance with recognised banking practice. This Loan was made according to other conditions mentioned in the deed in my records of the first (1st) day of March of the year two thousand and twenty-three (2023).

Cause of Preference : A General Hypothec for the amount of two hundred and thirty-four thousand Euro (€ 234,000), together with interests and charges due in connection therewith, against the Debtor, over and above a Special Hypothec for the same said amount of two hundred and thirty-four thousand Euro (€ 234,000), together with interests and charges due in connection therewith, and a Special Privilege for the amount of two hundred and nineteen thousand Euro (€ 219,000), together with interests and charges due in connection therewith, on the finished apartment

Kappara, Malta, as subject to thirteen Euro and twenty-one cents (€13.21) as its share from the perpetual and revisable groundrent burdening the whole site, as free and unencumbered, with all its rights and appurtenances, the whole site as better shown marked in red on the site plan attached to the deed, and the apartment as better shown on the floor and elevation plans attached to the deed.

Date : .....

Director ..... Notary

RICEVUTA LLUM

15 MAR 2023

€ 236.25c

entirely and in preference to the others.

- In practice, first it is the secured creditor (i.e., creditor ‘A’) who is going to be paid the full amount that he is owed. Then with the remaining balance, which is €200,000, since ‘B ’and ‘C ’are both unsecured, the rule applies the same for them and they have to the share the remaining amount (i.e., €200,000) proportionately. These are important building blocks to understand. So that everything comes together. As you can see, this what happens when neither of the creditors was secured. They had to share everything pro rata. This time, ‘A ’secures the hypothec and so, creditor ‘A ’would obtain a preferential claim and would rank first. This means that the claim of ‘A ’would be fulfilled entirely and it is only the remaining amount after ‘A’s ’claim is fulfilled entirely, that the amount is split pro rata between creditor ‘B ’and ‘C’.

- These documents show that for instance, I would order searches for ABC Company Ltd from a certain period to a certain period. Then as shown, these results would come up. Then for example, there would be ‘H ’number 1234 of 2022. This shows that there is a hypothec register. Why is registration important?

It is important for the purpose of ranking but most of all, it is most important for purposes of publicity. Those are public searches and so, hypothecs would come up in a public search and would be carried on your name. It is important so that if ABC comes to me and I am considering to grant a loan facility to ABC, I would know that there is another creditor who has already registered a hypothec on ABC's property. Then when identifying the hypothec, I would go for a note of registration and the note of registration would look something like the above.

- It would contain the name of the creditor, the name of the debtor, the creditor being secured, the cause of preference. In the above case, the cause of preference is a general hypothec for the amount of two three four thousand euros together with interests and charges due against the debtor over and above a special hypothec for the same set amount of two three four thousand euros together with interests and charges due and a special privilege on the property in Kappara which is being acquired by the debtor. As you can see, the date is of 15th March 2023 which is when the note was enrolled. This is important because practically it is important for us to determine which note was employed first.

  - General Hypothec v. Special Hypothec

  - General Hypothec v. Special Hypothec

  - A General Hypothec (GH) affects all the property, present and future of the debtor, both moveable or immovable, whether acquired 'inter vivos 'or 'causa mortis', whether acquired onerously or gratuitously, corporeal or incorporeal.

  - A Special Hypothec (SH) extends only to particular immovables, including improvements subsequently made in or on the property hypothecated.

  - [A] General Hypothec grants a ranking over all the property - present and future - of the debtor. A Special Hypothec, on the other hand, grants a ranking only on the immovable specified therein.

- The distinction between a general and a special hypothec is fundamental. In fact, this is very important for the exam.

- A general hypothec affects all the property, present and future of the debtor and therefore, now past. This refers to things that I own now and things which I will own in the future. Things that I have transferred licitly and not fraudulently cannot be challenged. So, on the face of it, it appears to be a very strong guarantee. It is over the entire patrimony, all the present and future properties of the debtor. However, in practice, it is very weak. Why? If the debtor licitly disposes of his or her property then, the general hypothec is worth nothing. Therefore, the general hypothec effects all the property present and future of the debtor both movable

and immovable. It extends over the entire estate of the debtor. Why is it considered a weak guarantee especially for bankers? Take the following case where the debtor has three properties and therefore, the GH extends over the three properties. But if the debtor alienates, transfers or sells these three properties then practically, the General Hypothec is not covering anything.

- What is different in the special hypothec? The special hypothec extends only to particular immovables, including improvements subsequently made in or on the property hypothecated. Therefore, the special hypothec extends only to one particular immovable. So, it appears to be weaker than a general hypothec. So, why do banks still greatly rely on special hypothecs? Bank do so due to the droit de suite. I am guaranteeing the debt through that property and it is regardless of how many times that property is sold. This means that even though the debtor transferred the property, I can still enforce my claim on that property which is charged by a special hypothec. Having said this however, there is the period of prescription but we will not go into that for the time being.
  - Kinds of hypothec
  - 2012. (1) [A hypothec] is general when it affects all the property present and future of the debtor
  - 2012. (1) [A hypothec] is special when it affects one or more:
  - (a) particular immovables of the following kind:
  - (i) things which are immovable by their nature, and products of such immovables so long as they are not separated therefrom;
  - (ii) the right of usufruct over the said immovables, during the continuance of such right;
  - (iii) the dominium directum over the said immovables given on emphytheusis, and the dominium utile over such immovables and
  - (b) particular movables as the Minister may, from time to time, Establish.
- These are the relevant articles which we have just read. With regards to article 2012(1)(a), we are essentially talking about immovables.
  - 308. The things following are immovable by their nature:
  - (a) lands and buildings;
  - (b) springs of water;

- (c) conduits which serve for the conveyance of water in a tenement;
- (d) trees attached to the ground;
- (e) fruits of the earth or of trees, so long as they are not separated from the ground or plucked from the trees;
- (f) any movable thing annexed to a tenement permanently to remain incorporated therewith.
- Unless a different intention appears from the circumstances, such thing shall be deemed to be so annexed to a tenement if it is fastened thereto by any metal or cement, or if it is otherwise so affixed that it cannot be removed without being broken or damaged or without breaking or damaging the tenement.
- 309. The things mentioned in paragraphs (c), (d), (e) and (f) of the last preceding article become movable as soon as they are separated from the ground, tree, or tenement, although they have not yet been removed elsewhere.
- 2028. (1) A conventional hypothec may be general or special.
- (2) Only the immovables and movables mentioned in article 2012 can be charged with a special hypothec.
- (3) A special hypothec shall extend to all improvements subsequently made in or on the property hypothecated.
- Tutti i lavori, qualunque siano, costituiscono un miglioramento e profittano, in conseguenza, ai creditori a titolo di accessione.
- F. Laurent, L. Siville, Principi di Diritto Civile, Milano, 1897:XXX.
- The General Hypothec, comparable to the charge (common law), is an underlying asset or group of assets which is subject to change in quantity and value. The GH does not affect the debtor's ability to use the underlying asset as normal, unless he fails to repay the loan or becomes insolvent. In that case the creditor would have prior ranking.
- General mortgages as were known in the feudal era, covering a person's whole possessions, were therefore suspect, even more so if they would not have been published.
- Sjef van Erp, From "classical" to modern European property law?, (2006) Maastricht University, Faculty of Law [ssrn.com/abstract=1372166]

- The GH is not foreseen in other Continental codes. In the prevalent view of the time, one debt could ruin all the credit of the contracting party (although credit does not depend on the generality or speciality of the hypothec but rather on the value of the estate of the debtor; moreover Maltese law does not dispense of publicity).

- It is a custom which was retained by the Maltese legislator (similarly to the ‘joint will ’between spouses).

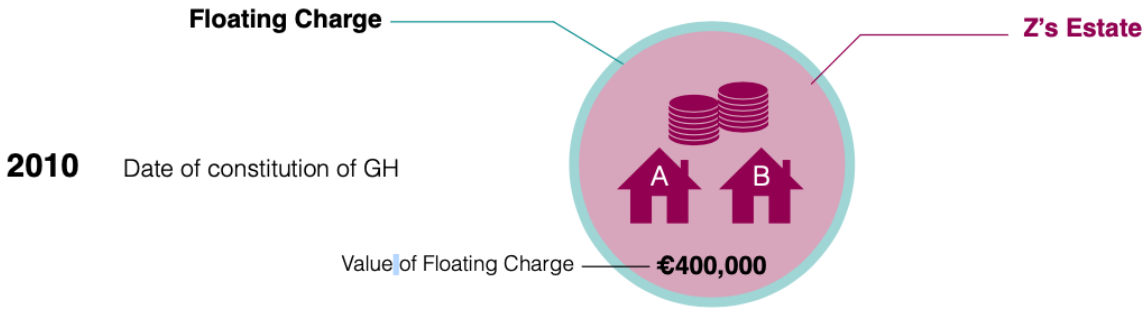
- P. De Bono, Sommario della storia della legislazione in Malta, (Valletta: Tipografia del Malta, 1897)

- Therefore, the floating charge in a general hypothec is the charge affecting all the property. So, it is not defined. It increases or decreases according to the patrimony/size of the estate of the debtor. In foreign jurisdictions, especially the Civil law jurisdictions including the French and the Italian, you will find that the notion of general hypothec or the notion as we refer to it in common law of the floating charge is non-existent. Why? They are considered as a remnant of the feudal era. As you know, the Civil Code was drafted in respect to the French evolution and so, the ideas relating to the feudal era were renewed.

- But is remains a custom within our Civil Code. Therefore, the general hypothec is something when compared to other Civil law jurisdictions, remains something characteristic of Malta. It is a custom which was retained by the Maltese legislator such as a joint will. The joint will that does not exist in France, Austria and Germany. So, these are instances where the Maltese Civil Code is different from other jurisdictions.

- Therefore, if you have a material deriving from Italy or France and they refer to hypothec, they are referring to a special hypothec. To them, a hypothec is a special hypothec and not the general hypothec.

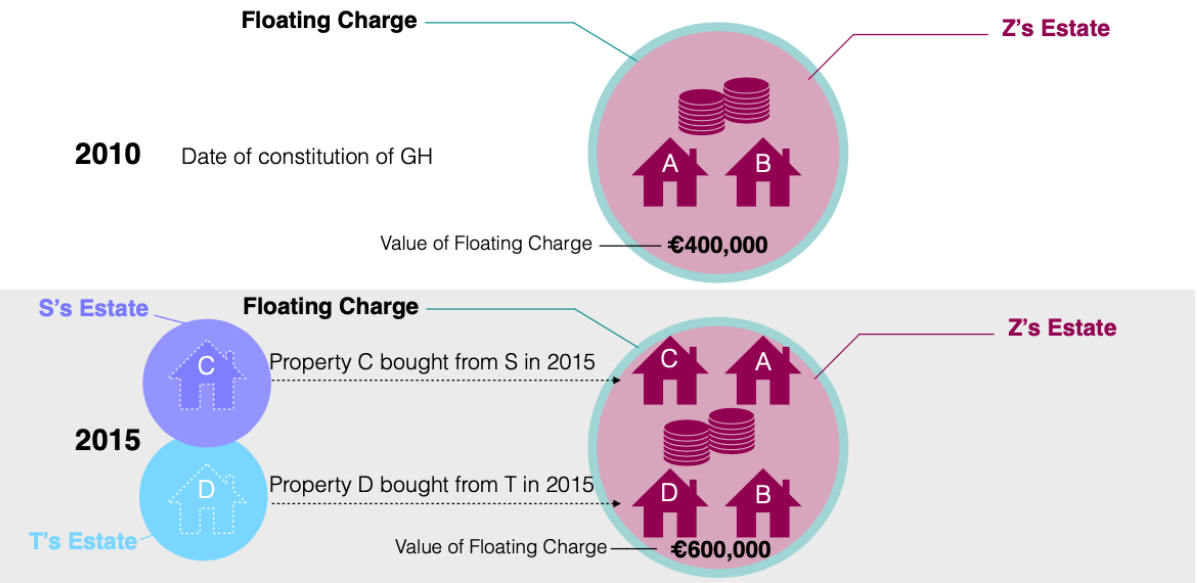
- Floating Charge (GH) v. Fixed Charge (SH)



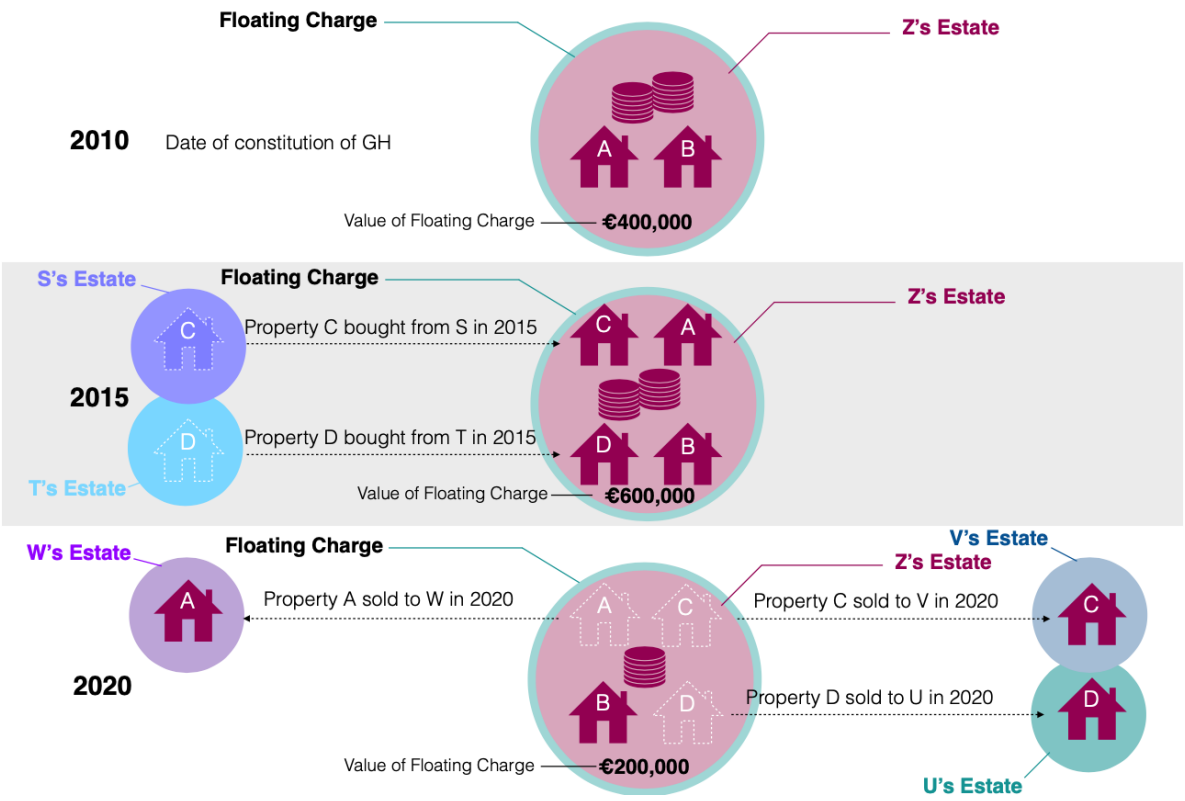
- XY constitutes a Floating Charge (GH) over Z's Estate

- XY constitutes a Floating Charge (GH) over Z's Estate

- Let us consider in practice the effects of the general and a special hypothec. The example is this. In 2010, XY bank granted a facility of €300,000 to debtor 'Z'. In the first hypothesis, XY constituted a floating charge that is a general hypothec. Remember that the amount owned to XY bank is €300,000. The bank decides to



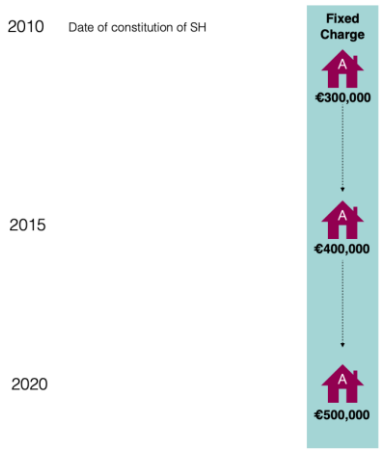
accept a general hypothec. It makes sense because at the moment, the value of the estate of the debtor is that €400,000. Would you financially agree? The bank is owed €300,000 and it registers a general hypothec over all the property of 'Z ' which is worth €400,000. The debt is of €300,000 and I secure it to a general hypothec worth €400,000. Financially, it makes sense.



- XY constitutes a Floating Charge (GH) over Z's Estate

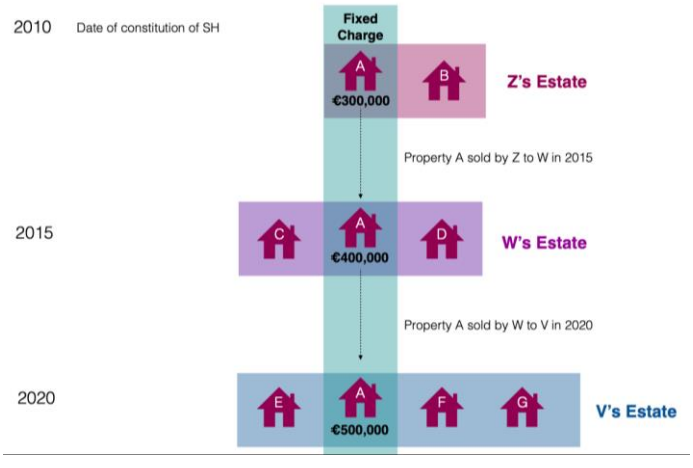
- Time goes by and 'Z 'acquires two properties from 'S 'and 'T'. So, what is relevant is that 'Z 'has another two properties to his portfolio. Therefore, his estate is worth €600,000. Is the situation advantageous/favourable to 'X 'and 'Y'? Yes, because now, the estate of 'Z 'is worth even more. But then, what happens is that 'Z 'makes some questionable decisions and 'Z 'transfers property 'A', 'C 'and 'D'. He spends all the money that he collected from his transfers to satisfy other debts and he is left with property 'B 'which is worth €200,000. Is now the situation favourable/advantageous to XY and the bank? No. So, this is the risk of a general hypothec. It seems that it is like a strong guarantee but it is not because it constitutes hardly a guarantee at all.

  - XY constitutes a Fixed Charge (SH) over Z's Estate



- Let us now consider the second hypothesis, when a bank secures a fixed charge, floating charge or a special hypothec. Fixed charge and floating charge are used interchangeably for general hypothecs and special hypothecs. Charges is the term used by the common law jurisdictions whereas, privileges and hypothecs are the terms used in civil law jurisdictions. This time they decided to secure the debt which is that of €300,000 through a fixed charge on property ‘A ’which is worth €300,000. Has XY bank been wise? It seems to have been wise because the property and the debt is of €300,000 and they secured the debt through a fixed charge for a special hypothec of €300,000.

  - XY constitutes a Fixed Charge (SH) over Z’s Estate (droit de suite)



- Why is a special hypothec stronger? As time goes on, property prices appreciate in time. So now in 2015, the property is worth €400,000 and in 2020, property is worth €500,000. So, you can see how the price of property is working in favour of the lender. It makes even more sense because say in 2015 ‘Z ’transfers the property to ‘W ’and then subsequently, in 2020 ‘W ’transfers the property to ‘V’. Can XY claim anything on property ‘A’? Is XY claim over property ‘A ’still valid?

- Let us say that ‘W ’decides to acquire the property without conducting the necessary searches. XY can still enforce its claim against ‘Z ’on the property that now has become ‘W’. There is a reason why time frames are of ten years and we will come to that. Within those ten years and even for another five, the property remains subject to the special hypothec.

26th April 2023

Lecture 2.

- We are going to go over the final part of our last week’s lecture. So, that we can build on it.

  - Do you remember the difference between a floating charge and a fixed charge? When dealing specifically with the topic of hypothecs, what is the floating charge represented by under Maltese Civil law? The general hypothec and its main characteristic is that it extends over all assets whether movable or immovable and when compared to a fixed charge, the floating charge can increase or decrease and the guarantee will only cover up the extent of your estate no matter how much it decrease or increase. What are the characteristics of a fixed charge? It is fixed and under Maltese law, it is represented by a special hypothec. The characteristics of a special hypothec extends only on immovable property over a specific property and the great advantage that it has over the general hypothec is that it has the droit de suite. We are going to cover all these differences in detail.

  - We took the example of a creditor XY. His credit is guaranteed in virtue of a floating charge here represented for a general hypothec over estate. As we go along, the value of the charge increases or decreases in accordance and corresponds to the extend of the patrimony of the estate of ‘Z’. For example, in 2015 the business of ‘Z ’was going through quite a good period. The GH was worth a lot but then, sort of things seem to take a downward turn in 2020. As a result, the value of GH was that of only €200,000. ‘Z ’had disposed of his assets.

- Let us take property ‘A ’which was disposed by ‘Z ’in 2020 in favour of ‘W’. Does the creditor XY has a claim over it? This is a floating charge. In 2020, ‘Z ’ transferred his property to ‘W’. So, ‘A ’left the patrimony/estate of ‘Z’. Does the creditor XY has a claim on property ‘A’? No. Why? Because when we are talking about a general hypothec, it only extends on the property of the present and future property of the debtor. The constitution of a general hypothec does not prohibit ‘Z ’from alienating his/her property. Why is it so easy? Usually, a serious creditor would first of all constitute a special hypothec rather than a general one and secondly, there would be certain clauses in agreements that for example state that anything is done by the debtor, to the mentioned security then, that would constitute an event of default and therefore, the creditor would be able to recall the credit immediately.

- Why does the bank ask for both a general and a special hypothec? What is the benefit of having both? The special hypothec is enough. The risk is that even if the special hypothec is sold through a judicial auction, there would still be debts which remain unpaid. As you might imagine, when property is sold through a judicial sale, it will fledge a price which is much lower than it should have fledged in the market. So, what it does it tries to guarantee its rights over and beyond so that if there are any other creditors, the bank would still rank first even with respect to other movable assets or even immovable assets.

- This is the general hypothec. Just because XY constituted a general hypothec over the property of ‘Z’, it does not mean that ‘Z ’is anyway prohibited from disposing of his property, excluding other specific contractual clauses. What about the fixed charge to a special hypothec which we are going to deal with today? When dealing with a special hypothec, we are talking of a fixed charge. The emphasis here, is no longer on the general patrimony/general estate of the debtor but rather the specific asset and is only concerned on this specific asset. In this case, there is a fixed charge over property ‘A ’and regardless of how much time passes, I still have a debt in my favour.

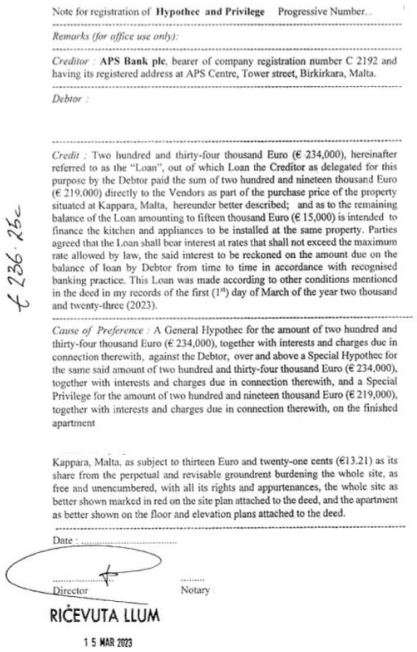
- Therefore, if we compare it to the general hypothec, an advantage that clearly emerges is that the bank have the benefit of the depreciating value of the property. As you can see, value depreciate over time. The second major advantage is that even if ‘Z ’who is the debtor, subsequently transfers the property to ‘W ’and even if ‘W ’were to subsequently transfer the property to ‘V’, such security/charge/guarantee will still remain intact. This is what we mean by the droite de suite/‘diritto di seguito’. The charge follows the transfer.

- So, if in 2020, ‘Z ’faces a situation of default and the bank has repossess or rather the bank before closure, it starts the necessary procedures to enforce its security, it can file an action on the basis of the debt owed by ‘Z ’against ‘V ’for ‘V ’who has

surrendered the estate. This is the actio hypotecaria that we are going to deal with today.

- Last week, we dealt with the simpler scenarios because we dealt with the importance of guarantees and the function of guarantees. Now this week, we are going to start dealing with what happens to competing claims. This is when it gets not slightly more difficult but this is where there is a further degree of elaboration.
- What happens when there are competing claims? And the golden rule here, is that the hypothec whether it is legal, judicial or conventional is not effectual unless it is registered under the public registry and it does not rank except from the date of its registration. The distinction between these kinds of hypothecs will be discussed later on.
  - Order of ranking between hypothecs
  - 2033. (1) A hypothec, whether legal, judicial, or conventional, is not effectual unless it is registered in the Public Registry, and it does not rank except from the date of its registration.
  - “It is essential to distinguish the date of the registration of the hypothec from the date of the contract creating the obligation and constituting the hypothec. It is the former which decides the ranking not the latter.”
  - P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, p. 49.
  - 2094. Privileged or hypothecary debts in the same rank, are paid ratably.
  - “prior in tempore potior in jure”
  - earlier in time, stronger in right
  - "The law favours those who establish their rights earlier rather than later."
- What is the importance of Article 2033? Two important points emerge from Article 2033. First of all, hypothecs are completely ineffectual unless they are registered and more importantly, it is not the date when the credit or the debt was contracted that is relevant but it is the date where the hypothec was registered. This is the importance of 2033, they need to be registered and they rank from the date of registration.
- Article 2094 provides for what we covered in the first lecture. For example, if you have a hypothec which was registered one in the morning and one in the evening on the same day, the creditor will be paid pro rata from the proceeds. The golden

rule is this prior in tempore potior in jure. This means the earlier in time, the stronger the right.



Note for registration of **Hypothec and Privilege** Progressive Number...

Remarks (for office use only):

Creditor : **APS Bank plc**, bearer of company registration number C 2192 and having its registered address at APS Centre, Tower street, Birkirkara, Malta.

Debtor :

Credit : Two hundred and thirty-four thousand Euro (€ 234,000), hereinafter referred to as the "Loan", out of which Loan the Creditor as delegated for this purpose by the Debtor paid the sum of two hundred and nineteen thousand Euro (€ 219,000) directly to the Vendors as part of the purchase price of the property situated at Kappara, Malta, hereunder better described; and as to the remaining balance of the Loan amounting to fifteen thousand Euro (€ 15,000) is intended to finance the kitchen and appliances to be installed at the same property. Parties agreed that the Loan shall bear interest at rates that shall not exceed the maximum rate allowed by law, the said interest to be reckoned on the amount due on the balance of loan by Debtor from time to time in accordance with recognised banking practice. This Loan was made according to other conditions mentioned in the deed in my records of the first (1st) day of March of the year two thousand and twenty-three (2023).

€ 236.25c

Cause of Preference : A General Hypothec for the amount of two hundred and thirty-four thousand Euro (€ 234,000), together with interests and charges due in connection therewith, against the Debtor, over and above a Special Hypothec for the same said amount of two hundred and thirty-four thousand Euro (€ 234,000), together with interests and charges due in connection therewith, and a Special Privilege for the amount of two hundred and nineteen thousand Euro (€ 219,000), together with interests and charges due in connection therewith, on the finished apartment

Kappara, Malta, as subject to thirteen Euro and twenty-one cents (€13.21) as its share from the perpetual and revisable groundrent burdening the whole site, as free and unencumbered, with all its rights and appurtenances, the whole site as better shown marked in red on the site plan attached to the deed, and the apartment as better shown on the floor and elevation plans attached to the deed.

Date :

Director Notary

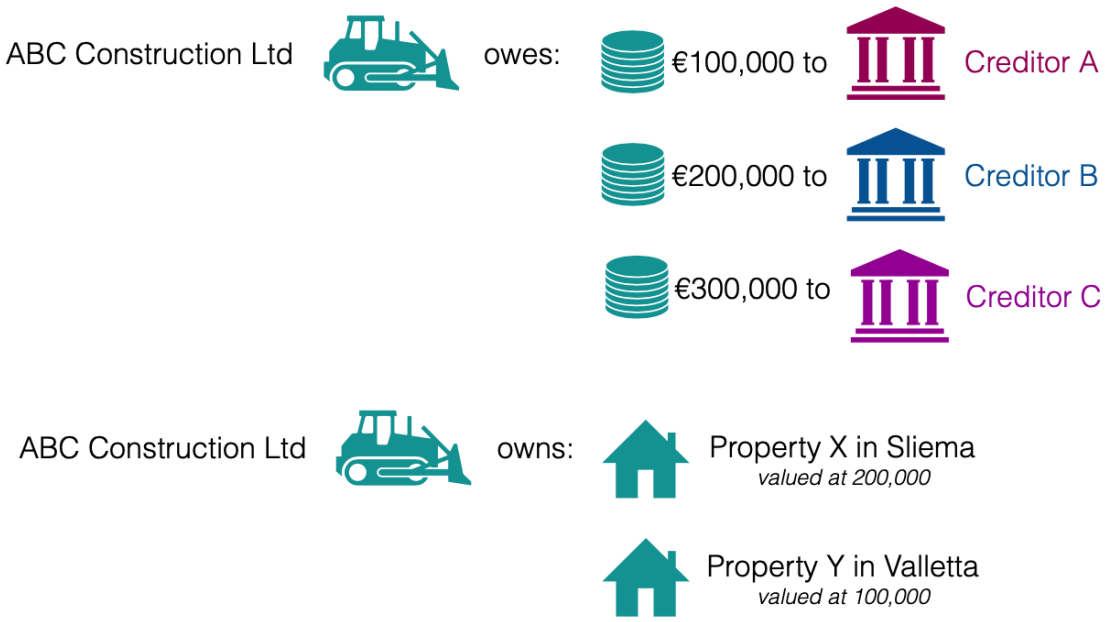
RIĊEVUTA LLUM

15 MAR 2023

- This is the same note we saw during our first lecture. This is a note of an enrolment of a hypothec. This is a practical example of what you find in the public searches. What is the important date here? The 15th March.
  - For example, here we are told that this loan was made according to other conditions mentioned in the deed in my records of the first 1st day of March of the year 2023. What does that mean? This means that the loan was contracted

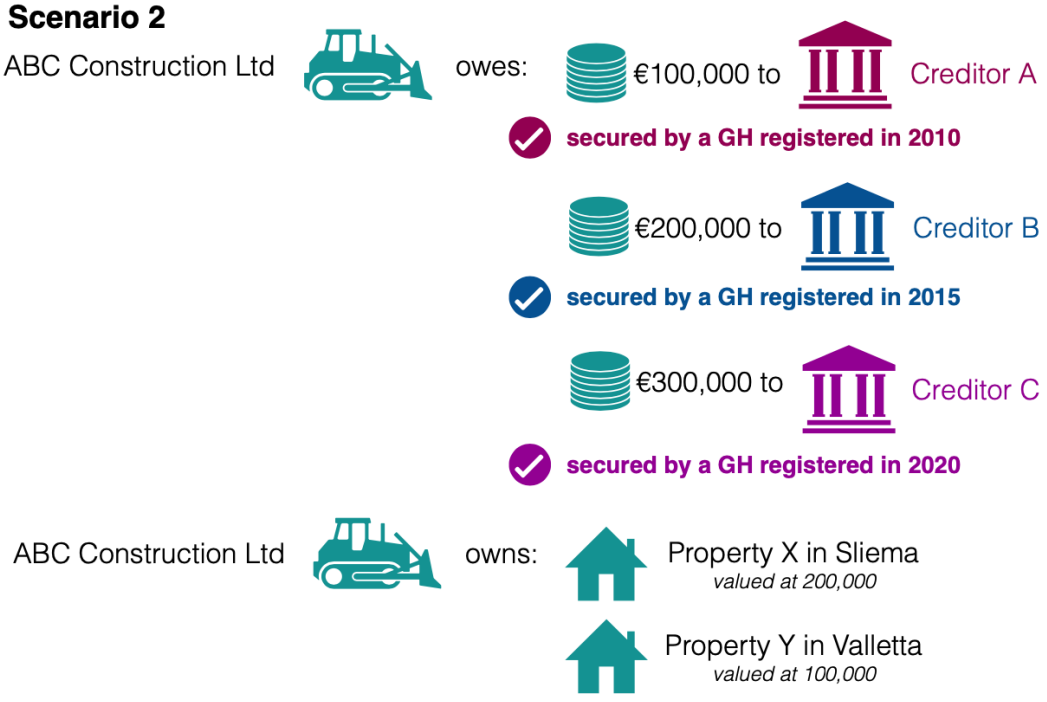
on 1st March 2023. However, the relevant date for us is the date of registration being the 15th of March.

Scenario 1



- This is the first scenario we looked at last week. We have a situation of three creditors who lent money to ABC Construction Ltd and unfortunately for the creditors, we have a situation where the debt owed to 'A', 'B 'and 'C 'is greater than the assets actually owned by ABC Construction Ltd.

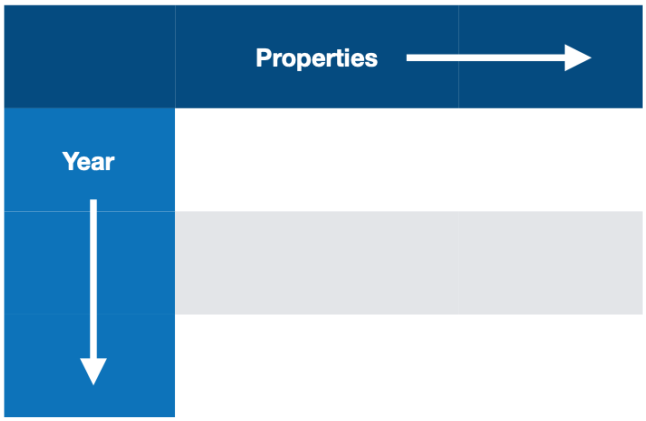
Scenario 2

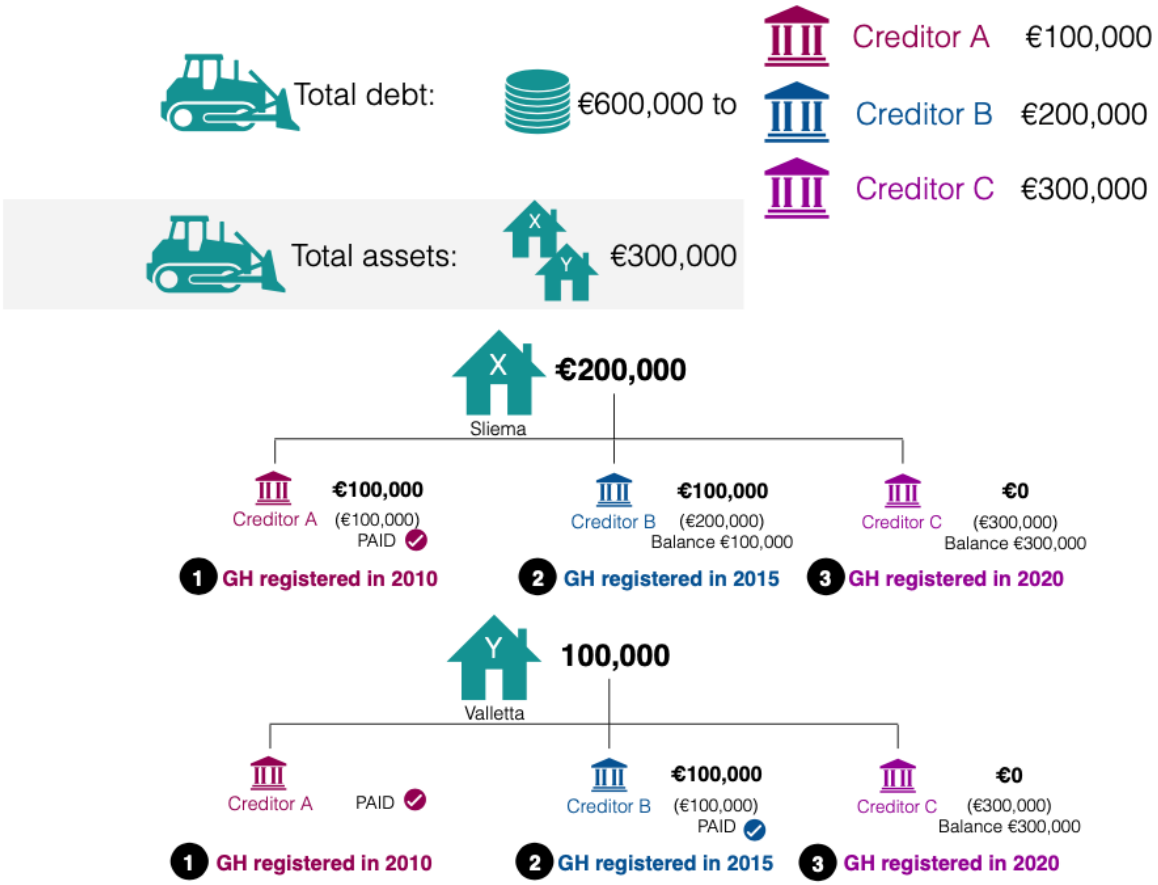


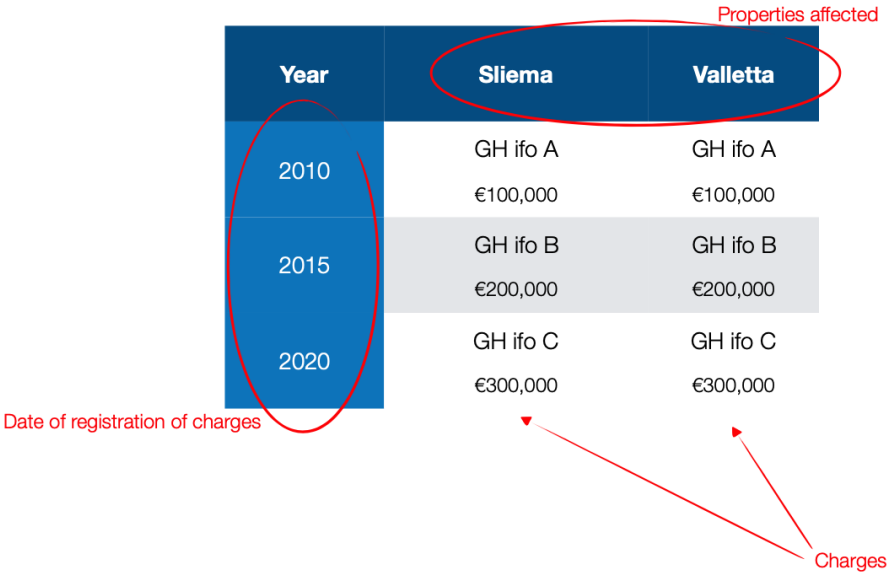
- Let’s build on this scenario. It is the identical scenario which we considered last week. Simply this time, all three creditors have secured their rights through a general hypothec. In this case, creditors ‘A’, ‘B ’and ‘C’, each in different and specific periods of time, constituted a general hypothec in their favour against the property of ABC Construction.

- How does this spell out in practice? What does this mean? There is creditor ‘A ’ who contracted a debt with ABC Construction Ltd in 2010 and as soon as the debt was contracted, creditor ‘A ’constituted a general hypothec. Creditor ‘B ’did the same in 2015, contracted a debt and constituted a hypothec in his favour. Creditor ‘C ’did the same in 2020. So, contracting a debt or rather in this case, contracted a loan in favour of ABC Construction Ltd which then was secured through a general hypothec. In practice, how does this spell out? Who is the privileged creditor whose rights are secured in the most adequate manner? Creditor ‘A ’has the strongest position because as we said before, prior in tempore potior in jure.

- The law favours those who registers their rights earlier than later. In this case, the one to establish rights the earliest was creditor ‘A’. He has a favourable and a strong position. This is a practical application of the rule we saw earlier.







- This gives us the opportunity to start looking into the methodology to determine the ranking of creditors. How do

we make sure that we get this right? By drawing a matrix which is basically a table/scheme. We start by listing down the years (i.e., the dates) which the hypothecs/securities constituted a column and then, we have another role listing the properties. This is crucial for our exam. A methodology which is suggested is the following, you list down the years along the main column and then, along the horizontal role, you list the number of properties. Which are the relevant dates and the relevant properties according to scenario 2?

- Which are the relevant properties? Property ‘X ’in Sliema and Property ‘Y ’in Valletta. The relevant properties are Sliema and Valletta and the relevant dates are 2010, 2015 and 2020. In the light blue column, I have to write the relevant dates. Along the role of properties, I have to list down the properties which are affected by the security. We are talking about Sliema and Valletta which are owned by ABC. Then, I will fill in the table in the following manner. This is so to speak, the easier part however, this is to be done carefully because this is crucial. This is fundamental for the exercise conducted correctly. I have to fill in the table with the securities.

- In the second row, below the title, why did I write GH in favour of A of €100,000? This is an exercise which will help me who ranks first. What happened in 2010? The creditor registered/enrol a general hypothec in his favour which extends over all property. In this case, the GH, present and future. At present, which properties are owned by ABC Ltd? Sliema and Valletta. Assuming the ownership of the properties remain the same throughout, the general hypothec extends over the properties of Sliema and Valletta.

- Say for example, in 2023, ABC Construction Ltd purchased a property in Victoria, Gozo. Would it be effected by the GH? Yes because it is present and future. Would ‘A ’still rank first? It will rank first. Let us assume that in 2023, ABC Ltd buy property in Victoria, Gozo. The general hypothec extends over movable and immovable property in Victoria. It has a registration. One must not look at when the debt was contracted but when the hypothec is registered. It was registered in 2010 and so, creditor ‘A ’would have a privileged claim even over the property in Victoria.

- For here, we are only talking about general hypothecs. Same thing goes for creditors ‘B ’and ‘C’. In this case, what we end up with is ‘A ’having a first ranking over all the property. Creditor ‘B ’has a second ranking whilst creditor ‘C ’has a third ranking. In practice, how does this spell out? And why do we really need the first ranking? In a situation where the assets held by the debtor are scarce, you need to secure your position. In this case for example, we will first proceed to have the property in Sliema sold through a judicial sale/judicial auction. So, ‘A ’ has a privileged claim. Let us assume that the property was sold for €200,000.

So, the first €100,000 go towards creditor ‘A’. In fact, the claim of ‘A ’is extinguished. ‘A ’was paid in full. The remaining €100,000 go into the one who ranks second. In this case, it is creditor ‘B’. Creditor ‘B ’is paid the remaining €100,000 although there is an outstanding balance of €100,000. Creditor ‘C ’ranks third and the funds are not sufficient to satisfy the claims of the creditors therefore, creditor ‘C ’remains unpaid.

- We proceed now to sell the property in Valletta which this time, fetches the amount of €100,000. Why is ‘A ’not entitled to the €100,000? Because he has been paid in full. If the debt is extinguished so does the security. In this case, it is the hypothec because the hypothec is along the debt. If the debt is no longer in existence, no longer does the hypothec. ‘A ’is completely uninterested in the sale property in Valletta. The €100,000 goes towards creditor ‘B ’who in this case was paid in full and nothing goes towards creditor ‘C’. The bottom line is that creditor ‘C ’remains unpaid. You can see the default of Creditor ‘C’. Creditor ‘C ’was negligent in not making sure that his claim would be secured adequately.

- This is why the bank would conduct the searches to make sure that if this were to happen, then the bank would rank first. The bank usually would not agree to give out the loan, unless it would be sure that it ranks first.

  - 2092 . Hypothecary debts are paid according to the order of registration ...

  - It is the registration, not the birth of the right, which gives rank to the mortgage. In practice, it is very rare that creditors who do not occupy the first ranks are paid.

  - The nature of the hypothec i.e. whether legal or conventional, general or special is irrelevant. Only the date of registration determines the ranking.

- Article 2092 is very important. Hypothecary debts regardless whether they are general, special, judicial, legal, conventional, they are paid in accordance to the order of date of registration. So, it is not the birth of the right and it is not when the law was entered into, it is not when the credit was granted, but it is when the hypothec/charge was registered. This is what we have to look at.

  - “The word “special” should not be construed as conveying some special attribute such as for example a priority of ranking over a general hypothec. … “Special” is here synonymous to specific” in the sense that the hypothec covers only the specific property indicated.”

  - “In reality if a general hypothec is registered before a special hypothec, the [special hypothec] will rank second on the relative immovable (since a general

hypothec covers all property and hence also the property covered by the special hypothec).”

- P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, p. 48-49.

- The word special is misleading because it implies that it represents something special when compared to the general hypothec. So when you say which one ranks first; the general hypothec or the special hypothec? You may say that the special hypothec ranks first. Is that reasoning correct? No. The fact that it is a special hypothec, it does not mean that it ranks before general hypothec.

- What does this ‘special ’means? ‘Special ’means that it extends over a specific asset. This means that if you are being misled by the word ‘special ’hypothec, think of it as a specific hypothec rather than a special hypothec. This will certainly eliminate any doubts that you might have. In reality, if a general hypothec is registered before a special hypothec, the special hypothec will rank second on the immovable.

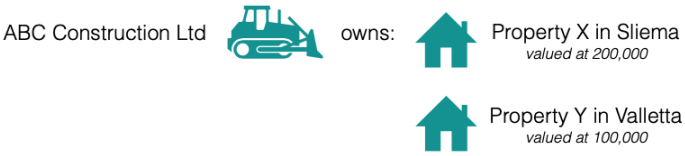
- Farrugia Randon is very useful especially for those who work in the banking sector because it is a book written by a lawyer for bankers. It is the perfect reading for banking law in Malta from a Civil perspective.

  - It is essential to distinguish the date of the registration of the hypothec from the date of the contract creating the obligation and constituting the hypothec. It is the former which decides the ranking not the latter.

  - P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, p. 48-49.

- We have seen this through practical examples particularly, in the actual deed which was shown.

Year	Sliema	Valletta	
2015	GH ifo B €200,000	GH ifo B €200,000	1
2020	GH ifo A €100,000	GH ifo A €100,000	2



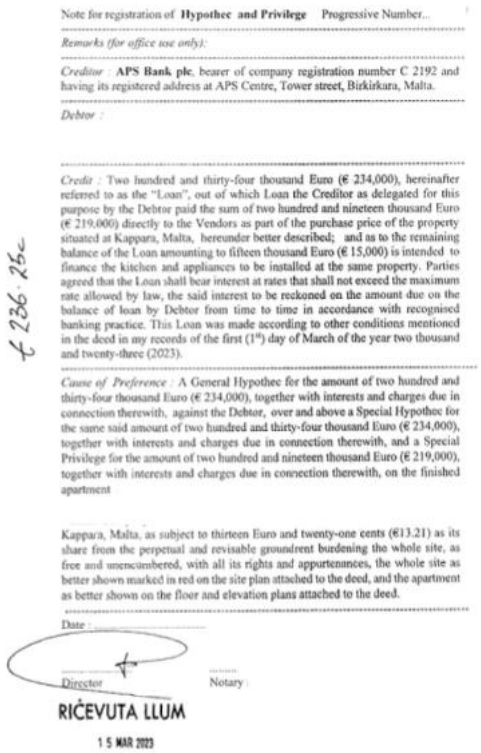
- Just to make sure that we have got the concept absolutely clear. ABC Construction Ltd has two creditors. This case is a different example from the one before. There is creditor ‘A ’and creditor ‘B’. Creditor ‘A ’contracted the debt in 2010 but only proceeded to register the general hypothec which have been constituted in 2010, in 2020. In the meantime in 2015, ABC had also contracted a debt with creditor ‘B ’in 2015 of €200,000 and this time, it was secured by a general hypothec registered in 2015. Who has the strongest right? And why? ‘B ’ has the strongest rights because it is not when the debt was contracted but it is when the property was registered. However, in this case, both will be paid in full because the total debt is parallel to the assets.

- If we were to fill in the matrix, we are not concerned with the fact that the debt was contracted in 2010. We are only concerned with the date of registration. So in this

case, since creditor ‘A ’registered his/her rights in 2020, in our matrix, creditor ‘A ’ could only feature from 2020 onwards.

- “The note contains:
- a. the particulars of the debtor and creditor;
- b. the date;
- c. nature and amount of the debt;
- d. any stipulated interest rate and other special conditions of the debts, and;
- e. the nature of the cause of preference (in cases of a SH a description of the property being secured is given).
- The note is signed by the Notary Public and is then given serial number and an indication the year.
- The note of hypothec is dated. This is very important since the date confers priority over hypothecs registered on subsequent days.”

- This slide shows what is effectively registered. Why should there be a description in a special hypothec and not in a general hypothec? Because it covers a specific property. So, you need to have the details of the specific property.



Page 1 of 1

Note for registration of **Hypothec and Privilege** Progressive Number...

Remarks (for office use only):

Creditor : **APS Bank plc**, bearer of company registration number C 2192 and having its registered address at APS Centre, Tower street, Birkirkara, Malta.

Debtor :

Credit : Two hundred and thirty-four thousand Euro (€ 234,000), hereinafter referred to as the "Loan", out of which Loan the Creditor as delegated for this purpose by the Debtor paid the sum of two hundred and nineteen thousand Euro (€ 219,000) directly to the Vendors as part of the purchase price of the property situated at Kappara, Malta, hereunder better described; and as to the remaining balance of the Loan amounting to fifteen thousand Euro (€ 15,000) is intended to finance the kitchen and appliances to be installed at the same property. Parties agreed that the Loan shall bear interest at rates that shall not exceed the maximum rate allowed by law, the said interest to be reckoned on the amount due on the balance of loan by Debtor from time to time in accordance with recognised banking practice. This Loan was made according to other conditions mentioned in the deed in my records of the first (1st) day of March of the year two thousand and twenty-three (2023).

€ 236.25c

Cause of Preference : A General Hypothec for the amount of two hundred and thirty-four thousand Euro (€ 234,000), together with interests and charges due in connection therewith, against the Debtor, over and above a Special Hypothec for the same said amount of two hundred and thirty-four thousand Euro (€ 234,000), together with interests and charges due in connection therewith, and a Special Privilege for the amount of two hundred and nineteen thousand Euro (€ 219,000), together with interests and charges due in connection therewith, on the finished apartment

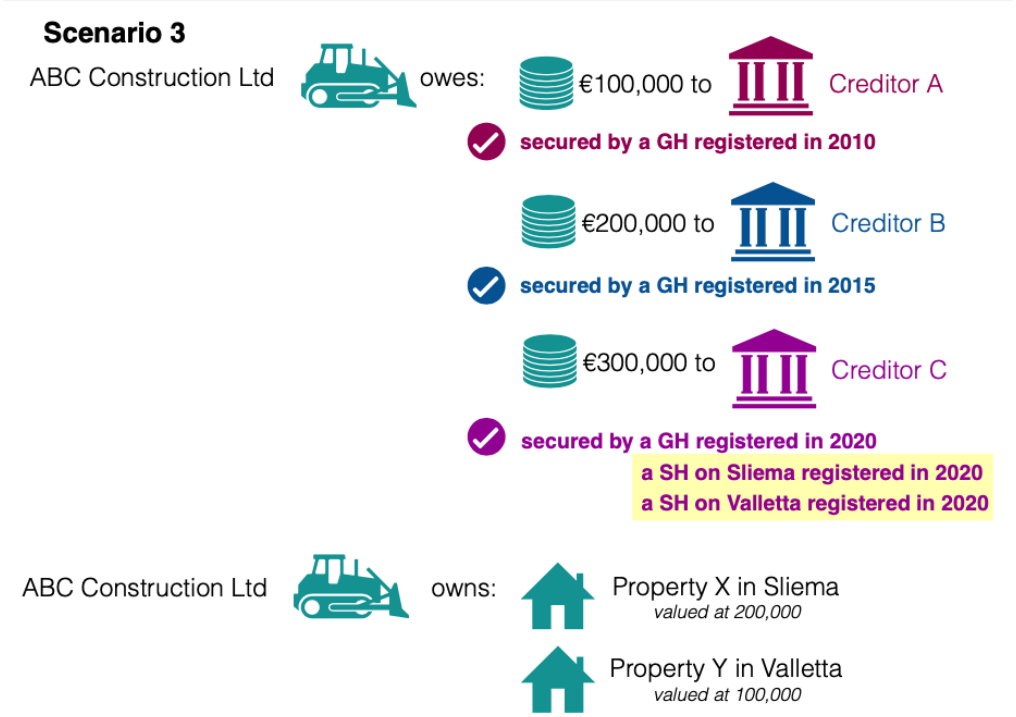
Kappara, Malta, as subject to thirteen Euro and twenty-one cents (€13.21) as its share from the perpetual and revisable groundrent burdening the whole site, as free and unencumbered, with all its rights and appurtenances, the whole site as better shown marked in red on the site plan attached to the deed, and the apartment as better shown on the floor and elevation plans attached to the deed.

Date :

Director *Notary*

RIĊEVUTA LLUM

15 MAR 2023



- This is where special hypothecs come in. Scenario 3 provides a situation where we have three creditors; 'A', 'B 'and 'C'. The example is very similar so, the structure remains linear. This time, the variant is that in 2020, creditor 'C ' constituted and subsequently registered in his or her favour a special hypothec on Sliema and a special hypothec in Valletta.

Year	Sliema	
2010	GH ifo A €100,000	

Complete the matrix.

- Let us work out the matrix which gives us a response to our query. Which are the relevant properties? Sliema and Valletta. In 2010, a general hypothec was registered in favour of 'A'. A general hypothec extends over present and future property and so, I should write the same.

Year	Sliema	Valletta
2010	GH ifo A €100,000	GH ifo A €100,000
2015	GH ifo B €200,000	GH ifo B €200,000
2020	GH ifo C SH ifo C €300,000	GH ifo C SH ifo C €300,000

- The next step is to write the next relevant that being 2015, where there was a general hypothec in favour of 'B 'up to the amount of €200,000. The same thing goes as well under Valletta. In order to complete the exercise, it gets more difficult. How should I fill in the third row? The third relevant date is 2020 and what do I write? We have a general hypothec and in our case, for the amount of €300,000 together with interest and charges over and above a special hypothec for the same amount over the properties in Sliema and Valletta. So what do I write here? GH ifo 'C 'for the amount of €300,000 and SH ifo 'C'. I gave a loan of three thousand euros and so, I want to guarantee those €300,000. The value of the flat is not guaranteed but what is guaranteed is the loan that he give to this client to buy the flat. What should I do under Valletta, we need to write the same thing. Why the SH does not rank first? The special hypothec does not mean privileged. Special means specific. Even when constituting a special hypothec on the property, you need to understand that even though you need to specify the

property, you need to constitute a hypothec. They rank according to the date of their

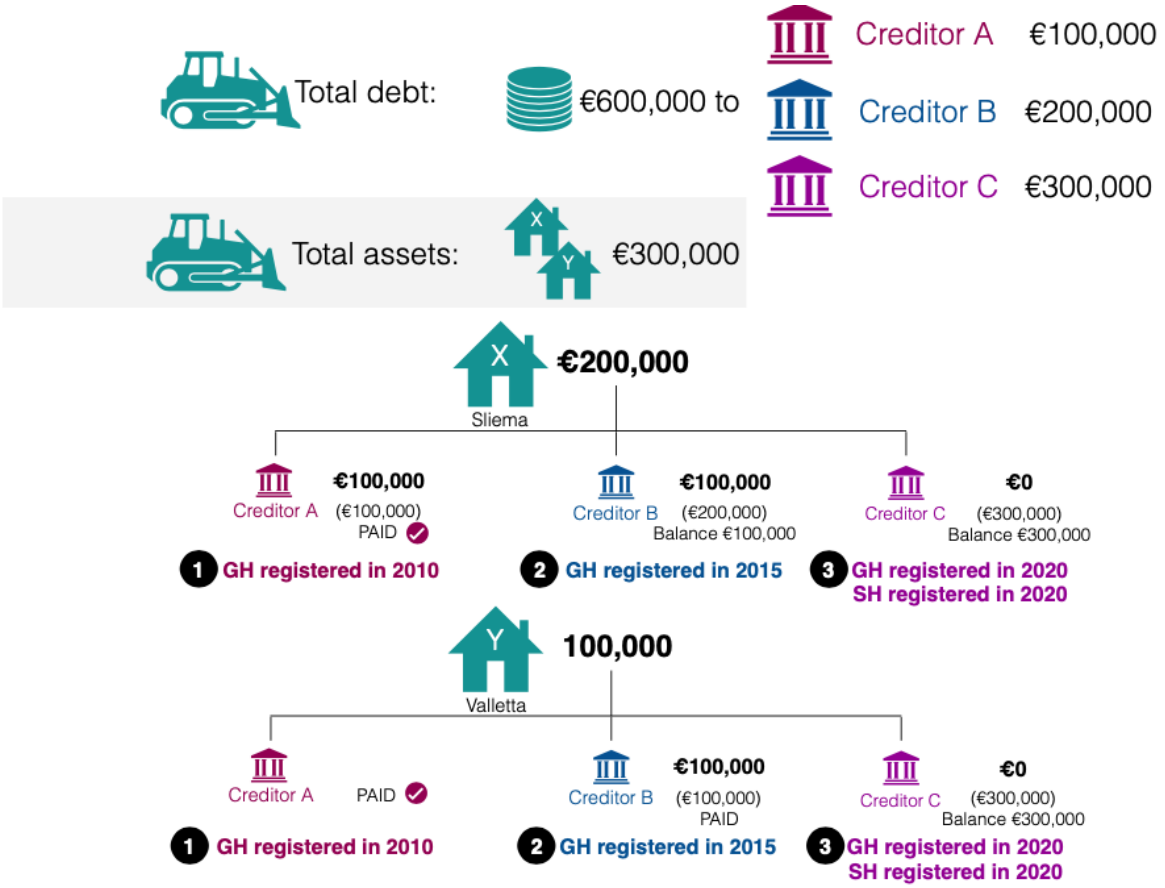
Year	Sliema	Valletta	
2010	GH ifo A €100,000	GH ifo A €100,000	1
2015	GH ifo B €200,000	GH ifo B €200,000	2
2020	GH ifo C SH ifo C €300,000	GH ifo C SH ifo C €300,000	3

registration.

- We have three creditors ‘A’, ‘B ’and ‘C’. They registered their hypothecary rights in 2010, 2015 and 2020. We need to establish their ranking in order to give advice to our creditor. This is what we have to do in the exam or we have to give an advice to the debtor on which creditor can take such property. The variant here is that on top of a GH, creditor ‘C ’secured his/her rights through an SH on Sliema and Valletta. So, the difficulty/novelty here is that one of the creditors decided to secure his right through a both general and a special hypothec.
- So, first we have to convert/transpose this into our matrix and then, determine the ranking in order to give advice to our client. In 2020, a GH which extends automatically to all the property by the debtor on top of that, a special hypothec

which extends specifically over Sliema and Valletta over the amount of a contracted debt of €300,000. What happens here is identical to what happened before which is practically that Creditor ‘C ’remaining unpaid. Why?

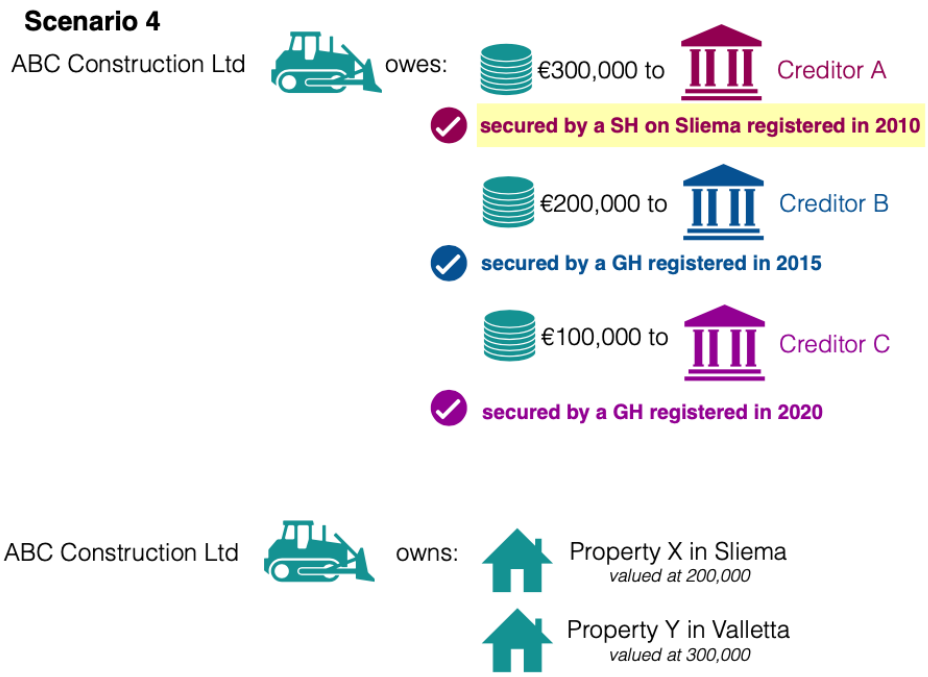
- The fact that ‘C ’registered a special hypothec does not change anything in terms of his ranking with respect to the other creditors. Why? Because his rights although specific, they were still registered after ‘A ’and ‘B’, meaning that effectively, creditor ‘C ’still ranks third.



- A summary of what we went over – Creditor ‘C ’secured his rights by a special hypothec, enjoys ranking on immovable securities.

  - [The creditor secured by a special hypothec] enjoys ranking only on the immovable secured by the special hypothec.”

  - P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, pp. 49-50.



- This is scenario 4. It provides very similar facts. This time, Creditor ‘A ’secures the debt of €300,000 through a special hypothec on Sliema. No GH in 2010. Creditor ‘B ’and ‘C ’this time, register a general hypothec; creditor ‘B ’in 2015 and creditor ‘C ’in 2020. ABC Construction Ltd still owns property ‘X ’in Sliema and property ‘Y ’in Valletta.

- How do I complete the matrix?

Year	Sliema	
2010	SH ifo A €300,000	

Complete the matrix.

- I have the year and the property. The years are 2010, 2015 and 2020. The properties are Sliema and Valletta.

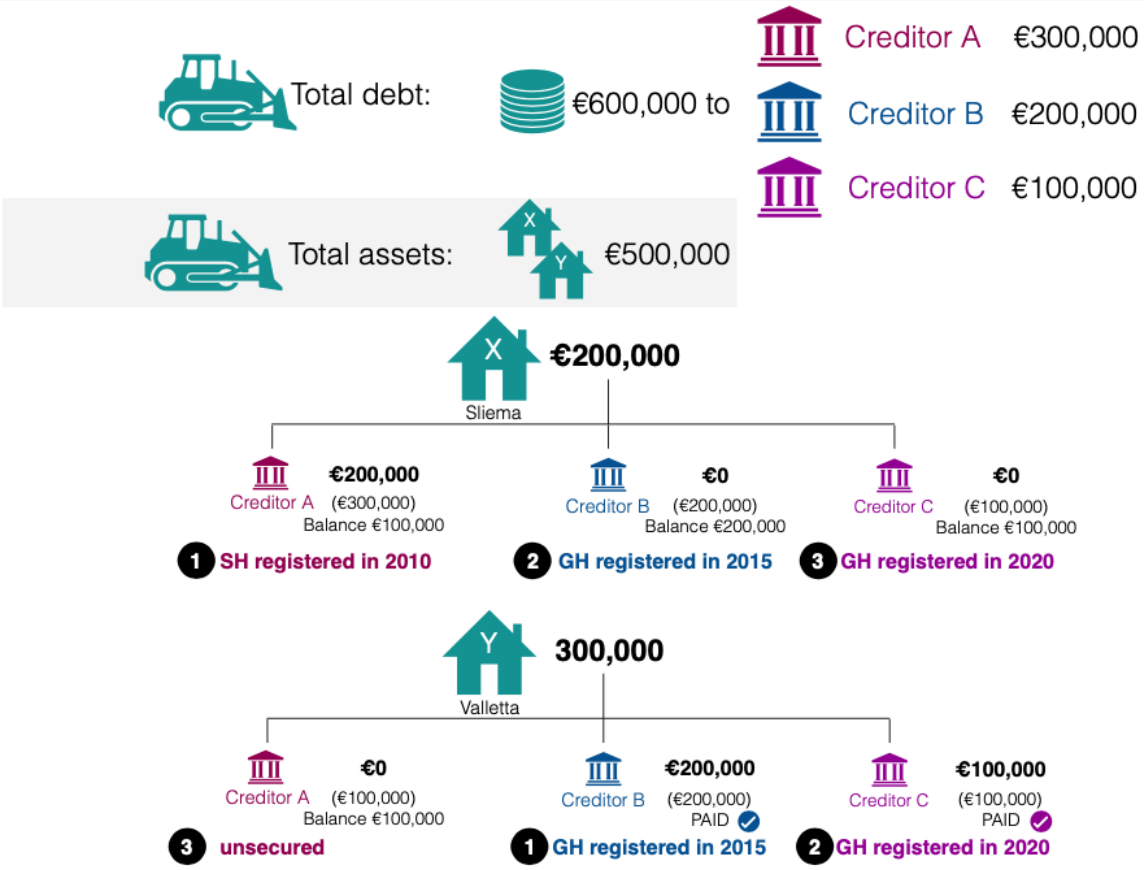
Year	Sliema	Valletta
2010	SH ifo A €300,000	
2015	GH ifo B €200,000	GH ifo B €200,000
2020	GH ifo C €100,000	GH ifo C €100,000

- Here, we have a special hypothec on Sliema. So, this is the disadvantage of a special hypothec. The advantage is the droit de suite which we will look into more detail in some moments. The disadvantage is that it is specific and so this is why, an SH is taken on top of a GH. In fact, what happens here is that with respect to Valletta, Creditor

‘A ’has no ranking. Then, creditor ‘B ’has a general hypothec and creditor ‘C ’also has a general hypothec.

Year	Sliema	Valletta
2010	SH ifo A €300,000 ❶	
2015	GH ifo B €200,000 ❷	GH ifo B €200,000 ❶
2020	GH ifo C €100,000 ❸	GH ifo C €100,000 ❷

- So, what happens here in terms of ranking? The ranking is as shown above. This is a scenario which contained a variant that this time creditor ‘A ’secured his/her rights through a GH secured also to an SH. So, creditor ‘A ’is still given priority because he was the first one to register. He is given priority not because it is a special hypothec but he is given priority because he was the first one to register. But what is the downside of a special hypothec? It is specific to only one property.



- Take the example of a judicial sale. When it comes to the property in Sliema, creditor ‘A ’has a first ranking. So, he pockets the €200,000 which are needed from the judicial sale. Creditor ‘B ’and ‘C ’get nothing because A’s claims are not satisfied or fulfilled.
- When it comes to Valletta, Creditor ‘A ’remains unsecured. When it comes to Valletta, first ranking is creditor ‘B’, second ranking is creditor ‘C ’who somehow get to satisfy their claims. The variant here which also included the difference in the loans granted to the creditors is that creditor ‘A ’remains the one out of the three with an outstanding balance, still to be fulfilled. It is unlikely to be fulfilled. But technically, it is still possible.
- A special hypothec extends only on the immovable specified in the hypothecary agreement and the note of enrolment.
    - 3. A special hypothec is a right de suite

- The droit de suite is ancillary to the right of preference; this allows the hypothecary creditor's preferential right to follow the property, even if it is transferred to third parties.

- special vs general

- 2013. (1) A special hypothec continues to attach to any immovables charged therewith as defined in article 2012(1)(a) and movables charged therewith under sub-article (1)(b) of the said article into whosoever's possession such immovable or movable may pass.

- (2) A general hypothec attaches to the property affected thereby only so long as such property does not pass into the hands of a third party.

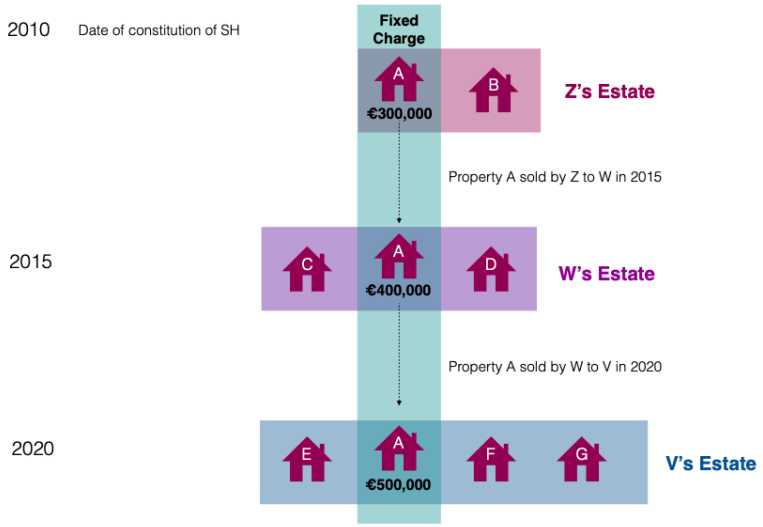
- 2086. As to property which is in the possession of a third party, prescription takes place in favour of such third party by the lapse of ten years from the day on which he acquired such property, even though the creditor may not have known that such property had passed into the hands of a third party.

- What is the droit de suite? It is an ancillary to the right of preference. It allows the hypothecary creditor's preferential right to follow the property. The right follows the property. So regardless of how many times the owner changes as the case is prescribed, until then, the hypothecary rights remain intact. This difference is explained in Article 2013.

- A special hypothec continues to attach to immovables charged therewith into whose such possession such immovable or movable may pass. The keywords here are 'into whoever's possession such immovable or movable may pass'. A general hypothec attaches to the property effected thereby only so long as such property does not pass into the hands of a third party. This is what we covered in the beginning lecture. The moment the property escapes the estate of the debtor then, the creditor has no claim over it.

- In a special hypothec, the rights attached to the property regardless of how many times it changes the ownership. Article 2086 which must be read in conjunction with the above. We will come to it later. It deals with prescription. This you covered under acquisitive prescription when doing law of property. This is the ten year prescription. If the property is transferred and even if with a special hypothec, the creditor does not take action within ten years from the transfer, the right is lost because the property would have been acquired free of any charges through an acquisitive prescription.

- XY constituted a Fixed Charge (SH) over Z's Estate (droit de suite)



- This is the example we did earlier. We are talking about a fixed charge. In practice, we are saying that in 2010, XY constituted a special hypothec over property 'A'. Let us assume that XY granted the money to 'Z 'so, that 'Z 'can buy property A. In 2010, the estate of 'Z 'was composed of property A and property B. In 2015, 'Z 'without the knowledge of XY transferred property A to 'W'. In 2020, 'W ' transferred the property to 'V'. In the meantime, 'Z 'still owes around €200,000 to XY. What happens there? XY has a specific claim over 'A'. But does he have a right of action against 'V'? Yes. This is because what the droit de suite applies.
  - "droit de suite"
  - The cause of preference enjoyed by a creditor remains unaffected by any alienation of the property subject to his rights. If the third party in possession of the said property pleads his right of ownership, the creditor, in proceedings for the realisation of the value of the property, may reply: "I am not exercising my right against you but over the property subject to my security, which is in your possession"

- V. Caruana Galizia, Notes on Civil Law, The University of Malta: Laws IV Year, 1981 (Reprinted), p. 815

- The “droit de suite” is dependent on the registration of the privilege of hypothec in the Public Registry.

- By virtue of this right the creditor is entitled to what is known as the “actio hypothecaria”, whereby the immovable property charged with a privilege or a hypothec is sold under the authority of the Court into whosoever’s hands such property may pass and, therefore, including third parties in possession.

- V. Caruana Galizia, Notes on Civil Law, The University of Malta: Laws IV Year, 1981 (Reprinted), p. 859

• Read the Caruana Galizia notes. This is the same material we covered with Dr Galea.

- 3. A special hypothec is a right de suite

- Effect against Third Parties

- Rights of creditors against third parties in possession.

- 2069. Creditors who have a privilege or hypothec which has been registered retain over the immovables or movables subject to the privilege or hypothec their right to be ranked and paid according to the order of the debts due to them or the registration thereof, into whosesoever hands such immovables or movables may pass.

- Other liabilities of third party in possession.

- 2071. The third party in possession is bound, … to surrender, without any reservation, the immovable or movable charged with the hypothec, unless he elects to pay all the hypothecary debts, as each of them falls due, whatever their amount may be.

- When benefit of discussion may not be set up.

- 2074. The benefit of discussion may not be set up against a creditor having a privilege or special hypothec over the immovable or movable.

• If we are dealing with the droit de suite, we come to the third fundamental element of hypothecs being the effect against third parties. With regards to Article 2071,

take the case of ‘V’. If he is challenged by XY, s/he has to surrender the property with a reservation.

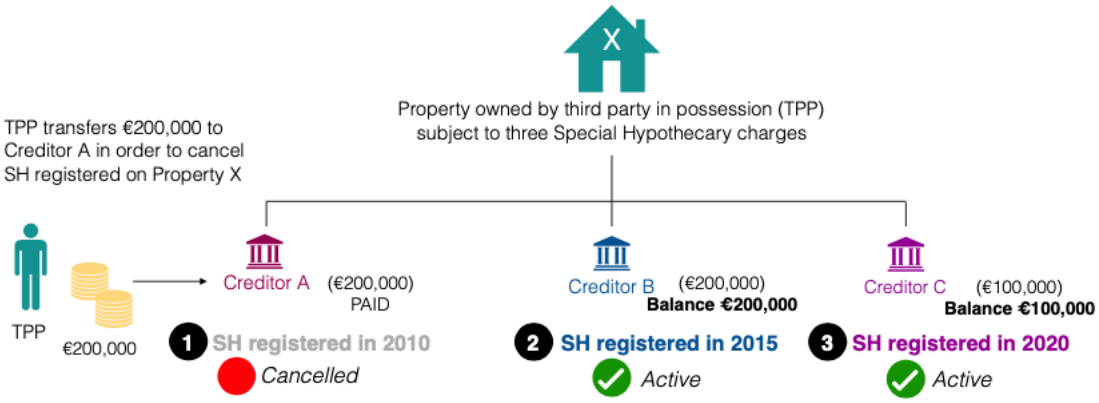
- Another alternative is to pay the debt owed to XY in subrogation of the debt of XY. This practically means that I pay the debt of someone else but then, that someone else owes that debt to me.
  - Third party in possession
  - A third party in possession is the owner of an immovable or part thereof subject to a privilege or a hypothec who is not personally liable for the debt secured thereby.
  - There exists, therefore, no relationship between the creditor and the third party in possession.
- What is also important besides surrendering the debt? Can the third party in possession say that the claim is against the debtor? And therefore, one should attack the property of the debtor first and then attack my property. Can the third party in possession break that defence? He cannot. Let us say that the debtor owns numerous assets around Malta, he cannot place the benefit of discussion.
- The above slide also mentions the definition of a third party in possession. A third party in possession is basically the person possessing the immovable who is not however, personally liable for the debts secured thereby. The owner of the property and the debtor are not the same person. This is why he becomes a third party in possession.
  - The third party’s obligation is to surrender the immovable under the authority of the Court in order that the creditor may cause it to be sold and obtain payment from the proceeds of such sale.
  - Upon the surrender of the immovable, his liability ceases.
  - The creditor, however, cannot claim payment from the third party in possession who may elect to do so instead of surrendering the tenement. The obligation of the third party in possession is, therefore, optional: uni res in obligatione (the surrender of the immovable), altera in facultate solutionis (the payment of the debt).
  - The position of the third party in possession is the same in respect of all the creditors i.e. he will have to pay all the hypothecary debts, as each of them falls due, if he wants to keep the immovable.

- Here, you have two options, the third party in possession may surrender the immovable. The moment the third party in possession surrenders the immovable, it is likely to cease vis-a-vis the creditor. So, the creditor cannot keep on chasing the third party in possession beyond the surrender of the asset. Of course then, the third party in possession would have a remedy against the debtor. This is a separate issue which you have probably dealt with under the law of sale last year. The other alternative is that if he does not want to surrender his rights, the alternative is to satisfy the debts.

  - The existence of several creditors having. Privilege or a hypothec over immovable property owned by a third party in possession does not affect the position of the latter: his position is the same as the debtor's vis-a-vis all and each of them.

  - In case of multiple hypothecs, payment made to one of the creditors does not release the third party in possession to the others and he will, therefore, have to pay all the hypothecate debts, as each of them falls due if he wants to keep the immovable.

  - V. Caruana Galizia, Notes on Civil Law, The University of Malta: Laws IV Year,



  1981 (Reprinted), p. 860

- It implies that let us say that there are three special hypothecs registered on property X. First one registered in favour of creditor 'A', second in favour of creditor 'B 'and thirdly, in favour of creditor 'C'. The third party in possession decides to pay creditor 'A'. Therefore, there is the cancellation of the special hypothec registered in favour of 'A'.

- Does it mean that now creditors ‘B ’and ‘C ’have nothing to do with property X? No. The implication is that in order to have his property to become un-accessible, the third party in possession must pay all the creditors. This is unlikely.
- What happens here is that this person being the third party in possession finds himself owning/possessing a property which is however, charged/burdened by a special hypothec in favour of creditors ‘A’, ‘B ’and ‘C’. We said that the option is either to surrender the property or to pay the debt.
- So, he decides to pay creditor ‘A’. Does this mean that his liabilities end there? No. Even though he obtained the cancellation of the special hypothec, creditor ‘B ’still has a valid claim over the property. In order to free the property of all the burdens, he has to pay all the creditors. He can negotiate something with creditors ‘B ’and ‘C ’and it gets really complex. But in this case, the easiest option is to surrender the property and if it is worthwhile, challenge then the seller.
    - Surrender is that act whereby the third party in possession gives up the possession of the immovable, under the authority of the Court, in order that the creditor may cause it to be sold judicially and obtain payment from the proceeds of such sale.
    - Upon the surrender of the immovable his liability ceases.
    - Other liabilities of third party in possession.
    - 2071. The third party in possession is bound, … to surrender, without any reservation, the immovable or movable charged with the hypothec, unless he elects to pay all the hypothecary debts, as each of them falls due, whatever their amount may be.
    - If the third party in possession fails to surrender the immovable, or the pay the debt, it is lawful for the creditor to demand judicially the sale of the immovable: this judicial demand is termed “actio hypothecaria”.
    - Actio hypothecaria
    - Creditors may demand sale of immovable or movable charged with hypothec.
    - 2072. (1) If the third party in possession fails to surrender the immovable or movable or to pay the debt fallen due, it shall be lawful for the hypothecary creditor to demand judicially the sale of the immovable or movable charged with the hypothec after having by means of a protest called upon the debtor to discharge the debt, and upon the third party in possession either to discharge the debt or to surrender the immovable or movable.

- (2) The said demand may not be made before the expiration of thirty days from the service of the protest on the debtor and the third party in possession.

- “The immovable property charged with a privilege or a hypothetic is sold under the authority of the Court into whosoever hands such property may pass and, therefore, including third parties in possession.

- Under our law the ... the “actio hypothecaria” is not necessary if the property is still in the debtor’s possession, against whom is available the personal action. The “actio hypothecaria” becomes necessary when the immovable charged with a privilege or a hypothec has been transferred or when the creditor wishes to obtain full payment of debt from one of the heirs of the debtor.”

- V. Caruana Galizia, Notes on Civil Law, The University of Malta: Laws IV Year, 1981 (Reprinted), p. 861

• This is the law which we has just described. Now, we come to the actio hypotecaria. What is the actio hypotecaria? If the third party fails to surrender immovable or pay the debt, then it is lawful for the creditor to demand judicially the sale of the immovable.

• So, what would the creditor do? The creditor would make a specific demand before the First Hall of the Civil Court demanding that, the property held in third party in possession is sold by a judicial auction. This is the actio hypotecaria. It is described under Article 2072.

- The General Soft Drinks Company Limited v. Joseph Pace et, FHCC, 30 June 2015, Rik. Gur. 1081/2006

- Illi l-azzjoni mibdija minn GSD taf l-għejjun tagħha fid-Dritt Ruman, iżda mal medda taż-żmien, l-istess actio hypothecaria twessgħulha l-għan u l-firxa tagħha b’mod li serviet biex tilħaq l-għan li tagħti rimedju lil kull kreditur ipotekarju dwar ġid tad-debitur. L-istess azzjoni li jipprovdi dwarha l-Kodiċi Ċivili tagħna, iżda, tingħata biss fil-każ fejn il-ġid tad- debitur ikun għadda jew waqa ’ f’idejn terza persuna: b’dan il-mod, it-terza persuna ma ssirx id-debitriċi tal-kreditur, imma jkollha titlaq minn idejha l-ġid fuq talba tal-kreditur ipotekarju, jew inkella jagħżel li jħallas il- kreditu direttament. ...

- Illi min-naħa l-oħra, minħabba li l-azzjoni ipotekarja tista ’ssir biss meta l-ġid ikun għadda f’idejn terz, kien hemm dejjem il-fehma li din l-azzjoni hija marbuta ma ’sura ta ’rabta ipotekarja jew privileġġ li jkun igawdi d-droit de suite. Kemm hu hekk, kien meqjus li l-qofol kollu tal-jedd tal- kreditur biex jista ’jinqeda bl-azzjoni ipotekarja sperimentali kien dan l-effett tad-droit de

suite, u li din is-sura ta ’saħħa ipotekarja kienet saħansitra element essenzjali u kostitutiv tal-jedd għall-imsemmija azzjoni.

- Does the action hypotecaria applies to any case where the is a hypothecary involved? Or when you need to enforce a hypothec? No. Jurisprudence tells us that the actio hypotecaria is used only when there is a third party in possession.

  - John Giordmaina et v. Amabile Aquilina et, FHCC, 31 October 2019, Rik. Gur. 510/2010

  - Peress li kemm Aquilina kif ukoll Zammit baqgħu inadempjenti, l-atturi istitwixxew din il-proċedura ta ’actio hypothecaria.

  - ... Jirrizulta sodisfaċentement li l-atturi għandhom a favur tagħhom ipoteka speċjali fuq il-garaxx numru internament immarkat 19 fi Triq il-Vitorja Ħal Qormi, liema garaxx illum il-ġurnata jinsab fil-pussess tal-konjuġi Zammit wara li xtrawh. Minħabba li l-atturi qua kredituri kienu rreġistraw ipoteka speċjali fuq il-ġid tad-debitur Aquilina, il-benefiċċju ta ’dik l- ipoteka jibqa ’miżmum minkejja t-trasferiment tal-ġid ipotekat lil ħaddieħor. Dan għaliex l-ipoteka speċjali hija dotata minn droit de suite/diritto di seguito li allura jsegwi lill-proprjetà hekk ipotekata sakemm ma tkunx ġiet liberata b’xi mezz kontemplat mil-liġi. Jirriżulta sodisfaċenteent li l-konjuġi Zammit huma t-terzi pussessuri tal-immobbli ipotekat favur l-atturi. Min-naħa l-oħra l-kreditur ipotekarju għandu kull dritt li jeżerċita l-azzjoni ipotekarja, mezz li toffri l- liġi sabiex jitħallas dak li hu dovut, kontra t-terz pussessur mingħajr ma qabel jeżerċita d-drittijiet fuq beni tad-debitur.

  - In oltre l-azzjoni ipotekarja hija azzjoni mibdija permezz ta ’rikors ġuramentat u maħsuba biex ir-rikorrent jiġi dikjarat kreditur ipotekarju bid-dritt fuq l-immobbli u jiġi awtorizzat mill-Qorti sabiex jibda l-proċedura tas-subbasta. Għaldaqstant l-actio ipotecaria tippreċedi l-bejgħ bl-irkant u mhijiex minnha nfisha l-proċedura tas-subbasta.

  - Skont l-Artikolu 2071 tal-Kodiċi Ċivili it-terz pussessur għandu żewġ għażliet :-

  - i. Iħallas id-dejn ipotekarju; u fin-nuqqas

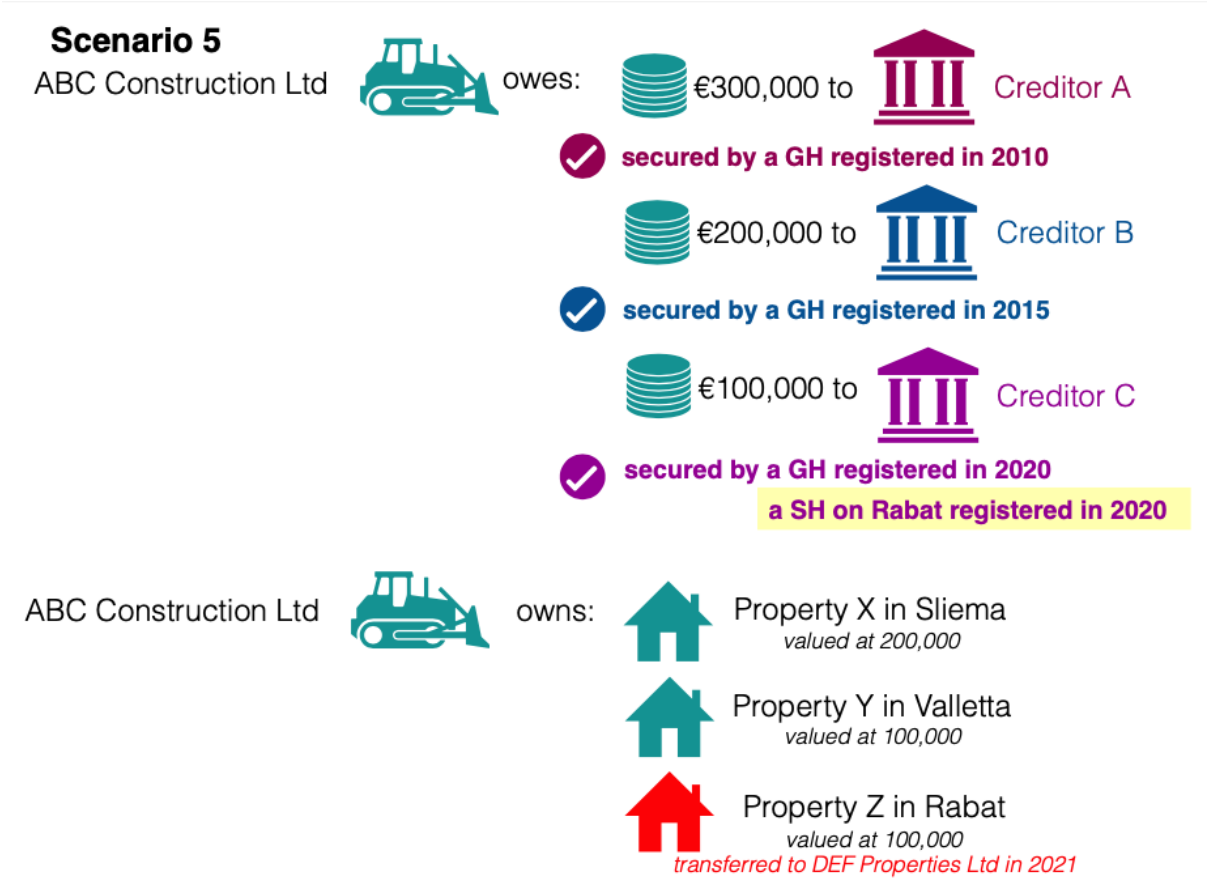
  - ii. Jirrilaxxa l-fond milqut mill-garanzija mingħajr ebda kondizzjoni.

  - B’dan ifisser għalhekk li l-obbligu tal-konvenuti Żammit bħala t-terzi pussessuri hu li jħallsu lill-kredituri, l-atturi fil-kawża odjerna, l-ammont dovut mid-debitur, il-konvenuti Aquilina. Fin-nuqqas il-konvenuti għandhom l-obbligu li jirrilaxxaw il-proprjetà ipotekata li tinsab fil-pussess tagħhom. Jekk it-terz possessur jibqa’ inadempjenti il-kreditur għandu d-dritt jipproċedi b’azzjoni ipotekarja sabiex

jikseb il-permess tal-Qorti sabiex issir il-bejgħ tal-fond milqut bl-ipoteka speċjali bis-saħħa tal-proċedura tas-subbasta. Dan hu dak li qed jitolbu l-atturi fil-kawża odjerna.

- Stabbilit illi l-garaxx li l-konvenuti Zammit xtraw minghand Aquilina huwa kolpit b'ipoteka speċjali favur l-atturi, isegwi illi l-eċċezzjoni tal-konvenuti Zammit li m'għandhomx relazzjoni ġuridika mal-atturi ma hiex fondata u qed tigi respinta. Il-Qorti ma tistax tillibera lill-konvenuti Zammit mill- osservanza tal-ġudizzju ġaladarba huma t-terzi pussessuri tal-garaxx kolpit bl-ipoteka speċjali de quo.

- This is another important case. The demand is intended to solicit an order from the Court to which the property could then be sold by a judicial sale. There is a decision which you can read through.



- Scenario 5 shows the application of the droit de suite. It provides similar facts and similar dynamics. So, the facts remain standard roughly throughout the cases.

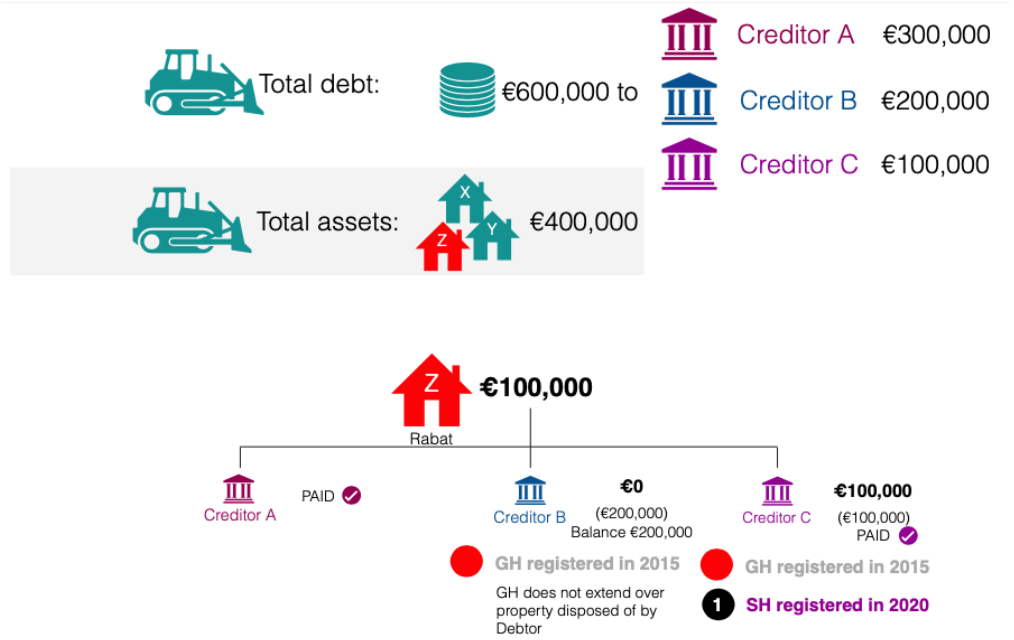
Creditor ‘A ’owed €300,000, creditor ‘B€ ’200,000 and creditor ‘C€ ’100,000. The difference here, is that creditor ‘C ’also registered an SH on the property in Rabat.

- What happens here? What is the variant? The variant here is that creditor ‘C ’ constituted and subsequently registered an SH on Rabat. Assume the property in Rabat remains within the patrimony/estate of the ABC Construction Ltd. Would that special hypothec have changed anything? No. Why? Because ‘A ’and ‘B ’ have a general hypothec. The variant is that in 2021, ABC transferred property Z in Rabat. What does this change in practice? The variant is that ‘A ’and ‘B ’are covered by the GH’s in an ordinary scenario where the property in Rabat remains in the patrimony of ABC Construction Ltd. ‘A ’and ‘B ’would have a privileged claim.

- So, until 2021, there is no doubt that ‘A ’and ‘B ’will have ranked first. In 2021, ABC transferred the property in Rabat to DEF Properties. Does this change anything in respect to ‘A ’and ‘B’? Yes. The difference is that the property transferred from one patrimony to another. The only creditor who had a SH on Rabat was ‘C’. ‘A ’and ‘B ’lost all the rights they had because a characteristic of a general hypothec is that it continues only on the present and future patrimony. The SH is different. When ABC sold their property to DEF. I can attack DEF.

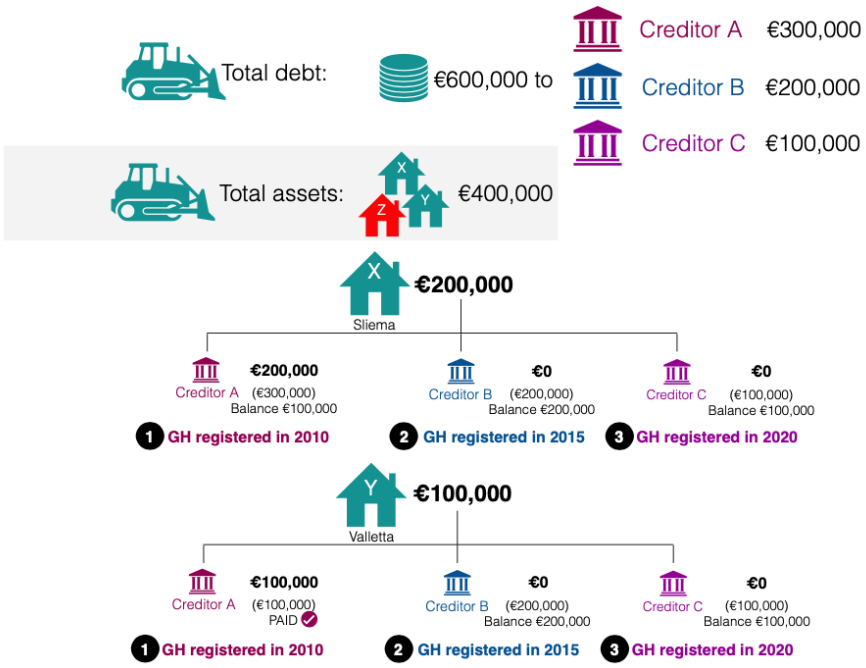
Year	Sliema	Valletta	Rabat SOLD to DEF Properties
2010	GH ifo A €300,000	GH ifo A €300,000	GH ifo A €300,000
2015	GH ifo B €200,000	GH ifo B €200,000	GH ifo B €200,000
2020	GH ifo C €100,000	GH ifo C €100,000	GH ifo C SH ifo C €100,000

- The three relevant years remain 2010, 2015 and 2020. The properties are Sliema, Valletta and Rabat. I fill in the GH’s and the SH's. Only creditor ‘C ’has an SH. What happens? In the question, there might probably be a note saying that in 2021, ABC Company Ltd transferred the property to DEF Properties Limited. You



need to remove/cut all the GH's. Therefore, the matrix still looks like the one before with the only difference that when you have a note in question saying that the property was transferred, at that point, I need to remove/cut all of them. The GH's left from the patrimony of ABC Company Ltd. Should the SH's be removed?

No.



- With respect to Sliema and Valletta, you have a situation where ‘A ’ranks first, ‘B ’ ranks second and ‘C ’ranks third. But when it comes to property Z, the claim of ‘A ’is fulfilled. The competition here is between ‘B ’and ‘C’. ‘B ’no longer has any assets to attack because the properties have been sold. The only properties which remain in the estate of ABC Construction Ltd are property X in Sliema and property Y in Valletta. Those were sold. Therefore, there is nothing else left to fulfil B’s claims. But there is still property Z. Who can challenge property Z? Only creditor ‘C ’can because it is only creditor ‘C ’who has a special hypothec. Property Z is sold because the third party in possession surrendered the property. As soon as the property was surrendered, it is sold judicially. The proceeds go towards creditor ‘C ’who gets paid in full and fulfil all his claims. So in this case, the only creditor who remains unpaid with an outstanding balance is creditor ‘B’.
- Keep in mind that any hypothec constituted in favour of other parties, can be challenged by these parties. So if I do anything to diminish my securities against a particular creditor, the creditor can of course challenge me. This is clearly seen in actio pauliana.
    - 4. A hypothec is indivisible
    - 2011. (2) Hypothec is of its nature indivisible, and it exists in its entirety over all the things so charged, over each of such things and over every portion thereof.
    - The immovable is bound, in all its entirety and in each of its parts, to the entire payment and to every fraction of the debt.
    - The immovable is bound, in all its entirety and in each of its parts, to the entire payment and to every fraction of the debt.
    - If various immovables are hypothecated for the same debt, each answers for the entire debt
    - If the immovable is partitioned amongst various owners, or even if part of the immovable is sold or transferred, by whichever title, to a third party, each part of the property answers for the entire debt
    - (Creditor may demand from each owner of any fraction of the property that which he might have demanded from the owner of the entire immovable)

- 4. A hypothec is indivisible
- 2011. (2) Hypothec is of its nature indivisible, and it exists in its entirety over all the things so charged, over each of such things and over every portion thereof.
- If the debtor passes away and his property passes on to his heirs, the division of the debt among these heirs, will not impede the creditor from enforcing his claim for the entire debt on that specific property (saving heir's right of redress against other co-heirs).
- The partial extinction of the secured credit does not have the effect of freeing up a corresponding portion of the hypothecated property.
- The hypothec acts as security for all the consequences that arise from the obligation, including interests, judicial costs and the costs of preservation of the hypothec.
- Privileges and hypothesis are indivisible because their function is to secure the whole debt and every part thereof and, consequently, each of the things charged and every part thereof must be liable for the entire debt.
- It is to be noted, however, that this character of indivisibility is to communicated to the principal obligation, which remains divisible whenever it is so: if, therefore, a debt is contracted by several persons, each of them is only liable personally for his share of the debt, but is liable indivisibly for the entire debt "ex hypotheca", in respect of the property charged therewith.
- 5. A hypothec constitutes an accessory right
- A hypothec is necessarily connected to a credit:
- it cannot be created or transmitted in isolation or
- independently from any form of credit (accessorium sequitur principale)
- A consequence is that a hypothec may only follow a valid obligation. The annulment or the rescission of the obligation would produce the extinguishment of the hypothec.
- 2084. Privileges and hypothecs are extinguished - (a) by the extinguishment of the principal obligation;
- ...

- 5. A hypothec constitutes an accessory right
- Exception in the case of novation:
- 1185. Any privilege or hypothec securing the former debt shall not extend to the substituted debt unless the creditor has made an express reservation to that effect.
- The creditor may assign his credit, and with it the hypothec deriving from it.
- Kinds of hypothec
- 2012. (2) A hypothec is legal, judicial or conventional: it is legal if it arises by operation of law; it is judicial if it originates from a judgment; it is conventional if it is established by contract.
- A Legal Hypothec is created by law in favour of specified persons in specified circumstances, e.g:
- 2019. (1) A minor has a general legal hypothec over the property of the parent to whose authority he is subject in respect of the liability contracted by such parent in the administration of the property of the minor.
- (2) Such hypothec arises from the day on which the administration of such property vests in the parent.
- (3) Where a parent contracts another marriage, the said hypothec extends over the property of the step-parent as from the day of the marriage, if the parent continues in the administration without the authority required by law.
- A Judicial Hypothec arises from a judgment. In this case a creditor who obtains a judgment in his favour may request that the crystallised credit be registered in the Public Registry and secured by means of a hypothec.
- “These originate from a judgment or from an award of arbitrators. Again it must be stressed that though these hypotheses arise from a judgment they still have to be registered and shall rank according to the date of registration.
- Thus a creditor who sues his debtor in Court and obtains a favourable judgment may request that this judgment in his favour be secured by a hypothec registered in the Public Registry.

- The judgment need not be final and conclusive i.e. may still be subject to appeal - provided the debtor may subsequently demand a reduction or cancellation of this hypothec.

- The unfortunate element in this type or hypothec is that there is a strong element of luck since one creditor may obtain a quicker judgment than another who had sued the same debtor at an earlier date, and hence register his hypothec earlier than the other editor thus ranking prior to him."

- P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, pp. 56.

3rd May 2023

Lecture 3.

- L-idea tal-llum hi li we manage to cover privileges by the end of the lecture we'll be in the in a very good place to finish the series of lectures this week, we just have some minor points to conclude in respect to hypothecs, then we are to cover privileges so next lecture we would have to do reductions, postponements, waivers and cover last year's past paper. Regarding the past paper, in order to answer it properly we still need the material from our next lecture. We will cover it next week during our lecture.

- Last week we concentrated mostly on special hypothecs, and the distinction between general and special hypothecs including the distinctive feature of a special hypothec which is of the droit de suite and how it operates when it comes to third parties in possession.

  - Inadequately secured debt

  - 2016. (1) The creditor of a debt secured by a general hypothec and whose rights are not otherwise already adequately secured, shall have, and may cause to be registered, as a further security of the same debt, a special hypothec over such of the immovable and movable property of the debtor which are of a kind referred to in article 2012 and which are of a value sufficient to secure the debt as provided in article 2063.

  - The debt must have been secured by a general hypothec (not available to creditors whose credit not secured by a hypothec or is only secured by a special hypothec). The main reason for the additional special hypothec is to grant hypothecary creditors a droit de suite over the debtor's property.

- A fresh public deed need not be signed for the constitution of the special hypothec, therefore, the debtor's consent is not needed, saving his right to reduce the hypothec.

- The additional special hypothec shall rank from the date of its registration (not from the date of the registration of the original general hypothec).

- P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, pp. 51-53.

- Conversion of general hypothec into special hypothec so what is one of the main advantages of general hypothec?

- The only point left to cover with respect to general hypothecs and special hypothecs, it is an important one which was recently reduced. It is that of a conversion of a general hypothec to a special hypothec.

- What is one of the main advantage of a special hypothec? It covers the entire property and if all the property is alienated/transferred, the guarantee is worthless.

- There is a special circumstance where the creditor sees that all of a sudden the assets are disappearing and not necessarily in a fraudulent manner. But where the creditor sees that the assets are diminishing, it might become convenient there to reduce so to speak, with inverted comas the general hypothec to a special hypothec, why?

- So that the property/guarantee can have the very important droit de suite, and this is catered for under article 2016 so the creditor of a debt secured by a general hypothec and whose rights are not otherwise already adequately secured, shall have, and may cause to be registered, as a further security of the same debt, a special hypothec over such of the immovable and movable property of the debtor which are of a kind referred to in article 2012 and which are of a value sufficient to secure the debt as provided in article 2063.

- So, as established also by Farrugia Randon, there are instances where all of a sudden a creditor finds himself in a situation where the general hypothec is clearly not going to suffice, so there, he would feel the need to reduce this general hypothec to a special hypothec so at least the guarantee can be tied to one particular immoveable.

- What's important is when issuing a special hypothec it shall rank from date of registration.

- Lay Lay Company Limited v. Nicholas Falzon noe, FHCC, 6 December 2011, Cit. 773/2005

- [Azzjoni] ghall-kancellament ta ’ipoteka specjali ezistenti favur tliet socjetajiet konvenuti minn erbgha u cioe` favur Alsan Enterprises Company Limited, B.D. Limited u Modern Design Properties Limited.

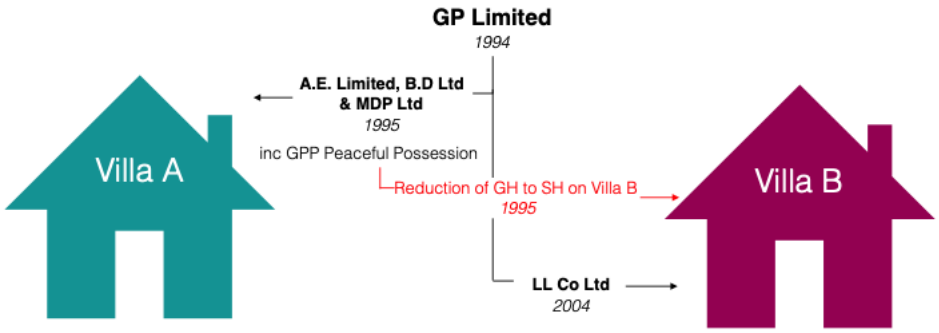
- ... Is-socjeta` attrici qieghda titlob li din il-Qorti tiddikjara li l-skop originali tal ipoteka specjali numru 16927 tal-1995 (Dok. “B” a fol. 10) a favur tat-tliet socjetajiet imsemmija gie ezawrit.

- 1. 29 March 1994 Transfer of Villa A and Villa B to GP Ltd

- 2. 26 August 1995 Transfer of Villa A from GP Ltd to A.E. Limited, B.D Ltd & MDP Ltd A.E Ltd et discover defects in title of Villa A while GP Ltd runs into financial difficulties. The only property owned by GP Ltd is Villa B.

- 3. 30 October 1995 Reduction of GH to SH on Villa B by A.E. Limited, B.D Ltd & MDP Ltd “...in warranty of the peaceful possession and true enjoyment of the immovable property .... as per deed in the records of Notary John Hayman of the twenty-sixth day of August of the year one thousand nine hundred and ninety-five (26.8.1995).”

- 4. 17 June 2004 Transfer of Villa B to LL Co Ltd



- A case where article 2016 became quite urgent was that of Lay Lay Company Limited v. Nicholas Falzon.

- Until 1994, Villa ‘A’ and Villa ‘B’ were the property of B.D Limited. In 1995, G) Limited transferred the property to A.E Limited, Alsan Enterprises Company

Limited. So what's relevant to us, in 1995 it transferred Villa 'A' to a particular company.

- X'gara, what happened? This is a practice which happens here in Malta, we have covered under the law of sale last year the warranty for peaceful repossession. Upon a sale, what usually happens is that the buyer constitutes in his favour a general hypothecated over the property of the seller in order to safeguard the warranty of peaceful possession. Upon the sale in 1995, there was the transfer and simultaneously there was the constitution of the general hypothec in favour of A.E Limited against GP Limited.

- A few months after the transfer, A.E Limited discovered defects in title of Villa 'A', so they discovered defects in title. There was a situation where A.E Limited would need to claim all or part of the money back from G.P Limited. But A.E Limited also noticed that GP Limited was running into financial difficulties. The only property that was still owned by GP Limited at the time was Villa 'B'.

- So what did A.E Limited do? It decided to reduce the general hypothec which it has in its favour (warranty of peaceful possession) to a special hypothec covering specifically Villa 'B' which was the only asset held by GP. so a s we can see this is how it presumes to put effect.

- You had a general hypothec, you were seeing that the company was running into international difficulties so whilst they were still in time they decided to reduce the general hypothec to a special hypothec.

- In 2004 Lay-Lay, LL Co Limited they acquired the company from GP Limited. They acquired Villa 'B' from GP Limited, does the transfer from GP Limited to Lay-Lay Company Limited effect the guarantee? No, why not? Because its a special hypothec so effectively we're seeing how effectively we're seeing how this instrument was used wisely by A.E company Limited. What happened was that L.L Company Limited decided to challenge the reduction.

- So the company decided to challenge what A.E Limited had done in 1995 which was that of reducing a general hypothec to a special hypothec but the court found that there was nothing undue which was carried out by A.E Limited, so it could find nothing that could be classified as abusive or illegal because in a matter of fact there was a transfer/contestation/case/suit going on regarding the title of Villa A.

- The court itself underlined that;

  - "L-artikolu 2064 tal-Kodici Civili jipprovdi li "It-thassir ta 'l-iskrizzjoni jista 'wkoll jigi ordnat b'sentenza jekk ma jigix ippruvat illi l-iskrizzjoni giet maghmula ghal

raguni legittima, jew jekk jigi ppruvat illi l- jedd tal-kreditur spicca.”, u dan huwa oneru tas-socjeta ’attrici li tipprova f’dan il-kaz.

- ... il-partijiet jaqblu u ma hemmx dubju li din saret in garanzija ghal pacifiku pussess ai termini tal-artikolu 1408 tal-Kodici Civili.

- Din il-Qorti thoss li ma tistax taqbel ma ’dawn is-sottomissjonijiet ghaliex fl ewwel lok, jirrizulta li ghalkemm il-prassi hija li l-pacifiku pussess jigi garantit b’ipoteka generali, fil-kaz odjern is-socjetajiet konvenuti hassew in-necessita` li jiggarantixxu d-drittijiet taghhom xorta ohra, u ghalhekk ezercitaw il-fakolta’ ghar-riduzzjoni li tippermettilhom il-ligi. Ghaldaqstant ma jistax jinghad li l-ezercizzju ta ’dan id-dritt huwa xi wiehed li jista ’jigi klassifikat bhala abbuziv u illegali u fic-cirkostanzi tal-kaz jidher li kif gja inghad iktar il-fuq hemm kontestazzjoni fuq l-art akkwistata mill-partijiet rispettivi.

- ... jirrizulta mill-atti ta ’din il-kawza illi GP Limited ma kellhiex bi propjeta ’taghha ghajr il-propjeta ’immobiljari mibjugha lis-socjetajiet konvenuti u dik mibjugha lis-socjeta’ attrici, oltre l-fatt li din is-socjeta ’kienet ser tigi kkancellata minn fuq ir-registru tal-kumpaniji, u ghalhekk l-effett ta ’l-ipoteka generali espressament pattwita u garantita ma kien ikollha l-ebda effett li kieku s-socjetajiet konvenuti ma rriducewx l-istess ipoteka generali ghal wahda specjali.

- “u ghalhekk l-effett ta ’l-ipoteka generali espressament pattwita u garantita ma kien ikollha l-ebda effett li kieku s-socjetajiet konvenuti ma rriducewx l-istess ipoteka generali ghal wahda specjali”.

- So not only did the court find nothing fraudulent going on, it even went on to state that no, this was specifically the purpose of deduction, why the court would allow such a conversion/reduction from a general to a special hypothec.

  - Kinds of hypothec

  - (2) A hypothec is legal, judicial or conventional: it is legal if it arises by operation of law; it is judicial if it originates from a judgment; it is conventional if it is established by contract.

  - When legal hypothec is granted.

  - 2017. A legal hypothec is granted only in the cases hereinafter specified. …

  - Judicial hypothec

  - 2023. Judicial hypothec originates from -

- (a) judgments given by any of the courts of Malta in favour of the parties obtaining such judgments;

- (b) awards of arbitrators, an executive title and decisions given by courts outside Malta, in favour of the parties obtaining such awards or decisions, provided the execution thereof has been ordered by a judgment of the competent court in Malta.

- Who can contract conventional hypothec

- 2024. (1) A conventional hypothec can only be contracted by persons who are capable of alienating the property which they charge with such hypothec.

- We don't have much time to go over this but it's important because one particular kind of hypothec may come out in the exam and it has certainly come out in previous questions.

- Kinds of hypothec, we're concentrating on a conventional hypothec, the one agreed between the parties. But there's also the legal and judicial which seem to come up less frequently in our discussion. Why? It's partly also because they are less frequent but they exist nonetheless.

- A legal hypothec is granted only in the cases hereinafter specified, in fact there is only a list of instances where a legal hypothec will come up.

- One of the typical cases is when you have minors, that in favour of minors. Minors would have a general legal hypothec over the property of the parent to whose authority is his subject.

- This you come across it more frequently when

  - For example a minor inherits property let's say the father deceases/he dies prematurely, and he inherits, the father dies intestate so he inherits quite an important segment of his father inheritance directly. There we heave problem because we have a minor inheriting a property, whose going to administer this property? In that case there's a court procedure to which usually the surviving mother would enter into the administration of the property which the minor would have inherited from his father. Premature death, assets of the father are inherited by the son who is a minor, the minor of course cannot administer the property. So what happens in that case through a procedure in the court of voluntary jurisdiction the mother comes in control in the administration of the property held now by the son because the property would have been transferred to the son by way of succession.

- In this case, part of this procedure is for the mother who is going to administer the assets to constitute against her and in favour of her son a general legal hypothec over all the property, this is making sure that the mother doesn't mis-administer the property of her son. This is one of the cases where the legal hypothec comes in.
- That's an example of a legal hypothec. What is also important is a judicial hypothec.
- A judicial hypothec originates from judgments given by any of the courts of Malta in favour of the parties obtaining such judgments. As well as awards of arbitrators.
- Why is this important? It's important because say for example you've won a case and a claim has been awarded to you and you need to safeguard and guarantee your rights, there you can go and register a legal hypothec against the property of your debtor and all you need is a court judgement. Once again it shall rank from date of registration.
- Something which is underlined by Farrugia Randon is that this is unfair because you might have a case which is decided in two years and a case which is decided in ten years and then the creditor who loses the case which is decided in two years can register the hypothec before the one whose case takes ten years to be decided.
- The points are this fact that let's say the principles of the system of judicial hypothecs. That's in order to make sure that you're also aware of judicial hypothecs which only arise from judgements or arbitration claims.

  - 2. Privileges

- Let's go on to privileges which should be now fairly more straightforward to understand than hypothecs because effectively what we're talking about are privileged legal hypothecs, so hypothecs which arise from the law but they are privileged as the word applies they apply on top.

  - Privileges v. Hypothecs

  - 1999. Privilege is a right of preference which the nature of a debt confers upon a creditor over the other creditors, including hypothecary creditors.

  - The privilege is a preference granted to a debt due its his particular quality. There is no conventional privilege that a debtor may freely confer onto his creditor, such as in the case of hypothecs.

- Privileges relate to the nature of the debt that they secure and not to the person of the creditor.
- L. Page, Privilèges: Etude théorétique et pratique, Paris,1960, 76
- Privileges v. Hypothecs
- Similarities
- Grants priority over other creditors
- Is an accessory right
- Is a droit de suite (similar to SH)
- Needs to be registered
- Differences
- Does not depend on the will of the parties; it arises from the law (similar only to legal hypothec)
- The order of registration does not influence its ranking of privileges (privileges rank according to their nature - ex causa hypothecs rank according to their date of registration - ex tempore

- Privileges vs Hypothecs, so let's start from the easiest one. We're talking about apples and oranges, why would we speak about apples and oranges? What's common with apples and oranges? They're fruit, they're both guarantees.
- What are the similarities? That they grant priority over other creditors. They are accessory rights, in that it must be necessarily tied to a credit, there is a droit de suite similar to a special hypothec but also to the general hypothec, so there is a droit de suite and they need to be registered. Those are the similarities
- But then there are differences, what are the differences? It does not depend on the will of the parties, it arises from the law. So you can't have contrary to hypothecs, you can't have a judicial privilege and you can't have a conventional privilege. Privileges arise only from the law, so similar in this respect only to legal hypothecs. Also very important, another important difference, the order of registration does not influence its ranking of privileges. So in the case of privileges it is not in the order of registration but under the nature of the tenure
- Privileges rank according to their nature, so ex-causa, hypothecs rank according to the date of registration.

- 1999. Privilege is a right of preference which the nature of a debt confers upon a creditor over the other creditors, including hypothecary creditors

- A privilege is another right of preference. However, a privilege ranks always prior to a hypothec even if the latter is registered at an earlier date.

- A privilege exists only in the cases stipulated by law and hence, in this sense, a privilege is always legal. The law has selected certain circumstances which it considered expedient and necessary to encourage. This it has done by granting a privilege to the relative creditor in these circumstances and hence conferring to him a ranking prior to all hypothecary creditors."

- P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, pp. 49-50.

- Let's go to the definition of a privilege, a privilege is a right of preference which the nature of a debt confers upon a creditor over the other creditors, including hypothecary creditors.
- So, priority in ranking is being given due to the nature of the debt. Issa, of course it also supersedes hypothecs. So if you have a hypothec registered in 2000 and a privilege registered in 2020. The privilege, it ranks even above the hypothecs

  - Privileges constitute privileged hypothecs; legal hypothecs reinforced by a privilege.

  - Baudry-Lacantinerie et Loynes, t. III no 1932; Planiol et Ripert, t. XII, no. 621; Ripert et Boulanger, t. II nos 3265 & 4063

- A way of looking at them is of treating them as privileged hypothecs, we were talking about the same instrument but this time it is a privilege, legal hypothecs reinforced in a privilege.

  - Kinds of Privileges

  - General Privileges

  - judicial costs

  - funeral expenses

  - death-bed expenses

  - wages of servants

- supplies of provisions
- Special Privileges
- Movables
- debt due to the pledgee
- debt due to a hotel-keeper
- debt due for carriage of goods
- debt due in respect of the price of a thing
- debt due to dominus for ground rent over fruits
- Immovables
- dominus over ground-rent
- architects, contractors, masons (person who supplied money)
- vendor or alienor for the price (person who supplied money

- We have two kinds of privileges, general privileges and special privileges and the ones we are mostly interested in (the ones we will concentrate during this series of lectures), is the special privileges over immoveables, in particular special privileges which can be claimed invoked by architect, contractors, masons or the persons who supply the money for the works and the vendor or the alienor for the price (person whose selling the property, the vender) or the person who supplied the money for the sale.
  - A typical example is a bank who provided the money for the sale of a property.
  - Special privilege over immoveables ; droit de suit
- The droit de suite, we've explained it already, special privileges over immoveables shall continue to attach to such immoveables or moveables whatever transfer takes place, this is why privileges are important and why one should registered them whilst in time as there are also specific time frames which apply because there is a droit de suite which otherwise would be lost
  - Special privileges over immovables: droit de suite
  - 2002. (1) Special privileges over movables, except those specified under sub-article (2), and general privileges as referred to in article 2003, cease to exist if

the property passes into the hands of a third party. (2) Special privileges over immovables and those movables which the Minister shall, from time to time, establish shall continue to attach to such immovables or movables whatever transfers to other persons take place.

- General privileges do not continue to attach to the property subject thereto even in respect of immovables. The debts secured by a general privilege are relatively small amounts, and the law could not, therefore, attribute a “droit de suite” to the creditor thereof; a right which obstructs the circulation of property.

- The droit de suite is dependent on the registration of the privilege or hypothec in the Public Registry; and in respect of privileges over immovables, the registration must have been effected within two months, after which time, although the legal hypothec attached thereto holds good, the privilege ceases to be effectual.

- V. Caruana Galizia, Notes on Civil Law, The University of Malta, p. 859

- Special Privileges on Immovables in favour of i) architects, contractors, masons, workers and ii) vendors

- The architects, contractors, masons and other workers employed in the “construction, reconstruction or repair” of an immovable also augment the value of the property and enrich the debtor hence, his creditors. Vendors increase the value of a debtor’s estate. It would be unfair if other creditors could benefit from the sale of the immovable without paying the price that would be due

- F. Laurent, L. Siville, Principi di Diritto Civile, Milano, 1897:XXX

- Let’s start dealing with the first one in favour of architects, contractors, masons, workers and then separately we are going to deal with special privileges on immoveables which are available for vendors or other people who would have supplied the money.

- Why are architects, contractors, masons, workers granted a special privilege? As they are augmenting the value of a property. So it would be unfair if you can sell a property for €500,000, if on that property that you’re selling for €500,000 which is going to another creditor, you still owe me €300,000 of debt for the works I’ve carried out. So, on particular property wherein either the workers or the venders would not have been paid the law grants them a special privilege because the reasoning is this, if you have yourself contributed to augment the estate of the debtor then obviously there cannot be other debtors/creditors who are paid in preference limitedly to that particular moveable.

- Special Privileges on Immovables in favour of
- i) architects, contractors, masons, workers and
- 2010. (b) architects, contractors, masons and other workmen, over the immovable constructed, reconstructed or repaired, for debts due to them in respect of the expenses and the price of their work.
- The same privilege is competent to the person who has, by means of a public deed, supplied money or materials for the construction, reconstruction or repair of the immovable, or for the payment of the workmen employed on such work, provided it is shown by the said deed that the supply was made for that purpose, and it is proved that the work was carried out or the payments to the workmen made, with the materials or out of the money supplied

- Lets look at the architects, architects, contractors, masons and other workmen.
- For debts due to them in respect of expenses and the price of their work, the price on their work on that particular moveable. If you pay them in respect of three of them or four of them and there is only one immoveable where you have to pay the special privilege applies to that one particular immovable.
- The same privilege is competent with person who by means of a public deed supplied money or materials (more commonly the bank) on the condition that it is shown by the said deed that the supply was made for that purpose, and it is proved that the work was carried out or the payments to the workmen made, with the materials or out of the money supplied. This is an important condition for the banker. Why is it important? Because all these requisites must be adhered to for the privilege to be regular.
  - “This is an important section of the law for the lending banker. It is essential that any loans for construction or reconstruction, etc. be made by a public deed - otherwise the privilege will not arise. Also important is the fact that the said deed itself must show that the supply is being made for such purpose. Thus the banker must ensure that the purpose of the loan is specified in the public deed. Finally it must be proved that the payments to the workers is made with the money supplied. Hence the practice of the banks to pay direct to the contractor, etc after having sight of invoice or bills or other documents which are kept by the bank as proof of the payment for that specific purpose.
  - The law is very demanding but with good reason. Indeed privileges have a high ranking and hence the law wants to ensure that fraudulent simulation to obtain prior ranking is not resorted to.”

- P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, pp. 60

- This is what Dr. Xerri just said, it's explained much more articulately in here, by Farrugia Randon

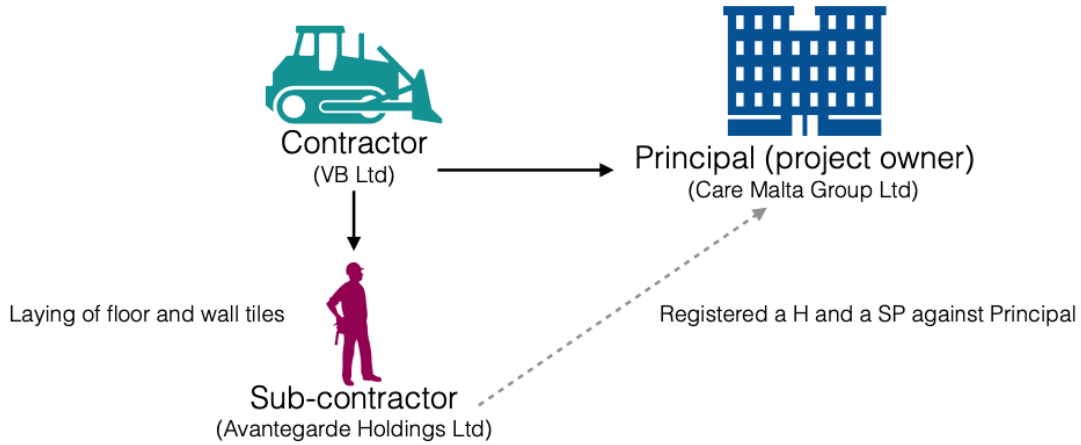
  - The same privilege is also competent to a third party in possession, over the immovable of which he has been dispossessed, for the repairs and improvements made in or on such immovable.

- This is only with respect of repairs and improvements.

  - Care Malta Group Limited v. Avantgarde Holdings Limited, Court of Appeal, 29 November 2013, App. Civ. 912/2008/1

  - Li gara kien li s-socjeta` attrici inkarigat lis-socjeta` VB Ltd biex taghmel xi xoghol fuq bini proprjeta` taghha. Is-socjeta` VB Ltd, in ezekuzzjoni ta 'dan l-appalt moghti lilha, tat sub-appalt lis-socjeta` konvenuta biex tipprovdi sanitary ware and fittings, kif ukoll biex tipprovdi u tqieghed madum tal-art u tal-hitan fl-istess fond. Is-socjeta` konvenuta tallega illi ghas-servizzi taghha ghad fadal bilanc x'jithallas u pprocediet biex tirregistra ipoteka u privilegg kontra ssocjeta` attrici u s-socjeta` VB Ltd.

  - Is-socjeta` attrici tissottometti illi hi ma ghandha ebda relazzjoni kuntrattwali mas-socjeta` konvenuta u hi ma hijiex debitrici ta 'din is-socjeta`, u allura qed titlob it-thassir tal-privilegg u ipoteka rregistrati fuq proprjeta` taghha.



- Caselaw, this is an interesting case, so a case you can see how it works in practice and grasp the concept a bit better, so the works were commissioned by the project owner which was Care Malta Group, Care Malta Group engaged

contractor VB Limited to carry out some works. Contractor VB Limited in turn sub-contracted the job of floor and wall tiles to a subcontractor, (Avantegarde Holdings). Avantegarde Holdings wasn't paid for the works it carried out. What do Avantegarde Holdings do?

- It decided to register a privilege for the amount for which it wasn't paid against Care Malta Group. Reasoning on the basis of equity would this make sense to you or not? So principle engaged contractor, contractor engaged subcontractor, subcontractor wasn't paid, so subcontractor is now registering a privilege, hypothec and a special privilege against the principal.

  - 1643. Il-bennejja, il-mastrudaxxi, u arti ġjani o ħra mqabbdin fit-tlug ħ ta 'bini jew xog ħol ie ħor mog ħti b'appalt, m'g ħandhomx azzjoni kontra dak li g ħalih sar ix-xogħol, ħlief sas-somma biss li huwa jkollu jag ħti lill-appaltatur fi ż-żmien li huma jmexxu l-azzjoni tag ħhom

  - 1143. Kull kreditur jista 'biex jit ħallas ta 'dak li jkollu jie ħu, je żer ċita l-jeddijiet jew l-azzjonijiet kollha tad-debitur tieg ħu, barra minn dawk li huma g ħal kollox personali.

  - First Hall ruled in favour of subcontractors but judgment was overturned on appeal:

  - Il-gurisprudenza u d-dottrina in materja jqisu li s-sub-kuntrattur ma jgawdix il-privilegg naxxenti mill-Artikolu 2010(b) tal-Kodici Civili. Tali privilegg jispetta biss lillkuntrattur principali li ghandu rapport kontrattwali dirett ma 'sid l-art. [Baudry-Lacantinerie] wkoll jghid li s-sub-kuntrattur ma ghandux dan il-privilegg ghax ma ghandux relazzjoni diretta mal-proprjetarju…

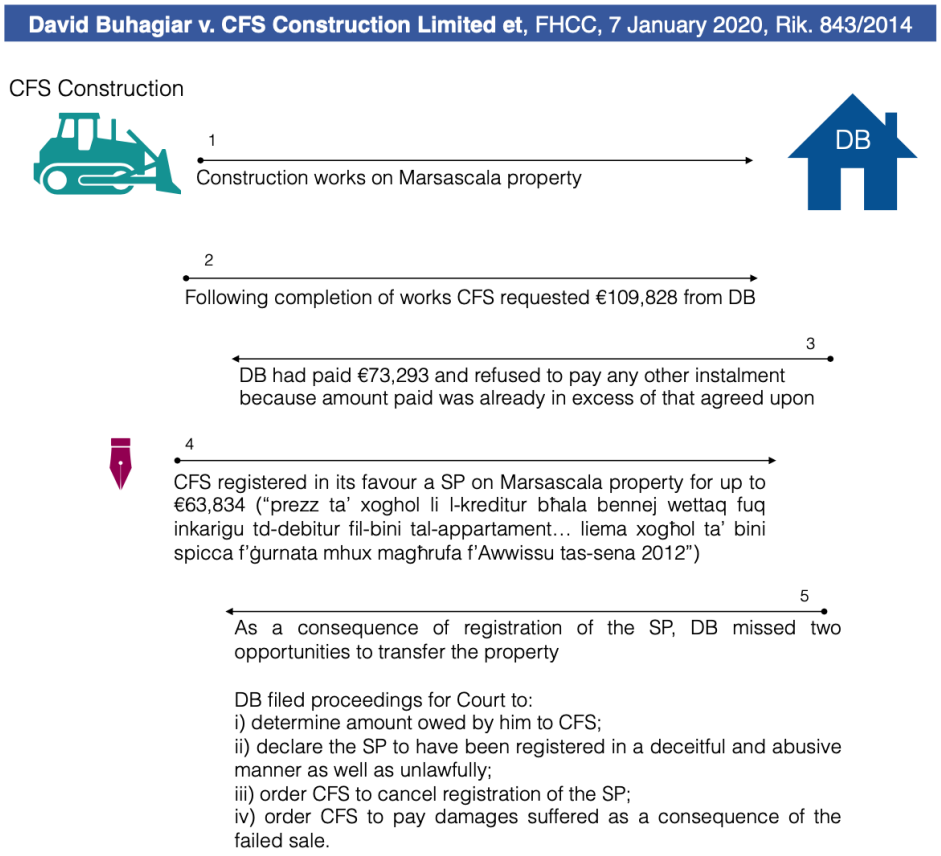
  - Il-gurisprudenza u d-dottrina in materja jqisu li s-sub-kuntrattur ma jgawdix il-privilegg naxxenti mill-Artikolu 2010(b) tal-Kodici Civili. Tali privilegg jispetta biss lillkuntrattur principali li ghandu rapport kontrattwali dirett ma 'sid l-art. [Baudry-Lacantinerie] wkoll jghid li s-sub-kuntrattur ma ghandux dan il-privilegg ghax ma ghandux relazzjoni diretta mal-proprjetarju…

- What did the company invoke in its favour? It invoked two articles. The first one is article 1643, against the personal commission to the works, and basically it said listen article 1643 dealing with locatio operis gives us as people employed in the construction of this building a right of action against the person who commissioned the works, they have also claimed to have been acting on the basis of article 1143. So this is the actio debitoris rei, which we covered last year.

- Basically they said it seems that the law is somehow providing a connection but the matter remains could they have registered a privileges? They're

subcontractors could they have registered a privilege or not? This was an interesting case because First Hall decided in their favour but then it was overturned in Appeal.

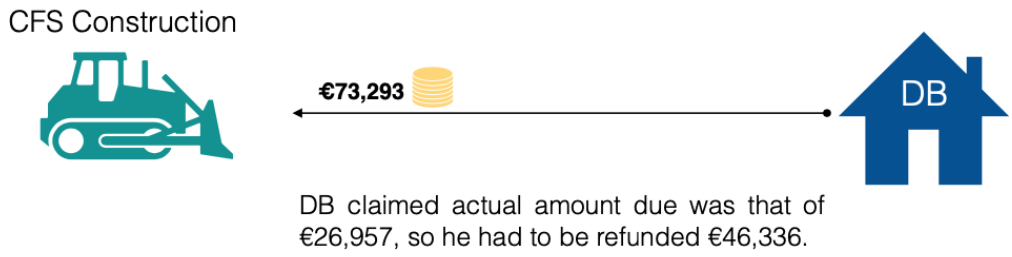
- It seems here in this particular case it emerged that wasn't Care Malta that had paid, Care Malta had paid the contractor, it was in fact the contractor who had paid the subcontractor. So the court disagreed with what the subcontractor is trying to do here. You can read the judgement. Il-qorti kwotat lil Ricci. The implication is that it still would have been able to invoke a privilege in its favour.
- What's interesting is that however at First Instance, it was upheld what they tried to do but then it was overturned.
- It's worth reading.



- Another, it's quite straightforward, Buhagiar vs CFS. In this case CFS construction was working for buhagiar, following the completion of the works CFS requested €109,000 from Buhagiar. DB (Buhagiar) had already paid €73,000, and refused to pay any other instalments, so CFS requested €109,000, DB claimed that it had paid already the amount that was due. And that CFS construction was not owned anything else. What did CFS do? (This is where privileges can be abused). CFS registered in its favour a special privilege on the Marsaskala property for up to €63,000 which is the difference of what buhagiar had paid and what CFS was requesting.

- What happened? If you register a privilege there is a problem. The main problem is represented by the fact that you are trying to sell the property but prospective buyers during the process when the searches are being conducted they will find out that there is a special privilege on the property. If there is a special privilege on the property, the property is not unencumbered, so if the property is not unencumbered of course the consequence is that they would not be interested to buy a property.

- Buhagiar claimed not only that he suffered damages from this abusive relation but also that in reality, the amount that it owed was limited to that of €26,000. So in its defence (Buhagiar) it not only said that the special privilege was registered reusably but the registration had damages and Buhagiar claimed €73,000 when



in reality CFS were owed €26,000.

- Illi l-Qorti rat il-konteġġi … [u] taqbel li l-attur mhux responsabbli għal spejjeż ta 'demolizzjoni u għall-common parts. Apparti li ma jissemma xejn dwar dawn filkuntratt tal-akkwist tiegħu, rigward il-common parts dan għandu d-dritt tal-użu u xejn iżjed. M'għandux sehem mill-partijiet komuni. Għalhekk ma jistax jiġi

mitlub iħallas ta ’xi ħaġa li mhix proprjeta` jew komproprjeta` tiegħu. Taqbel ukoll mal-bqija tal-konteġġi;

- Illi jirriżulta li l-ipoteka legali speċjali ġiet iskritta fil-11 ta ’Settembru 2012 mingħajr ma x-xogħlijiet ġew imkejjla fil-preżenza tal-attur; mingħajr ma ġie ppreżentat kont aħħari ddettaljat, itemised, u bl-irċevuti relattivi; b’konteġġi esaġerati meta mqabbla mar-rati kummerċjali allura viġenti fis-suq ħieles; ġiet iskritta mingħajr avviż l-ipoteka legali speċjali sentejn sħaħ wara li tlesta x-xogħol - u dan mhux biex is-soċjeta` konvenuta tikkawtela xi ħlas lilha dovut mill-attur, imma biex Carmelo Farrugia minn hawn jew minn hemm jieħu l-flus li kien qiegħed jippretendi li kienu dovuti lilu mingħand missier l-attur: kwistjoni li għall-attur hija res inter alios acta. Bla ebda dubbju, l-iskrizzjoni saret in mala fede;

- So, what happens here? The challenge was of course of Buhagiar vs CFS, and Buhagiar wanted to have that registration annulled.

  - Illi l-attur ipprova li sab il-bejgħ tal-appartament iżda sfratta meta n-Nutar li għamel ir-riċerki sab ma wiċċu l-ipoteka li l-attur ma kienx jaf biha. Għalhekk kien kostrett ikompli jħallas lura s-somma li ssellef mill-bank, flimkien mal-imgħax. Ġab prova li ħallas €6,865.30 imgħaxijiet minn Settembru 2013 – xahar li fih bagħat l-ittra uffiċjali li biha intima lill-konvenuti li kien sfrattalu l-kuntratt – sal-31 ta’Mejju 2016.

  - Għar-raġunijiet kollha premessi, il-Qorti qegħda taqta` u tiddeċiedi din il-kawża billi :- …

  - (3) tilqa ’l-ewwel talba billi tistabilixxi l-prezz dovut mill-esponent għaxxogħlijiet li l-intimata CFS Construction Ltd wettqet fl-appartament 3, San Andreas Court, Triq il-Gardiel, Marsaskala, skond il-ftehim li kellhom ilkontendenti fis-somma ta€ ’26,957. ...

  - (5) tilqa ’t-tielet talba billi tiddikjara li l-iskrizzjoni tal-privileġġ speċjali u lipoteka legali speċjali fuq imsemmija fuq l-appartament tal-esponent (H. 12670/2012) saret b’qerq, abbużivament, u mingħajr jedd legali; ...

  - (6) tilqa ’r-raba ’talba billi tikkundanna lill-istess CFS Construction Limited sabiex, fi zmien xahrejn tersaq fuq l-att tal-kanċellament tal-istess iskrizzjoni ...

  - (7) tilqa ’l-ħames talba billi tikkundanna lill-konvenuti, jew min minnhom, jirrifondu lill-esponent is-somma ta€ ’46,336 - ammont li jirriżulta mħallas żejjed; ...

  - (9) tilqa ’s-seba ’talba billi tillikwida l-istess danni fis-somma ta€ ’6,865.30.

- Would you think Buhagiar was successful in his claim or not? This case is important because it shows you what happens when there are abusive registrations. In this case the court looked into the matter and it found the real fact that yes the money was not due so it upheld the claim by Buhagiar that he only owned a limited amount to CFS and it even awarded damages for the abusive registration. The damages in this case were represented by the interest that Buhagiar kept paying on the loan which the bank had granted him for the development of that property. The fact that Buhagiar could prove that he had paid over the years €6,000 in interest which he would not have paid had the property been sold. Had that abusive registration not been in place and therefore with buyers being interested in his property.

  - Special Privileges on Immovables in favour of

  - ii) vendors

  - Sale & Loan

  - 2010. (c) The vendor or any other alienor, whether under an onerous or a gratuitous title, over the immovable sold or alienated by means of a public deed, for the whole or the residue of the price, or for the performance of the covenants stipulated in the deed of sale or alienation. The same privilege is competent to the person who has, by means of a public deed, supplied in whole or in part the money for the payment of the price agreed upon, provided it is shown by the deed of loan that the money was supplied for that purpose, and it is proved that the money taken on loan has been paid to the vendor or other alienor

  - Lombard Bank Malta p.l.c. v. IV's Co. Ltd, Civil Court (FH), 3 July 2003, C. 63/2002/1

  - … kuntratt ta 'self mhux l-istess bhal kuntratt ta 'overdraft, johrog ukoll millawturi aktar kwotati, bhal Messineo, Vidari, u Torrente. Dan ta 'l-ahhar, fil-fatt, jghid li "l-apertura di credito non deve confondersi con il mutuo (promessa di mutuo)". Dan l-istess awtur ikompli jispjega li "il mutuo é un contratto reale che si perfeziona, dunque, con la consegna della somma, l'apertura di credito e l'anticipazione bancaria sono, invece, contratti consensuali: … senza che la somma sia a lui consegnata e senza che si stipuli un successivo contratto definitivo di mutuo, come sarebbe necessario se di promessa di mutuo si trattase" (Manuale di Diritto Privato; 9° Ediz; pag. 572).

- Finally we have, we've read the special privileges on immoveables, (Dejjem on immoveables) on immoveables with respect to architects, contractors and masons. Now we are dealing with the instance which is that of special privileges

on immoveables in favour of vendors. So, we've gone through it before. It's very important, something very relevant to those going into banking law, that the law specifies that the money should be provided by a loan.

- If we recall from our lectures last year, jekk kien hemm overdraft facility, is that equivalent to a loan under maltese law? This is something which is one of those points which is subject to interpretation, so the bank whenever it drafts an overdraft facility it doesn't constitute a special privilege why? Because as it is stated under maltese law kuntratt ta' self mhux l-istess bhala kuntratt ta' overdraft. And the law here only specifies it's the deed of loan that must be shown. It's a restrictive interpretation that at the time the law of guarantees was written overdraft facilities did not exist, this is a product which came much later. Dr. Xerri doesn't necessarily agree with the strict and narrow interpretation of loan, how it is applied to the law of guarantees. (For those working in a bank it is relevant to know that the money coming from a deed of loan, especially privilege would not be registered because a special privilege can only emerge in virtue of the law and the law specifies that the reference that must be shown is the deed of law.

  - "This is also of extreme importance to the lending banker. Thus the loan must arise from a public deed. The purpose of the loan must also clearly arise therefrom. In order to ensure complete proof that the loan is made for the purchase of the immoveable, such loan is paid directly by the bank (creditor) as delegated by the customer (debtor) to the vendor."

  - P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, pp. 61.

- It is also extremely important that the loan must arise from a public deed, in order to ensure proof that the loan is made for purchase of the immoveable such loan is paid directly by the bank (creditor) as delegated by the customer.

- The bank will pay the vendor directly, why would the bank want to pay the venter directly? It would do so as to make sure that no doubts will arise as to the reason for which that money would have been used. It will pay the bank, when it grants you a loan it will also pay the vendor directly and the contractor/architect directly, in order to make sure that all the requisites listed under the law are fulfilled.

  - Registration of special privileges over immovables

  - Period for Registration

  - 2029. Special privileges over immovables and over those movables as specified in articles 2002(2) and 2012(1)(b) are ineffectual unless they are registered in the Public Registry within the time of two months.

- 2030. The time referred to in the last preceding article shall run-
- (a) as regards the debts mentioned in paragraphs (a), (c)and (d) [dominus, vendor and co-heir] of article 2010 from the date of the contract;
- (b) as regards the debt mentioned in paragraph (b) [architect, contractor, mason etc.] of the said article from the day on which the works are completed, or, as the case may be, from the day of the adjudication of the immovable;
- (c) as regards the debts mentioned in paragraph (e) [advocate and legal procurator] of the same article from the date of the judgment or of the act by which the suit is terminated

- Registration, this is very important, they are all effectual, this is crucial, of absolutely fundamental importance, they are in effectual unless they are registered within a period of two months. From when do these two months start lapsing? So, in the case of the venders its from the date of the contract. Which regards to the architect contractors mason and so on, they start from the day on which the works are completed.
  - Special Privileges on Immovables
  - i) architects, contractors, masons, workers and
  - “The two month period in this case starts running from the day on which the works are completed. … When a loan for construction is granted, the creditor has to necessarily register a special privilege over the immovables at the time when the relative works have not yet even started. Thus a special privilege is registered in the Public Registry prior to the relative loan being paid to the contractors etc., for works affected. This necessitates a deed which is published on completion of the relative works and in which the creditor refers to the first contract, states the sum which has been disbursed and paid to the contractors and states the date of termination of such works. This is a deed which confirms that the intention and requisites of the law for the creation of the privilege have been followed. The author is of the opinion that the reference to completion of works in this particular case is to be linked only to the works carried out by such financing. It is believed that the lender should not wait until all the works on the tenement, even those not financed by him, be completed. Completion is to be here regarded as relative completion, i.e. relative to the works financed by the creditor. If this is correct, the lending banker should follow the account carefully so as to enable him to “conserve the privilege” within the two month period.”

- P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, pp. 64.

- Special Privileges on Immovables

- ii) vendors

- “The two months start running from the date of contract (i.e. from date of contract of purchase - including loan for purchase)”

- P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, pp. 64.

- What’s particularly important in respect to architects and contractors? That, the bank will supply money and when the bank supplies money, the bank will register a special privilege. But, is that completely effectual or not? No because the works have not been completed yet. So what a bank would do is that it would follow the works and upon completion of the works it would make sure to register that privilege within two months of the completion of the works. This is what we refer to as the conservation of the privilege, you register the privilege at the moment the money is made available but then you conserve it, you keep it effectual when you register the conservation within a period of two months from when the works would have been finalised.

  - Retroactivity of Registration

  - The registration of the special privilege is retroactive to the date of the event through which it arises, as long as it is enrolled in time.

  - 2031. (1) The aforesaid privileges, if registered within the time mentioned in the last preceding article, shall not be affected by any alienation of the property charged with the privilege, or by any hypothec or burden created thereon, during the course of the aforesaid time.

  - “During the two month period, any alienation of the relative property shall not affect the privilege, i.e., if the property is sold within the said two months period but before the privilege is registered, such privilege still holds good provided the privilege is registered within such two month period.”

  - P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, pp. 65.

- This is important, retroactivity of the registration, ok, what happens if I have two months for which I can register the privilege but in that two month period the buyer

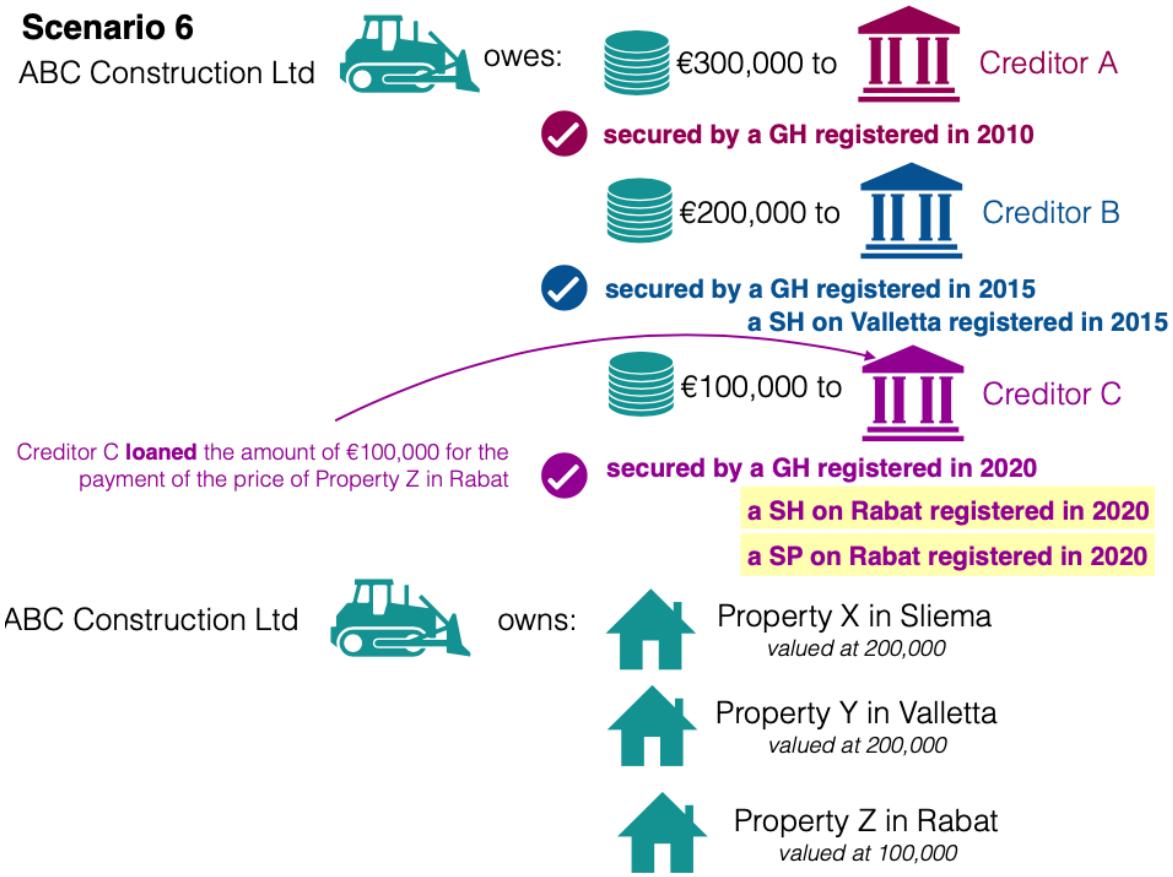
sells the property, what happens there is my privilege still effectual or not? Yes it is because the registration is retroactive. For the purposes of the law if it's registered within that two month period the relevant date for the special privilege is the date when the contract had beens signed.

- Ranking of Privileges and Hypothecs
- There are three ranks of creditors:
- The first ones are the privileged creditors, who precede all the others and regulate themselves according to their different priority.
- The second ones are the hypothecary creditors, who rank according to the dates of their hypothecs.
- The third ones are the unsecured creditors who do not distinguish themselves and compete with the other creditors.
- J. Domat, Le leggi civili nel lor ordine naturale, Venezia, 1805:III, 442
- Of the Effects of Privileges and Hypothecs
- Relations existing between the Creditors of the same Debtor
- 1. Privileged Creditors
- 2. Hypothecary Creditors
- 3. Simple (unsecured) Creditors

- Bottom line, what are we saying? We are saying that there are three ranks of creditors, three are the privileged creditors, the hypothecary creditors and the simple creditors. The privileged rank on top, the hypothecary second, unsecured creditors lie third.
  - Rule of Priority
  - Privileges however, even between themselves, do not rank according to registration but according to their nature. Thus, the law specifically creates a ranking of privileges and states which privileges shall rank ahead of the other - irrespective of the date of registration of the privileges.
  - P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, pp. 62
- This we've covered already, we'll come to it again when we apply it.

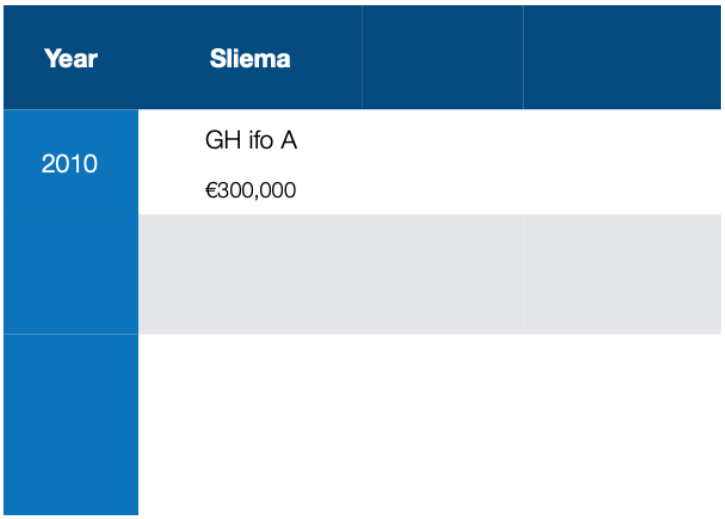
- Rule of Priority
- 2091. (1) Saving the provisions of the last two preceding articles, in all cases of competition of privileged debts, differing in degree, the order in which the privileges are set forth in articles 2003, 2009 and 2010 shall determine their respective priority
- 2010. The privileged creditors over immovables are:
- (a) the dominus over the dominium utile of the emphyteutical tenement...
- (b) architects, contractors, masons and other workmen, over the immovable constructed ...
- (c) the vendor or any other alienor, whether under an onerous or a gratuitous title, over the immovable sold or alienated ...
- (d) co-heirs and other co-partitioners, over the immovables which were the subject of the partition ...
- (e)the advocate and the legal procurator, for the fees due to them for their services in the action for the recovery of the immovable

• Priority what's the priority of privileges? What determines the priority in case of privileges? As we said, mot the date of registration but the order set forth in the respective articles.



- First example, and we can work it out. ABC Construction Limited, our typical case. Three creditors one of them registers a special hypothec, the second one registers a general hypothec and a special hypothec, the third one registers a general hypothec, as special hypothec and a special privilege. On which place is

he still registering a special privilege? On the fact that creditor ‘C’ is a bank that loaned the amount of €100,000 for the payment of the price of Property Z in Rabat.



- X’se jigri hawnhekk? Can we complete this? X’irrid naghmel, years, what years are relevant? 2010, 2015 and 2020.
- What matters to me is when the registration took place, not when the sale or transfer took place, when the registration took place. So here there are three registrations, one in 2010, another one in 2015 and another in 2020. So the relevant dates to me are 2010, 2015 and 2020. What properties are relevant to me? All three of them because there is a general hypothec. Here I put Sliema, Valletta and Rabat.
- How do I fill in the gaps? The first one is quite straightforward, General Hypothec in favour of ‘A’ in Sliema, let’s assume that creditor ’A’ had loaned these €300,000 for ABC Limited to develop the property in Sliema and it constituted a general hypothec, there the general hypothec obviously applies but does it apply in relevance to Sliema or to the other properties as well? Also to the other properties and you have to write Valletta and Rabat and write G ifo ‘A’ up to the value of €300,000.
- In 2015 what happened? In 2015 GH instantly on 2015, SH registered in 2015. So what goes in the second row? GH fuq kollha up to the value of the property or the amount? Up to the amount, dejjem €200,000. Is there something different that I have to do here? In Valletta, I also have to include a special hypothec. So GH ifo B and SH ifo B.

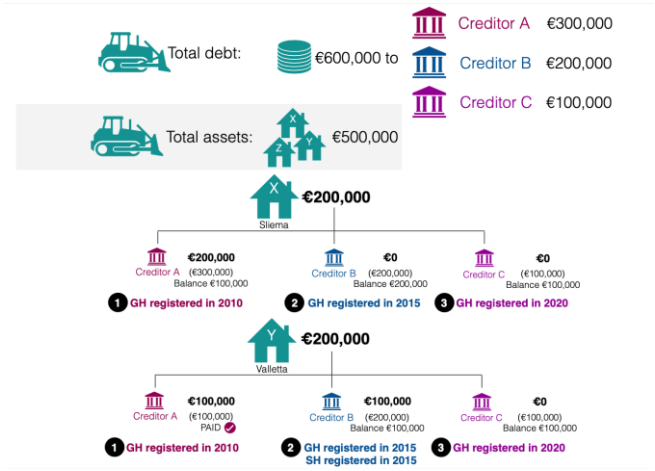
- Third last row, the one what would I have to write? GH fuq kollha, and a special hypothec to special privilege up in €100,000 ‘C’ but favour of Rabat. limitedly on

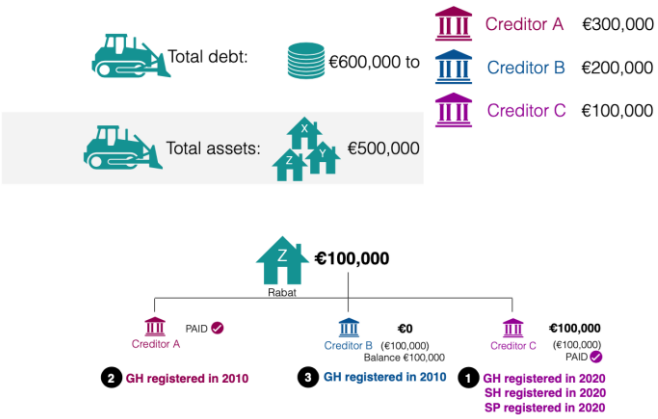
Year	Sliema	Valletta	Rabat
2010	GH ifo A €300,000 (1)	GH ifo A €300,000 (1)	GH ifo A €300,000 (2)
2015	GH ifo B €200,000 (2)	GH ifo B SH ifo B €200,000 (2)	GH ifo B €200,000 (3)
2020	GH ifo C €100,000 (3)	GH ifo C €100,000 (3)	GH ifo C SH ifo C SP ifo C €100,000 (1)

Year	Sliema	Valletta	Rabat
2010	GH ifo A €300,000	GH ifo A €300,000	GH ifo A €300,000
2015	GH ifo B €200,000	GH ifo B SH ifo B €200,000	GH ifo B €200,000
2020	GH ifo C €100,000	GH ifo C €100,000	GH ifo C SH ifo C SP ifo C €100,000

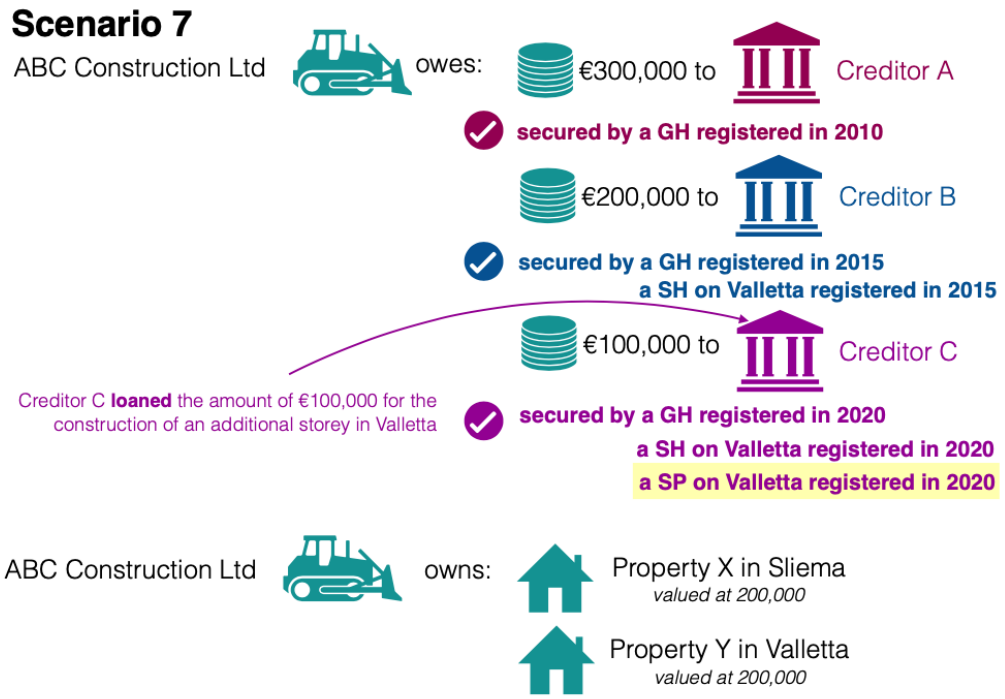
- If I had to determine the ranking on each property, what would I get?

- Let's start with Sliema, 'A' Would rank first, it would rank 1, 2, 3 because of the registration. Valletta, how would it be ranked? Valletta x'inhu r-ranking ta' Valletta? A special hypothec doesn't mean it is special in terms of ranking it means it's specific, specific to a particular property, in this case the ranking would not be affected, so with respect to Valletta it would be 1, 2, 3. Rabat, what is the ranking in Rabat? 2, 3, 1 because of the privilege.



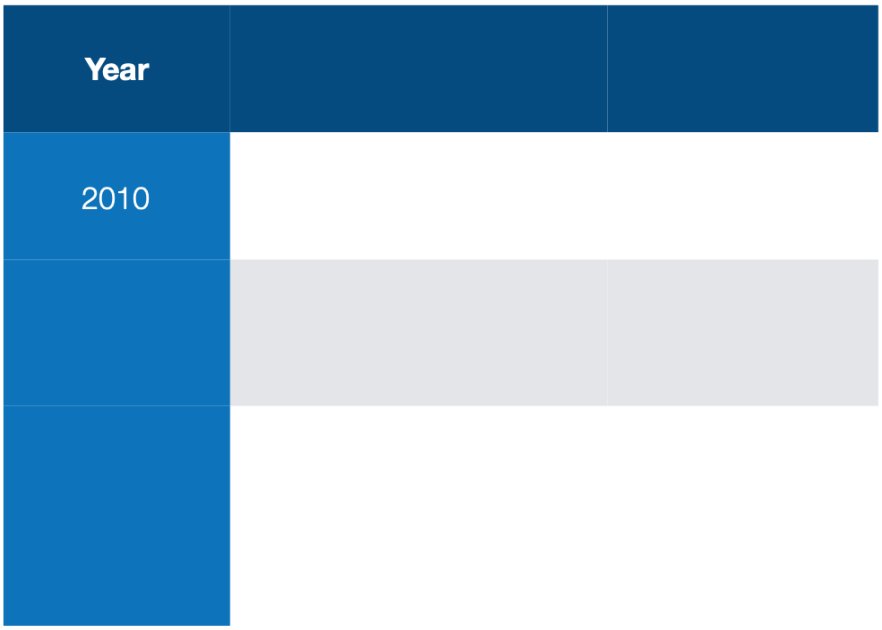


- In the case of the privilege it does make a difference, in the case of a special hypothec it doesn't. So this is the ranking, '1, 2, 3', '1, 2, 3' and '2, 3, 1'. This is how it would work in practice, it comes to the sale of Sliema, '1, 2, 3', it comes to the sale of Valletta '1, 2, 3' but in the case of Rabat, creditor 'C' would rank first.



- The same table, the difference here between scenario 7 and scenario 6 is that in the first case the money was loaned for the payment of the price of the property,

in scenario 7, the amount is loaned for the construction of an additional storey. So the



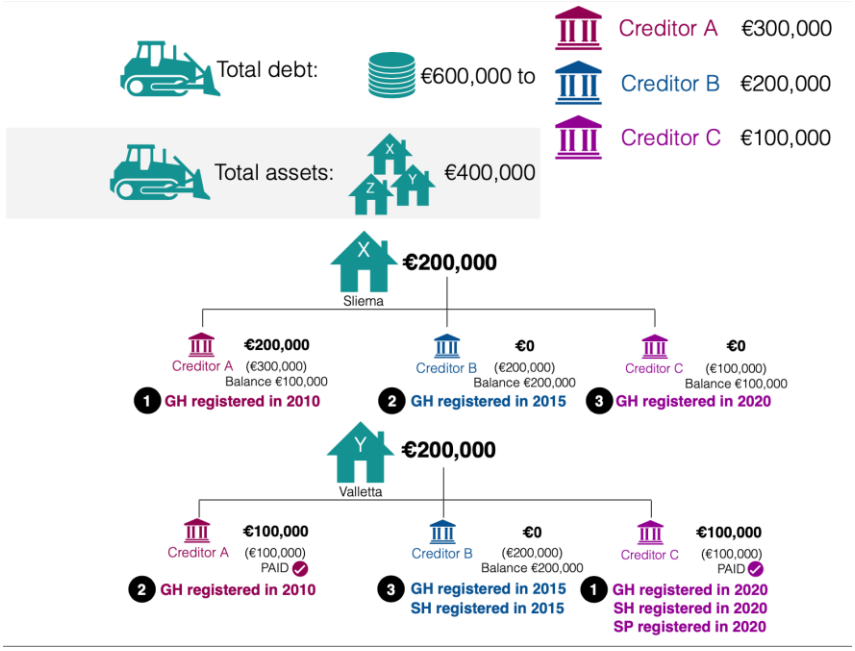
Work out the ranking of each creditor on each property.

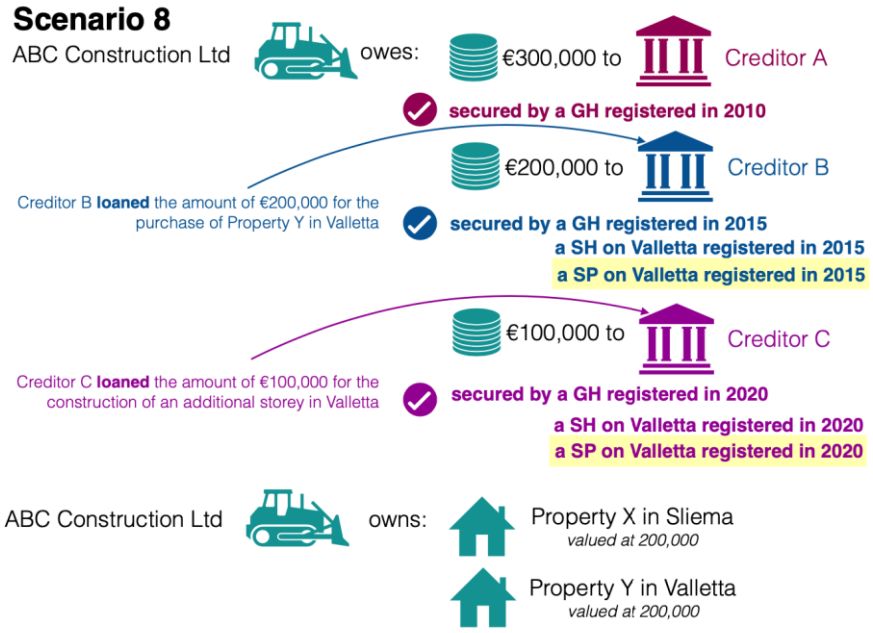
difference here is quite academic.

- We can work out the ranking

Year	Sliema	Valletta
2010	GH ifo A €300,000 (1)	GH ifo A €300,000 (2)
2015	GH ifo B €200,000 (2)	GH ifo B SH ifo B €200,000 (3)
2020	GH ifo C €100,000 (3)	GH ifo C SH ifo C SP ifo C €100,000 (1)

- And the result would be the same. ‘1, 2, 3’ and ‘2, 3, 1’ with the special privilege they rank first.





- Scenario 8, this is where it gets interesting.
- The privilege is granted in the case of loans given for the purposes of construction up to the amount that was loaned for the specific purpose of construction. So if the property is worth €500,000, your privilege is limited to the amount that was loaned for the purposes of the construction, so if only €200,000 were loaned you have the privilege up to €200,000.
- Scenario 8, here we have competing privileges. What is the difference here? We have creditor ‘A’ secured by a GH in 2010, then we have creditor ‘B’, secured by a GH, SH and SP (SP in virtue of a loan for the purchase of property Y), creditor ‘C’ also on Valletta, so this time I have competing registrations on the same property, Valletta. So in 2015, the ABC Limited loaned out an amount of money, borrowed an amount of money in order to purchase the property, five years later it borrowed an amount of money to renovate it. (This would never happen that creditor ‘C’ would agree to lend money in his scenario, this is a fictitious scenario but it can happen, its mostly there to test our knowledge on ranking). Yet let’s say ABC went first to creditor ‘B’, and then it went to creditor ‘C’, it defaulted its payments and in the meantime it owns property X and property Y.

Work out the ranking of each creditor on each property.

- How would I fill this in?
- 2010, 2015 and 2020 over A, properties, Sliema and Valletta.
- GH fuq il-propjetajiet kollha because it's a GH, issa GH fuq il-propjetajiet kollha 2015, SH on Valletta and SP on Valletta. The difference here is that the amount of €200,000 was loaned for the purchase of the property in Valletta, the €100,000 were loaned for the construction and additional storey. So the nature of the privilege is different.

Year	Sliema	Valletta
2010	GH ifo A €300,000 (1)	GH ifo A €300,000 (3)
2015	GH ifo B €200,000 (2)	GH ifo B SH ifo B SP ifo B €200,000 (2)
2020	GH ifo C €100,000 (3)	GH ifo C SH ifo C SP ifo C €100,000 (1)

Work out the ranking of each creditor on each property.

- How do we rank them therefore? Valletta has SH's and SP's, which rank first? The SP. We have two SP's, which one comes first the one made in 2015 or in one made in 2020? According to the order in the law, which did we deal with first? What's important to keep in mind when working out this example, is that here we have competing privileges, when it comes to competing privileges it is not the order off registration but the order in which they are mentioned and the first

creditors who are mentioned are architects, masons and so on. So it will be in the following. Sliema ‘1, 2, 3’ because they are only listed as general hypothecs and the order would be ‘1, 2, 3’ why? First the architect and mason, then the vendor and finally then other creditors. So here you can see how the SP registered in 2020 sort of overturns everything.

- Here we have three loans, 2010, 2015 and 2020. Different guarantees were registered. The first one is just a GH, in the second and third they were both an SH and an SP could they be registered as an SP? Yes they could because creditor ‘B’ was supplying money for the purchase of the property, creditor ‘C’ was supplying money for the construction of the additional story. So the SP’s are regular.

- We have a situation where in Sliema it’s quite clear because they are only hypothecs and hypothecs rank according to the date of registration. The problem arises when it comes to Valletta, why? Because in Valletta we have SP’s, SH’s and GH’s. We know that the SP’s supersede hypothecs, so we know that it is the SP that ‘wins’ so to speak, the problem is which one is going to rank first, the SP in favour of creditor ‘B’ or the SP in favour of creditor ‘C’? And we agreed that when it comes to competing privileges, which one prevails? According to the order in which they’re mentioned in the law, and the ones that are mentioned first are architects and masons, then the vendor, so in this case, imagine creditor ‘C’ leapfrogging everyone, leapfrogging creditor ‘B’ and ranking first, so you’d have ‘C’ ranking first in virtue of the SP, creditor ‘B’ ranking second in virtue of the SP and ‘A’ ranking third in virtue of the GH.

  - 2010. The privileged creditors over immovables are:

  - (a) the dominus over the dominium utile of the emphyteutical tenement...

  - (b) architects, contractors, masons and other workmen, over the immovable constructed ...

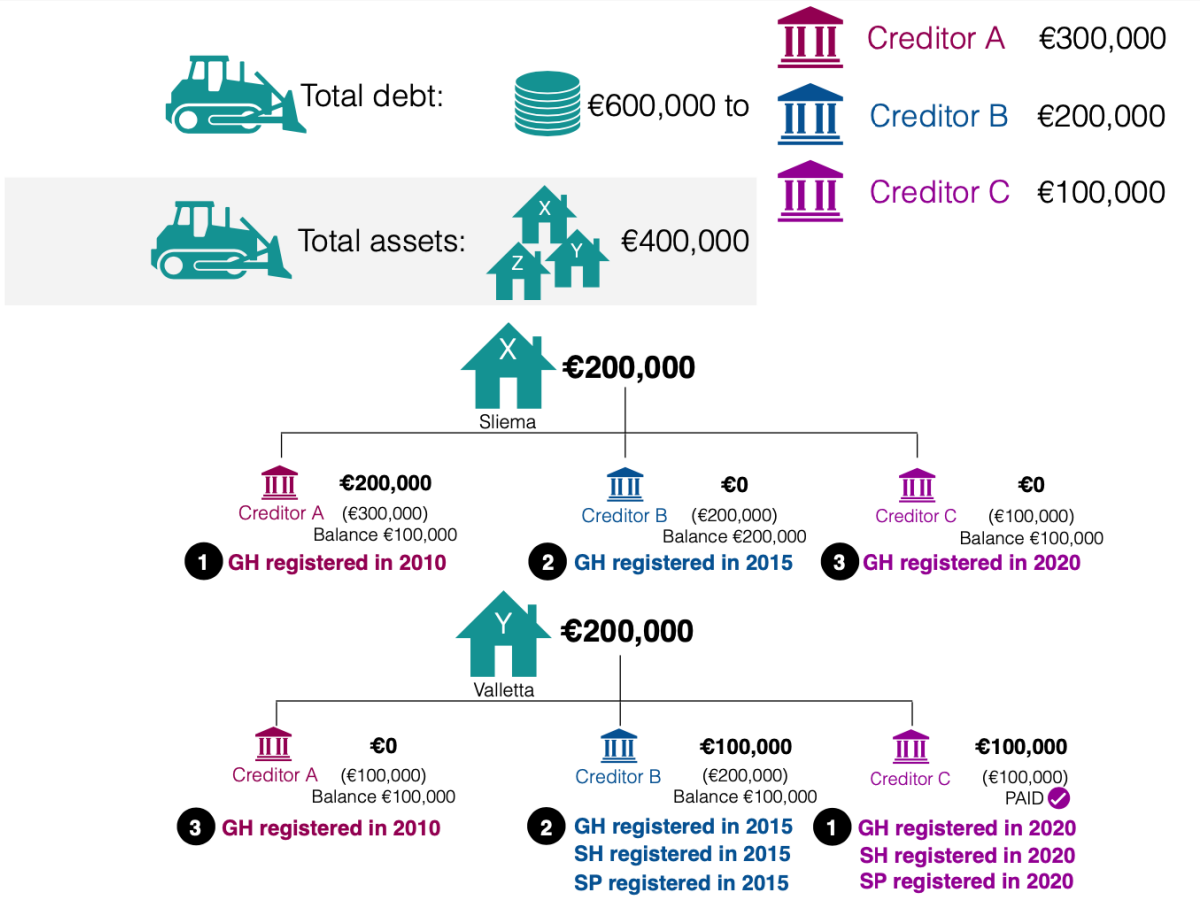
  - (c) the vendor or any other alienor, whether under an onerous or a gratuitous title, over the immovable sold or alienated ...

  - (d) co-heirs and other co-partitioners, over the immovables which were the subject of the partition ...

  - (e)the advocate and the legal procurator, for the fees due to them for their services in the action for the recovery of the immovable

- The bank comes in in virtue of the proviso to article 2010(b), so architects contractors and masons, the same privilege, is competent to the person who has

by means of a public deed supplied money or materials for the construction, re-construction or repair of the immoveable or for the payment of the work and employment of such work provided that it is shown that the supply is made for such purpose and it is proved that the work was carried out or the payments to the workmen made, with the materials or out of the money supplied. This is something the bank would need to know very well that it would only concern its special privileges over the property if it makes sure (first of all to prove that the money was used for the purposes of construction and secondly that it was registered in those two months).



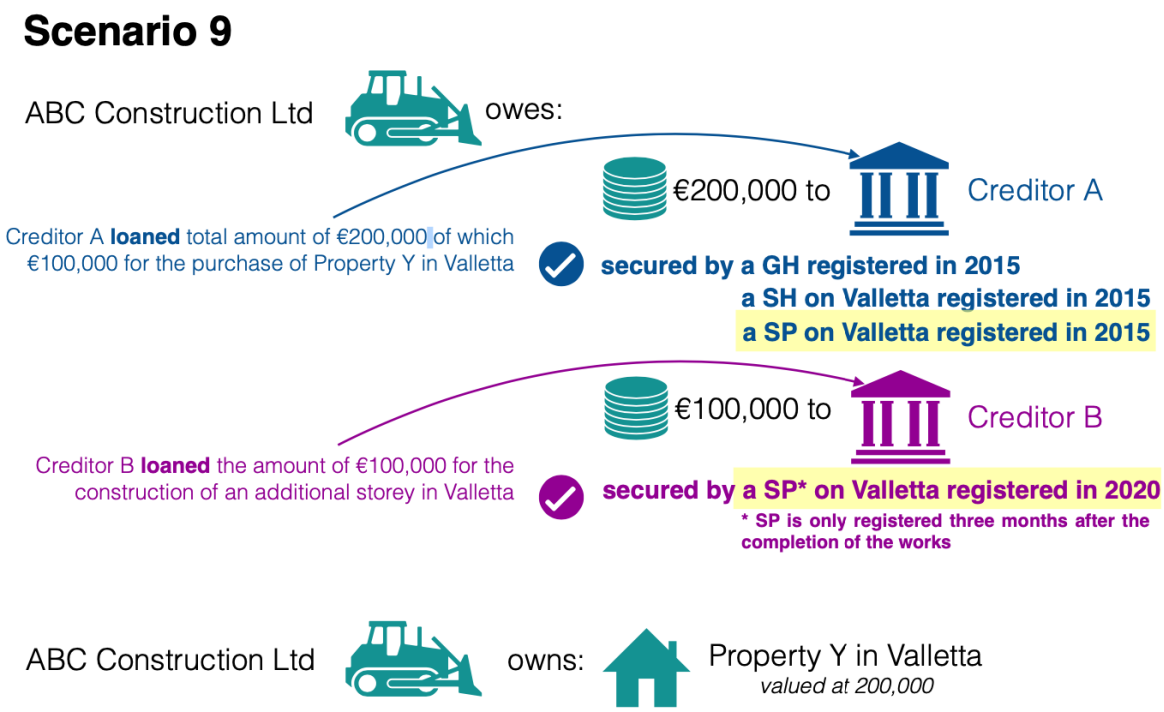
- 2022. The creditor who has a privilege over an immovable, has a special legal hypothec over the immovable subject to the privilege.

- Failure to register the privilege within the two months from sale causes the creditor to lose privileged status; his privilege “degenerates” into a hypothec which ranks with respect to third parties only from the date of its registration.

- “If the privileges are not registered within the said period of two months this cause of preference is not lost completely but undergoes a mutation. It changes into a hypothec. Since this “underlying” hypothec is created by law it is called a

Special Legal Hypothec. This hypothec has to be registered just like any other hypothec. The difference now lies in the fact that whilst the privilege ranked according to its nature, this underlying hypothec will rank according to the date of its registration."

- P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, pp. 65



- We underlined, this is the working of the other example. The question is we said that the special privilege must be registered with a period of two months, if it is not registered within a period of two months is it lost completely and irrevocably? No, this is important, on the one hand we're saying on privileged creditors and the law gives them privilege and they have they can rank on top above everyone, and then we're saying if they don't register within two months, then they have to face the drastic draconian consequence that they don't rank at all? What happens here?

- The law relegates if these two months lapse the special privilege to a special legal hypothec, which is why we dealt with legal hypothecs at the beginning of the lecture. It's just a relegation from the special privilege to a special legal hypothec. What is the disadvantage? The creditor can proceed to register a special legal hypothec, so he doesn't need the agreement of the debtor but the difficulty arises

is that it ranks from the date of registration. So the problem of not respecting the two month deadline is that the strength that the law gave you as a special privilege is diluted to a special legal hypothec, be it a hypothec or be it legal therefore arising from the law it doesn't rank in preference to other hypothecs. So it doesn't have the same strength as a privilege so in this case what would happen is the following

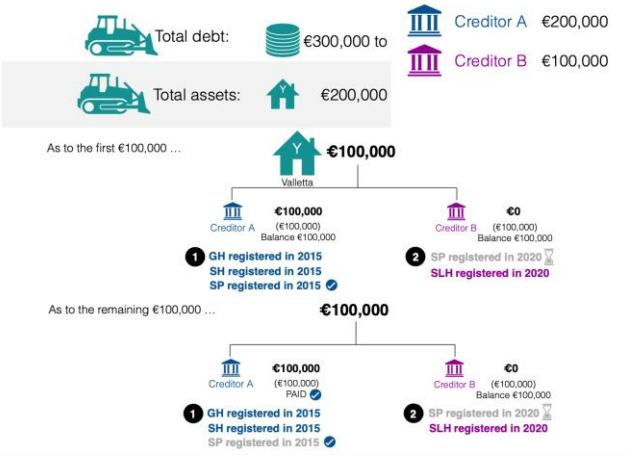
- This is a case that also comes out frequently in exam papers.
- You have creditor 'A' and creditor 'B' one who registered a special privilege, and the other one registered a special privilege but three months after the completion of the works.

Year	Valletta
2015	GH ifo A SH ifo A €200,000 SP ifo A (up to €100,000)
2020	SP ifo B €100,000

Year	Valletta
2015	GH ifo A SH ifo A €200,000 SP ifo A (up to €100,000)
2020	SP → SLH ifo B €100,000

- What happens here? Tigi SLH, so who ranks first in Valletta? 'A', had they registered the special privilege in time, who would have come first? 'B' would have come first because of the nature of the debt, which is that of construction not of purchase so it ranks first. But we can see and it is explained in the slides, the SP is ineffectual because it was registered too late, what then creditor 'B' did was register an SLH but when registering a SLH the problem that it is a hypothec it still ranks behind the SP which was duly registered in favour of 'A'
- Creditor 'A' buys the SP limited to €100,000 why is the amount limited to €100,000? Because the loan was of €200,000 the total amount but only €100,000 were lent specifically for the purchase of the property. (So it's not covered by the SP), so what happens here is the following with respect to the first €100,000 where we have a GH, a SH and a SP, so GH and SH in favour of 'A' for €200,000 but SP up to €100,000. So the first thing we do is the following. As far as the SP is concerned, the SP ranks first, so that €100,000 is recovered immediately, as to

the remaining €100,000 then what we have is ranking between hypothecs. And in the ranking between hypothecs, the first one registered was in 2015, so 'A' gets the remaining amount to the complete exclusion of 'B' and as you can see 'B' remains unclear.



- 2093. Hypothecs registered on the same day confer on the creditors an equal rank, without any distinction between registrations made at different hours of the same day

- 2094. Privileged or hypothecary debts in the same rank, are paid ratably.

- Final point, hypothecs registered in the same day what happens? They offer an equal rank and even privileges and hypothecary debts in the same rank are paid rateably so this is important, they are paid pro-rata when they are registered on the same day or as they rank on the same level when it comes to privileges.

10th May 2023

Lecture 4.

- Today's plan is to conclude these series of lectures, so today our main task is to deal with the certain circumstances we dealt with hypothecs so far, general and special privileges we did during last lecture, and now during this lecture we'll see how the order can in accordance with the will of the parties involved be altered, because the order is not set in stone and the parties may change it by agreement and in accordance with their respective interests.

- Second part of the lecturer we'll also be working out last year's past paper.

  - Merchant Shipping Act, Cap 234 Laws of Malta

- 50. The debts hereunder specified are secured by a special privilege upon the vessel … :

- (b) fees and other charges due to the registrar of Maltese ships arising under this Act ...

- (g) the expenses incurred for the preservation of the ship and of her tackle including supplies and provisions to her crew incurred after her last entry into port;

- (h) wages and other sums due to the master, officers and other members of the vessel's complement in respect of their employment on the vessel, including costs of repatriation and social insurance contributions payable on their behalf;

- (i) damages and interest due to any seaman for death or personal injury and expenses attendant on the illness, hurt or injury of any seaman;

- (j) moneys due to creditors for labour, work and repairs previously to the departure of the ship on her last voyage

- Income Tax Management Act, Cap. 372 Laws of Malta

- 23. (11) Notwithstanding the provisions of any other law, the demand notice by the Commissioner referred to in sub-article (7), showing the amount due to be paid under this article, shall constitute a privileged claim over the assets of the employer (including the assets of a principal officer in the case of a body of persons) ranking immediately after the wages of employees and claims of the Director of Social Security for any amounts due by way of contribution under article 116 of the Social Security Act, and shall be paid after such wages and claims in preference to all other claims whether privileged or hypothecary.

- Social Security Act, Cap. 318 Laws of Malta

- 116. (3) Notwithstanding the provisions of any other law, the claim of the Director of any amount due by way of any Class One or Class Two contribution under this article shall constitute a privileged claim in the case of a Class One contribution, ranking equally with wages of employees over the assets of the employer, and, in the case of a Class Two contribution, over the estate of the self-employed or self occupied person concerned and shall be paid in preference to all other claims (excluding wages) whether privileged or hypothecary.

- Employment and Industrial Relations Act, Cap. 452 Laws of Malta

- 20. Notwithstanding the provisions of any other law any claim by any employee in respect of a maximum of three months of the current wage payable by the employer to the employee, and compensation for leave to which the employee is entitled, together with any compensation due to the employee in consideration of the termination of employment, or any notice thereof, shall constitute a privileged claim over the assets of the employer and shall be paid in preference to all other claims whether privileged or hypothecary:

- Provided that, in every case, the maximum amount of the privileged claim shall not exceed the equivalent of the national minimum wage payable at the time of the claim over a period of six months

- Value Added Tax Act, Cap. 406 Laws of Malta

- 62. The Commissioner shall have a special privilege over the assets forming part of the economic activity of a person in respect of any tax due by that person under this Act and the said tax shall, notwithstanding anything contained in any other law, be paid in preference to a debt having any other privilege, excepting a debt having a general privilege and a debt mentioned in article 2009(a)or (b) of the Civil Code.

- Let’s deal with one final point regarding last lecture that we didn’t have the time to explain, when we were working on our assignments, we’ve come across certain words and pieces which discuss that there are general privileges and special privileges in accordance to the civil code but then there are privileges which emerge from other legislative rights and other legislative instruments.

  - For example when you have cases where tax, vat, income tax is still due.

- We’re going to look at those briefly and then we are going to see how do they interact with special and general privileges as contemplated under the civil code.

- There’s the Merchant Shopping Act where for example debts, it lists a number of debts which are secured by a number of privilege. This is not so important to us because we’re dealing with immoveables.

- So what we’re concerned with mostly is for instance the Income Tax Management Act where in virtue of article 23 the commissioner shall constitute a privileged claim any debts due to the commissioner shall constitute a privileged claim over the assets of the employer.

- The Social Security Act also constitutes a special privilege, so this time privileged claim of the Director of any amount due by way of any Class One or Class Two contribution and we can see that the special privileges extend over the assets of

the employer or over the estate of the self employed or self occupied person, the employer and the occupied person reflects the distinction between class one and class two.

- Then you have the Employment and Industrial Relations Act, where a claim by an employee in respect of a maximum of three months of the current wage is also the privileged claim.
- Then you have the VAT Act, once again the commissioner shall have a special privilege over the assets forming part of the economic activity of a person in respect of any tax due.
- We don’t need to go into specific detail.
  - Konkors ta' kredituri tas-socjeta' JM Group Limited, Court of Appeal, 29 March 2019, Rik. 683/06 SM
  - … n-nuqqas tal-Kummissarju tal-VAT li jirreġistra l-privileġġ ma jestingwix ilkreditu, u skond l-Artikolu 62, dan il-kreditu għandu jitħallas “bi preferenza fuq dejn li jkollu xi privileġġ ieħor”.
  - “Bil-privileġġ speċjali, debitament reġistrat, il-Kummissarju tal-VAT ikun jista ’ jinforza l-kreditu tiegħu fuq dik il-proprjeta` immobbli partikolari, f’idejn min tkun. Jekk ma jirreġistrax ipoteka speċjali, allura jrid jissodisfa ruħu mill-assi li jkollu ddebitur, b’dan, pero`, li anke jekk dawk l-assi jkunu milquta b’xi privileġġ, ilKummissarju jitħallas l-ewwel …
  - Il-fatt li dan l-artikolu jagħti lid-Direttur preferenza qabel kull privile“ ġġieħor”, ma jfissirx li d-dejn tad-Direttur irid hu wkoll ikun munit bi privileġġ reġistrat. Il-liġi trid li erarju jitħallas qabel il-privileġġi l-oħra, jiġifieri qabel krediti oħra, anke jekk muniti bi privileġġ.
  - Konkors ta' Kredituri ta' VZ et, Court of Appeal, 29 May 2015, App. Civ. 831/2007/1
  - Il-kaz odjern jirrigwarda l-bank HSBC Bank Malta p.l.c. li huwa kreditur tal-konjugi Z, fil-kwalita` taghhom ta ’garanti tas-socjeta` Biochemicals Limited, fis-somma ta€ ’3,316,812.84, oltre l-imghaxijiet legali skond kuntratt ta ’ kostituzzjoni ta ’debitu in atti Nutar Dottor Clyde La Rosa ta ’l-10 ta ’Gunju 2003, liema kuntratt gie rez titolu ezekuttiv permezz ta ’ittra ufficjali datata 11 ta ’ Settembru 2003.
  - Illi wara subasta bin-numru: 135/2004 fl-ismijiet: HSBC Bank Malta p.l.c. vs VZ et giet depozitata garanzija bankarja bin-numru: 8820071018 ghall-ammont ta'

erba' mija u tletin elf lira Maltija (Lm430,000) ekwivalenti ghal (€1,001,630.57) sabiex tkopri l-ammont offrut mill-istess bank animo compensandi fl-istess subasta

- … Fit-3 ta ’Mejju 2006 il-Bank rikorrent ipprezenta rikors ghall-approvazzjoni taccedola ta ’kompensazzjoni in vista ta ’l-offerta animo compensandi tieghu, liema talba giet opposta mill-Kummissarju tat-Taxxa fuq il-Valur Mizjud u millKummissarju tat-Taxxi Interni minhabba l-pretensjoni taghhom li jgawdu privilegg fuq il-proprjeta` li nbieghet bis-subbasta.

- What’s interesting is that in a recent decision it was held that, we might say that we’ve learnt that privileges need to registered and in a to the other privileges and in a recent decision it was held that no it doesn’t need to be registered and what the law wants is for the claim to be privileged. As we’re going to see, the state comes in in preference to all the other privileged and hypothecary creditors and a relevant case is this, this is a particular case, also not that old and they were a number of creditors.

  - Illi l-krediti ta ’l-HSBC Bank Malta p.l.c. huma kif jidher hawn taht, u cioe`:

  - Nota ta ’ipoteka bin-numru I 8109/1998 ghall-ammont ta ’Lm450,000 ekwivalenti ghal €1,048,218;

  - Nota ta ’ipoteka bin-numru I 1639/2000 ghall-ammont ta ’Lm370,000 ekwivalenti ghal €861,868.15;

  - Nota ta ’ipoteka bin-numru I 1640/2000 ghall-ammont ta ’LmM700,000 ekwivalenti ghal €1,630,561.30.

  - Il-krediti tal-Kummissarju tat-Taxxa Fuq il-Valur Mizjud huma:

  - It-taxpayer iddikjara kreditu ta€ ’137,320.59 li jkopri l-perjodu mill-1 ta ’Jannar 1999 sa Marzu 2005.

  - L-Estimated Tax (Lm113,441.00) huwa l-ammont li d-Dipartiment ikun hareg bhala stima ghax ma jkunux dahlu denunzji. F' dan il-kaz, id-denunzji mhux sottomessi jammontaw ghal 12-il denunzja.

  - L-Audit Assessment ammontanti ghal Lm121,258 ekwivalenti ghal €282,455.15 huwa ammont globali fuq diversi perjodi li fuqhom id-Dipartiment ikun hareg assessment peress illi ma jkunx qabel/accetta l-figuri dikjarati fid- denunzji ta ’ l-istess perjodi.

- Inoltre, minn ezami tad-dokument a fol 237, il-Kummissarju tat-Taxxa Fuq il-Valur Mizjud talab ukoll l-ammonti ta€ ’56,491.03 ta ’administrative penalty u l-interessi ammontanti ghal €160,649.96.

- Il-krediti tal-Kummissarju tat-Taxxi Interni huma

- bhala Final Settlement System (FSS) tal-Biochemicals International Limited – Lm44,201;

- bhala FSS ta ’Price Club Operators Limited – Lm83019;

- waqt li Social Security Contributions (SSC) ta ’Biochemicals International Limited - Lm120,448;

- waqt li SSC ta ’Price Club Operators Limited - Lm169,154.

- Inoltre personal tax ta ’VZ – Lm6,945;

- Biochemicals International Limited bhala kumpanija – Lm5,1340;

- Price Club Operators Limited – Lm4,361

- b’dan li t-total mitlub kien ta ’Lm451,088, ekwivalenti ghal €1,050,752

- Il-Krediti tar-Registratur tal-Qrati u Tribunali Civili huma ta ’Lm14.16, ekwivalenti ghal €32.98, Lm191.16, ekwivalwenti ghal €445.28 u Lm88.50, ekwivalenti ghal €206.15.

• There was HSBC and HSBC had these three hypothecary claims, these are the type of claims that we are dealign with in our example, so you have three hypothecary notes safeguarding the rights of HSBC over those amounts.

- … bazikament il-gurisprudenza fuq is-suggett in ezami l-aktar li giet trattata kien propju fil-kawzi segwenti

- (a) Konkors ta ’Krediturі Da Vinci Limited (deciza mill-Prim’Awla tal-Qorti Civili fit-13 ta ’Novembru 2000) fejn fil-klassifikazzjoni tal-krediti ammessi saret fl-ordni segwenti

- (i) L-ewwel grad: Spejjez gudizzjarji sabiex sar il-bejgh tal-fond immobbli u sabiex isir il-qsim tar-rikavat

- (ii) Fit-tieni grad: Il-Kummissarju tat-Taxxa fuq il-Valur Mizjud li hu privileggjat a tenur ta ’l-Artikolu 62 ta ’l-Att dwar it-Taxxa fuq il- Valur Mizjud;

- (iii) Fit-tielet grad: Il-paga ta 'l-impjegati sal-ammont massimu ta 'Lm 200 u talbiet tad-Direttur tas-Sigurta` Socjali ghall-kontribuzzjonijiet ta 'l-Ewwel Klassi u privileggjati skond l-Artikolu 116 (3) tal-Kap. 318;

- (iv) Ir-raba 'grad: Il-Kummissarju tat-Taxxi Nterni ghat-taxxa dovuta bhala PAYE u privileggjata skond l-Artikolu 23 (8) ta 'Kap 372;

- (v) Mill-hames sa l-Ghaxar grad gew klassifikati kredituri ohra ipotekarji blHSBC Bank plc jikklasifika fis-seba 'grad;

- (vi) Mill-hames sa l-Ghaxar grad gew klassifikati kredituri ohra ipotekarji blHSBC Bank plc jikklasifika fis-seba 'grad;

- Jinghad fl-Artikolu 23 tal-Kap. 372 [Income Tax Management Act], illi t-talba ghallhlas tikkostitwixxi "talba privileggjata fuq l-assi ta 'min ihaddem", (li lanqas ma jghodd ghall-Victor Zammit personalment) u mhux fuq l-assi ta 'min hu legalment responsabbli ghall-hlas. Hekk ukoll l-Artikolu 116(3) tal-Kap. 318 [Social Security Act] jghid li talba ghall-hlas tikkostitwixxi "talba privileggjata fuq l-attiv tal-principal" jew "fuq l-assi tal-persuna li timpjega lilha nfisha", u ma hemm ebda artikolu li b'xi mod jestendi l-privilegg fuq l-attiv tal-ufficjal principali tal-entita` li tkun responsabbli ghall-hlas.

- F'dan il-kaz, il-proprjeta` mibjugha ma kinitx tas-socjetajiet kummercjali primarjament responsabbli ghall-hlas tat-taxxa jew kontribuzzjonijiet, izda tal-"ufficjal principali" li, kif rajna, jista 'jkun responsabbli in solidum ghallhlasijiet, izda minghajr ma l-kreditur igawdi xi forma ta 'privilegg fuq l-assi tieghu ghall-hlas

- Hawnhekk, pero, qed isir il-konkors tad-Direttur personalment, u huma l-flus ta ' dan li jridu jitqassmu u mhux tal-kumpanija. L-assi personali ta 'Victor Zammit ma humiex tal-kumpanija imsemmija jew tal-haddiema, u r- responsabbilta` tieghu tidhol biss biex tigi kkunsidrata peress li hu garanti solidali ghad-dejn. Kwindi, il-bank appellant jippregwarda fuq dawn il-krediti bis-sahha tal-ipoteki li hu rregistra favur tieghu.

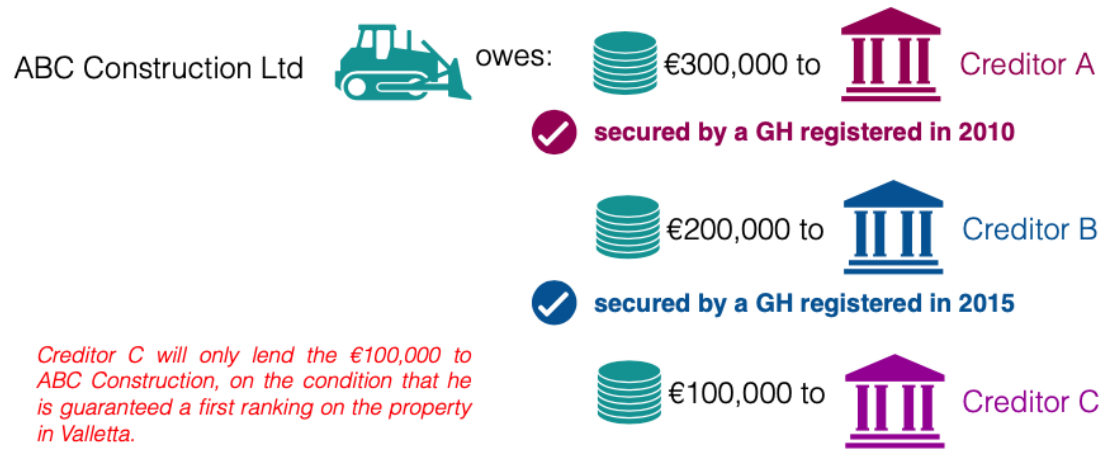
- But then HSBC was competing with the commissioner for VAT, it was competing with the commission for Inland Revenue and it was also competing with the Court Registrar. In this case the court decided to rely on what had been decided in a previous case where you can see how the ranking would work, there would be first the judicial expenses, then the vat commissioner, then the wages for the employees, then the commissioner for the inland revenue and only then would HSBC finally in advantage of the right of the judicial sale would benefit from these funds.

- So, this is an extremely controversial topic, how the government without registering any privileges can come in and supersede everyone. As you might imagine if you have a company which went bankrupt, there may hardly be any funds to repay the bank.
- So in practice this is what happens. So that's a layer which we have to introduce to our analysis, even though it is not so important as we are concentrating on the articles of the Civil Code. It's important that we're aware of this dimension.

  - Ghaldaqstant
  - (a) Fl-ewwel grad, flimkien mar-Registratur tal-Qrati u Tribunal Civili ghandu jidhol ukoll l-HSBC Bank Malta plc ghas-somma ta' spejjez inkorsi biex sar ilbejgh bis-subbasta; dawn it-tnejn jigradwaw pari passu fl-ewwel grad;
  - (b) Fit-tieni grad, jerga 'jidhol l-HSBC Bank Malta plc ghall-krediti tieghu munita b'ipoteki;
  - (c) Fit-tielet grad, jidhol il-kreditu tad-Direttur tas-Sigurta` Socjali;
  - (d) Fir-raba 'grad jidhol il-Kummissarju tat-Taxxi Interni.

- This was a particularly interesting case because HSBC managed to go straight up to the first rank because it claimed successfully that since it was the personal residence
- Personal residence of the debtor all the dues which were owed by the company which were therefore owed to the commissioner for inland revenue, where the law gave them a privileged claim this privilege went under the exercise of the instance of the company directive so HSBC in this case managed to defend itself quite well.
- This is a detail which is not required for the exam

- Today's lecture, we've dealt with hypothecs, we've dealt with privileges now we're



dealing with a situation.

- The situation is this, ABC Construction Ltd has been granted two loan facilities. One by creditor 'A' the other by creditor 'B'. Issa, both of them both creditor 'A' and creditor 'B' have previously constituted hypothecs in their favour.
- So would would rank here first over Sliema? 'A' and second 'B'. On behalf of Valletta? The same. Now, ABC construction want to embark on a new project which requires a loan of €100,000. So he goes to creditor 'C' and creditor 'C' very diligently goes through his searches and creditor 'C' tells him we have a problem, because hypothetically speaking I have these €100,000 which I could lend you, the problem is that the only two assets you own are secured in favour of securing two debts owed to another two creditors and here I would rank third.
- So he tells him I will lend you these €100,000 on condition for example that I rank first at least with respect to the property of Valletta which is the most valuable asset that ABC Company Limited owns. Can 'C' demand this or not?
- Kif qieghda s-sitwazzjoni ma jistax, trid issir xi haga, trid issir is-subordination. X'se nikkunsidraw illum? Dan il-creditor 'C' ovjament jekk ha jislef il-lflus irid jitfa

l-kundizzjonijiet tieghu hu ghandu dritt, imma dan qal ABC Limited go to the other creditors and negotiate to them and they have to subordinate their rights to mine for me to grant you the credit.

- We will see what options are available and this is crucial now to complete all the information that we need for the working of the exercise.

Year	Sliema	Valletta	
2010	GH ifo A €300,000	GH ifo A €300,000	1
2015	GH ifo B €200,000	GH ifo B €200,000	2
2020	GH ifo C €100,000	GH ifo C SH ifo C €100,000	3

Creditor C wants advice on how to secure a first ranking.

- Creditor C (this is one of the questions we might get) wants advice on how to secure a first ranking on Valletta.
- What does the law tell us?
  - Right of creditor to modify own rights.
  - 1996A. (1) It shall be lawful for a creditor to subordinate, postpone, waive or otherwise modify his existing or future rights of payment, enforcement, ranking and other similar existing or future rights in favour of another person.
  - Such subordination, postponement, waiver, modification or similar action may be made by agreement with or by unilateral declaration to any person, including another creditor, whether determined or yet to be determined at the time of the entry of such agreement or the making of such declaration.
- It's the right of the creditor, what are the options available? The options available, very briefly are five.
  - Cancellation — An act of the creditor whereby he consents to the total cancellation of the hypothec.

- Reduction — An act by the creditor whereby he reduces the amount of debt secured by the hypothec, or retain such amount but reduce his security.

- Waiver — An act by the creditor whereby he renounces his rights in so far as these affect one or more immovables falling under the hypothec registered in his favour. His rights, however, remain firm and valid vis a vis the other property of the debtor.

- Postponement — An act of the creditor whereby he agrees to rank after other specified creditors which ranked after him.

- e.g. A has a first ranking while B has a second ranking; A can postpone his rights to B so that B will now rank first, and A second.

- Subrogation — On receiving payment from a third party, a creditor may or may be bound to subrogate such third party in his rights i.e. place such third party in his legal shoes. The subrogated creditor will then enjoy the ranking of the subrogating creditor.

- So cancellation, the cancellation is the most straight forward, it's the one where the hypothecary note is cancelled, prattikament the hypothec or the privilege is considered as no longer in existence.

- If the nature of the debt qualified as a privilege it is easy the bank would still probably require a waiver but technically speaking it is sufficient to grant first ranking.

- Then you have a reduction, an act of the creditor whereby he consents to the total cancellation of the hypothec, or retains such amount to reduce his security he might say the amount owed to me is less than that which is contained in the original lease.

- Then you have a waiver, which is a renunciation, an act by the creditor whereby he renounces his rights in so far as these affect one or more immovables falling under the hypothec registered in his favour.

  - For example in this case the waiver could be an alternative because ABC would go to creditors 'A' and 'B' and tell them can you waive your rights in favour of 'C' on Valletta and on some conditions they might accept, if they accept. If they accept they waive their rights in favour of 'C' and in that case 'C' could go up in the ranking and rank first.

- There's a postponement, which is quite self-explanatory, an act of the creditor whereby he agrees to rank after other specified creditors which ranked after him.

So they might decide to invert the ranking, they would do it on the condition that a good part of the loan would be repaid or that at least a substantial part of what is due is actually paid. This is what usually happens.

- Finally something which is also common in practice, it's subrogation. It happens when you pay the debt of a debtor, another debtor and you step into the shoes of the creditor. So now, rather than being indebted to the original creditor now the debtor is indebted to you. Because you paid the debt on behalf of the interest of the debtors. So now the debtor owes the money to you and not to the creditor who has been paid to the satisfaction of all his payments.
- Then there is subrogation, on receiving payment from a third party, a creditor may or may be bound to subrogate such third party in his rights.
- Let's see them work in practice.
  - Cancellation & Reduction
  - Reduction of registration. 2059. (1) The reduction of a registration is a partial cancellation thereof.
  - (2) A registration may be reduced –
  - (a) if a part of the debt is extinguished;
  - (b) if the right of the creditor, previously affecting the whole of an immovable, or several immovables, is restricted to a part of such immovable conveniently separable therefrom, or to one or some only of such immovables.
  - How registration may be reduced or cancelled.
  - 2060.(1) A registration may be reduced or totally cancelled either with the consent of the creditor given in a public deed, or in virtue of a judgment of the competent court.
  - ... may be ordered by court in the case of GLHs, JHs & certain GH's
  - When reduction may be ordered by court.
  - 2062.(1) Besides in the case mentioned in article 2027 [i.e. right of the debtor to cause amount expressly stated by creditor to be reduced in case of debts which are conditional as to their existence or indeterminate as to their value], the reduction of a registration may be ordered by a judgment in the case of a general legal hypothec, or of a judicial hypothec, if it is shown that the

registration can be restricted as to the property affected thereby without injuring the interests of the creditor.

- (2) The same rule shall apply in the case of a general conventional hypothec created to secure a right contingent upon an uncertain event …; and any renunciation of the right to demand the reduction is void, unless it is made by a public deed on a day subsequent to that of the instrument by which the hypothec was created.

- … value of security shall always exceed registered debt by at least one-half

- Value of immovable property to which the registration is to be restricted.

- 2063.(1) The reduction, however, shall not be ordered in any of the cases referred to in the last preceding article, if the value of the immovable property to which the debtor demands that the registration should be restricted, does not exceed, by at least one half, the amount of the registered debt together with the interest accrued due, and that which will become due up to five years from the day of the reduction.

- … may exceptionally be made without the consent of the creditor

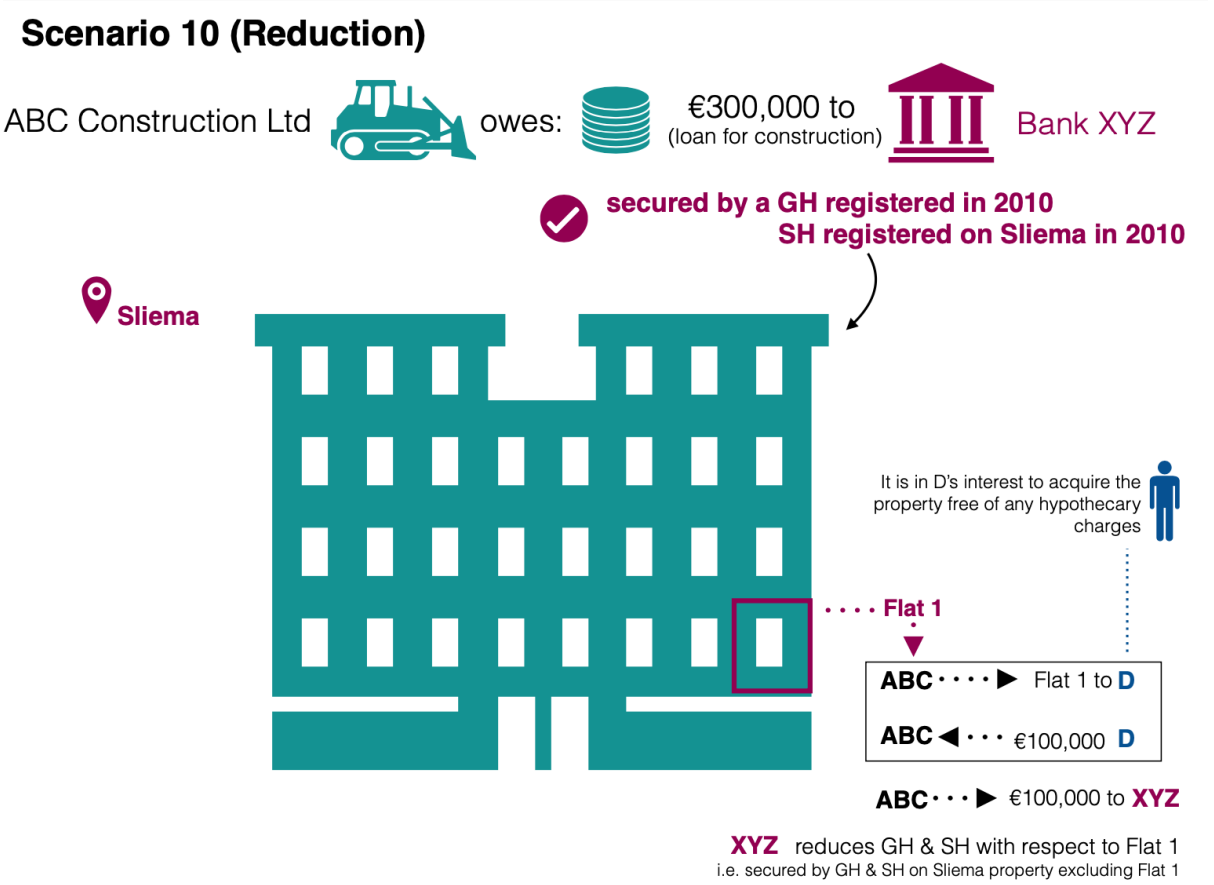
- When reduction of registration may be made without the creditor's consent.

- 2061. If the total or partial extinguishment of a registered debt results from a judgment which has become res judicata or from any other public deed, the cancellation of the registration, or the reduction thereof as to the amount of the debt, may be effected without the consent of the creditor.

- … may be ordered by judgment if registration is founded on an unlawful cause if the right of the creditor would have been extinguished

- Cancellation of registration may be ordered by judgement.

- 2064. The cancellation of a registration may also be ordered by a judgment if it is not shown that the registration was made for a lawful cause, or if it is shown that the right of the creditor is extinguished.



- We can go through the articles ourselves and we just explained them briefly here.
- Let's take the first case, reduction. How reduction come into play? Consider the case that ABC Construction Limited owes €300,000 to bank XYZ. Bank XYZ loan the money for the construction of a block of apartments, bank XYZ decided to secure the credit that would offer ABC Construction Limited through a general hypothec and a special hypothec registered on this new block of apartments in Sliema erected in 2010.
- Now what happens? Of course ABC Construction Limited wants to start making some money, part of which would go towards repaying the loan which was ranked by XYZ. So, he's about to sell flat number 1 to 'D'. If you were 'D', you engage a notary and the notary starts looking through the records of ABC Construction Limited. What would definitely come up in those records, in those searches?
- Definitely the special hypothec and the general hypothec.
- So I want to sell and I can't because 'D' is certainly not interested in purchasing a property which is burdened by a general hypothec and a special hypothec.

- A general hypothec is okay because when the property is transferred to him it would not longer be effected by GH but certainly there will be a SH in favour of the bank

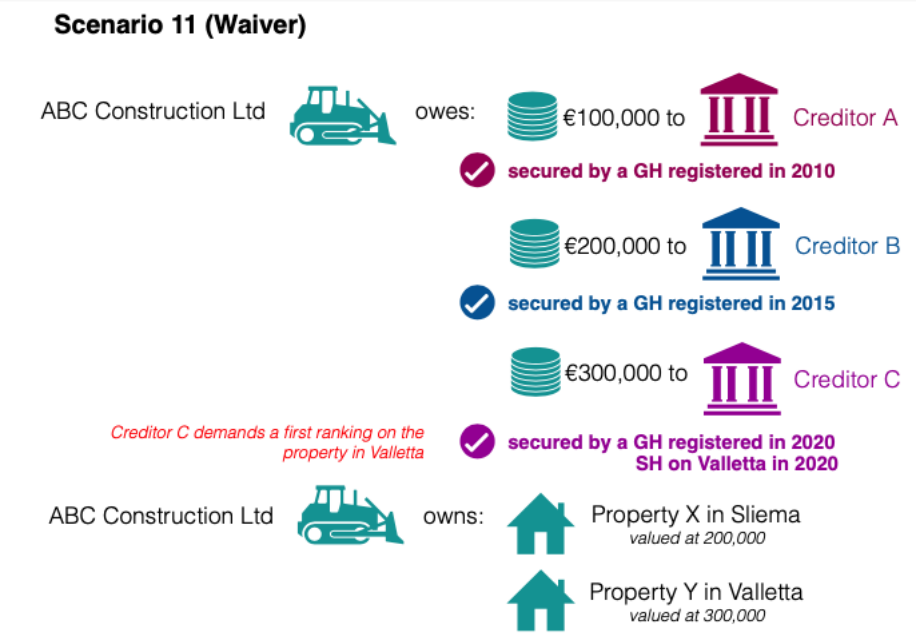
- What could this be? ‘D’ wants to buy, ABC wants to sell and it’s in XYZ’s interest for ABC to sell because it is in the process of the sale that ABC can repay part of the loan.

- The condition, so what ABC Limited, the Construction company will do, is that they will go to the bank and tell them to tell the branch manager that they are ready to start selling property they have entered a promise of sale however of course one condition on conclusion of the sale is that I sell it to ‘D’ in this case to the prospective buyer completely unencumbered so there shouldn’t be any charges burdening the property. Can you please reduce your rights with respect to the block in Sliema but limitedly with respect to flat 1? What would the bank reply?

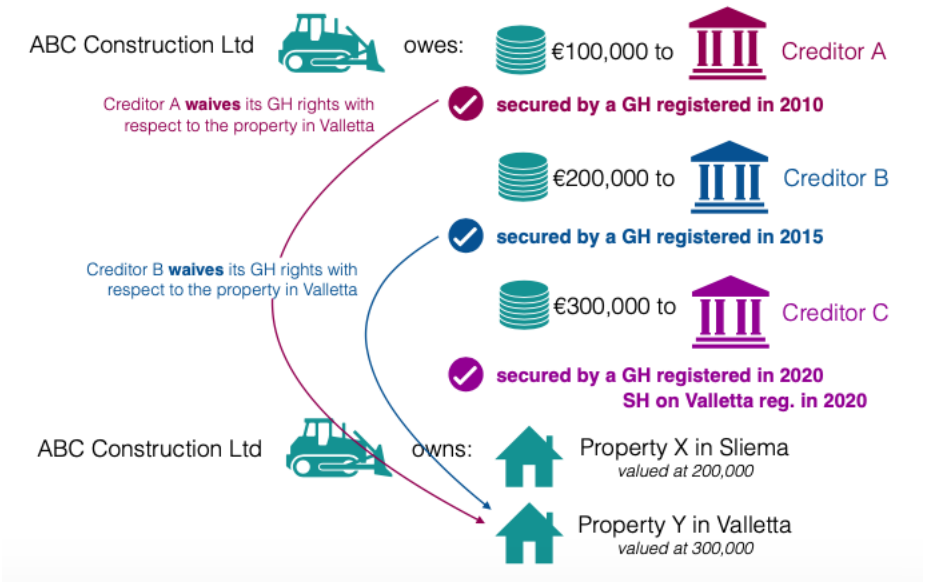
- The bank will reply yes I’m willing to do it as long as all the proceeds of the sale go directly towards the repayment of your loan. This is what is usually done in practice. The bank would state all of part of it. This is what is usually done, so what happens? The moment that the money is transferred to ABC, ABC deposits the money in its bank account upon confirming that hate money has been deposited in its overdraft or bank account the bank will proceed to reduce its hypothec. So practically the hypothec, the special hypothec relates to all the property, except for flat number 1.

- The hypothec cannot be divided. Here one can have flat 1 sold by judicial auction to satisfy the debt I have. In this case what would happen? Exactly what we explained.

- Creditor ‘C’ is demanding a first ranking on the property in Valletta, ABC Construction Limited goes to its other creditors, it goes to creditor ‘A’ and it tells creditor ‘A’ can you please waive your rights with respect to Valletta? Yes, and creditor ‘B’ does the same, which means that now the general hypothec on Valletta, they waive their rights on a particular property. This is the example of reduction tajjeb, that’s reduction.



- The next scenario is waiver, x'inhu jigri hawnhekk?
- In this case creditor 'C' is willing to grant an amount of money to ABC Construction Limited to purchase a property in Valletta. F'dan il-kaz probabilment ikollu special privilege imma what we are concerned with mostly is how it works.
- So, creditor 'C' knows that since he's negotiating with ABC Limited in 2020, the problem is that creditor 'C' and creditor 'B' in virtue of a general hypothec which has been registered years before it started negotiating with ABC Company Limited they would have a prior ranking. This obviously represents a problem. Why? Because we know that hypothecs rank in accordance to the date of registration. So here, with this special hypothec registered on Valletta be effective in any way if I want the first ranking on Valletta? No because do general hypothecs supersede general hypothecs? No because it's just a hypothec, it's a hypothec specific to a certain property.
- So creditor 'C' tells ABC Construction Limited, go negotiate with creditor 'A' and creditor 'B' I want their guarantees to have nothing to do with the property in Valletta, in Valletta I want to rank absolutely first without any doubt as to who should rank first.

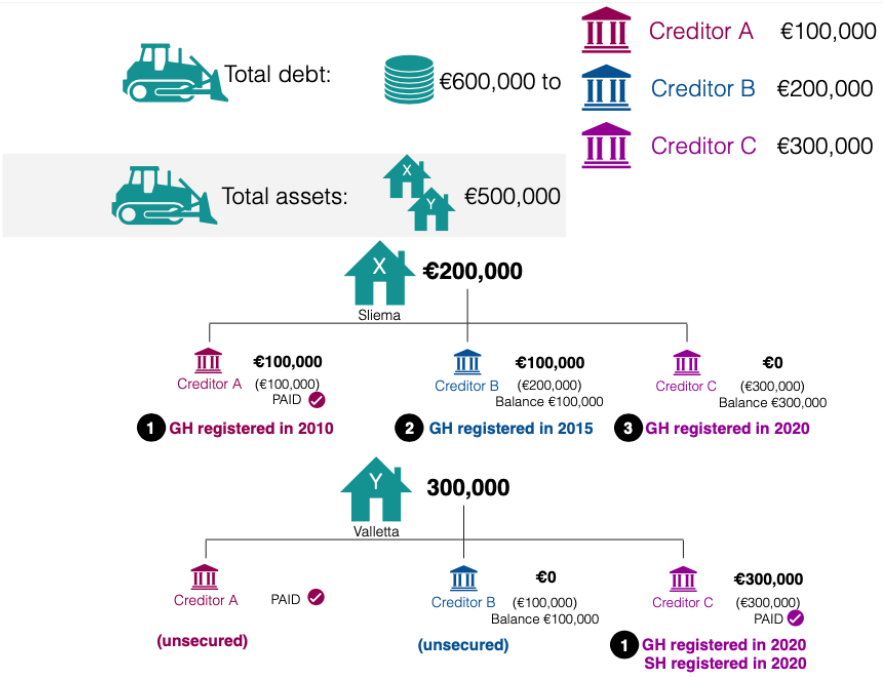


- What happens is that ABC Construction Limited goes to the creditor ‘A’ and asks creditor ‘A’ to waive their hypothecary general rights to Valletta only with respect to Valletta, keep in mind there’s both Sliema and Valletta and what creditor ‘C’ is demanding is a first ranking in Valletta.
- ABC Construction Limited does the same thing with ‘B’ saying can you waive your general hypothecary rights only with respect to Valletta? They will repose their own terms, ABC will comply and they will waive it. That was a situation where then creditor ‘C’ seems to have a very strong position on Valletta, if the others waived their rights would ‘C’ have a strong position on Valletta? Yes. But, this is only with respect to Valletta.

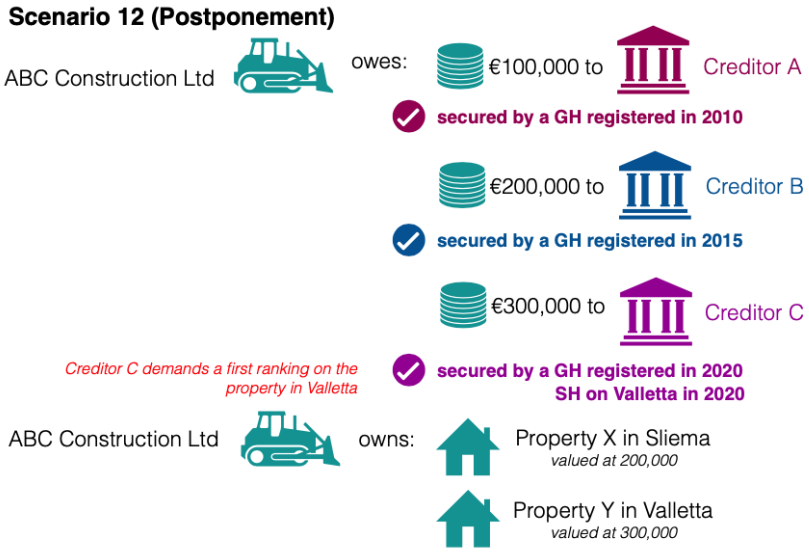
Creditor A's and **Creditor B**'s rights on Sliema remain intact

Year	Sliema	Valletta
2010	GH ifo A €100,000	GH ifo A €100,000
2015	GH ifo B €200,000	GH ifo B €200,000
2020	GH ifo C €300,000	GH ifo C SH ifo C €300,000

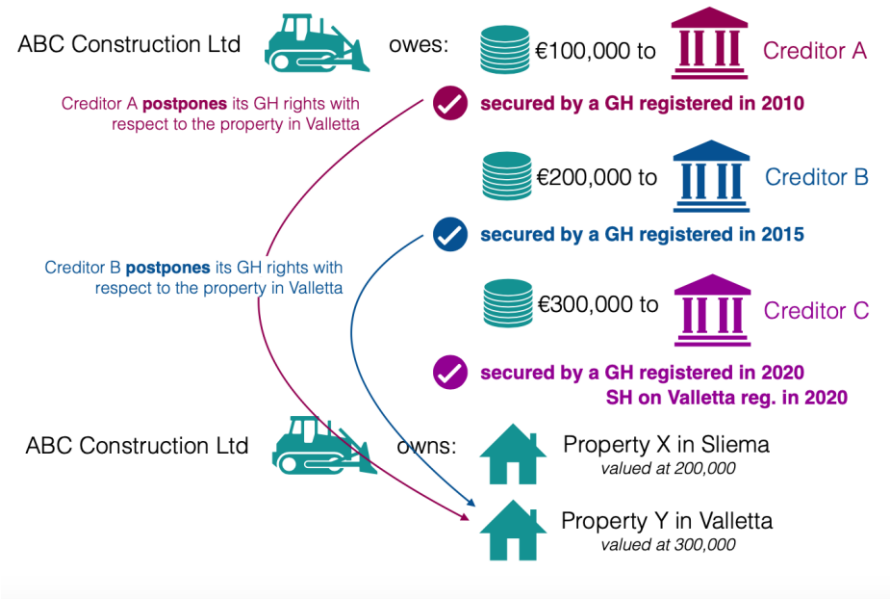
- So what happens is this, they waive their rights with respect to Valletta and in that case there's no doubt that 'C' is the only security creditor on that property but with respect to Sliema, the situation doesn't change. For a bank or for a creditor to sign a waiver it needs something concrete in return, (everything is public). When waiving their rights they are waiving their rights only in preference as there would be something in return for them. If they want to do something less drastic there is another way they can postpone meaning they can let one particular creditor leapfrog them so to speak.



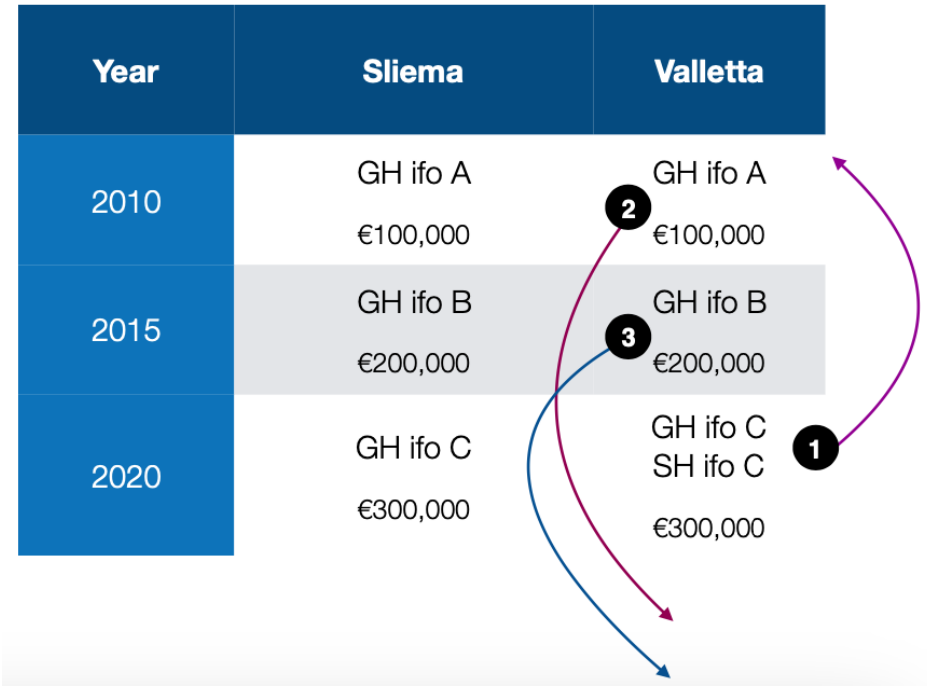
- In practice what happens mela? When Sliema is sold creditor ‘C ’ranks third so creditor ‘C ’isn’t paid at all, but when it comes to Valletta, creditor ‘C ’ranks first and he gets everything.



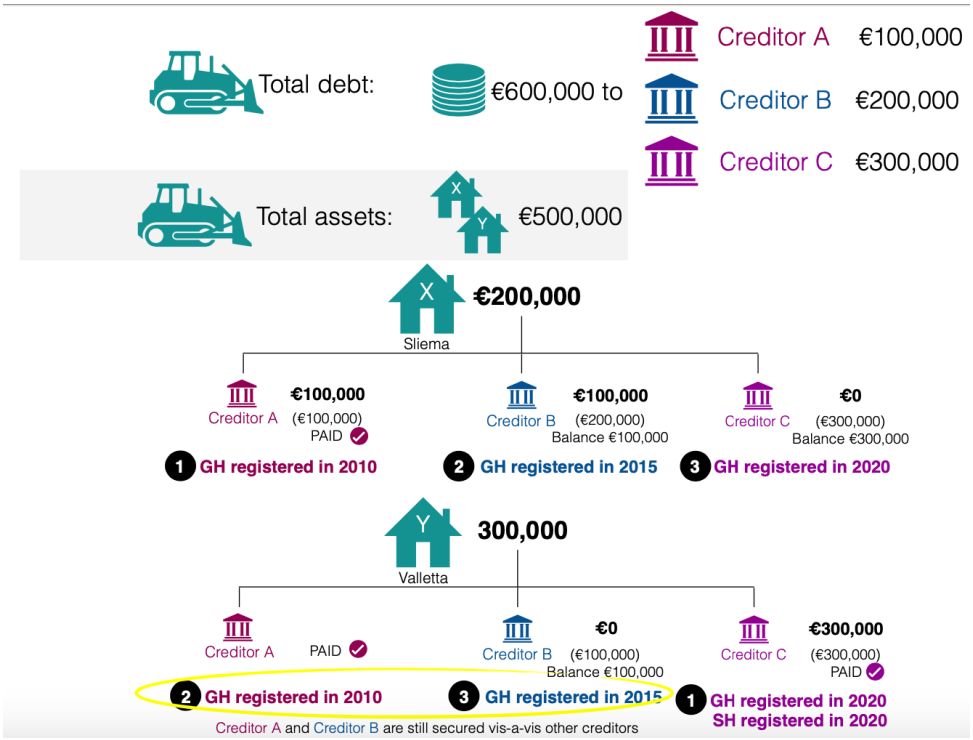
- Another alternative, which is the postponement? The postponement works exactly as a waiver simply it is less drastic, in that you are not relinquishing your rights completely you are simply giving way to another creditor to surpass you.
- The situation here is identical to the previous one, three loan facilities, two assets and ABC is faced by a demand by creditor ‘C’ because creditor ‘C’ is demanding a first ranking on the property in Valletta. Same situation completely. creditor ‘C’ same situation completely.



- In this case 'A' would agree to postpone its rights with respect to Valletta in favour of 'C', 'B' would do the same, we're talking here about postponement, just postponement.

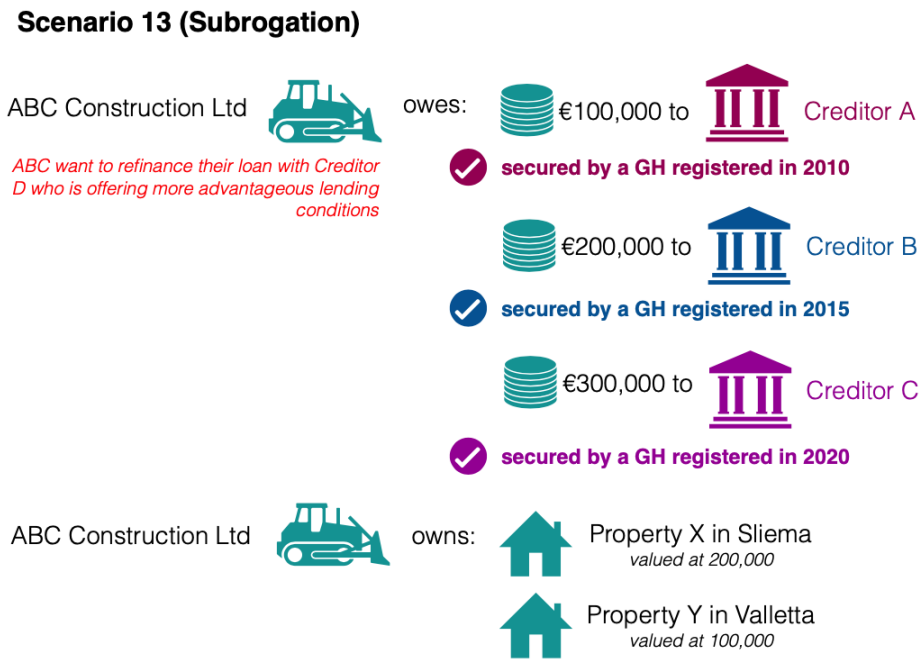


- ‘C’ would now rank first because the others would have postponed their rights, ‘A’ and ‘B’ now they’re not a position as rightly underlined by us, in this case they are not rightly secure and in this case the only thing that happens is that they’re letting one go on top.
- So, ‘A’ would still rank ahead of ‘B’ but both of them would rank behind ‘C’ so for example If the property is sold here, with respect to Sliema ‘1, 2, 3’ according to the rank of registration no issues over there, but with respect to Valletta even though there is nothing left out of the sale because all the proceeds go to satisfy the claim owed to creditor ‘C’, so ‘C’ would rank first, ‘A’ would rank second and ‘B’ would rank third.



- That is the postponement.
  - Subrogation ex parte debitoris
  - When the debtor finds a person who is willing to pay his debts with subrogation.
  - The conditions are:
  - a. A loan which the debtor obtains from a third party;
  - b. That the money obtained in this way has been made use of to pay the debt;
  - c. The loan must have been made with the condition that the new creditor is to succeed in the rights of the former creditor;
  - d. Both the loan and the receipt of payment must be made by public deed.
  - 1165. (1) The payer shall be subrogated to the rights of the creditor, by agreement –
  - …
  - (b) when the debtor borrows a sum for the purpose of discharging his debt, and of subrogating the lender to the rights of the creditor:
  - Provided that such subrogation shall not be valid unless –
  - (i) the loan and the discharge are made by a public deed,
  - (ii) it is stated in the deed of loan that the sum has been borrowed in order to discharge the debt, and
  - (iii) it is stated in the discharge that the payment has been made with the money furnished for the purpose by the new creditor
- We come to the final example, subrogation and know how it works so we barely need to go into the necessary detail, but what are we talking about? What are the conditions for a subrogation ex parte debtors?
- First of all a loan which a debtor obtains from a third party, that the money obtained in this way has been made use of to pay the debt, so we're talking about a situation where you borrow an amount of money to pay a debt. The loan must have been made with the condition that the new creditor is to succeed in the rights

of the former creditor, both the loan and the receipt of payment must be made by public deed.



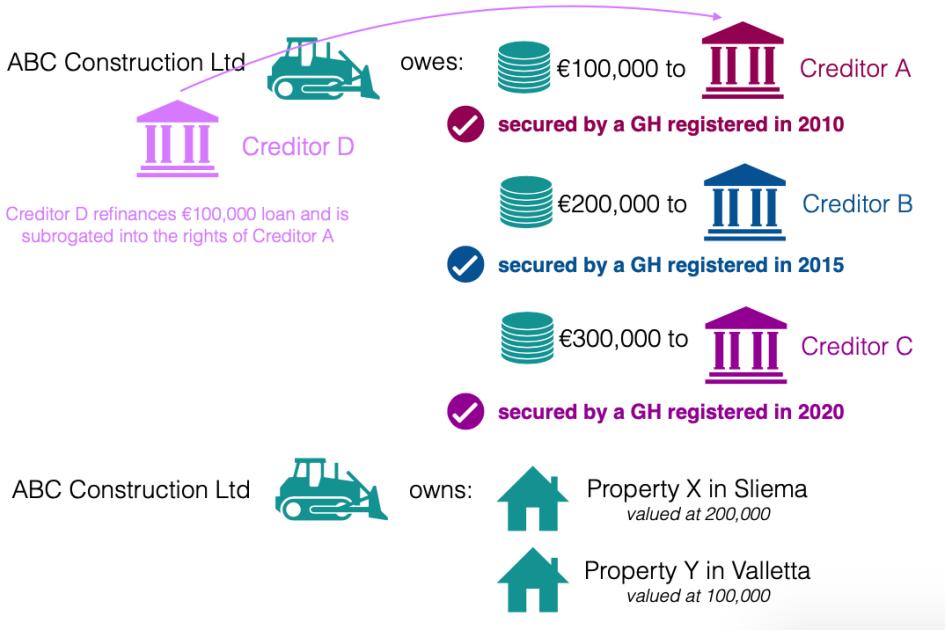
- A

situation in practice.

- There is ABC Construction Limited and there are three creditors, issa ABC feels that the amount of interest which creditor ‘A’ is charging it is high compared to other alternatives. So he goes around shopping a number of banks. He’s happy with how much he’s paying creditor ‘B’, and he is happy with how much he’s paying with creditor ‘C. So in this case, he goes to another bank ‘D’, bank ‘D’, creditor ‘D’ and creditor ‘D’ tells ABC Construction Limited I can offer you a much lower rate of interest, for ABC Construction Limited, this makes a lot of difference because the amount that ABC Construction Limited will be saving every year will be enormous.

- Of course, however bank ‘D’ will first of all to make the switch will have to pay the debt which ABC Construction Limited owes to creditor ‘A’. What is the problem with creditor ‘D’ entering so late in this series of transactions? If creditor ‘B’ registers a simple hypothec, creditor ‘D’ will rank behind creditor ‘C’ and creditor ‘D’. So what happens here? Creditor ‘D’ will accept what we call to refinance the loan of ABC Construction Limited. So ABC Construction Limited will take out a loan from creditor ‘D’ to pay creditor ‘A’ and since the amount that ABC Construction Limited is borrowing from creditor ‘D’ will be used to repay creditor

'A' what happens is that 'D' will step into the shoes of creditor 'A' as long as it is done by



public deed and in accordance with the conditions stated in the law.

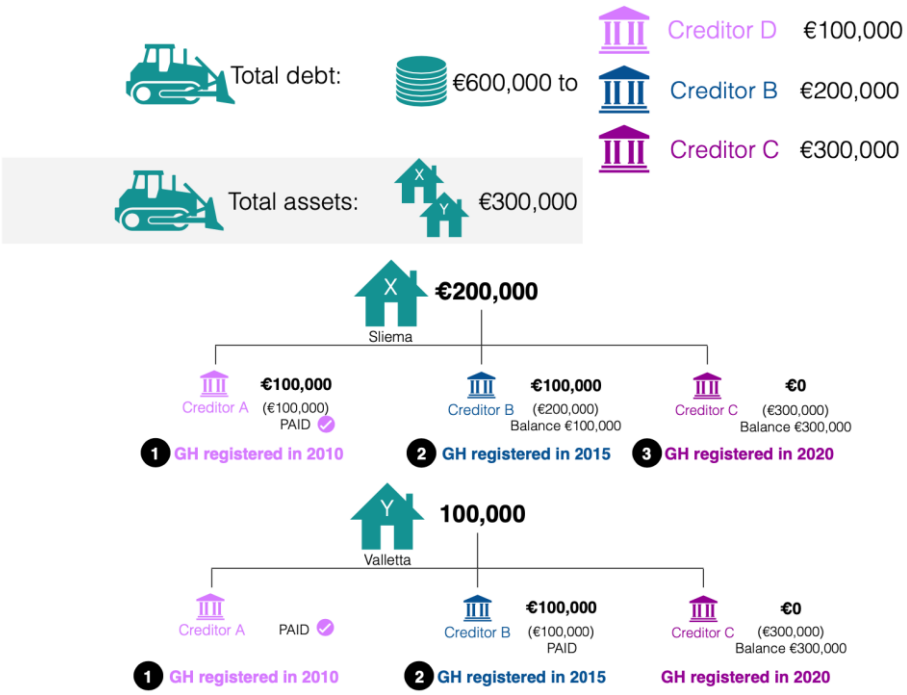
- So practically what happens in that case, creditor 'A' cannot object because of course ABC Construction Limited is going to come up with the money and what will happen is that now creditor 'D' refinances the €100,000 and is subrogated into the rights of creditor 'A'.

- What before was owed, the preferences that were let's say to which creditor 'A' was entitled, they have now been acquired by 'D', so now the order is 'D', 'B', 'C', in a way that if this property were sold by judicial auction both Sliema and Valletta, in both cases creditor 'D' would rank first so creditor 'D' would be repaid in preference to all the other creditors with respect to any amounts that are due.

Year	Sliema	Valletta
2010	GH ifo D €100,000	GH ifo D €100,000
2015	GH ifo B €200,000	GH ifo B €200,000
2020	GH ifo C €300,000	GH ifo C €300,000

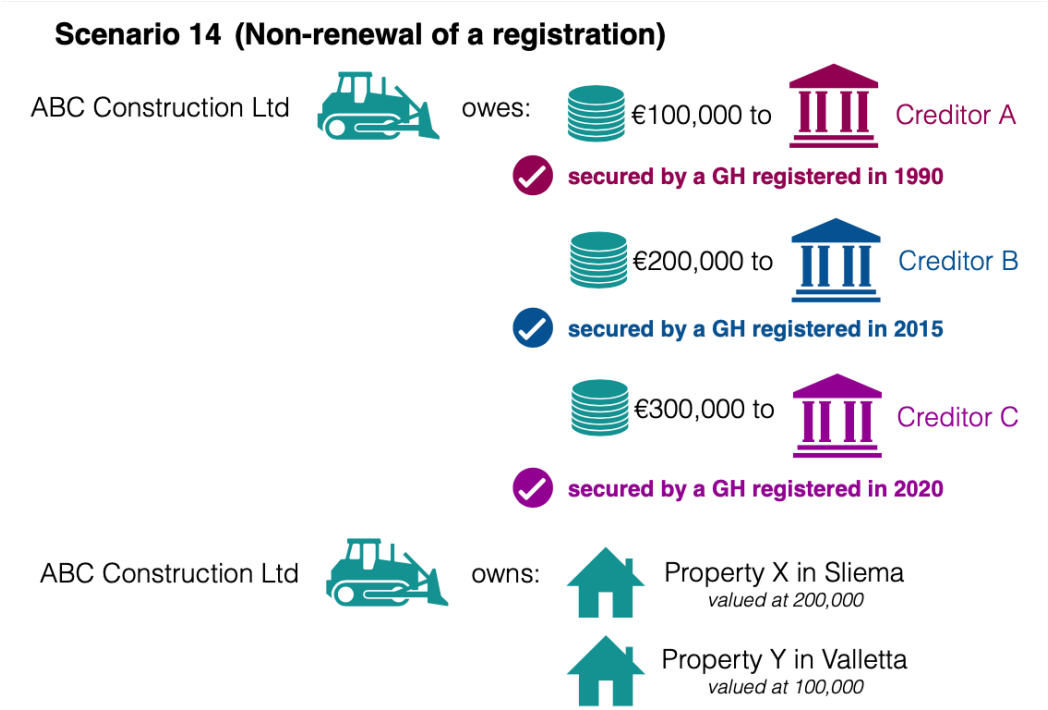
- So as one can see, creditor 'D' here satisfies its claim immediately in preference to all the others.

- No permission is needed from ‘B’ and ‘C’ because their interests are not being prejudiced.



- Renewal of registration of privileges and hypothecs
- 2053. (1) The registration of a privilege or hypothec in the Public Registry shall cease to have effect after thirty years from the date thereof unless such registration is renewed before the expiration of the said time.
- The registration of a privilege or hypothec in the Public Registry shall cease to have effect after thirty years from the date thereof unless such registration is renewed before the expiration of the said time.
- Renewals made after the prescribed time shall, even in the case of a privilege, have the effect of an original hypothec which shall rank only from the date of the registration.
- A hypothec or privilege renewed within the prescribed time shall retain the original ranking it enjoyed.
- P. Farrugia Randon, Aspects of Maltese Law for Bankers, Institute of Bankers (Malta Centre), 1983, p. 66.

- Some final points relating to time limits (these are very important). The renewal of registration of a privilege or hypothec. Unless the registration is renewed, the

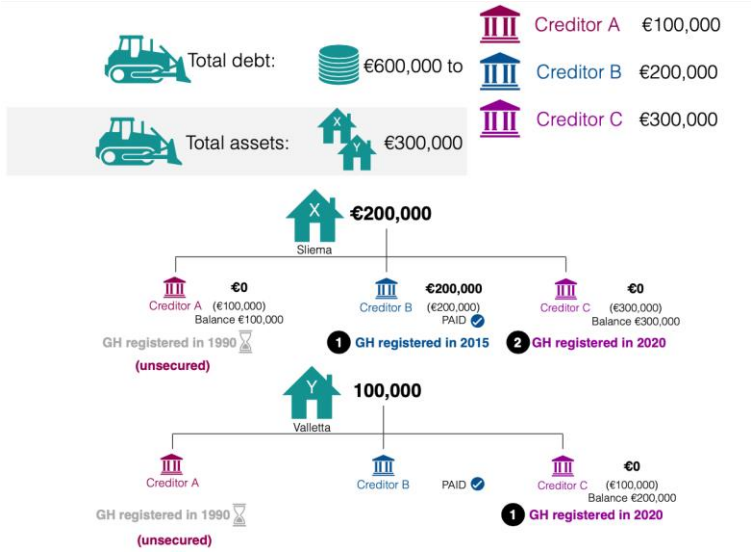


effect of the hypothec lapses after thirty years.

- So in practice, this is important, there was a GH registered in the 1990. This is the last scenario, the non-renewal of a registration, so secured by a general hypothec in the 1990 but thirty years have lapsed. So who ranks first? 'B' and then 'C'. It is very easy.

Year	Sliema	Valletta
1990	GH ifo A €100,000	GH ifo A €100,000
2015	GH ifo B €200,000	GH ifo B €200,000
2020	GH ifo C €300,000	GH ifo C €300,000

- We had registration dating back to 1990 but thirty years have lapsed so it is creditor ‘B’ who ranks first. So if one had to sell the property, GH remains an insecure creditor.



  - Extinguishment of Privileges and Hypothecs
  - 2084. Privileges and hypothecs are extinguished -
  - (a) by the extinguishment of the principal obligation;
  - ...
  - The extinction of the obligation kills the very purpose of these securities.
- That we’re talking about here are accessory rights.
  - 2084. Privileges and hypothecs are extinguished -
  - (d) prescription
  - Privilege or hypothec extinguished by prescription of principal debt
  - When prescription in acquired by debtor.
  - 2085. Prescription takes place in favour of the debtor, in respect of property of which he is in possession, by the lapse of the time established for the prescription of the debt to which the privilege or hypothec refers.
  - … prescription takes place in favour of third parties in possession by lapse of ten years

- When prescription is acquired by third party in possession.

- 2086. As to property which is in the possession of a third party, prescription takes place in favour of such third party by the lapse of ten years from the day on which he acquired such property, even though the creditor may not have known that such property had passed into the hands of a third party.

- Issa, extinguishment of privileges and hypothecs and now we deal, the more obvious one which is if the principal obligation is extinguished then so are the privileges and hypothecs are attached to it, that is what we are talking about here, accessory rights. As soon as the debt is prescribed, so does the hypothec, article 2085.

- Then we have a very important one which is of the third parties in possession, the prescription is that of ten years, article 2086. Innutaw mhux in possession, the article is not questioning possession, it is mentioning the lapse of ten years from the day on which he acquired such property.

  - Lay Lay Company Limited v. Alsan Enterprises Co Ltd, FHCC, 16 July 2019, Rik. 71/2016/LSO

  - Permezz tal-kawza odjerna, is-socjeta ’rikorrenti qeghda titlob li jigi ddikjarat li l-ipoteka specjali numru 16927/1995, li giet registrata fuq il-villa “Xlukkajra”, fi Triq is-Silg, Marsaxlokk, flimkien ma ’porzjon diviza tal-istess art, hija preskritta ai termini tal-artikolu 2086 tal-Kodici Civili. ...

  - 2086. As to property which is in the possession of a third party, prescription takes place in favour of such third party by the lapse of ten years from the day on which he acquired such property, even though the creditor may not have known that such property had passed into the hands of a third party

  - Il-ligi trid li minħabba li l-kreditur ikun irreġistra ipoteka speċjali fuq il-ġid tad-debitur, il-benefiċċju ta’ dik l-ipoteka jibqa ’miżmum minkejja t-trasferiment tal-ġid ipotekat lil ħaddieħor. It-terza persuna li tikseb il-ġid hekk ipotekat tikseb il-preskrizzjoni dwar dak il-ġid fi żmien għaxar snin minn dakinhar li l-ġid ikun għadda għandha, minkejja li l-kreditur ma jkunx jaf li jkun sar trasferimentbħal dak. Is-socjeta ’rikorrenti tghid li ghaddew aktar minn ghaxar snin minn meta akkwistat villa “Xlukkajra”, ghaldaqstant a tenur tal-artikolu 2086, bhala terza persuna, ghandha dritt titlob il-kancellament tal-ipoteka specjali registrata mis-socjetajiet intimati fis-sena 1995, li qeghdha tghabbi l-proprjeta ’taghha.

  - [Difiza tal-intimat]

- Is-socjeta 'rikorrenti ma kellhiex ghal dawn l-ahhar ghaxar (10) snin pussess tal-art kontinwu, mhux miksur, pacifiku u pubbliku u mhux ekwivoku skont l-artikolu 2107 tal-Kap. 16. Dan huwa dovut ghal proceduri legali li kellha quddiem il-Qrati matul is- snin. Ghaldaqstant, il-pussess li seta 'kellha kellu jigi interrot b'dawn il-proceduri.

- The wording of 2086 was the subject of a recent case. Lay Lay Company vs Alsan which is the same case when we dealt with a reduction of a general hypothec to a special hypothec. The facts relate to the same case, you had a reduction of a GH to a SH and Lay Lay wants to remove that registration at all costs and Lay Lay Company Limited lost its first claim because the court confirmed that yes here AV Limited and the other parties had a right to reduce the GH to a SH. So it attempted later on a subsequent challenge (don't forget Lay Lay Company Limited did acquire the property in 2004. It attempted, a subsequent challenge just to have this SH taken out completely, on the basis of prescription.

- Since it had acquired the property in 2004, ten years lapsed by the time when they decided to file this case which was in 2016, and the argument of Lay Lay company was we acquired the property ten years ago, by this time nothing happened so now in 2016 ten years have lapsed, I am a third party in possession so now we can have the registration extinguished, the hypothec in this case the special hypothec extinguished because of prescription because of the lapse of ten years. Could it request that extinguished/struck out or not?

- If you recall acquisitive prescription, if we were to consider acquisitive prescription one fundamental requirement is good faith, rather a title and other requisites and in fact the plea by Alsan Enterprises and Co was 'il-pussess f'dawn l-ghaxar snin kien miksur, ma kienx pacifiku u kien ekwiviku. Allura there was doubt as to how 2086 was to be applied. But the court went into a very strict interpretation of the article.

  - ... il-legislatur ried li [ghall-artikolu 2085] tinghata interpretezzjoni ghal kollox dejqa, dik li f'gheluq l-ghaxar (10) snin minn dakinhar li t-terza persuna tkun akkwistat il-beni, l-ipoteka tispicca favur taghha. Fil-fatt, il-legislatur sahansitra jqis l-iskrizzjonijiet li jsiru fuq talba tal-kreditur ma jiksrux il-mixi tal-preskrizzjoni favur it-terz pussessur (u id-debitur). ... il-Qorti hija sodisfatta li l-elementi mehtiega sabiex din l-azzjoni tirnexxi gew ippruvati mis- socjeta 'rikorrenti.

  - Tilqa 'l-ewwel talba u tordna li l-ipoteka specjali numru 16927/1995 registrata fuq [Villa B] skadiet u spiccaw ukoll l-effetti taghha fuq l-istess proprjeta'.

- In fact the court stated ‘il-legislatur ried li [ghall-artikolu 2085] tinghata interpretezzjoni ghal kollox dejqa, dik li f'gheluq l-ghaxar (10) snin minn dakinhar li t-terza persuna tkun akkwistat il-beni, l-ipoteka tispicca favur taghha.’
- So in this case because by that time these creditors had retracted then in that case the rights of the hypothec had to be extinguished because of prescription. It’s a controversial decision with it’s effect in practice but if you look at the wording on the law it’s clear, prescription takes place in favour of such third party by the lapse of ten years by reference to the manner in which the property was possessed during those ten years.
- Is it leaving it out because it is presuming that it must be compatible with the articles regarding prescription or is it leaving it out for a purpose?
- The court decided to go for a more literal/narrower interpretation so this case the effects of the hypothec were held to be extinguished.
  - Code of Organisation and Civil Procedure
  - Right of creditor to re-sell immovable property to be exercised within two years.
  - 356.(1) The time period contemplated in article 2086 of the Civil Code, in respect of property adjudicated in a judicial sale, shall be of two years to commence to run from the date of enrolment of the act of adjudication in the Public Registry.
  - (2) The said period of two years shall be reduced to four months from the date of service by a judicial act of a copy of the act of adjudication, or of a copy of the note of enrolment of the act of adjudication in the Public Registry, and this in respect only of any hypothecary or privileged creditor on whom such service is made.
  - ...
- One final note, relating to the judicial sale by auction so the period which is contained here in article 2086 goes down to two years or possibly four months in the case of a judicial sale. Its important that in the case of a judicial sale, where the property is sold by a judicial sale it is not so free and unencumbered. Chargers remain applicable but in this case the right is limited in time, so they don’t have ten years they have less.
  - Care Malta Group Limited v. Avantgarde Holdings Limited, Court of Appeal, 29 November 2013, App. Civ. 912/2008/1

- Last week when dealing with special privileges in favour of contractors, masons, architects we refereed to this case where there was a subcontractor and the issue was could the subcontractor claim a special privilege, register a special privilege at least up to the amount that he was owed by the principal in the case that he wants to trade by the contractor and there was a specific question saying, are there any cases where the subcontractor could possibly registered a hypothec in it's favour? The answer is no, the court has excluded subcontractors from benefiting from the right to register a privilege.

- We said that contractors by law may register a special privilege because theirs is a privileged debt in this case Care Malta vs Avantgarde, the case related to a subcontractor who has not been paid by the contractor and since he wasn't paid, the subcontractor proceeded to register a special privilege on the property. Care Malta objected to this registration and said this registration is not regular because he is a subcontractor and there is no direct relationship between me as the principal and the subcontractor and the arguments raised by the subcontractor are plausible, because he was acting upon the instructions of the contractor and for the benefit for the principal the only problem was that there was no direct juridical link between the subcontractor and the principle because the only link that there was was between the subcontractor and the contractor.

- So the question here was could the subcontractor have a special privilege in view of the contractor? We discussed this case and there were arguments which would have been in favour of the subcontractor but the short answer is no. the privilege which the law grants to the contractor under the civil code cannot be used by the subcontractor.

- What do we need to cover for the purpose of this exercise? What we need to concentrate on are the slides which we have been given in this series of lectures. We will not be asked on something which we have not tackled in the slides or discussed in class. This is also very important.

- 2022 June Exam Paper

  - Key Contractors Limited (Key) has made a number of property investments over the years. The company's searches reveal the following notes of hypothecs and privileges registered against it:

  - (1) 1991 - Favour A (Lender) - €50,000 Loan - GH and SH on property in Cospicua

  - (2) 1997 - Favour B (Lender) - €70,000 Loan for purchase - GH, SH & SP on property in Attard

- (3) 2005 - Favour C (Lender) - €100,000 Loan for purchase - GH, SH & SP on property in Naxxar
- (4) 2006 - Favour D (Contractor) - €50,000 Cost of works and materials - SP on property in Naxxar
- (5) 2007 - Favour E (Lender) - €100,000 Loan for construction - GH, SH & SP on property in Naxxar
- (6) 2012 - Favour F (Lender) - €200,000 Loan - SH on properties in Cospicua and Attard
- (7) 2020 - Favour G (Purchaser) - €120,000 - GH in support of warranty of peaceful possession granted for sale of property in Valletta
- Besides the abovementioned properties Key also owns another property in Paola.
- Key eventually transferred the property in Cospicua to Island Real Estate Limited.
- Despite the stable property market, Key is currently facing certain financial difficulties which are unsettling its creditors.
- Advise Key Contractors Limited in view of the below:
- Lenders C and E are contemplating the foreclosure of their respective loans. Moreover, Lenders C and E have come in possession of evidence that the material which Contractor D supplied to Key was not used on the property in Naxxar but on another project elsewhere.
- Purchaser G has recently discovered that the property that he was sold by Key has a defective title, and is now fearing that the GH is not adequately securing any potential claims he might have against Key.
- Lender F is growing increasingly impatient with Key’s partial defaults and wants to consider its options.
- Lender H, towards whom Key does not have any commitments yet, is willing to grant some financial breathing space to Key, however it wants to secure, at the least, a first ranking on the property in Paola.
- Lender B has recently discovered that the SP was only registered three months after the purchase of the property. Lender B is concerned about whether this

oversight might affect his ranking, particularly in the case of the sale of the Attard property.

- What we're faced in our exam is something similar to this, the format is always the same. There will be a debtor who is bound towards several creditors and we will have to advise, telling the debtor (who is our client) basically how the various creditors rank on respective properties.
- In this case there was Key Contractors Limited (fictitious example), they have a number of loans, so they have €50,000, we are mostly concerned with the registrations, with the hypothecary privileged rights.
- So in this case what we're concerned about was that where was a GH and SH on a property in Cospicua registered in favour of 'A' in 1991. Similarly, a GH, SH and SP on the property in Attard registered in 1997. Then a GH, SH and SP on the property in Naxxar registered in 2005 (we have to assume that the date over here, the first column is the date of registration). That's the only date we're concerned with we don't need to complicate things further. In 2006 there was a SP in Naxxar up to €50,000 in favour of contractor 'B', then there was a GH, SH and SP on Naxxar inn favour of creditor 'E', then an SH on Cospicua and Attard in favour of creditor 'F' and a GH in support of the warranty of peaceful possession granted for the sale of property in Valletta up to €120,000 granted in favour of 'G'.
- The exercise we have to try and do is fairly simple. So, you list down in the order in which it is reproduced on the paper.
- Here on the first column the dates of the enrolment, so when there was the enrolment/registration and the properties at the top.
- Then you see what applies and what doesn't.
- Key also owns another property in Paola, so what we do is that on top of the properties mentioned in this case so, Cospicua, Attard, Naxxar and Naxxar once again, Cospicua and Attard, then we have Valletta and finally Paola. So these are the five properties that we are concerned with.
- So the starting point is this. The first row and the first column.
- We're given more information which is important to us to fill in the table property.
- So Key eventually transferred the property in Cospicua to Island Real Estate Limited, so this is relevant because Key eventually transferred the property in Cospicua (we have to assume it was done after the hypothecation. So in this case the property is sold.

- Issa, if we build it step by step it is very easy, if it's done step by step it's very difficult to get anything wrong.
- Finally despite the stable property market, Key is currently facing certain financial difficulties which are unsettling its creditors.
- Let's start filling in the table, let's take the first one. Let's take 'A', creditor 'A'.
- Creditor 'A' we're told has a GH and a SH on the property in Cospicua, how do we fill in the relevant details? We're told it has a GH and an SH, so we write them under Cospicua.
- In Attard here, if Attard is not mentioned why did I put a GH? In this case when you have a GH you keep/proceed that GH in favour of 'A' under all the columns.
- Second one, in favour of 'B' GH, SH and SP in favour of Attard, x'se naghmel hawnhekk? GH, SH and SP under ATtard, and what about the others? All would be GH, it is not SH because SH is specific. SP is the same, the privilege is the same.
- Ghaliex jiena hawnhekk bqajt ghaddej bil-GH? Eija nassumu li per ezempju, mela jekk Attard kienet diga fil-patrimonju ta' key contractors m'hemmx problema, fis-sens hemm il-GH tapplika fuq il-propjeta kollha. Issa jekk nassumu li Naxxar, Valletta u Paola inghalqu wara, dawk xorta ghandhom il-GH? Iva ghax il-GH in the rank hija ukoll fuq future property, mela f'dak il-kaz mhux ghax il-GH saret fin-1991 u l-propjeta inxtrat fit-2006, mela l-propjeta li nxtrat fit-2006 ma tigix affetwata mil-GH, le. il-GH tapplika xorta.
- Hawnhekk x'qed naghmlu taht H'Attard, GH, SH u SP, that's evident, obviously the GH as what happened with the previous registration/enrolment it applies across the board. SH's and SP's are not however repeated under the other column because a SH and SP is specific to that particular immoveable.
- Repeat this exercise with all of the properties, the only difficulty that there is, the only thing that you have to keep in mind at this stage is if it is a GH, it is enumerated under each property, if it is an SH or an SP it is limited to that particular immoveable. The final picture during the remuneratory exercise which is not complete should look like this.
- The first part is to look at the properties and look at the years of registration and compile this, make sure that you include all the properties, all the registrations and of course more importantly all the hypothecary and privileged notes.

- That's the first part, I looked at the properties and saw the hypothecary registrations. It might be the case/would be the case in our exam that however not all hypothecary registrations would be valid for a number of reasons.

- Let's look at them, we have four things we have to look out for.

  - The first one is the fact that the GH and SH on the property in Cospicua in favour of 'A' were registered in 1991. What's the problem with it? The thirty years prescription. We have to assume that once we're told the creditor has nothing, so we have to assume. For the purposes of the thirty years, there are, jekk l-ezami ma jghidilniex li l-ipoteka get renewed, irridu nassumu li ma gietx, irridu nassumu li m'ghamel xejn, assume that the creditor did nothing.

  - What effect does it have on our table? L-ewwel row tigi cancelled, kollha anke l-SH? Iva. L-SH milquta min zewg irregolitajiet. Jiena l-ewwel haga li se naghmel immur fuq 1991 u naqta kollox ghax ghaddew it-tletin sena u ma gewx renewed.

  - L-ipoteka giet registrata fin-1991, fit-2021 ghaddew tletin sena, l-ipoteka ma kienitx renewed u giet minghajr effet. So naqta 1991.

  - Xi jmiss? The second point I have to look out for is this, Key eventually transferred the property in Cospicua to Island Real Estate Limited. Does this effect me? Kif taffetwani lili? Jekk il-propjeta giet trasferita u din kienet propjeta bil-GH, garanzija, jiena prattikament la din il-propjeta harget mil-patrimonju tad-debitur mela awtomatikament l-ipoteka m'ghadiex tiswa fuq din il-propjeta specifika allura naqbad Cospicua u nhassar kollox, imma mhux kollox kollox ghax special hypothec attaches to the property, there's a droit de suite, jiena rrid naqta kollox barra l-SH in favour of 'F'. L-ohra ghaliex tinqata tan-1991, tinqata minhabba t-tletin sena. By selling the property my rights on the property remain intact, vis a vis the property but my rights are intact. The transfer took place from Cospicua to Island Real Estate Limited.

    - If the answer is not incorrect you will get marks, if someone said but one has to watch out for whether the ten years elapsed, you will get marks. Biex taghti parir lill kreditur, irid ikollok vizibilta x'qed jigri mal-krediturl kollha.

  - It-tielet haga li tikkoncernani x'inhi? What else? Lenders 'C' and 'E' have come in possession of evidence that the material which Contractor D supplied to Key was not used on the property in Naxxar but on another project elsewhere. Does this effect me? The special privilege here is affected. 'C' and 'D', they come into possession of some form of information/evidence that the amount that is being claimed here on Naxxar by creditor 'D' that was not material or services that he rendered for the benefit in ameliorating the property in Naxxar. He used it to ameliorate another property. So in that case one cannot register a special

privilege because the works were made out on another property not on that particular property.

- According to the case we covered last week, if Key Contractors couldn't sell because of the SP as it was registered incorrectly.

- Finally the last point is this. Lender B has recently discovered that the SP was only registered three months after the purchase of the property. Lender B is concerned about whether this oversight might affect his ranking, particularly in the case of the sale of the Attard property. Lender B is concerned about whether this oversight might affect his ranking, particularly in the case of the sale of the Attard property. Does this affect the SP? Yes because it wasn't registered in two months. Once again here, the SP in favour of 'B'. What happens however? Are the effects extinguished or are there any other rights which are still competent to 'B'? By mention of the law he is still granted the right to enrol a special legal hypothec. So even though he enrolled/registered the SP late he could still enrol/register a special legal hypothec. What is the disadvantage here? In this case it's not affected because it still ranks first but it is something we need to note because it's something for the exam.

- We are expected to write the table and a short explanation, not long, a short paragraph but with respect to each question we need to know what conclusion we have come up to. The matrix alone is not enough, if you get the matrix right you can't fail. It is something to look at to determine (if you get everything wrong) it is looked at in order to determine whether the candidate has assessed the situation property or not.

- If one displays the entire working that way they don't know that it's by luck but that the process was followed.

- When answering the questions, we will have five sub-questions and each sub-question will carry a number of marks.

- So in this case, per-ezempju

- Lenders C and E are contemplating the foreclosure of their respective loans. Moreover, Lenders C and E have come in possession of evidence that the material which Contractor D supplied to Key was not used on the property in Naxxar but on another project elsewhere.

    - Hawnhekk in the short paragraph/response irridu nindikaw x'inhu r-ranking ta' 'C' and 'D' mela jiena ha mmur fuq 'C' u r-ranking fuq Naxxar, il-pozizzjoni hija fuq il-propjetajiet in generali, pero fuq 'C' hija ghandu second preference H'Attard, ghandu second preference Naxxar u fuq Naxxar ghandu special

privilege. X'inhi l-pozizjoni ta' creditor 'C', hemm Naxxar, u kif jikkumpara ma 'E'? 'E' ranks before ghax construction ghax privileges rank according to the law. Jiena mort fuq creditors 'C' and 'E', rajt li dan the strongest guarantee hija always second except for Naxxar where he has a special privilege. X'hin mort fuq 'E' rajt l-istess, 'E' is third in Valletta and Paola he is ranking third but in Naxxar he also has a special privilege. Here in Naxxar we have competing privileges, 'E' and 'C', which privilege prevails? We have to look at the nature of the debt, and 'E' loaned out money for the purposes of construction, for the development of another storey, 'C' loaned out money for the purchase, and the law, the privilege granted in favour of leases and contractors comes before granted to sellers. ('E' jaqa l-ewwel, 'C' jigi second, u 'E' msemmiha l-ewwel) If we describe that very briefly, it is enough.

- Purchaser G has recently discovered that the property that he was sold by Key has a defective title, and is now fearing that the GH is not adequately securing any potential claims he might have against Key.

  - X'gara hawnhekk? 'G' ghandu GH for the warranty of peaceful possession, issa qed jibza li the property, purchaser 'G' has just discovered that the property that he bought from Key has a defective title, mela purchaser 'G' has a GH on all the properties, 'G' was sold a property, sale of property in Valletta, dan il-warranty of peaceful possession, he constituted a GH in his favour. X'se jigri hawnhekk? Qed jara li key contractors qed ifalli, x'jista jaghmel, what can he do? There was a specific case that we dealt with last week, the reduction, from a GH to an SH. Li gara f'dan il-kaz, Key sold a property in Valletta to 'G', mela, x'se jaghmel? Dan ghandu GH u qed jara li l-GH ma tiswa xejn. The property was transferred to 'G'. G bhal ma jigri dejjem, bil-warranty of peaceful possession, ghamel GH fuq il-propjeta' ta' Key. Xorta tirrenjkja, il-problema hi li hu qed jirrenjka dejjem l-ahhar, mela x'se jaghmel fil-GH? Jipprova jikkonvertiha f'SH, x'se jigwadanja? Hija l-unika haga li jista jaghmel.

- Lender F is growing increasingly impatient with Key's partial defaults and wants to consider its options.

  - Lender 'F' x'inhi l-pozjzzjoni tieghu? Lender 'F' ghandu droit de suite, u ghandu SH, li m'hix b'sahhitha. Mela xi jrid jaghmel? Droit de suite allura jissustitwixxi bl-actio hypotecaria. 'F' ranks fourth. m'ghandux garanzija b'sahhita imma dghajfa, allura fejn tidher b'garanzija b'sahhita jrid jiftah l-actio hypotecaria.

- Lender H, towards whom Key does not have any commitments yet, is willing to grant some financial breathing space to Key, however it wants to secure, at the least, a first ranking on the property in Paola.

- Lender ‘H’ ma jezistix pero jrid garanzija fuq Paola, so irridu naqbdu Paola u nghidulu xi jrid jaghmel fuq Paola. Lender ‘H’ diehel fl-istampa wara, x’se jigi? Dan irid garanzija fuq Paola pero hemm hafna GH’s xi jrid jaghmel? Jitlob waivers and postponements.

- Lender B has recently discovered that the SP was only registered three months after the purchase of the property. Lender B is concerned about whether this oversight might affect his ranking, particularly in the case of the sale of the Attard property.

  - Din ghamilniha diga, l-SP taqa’ SLH, potenzjalment setat afffetwatu pero m’affetwatux ghax kien u baqa l-ewwel.

June 2022 Exam Paper

	Cospicua	**Attard**	**Naxxar**	**~~Valletta~~**	**Paola**
1991	~~GH *ifo* **A***~~ ~~SH *ifo* **A***~~ ~~€50,000~~	~~GH *ifo* **A***~~	~~GH *ifo* **A***~~	~~GH *ifo* **A***~~	~~GH *ifo* **A***~~
1997	~~GH *ifo* **B****~~ ~~€70,000~~	GH *ifo* **B** SH *ifo* **B** ~~SP *ifo* **B** ****~~ ↳SLH *ifo* **B** €70,000	GH *ifo* **B** €70,000	~~GH *ifo* **B**~~ ~~€70,000~~	GH *ifo* **B** €70,000
2005	~~GH *ifo* **C****~~ ~~€100,000~~	GH *ifo* **C** €100,000	GH *ifo* **C** SH *ifo* **C** SP *ifo* **C** €100,000	~~GH *ifo* **C**~~ ~~€100,000~~	GH *ifo* **C** €100,000
2006			~~SP *ifo* **D*****~~ ~~€50,000~~		
2007	~~GH *ifo* **E****~~ ~~€100,000~~	GH *ifo* **E** €100,000	GH *ifo* **E** SH *ifo* **E** SP *ifo* **E** €100,000	~~GH *ifo* **E**~~ ~~€100,000~~	GH *ifo* **E** €100,000
2012	SH *ifo* **F** €200,000	SH *ifo* **F** €200,000			
2020	~~GH *ifo* **G****~~ ~~€120,000~~	GH *ifo* **G** €120,000	GH *ifo* **G** €120,000	~~GH *ifo* **G**~~ ~~€120,000~~	GH *ifo* **G** €120,000

* Cessation of effect of hypothecary charge due to non-renewal
** Property sold
*** Material used on another property
**** SP registered 3 months after completion

The Law of Guarantees.

Dr. Patrick Galea.

14th February 2023

Lecture 1.

- Our assignment, our discussion, relates to some aspects of the law of guarantees which means that we shall be looking at the contracts of suretyship, pledge, privileges and hypothecs and if we have the time because we are operating on a very strict tight budget security by title transfer.
  - To understand the raison d'être of the notion of guarantee there are a few clear first principles which we ought to keep in mind all through and going back indeed to something we had spoken about (take our mind to first year, prolegomena). It is the rule that inherent in a person's patrimony (we may recall this discussion) that when a person engages/binds themselves, this engages all the entire personality.
  - There is no division of personality or segregation as a rule of assets but the assets of a debtor are the rules of common guarantee of the creditor, articles 1994 and the subsequent articles of the civil code.
  - We had this rule that whatever a person has or will have, assets present and future responds to the claims of a creditors present and future.
  - To remind us, but it is worth repeating, it is irrelevant whether the liability arose before or after the asset was acquired by a person.
  - There is as a general rule the unity and a tradition against the segregation of a person's assets.
  - The second rule is that there is the pro rata ranking of creditors over the assets present and future of a debtor otherwise phrased as the par conditio creditorum, (the parity of treatment of creditors) unless there is a lawful cause of preference. These are found in article 1994 and 1995.
    - Article 1994.
    - **1994**. Whosoever has bound himself personally, is obliged to fulfil his obligations with all his property, present and future.
    - Article 1995.

- **1995**. (1) The property of a debtor is the common guarantee of his creditors, all of whom have an equal right over such property, unless there exist between them lawful causes of preference or there shall have been a transfer of any property by way of security or a transfer under a security trust for such purpose in accordance with this Code.

- (2) Property is lawfully transferred by way of security, if made in accordance with article 2095E or articles 2095F to 2095I and such transfer shall not be subject to re-characterisation as any other contract.

- (3) Creditors of the transferor may impeach any transfer by way of security as aforesaid if the transfer is made in fraud of their rights. For the purposes of article 1144 such transfers shall be considered to be onerous and in case of a security trust, the creditor must prove fraud on the part of both the transferor and the transferee but it shall be sufficient if he proves fraud either on the part of the security trustee or on the part of the beneficiary whose interest is being secured thereby.

- What we are going to discuss (this was the introitus) are rules of lawful cause of preference. The rules of the civil code. There was an effort to try and bring them in line to cater for important growing industries such as shipping and aircraft finance provide for what is known as subordination or postponement.

  - An example is you approach a lender, a bank, a finance institution, the bank will say fine I am looking at the ranking of creditors, there is for example the unpaid seller or supplier but I will not advance money unless I come number 1 and therefore the finance institution, the bank will tell you I will not advance money unless I become first ranking, number one, and I am not prepared to take the risk of being number two.

- It will be a condition precedent of this loan that there is sometimes it's called subordination, sometimes it's called postponement. Whereby the original first lender in our case the supplier or the seller accepts to rank after the bank. The supplier or seller from being number 1 signs up to being number 2. That is the precedent. It will be a condition precedent for the money to be advanced.

- Whilst this can be done by a private writing it invariably happens by a very serious contract which is given publicity in the appropriate register, the public registry, land registry, aircraft or ship registry.

- Just to conclude, yet we will open a wider discussion. There is a very brief statement that the rules of lawful causes of preference do not effect the rights

arising from the right of retention (jus retenziones). (We will discuss the right of retention when we discuss pledge).

- Security and guarantee are used interchangeably, the terminology is confusing and it has nothing to do with when you buy securities with a stock market.

- The articles say that in the case of security, the introductory sub-title, rightly provides that in the case of ship or aircraft mortgage finance, the right of retention does not apply except as part of the finance mortgage documents because as we know for sure the right of mortgage also has the right to take possession of a ship or an aircraft. So to be clear here it is stated that the traditional roman law rules of jus retenziones do not apply in the case of mortgage or ship finance.

- Interestingly, this is a historical overtone, the English law has a term called lien (we will meet this if we read something in security). There is a rule in the commercial code which acknowledges the custom of commercial agents and other agents, commission merchants, the commercial agent is the agent who transacts in the name of the principal, the commission merchant is what today we call a wholesaler, the stockist, you go to the warehouse but you are not dealing with the principal. You go to a warehouse where there is a stock of many things which are owned by the commission merchant. You are dealing with the merchant directly. These have traditionally bycustomed a right of retention to hold the object to secure the commission.

- If I go to a commission merchant to buy furniture, the stock may or may not belong to the merchant but I am dealing with the merchant if it is on consignment the merchant has the right not to release the stock unless it is paid price and commission. These rights are unprejudiced by the right of retention, it is a historical overtone more than anything else.

- We will lead this to a wider discussion on the law of security and guarantees.

  - The basic principle which we're looking at here in what the traditional language calls a lawful causes of preference, relates to the principle of solvency and ranking of creditors. We will understand that there are situations where a debtor, a business cannot pay it's debts as they fall due on a regular basis.

  - Solvency comes from the latin term solvere, solvere in datum solutio is when you need to pay, in debitum solutio is when you pay what you didn't pay so in our mind solvere, insolvency relates to payment.

  - In general terms there are two tests of insolvency.

- The first is where the liabilities exceed the assets (more liabilities than assets, there is a negative equity situation).

- The second test is the test of liquidity and as we said, in solvere has to do with payment, in the sense that the business is unable to keep up its payment as they fall due, liquidity, even though the assets may exceed the liabilities. Certain assets may be valuable but difficult to liquidate, it takes time, you can't tell a creditor you might sell an asset in 9 months time.

- That is why financial statements, also normally have an indication of a liquidity programme where a business anticipates to get its liquidity through sale and so on. Liquidity is a very important rule. (an asset could be a stocks, moveable, receivables, people who owe a business, you have to see what you manage to collect, the typical assets of a balance sheet sides, sometimes you cannot cash a good will. It's not easy, sometimes you can. Assets are stocks, moveable, vehicles, immoveables, debtors, warehouses).

- The philosophy and this is very important for us to understand, the thinking, the ideological political choices behind this is that there have to be creditors who have a stronger ranking than others. A lender, a bank, a financier, a seller, will obviously consider its position if it is unpaid (the creditor/debt) and obviously the question of ranking here comes in.

- This is because in the event of insolvency those who are rank-secured (as the term goes), those who have a preferential ranking, a better chance to be paid than those who do not have a preferential ranking as the term goes these non-secured creditors tend to remain whistling in the wind.

- This is the rationale, and therefore this is key, fundamental to access to finance, a lender will assess obviously the reliability. A lender will assess what the security of offer will realise on what is known as a forced sale.

- Security and strength of security is fundamental to access to finance. If you go to a bank ask for money and offer nothing, you'll be in a stronger position if you offer substantial good security. The bank will prise the risk in the interest rate and conditions imposed because as we know the greater the risk the more expensive the loan is. So this is essential to understand its role with finance and lending.

- Therefore ranking is as we're saying very important in giving.

  - Let's go to a simple example you ask for a house loan, you have to put part of it in funds and give first ranking, do a life policy, I have to see your earnings, at it's simplest levels. In the risk waitings of a bank they will say our exposure is so much, the cost of our money is so much, as the bank is its stock, money

costs money to the bank. What will this cost? If it is sold fetch, realise and therefore make a risk assessment. The story of the financial crisis of 2008, were loans were given galore and loan managers took a commission regardless of the money they loaned and now we know what happened and it brought down important players in the banking institutions.

- This therefore, if we were to summarise this has the following essential rules.

  - Ultimately if a business or a debtor defaults there will be the sale of an asset/the assets, how the asset is sold depends, it could be an auction or a sale on the market, it depends, but the principle is that the assets will be sold and the creditors will be paid in order of ranking.

  - The second is that this rule therefore is very closely linked even if you read the companies act on insolvent dissolutions and winding up it is closely linked to the orderly distribution and the orderly conclusion of insolvency proceedings. Recently we had very important amendments.

  - This is the fundamental thinking, therefore an asset gives ranking, ranking allows access to money and liquidity and in the event of a default the asset is realised and is then the resulting proceeds there is payment in accordance with ranking.

  - There are a lot of technical details but in the event of a technical insolvency an asset is sold and from the proceeds which are realised then creditors which can be paid are paid. This links very importantly with the rule in which we will discuss in civil procedure on a procedure known as the ranking of creditors.

  - This is a procedure whereby the courts establish ranking, there is no unfortunately systematic comprehensive document on ranking it is established by practice, by the way it happens but as we say it is wages and salaries, taxes, including VAT, social security, banks, suppliers etc, those are normally the leading creditors. We have ranking etc.

  - We know that this is linked to the procedure of ranking of creditors. Where there is insolvency, where the assets have been sold and released and there is liquidity available, it is the run (in fact it's why it's known as the competition of creditors, creditors competing who is getting paid and who is not getting paid). This is linked with certain provisions of the companies act which prohibit discrimination between creditors which empower a liquidator to look at transactions of the past 18 months to see whether there is any attempt to discriminate because these rules are rules of public order again because creditors are protected.

  - The other point we will mention again, there is the duty of directors to stop trading or take some measures if they realise that a company faces the prospects of

insolvency or a serious deplete in capital.(we will not go into any detail, just link it in our heads)

- Where there is a director seeing a loss in capital or risk of insolvency they have to meet and call to see what the next steps are.
- The european regulation on insolvency bis II (recast). This was recently recast because again the rules, it's a rule of procedure and of public policy it is very important to establish the seat of insolvency because it gives jurisdiction and choice of law, the regulation will provide rules to establish the seat(situs)/place of the business because that links with both jurisdiction and consequently applicable law because the applicable law is a rule of public policy, lex fori. So the moment you establish the situs and the court the lex fori is the substantive rule of procedure, the determination of ranking, who comes 1, 2, 3, 4, it is a rule of the lex fori. In the mind of the drafters there are transnational businesses who have various outlets when one goes into difficulty the other does not.
- Where the directors see that there is a serious loss in capital or a risk of insolvency they have to call the shareholders to decide on a course of action, company recovery procedure, stopping trading, erasing finance and so on.
- The insolvency II regulation establishes rules of jurisdiction and choice of law where you have pan-european businesses and the fulcrum is to determine the centre of affairs of the business, which attracts jurisdiction, which court/national court has jurisdiction and because it is a matter of procedure the lex fori is applicable.
    - If the German court is the court having jurisdiction on this then obviously the German lex fori on insolvency will apply.

- We are now discussing the guarantees and there are personal guarantees and real guarantees.
    - The real guarantees are pledge, and privileges and hypothecs and maybe the right of retention whilst the personal guarantee is what we will be essentially going to start discussing today which is the suretyship.
    - A linguistic misnomer is that the suretyship is the traditional fideiussione (ubere in latin is to swear, fideio is I swear on their faith) bring you the person and vouch for its credibility. In French it is nontesmain
    - The reason we are mentioning this is not to get confused because the Maltese term of suretyship is 'pleggerija', which has nothing to do with pledge. The 'pleggerija' is maltese suretyship, (hence why in criminal law ngħidu ħareġ bi

pledge, guarantee, pleggerija is the maltese suretyship) let's not confuse it with pledge.

- Pledge is when I give my watch to someone and this someone lends me money against giving my watch. This is a personal guarantee, a suretyship.

- Suretyship is a personal guarantee whereby a party guarantees the liability, responsibility, the engagement of another. You have taken a debt and in order that the debt is extended to you I subscribe to it as well, I underside it, I guarantee it, if you fail I will enter into the discussion. It doesn't have to be a money obligation it could be a performance obligation, very often this happens when in contracts of works there is what is known as a performance guarantee.

- A guarantee, a characteristic of this contract is that one is taking a risk on the assets of a person, if I lend money to you and it is guaranteed by a third party I do not have any intangible assets in my hand, I don't have a house, a deposit or anything but I am trusting the credit worthiness of the guarantor.

- It is not a real guarantee but a personal guarantee, if it were a real guarantee there would be an asset involved, whatever the asset this is a personal guarantee depending on, (that is why the question is a bit stupid), which is the better guarantee, a real guarantee or a personal guarantee. If the personal guarantee is a person who is liquid, solid, has deep pockets then it's a good guarantee, a real guarantee is what you have, the object, the res, that's why it's a real it has the res involved.

- The first is that suretyship is a subsidiary accessory obligation. In other words it is contingent on the existence of the principal debt. The validity of a suretyship presupposes the existence of a valid principal obligation. (We will develop this tomorrow).

- In general terms, if the principal obligation is annulled the suretyship is likewise annulled) (it will not be annulled automatically it will be actions by court) a court would have to declare that once the principal obligation is annulled or invalid then the suretyship is likewise invalid. That is why we said it is a subsidiary and an accessory obligation, it is subsidiary because it depends on the principal obligation accessory because it is a sort of extension of the principal obligation.

- If there is payment of the suretyship and the principal obligation is annulled there could be action for refund but again then there are the rules for in debiti solutio, action for the suretyship and there are rules that before paying the surety has to inform the debtor because if the surety pays the creditor then the surety will go after the debtor to be indemnified. There are rules that the debtor pays at it's risk, that's a separate discussion.

- So, just to make the point in a situation of suretyship and other also guarantees but very much so in the case of suretyship there are three parties.
  - There is the creditor
  - There is the debtor
  - There is the surety (contract known as suretyship)
- There are different rules and orders of relationships between the creditor and the surety, the surety and the debtor, co-sureties between themselves. Today we will commence a discussion on the general rules on the validity of suretyship.
- There may be multiple sureties for the same debtor or different debtors guaranteed by one surety and then there are relations between sureties between themselves and surety and the debtor.
- A suretyship cannot be contracted on more onerous terms than the principal obligation and is null and invalid to the extent that it is on more onerous terms. In other words it can be on less onerous terms, on the same terms but not on more onerous terms. The latin maxim is it cannot be “in duriorem causam”
- Suretyship requires article 1233 (c)/(d) paper writing (signature the traditional way) cannot be done online, as they call it today in wet ink and because of the seriousness of the contract it cannot be presumed but has to be expressed.
  - Article 1233.
  - **1233**. (1) Saving the cases where the law expressly requires that the instrument be a public deed, the transactions hereunder mentioned shall on pain of nullity be expressed in a public deed or a private writing:
  - (a) any agreement implying a promise to transfer or acquire, under whatsoever title, the ownership of immovable property, or any other right over such property;
  - (b) any promise of a loan for consumption or mutuum;
  - (c) any suretyship;
  - (d) any compromise;
  - (e) any lease for a period exceeding two years, in the case of urban tenements, or four years, in the case of rural tenements;

- (f) any civil partnership; and
- (g) for the purposes of the Promises of Marriage Law, any promise, contract, or agreement therein referred to.
- (2) Where, in the case of a private writing, the writing is not signed by each of the parties thereto, it must be attested in the manner prescribed in article 634 of the Code of Organization and Civil Procedure.

- The language has to leave no doubt that it is being expressly contracted and there have to be clear references to the original obligation.

15th February 2023

Lecture 2.

- Yesterday we spoke about the nature of the contract of suretyship just to read you into the discussion we said there are generally three parties. To pick up and recapitulate what we started yesterday, we introduced the contract of suretyship we said it is a personal guarantee not a real guarantee, the parties are creditor, debtor and surety.

- Suretyship is an ancillary and accessory contract it has the requirements of a contract, it has to be concluded in traditional paper writing and assumes for its validity and we made a caveat. The existence of a valid obligation therefore if the principal obligation is null or annulled then it brings with it the annullability or nullity depending on the contract of suretyship.

- To close on what we were trying to say yesterday, let's go back to the statement and principle that suretyship assumes the existence of a valid principal obligation such that as we have said if the principal obligation is annulled, the suretyship being subsidiary dependent on the principal obligation and condolent is nullable and annulled

- However there are situations, and we are referring specifically to article 1926 (2)
  - Article 1926.
  - **1926**. (1) Suretyship can only exist in respect of a valid obligation.
  - (2) Nevertheless, suretyship may be contracted for an obligation which can be annulled on some plea personal to the debtor, as for instance, that of disability arising from minority or interdiction.

- Article 1926(2), which is an exception to this rule and this exception states that a suretyship remains valid and therefore not annulled or null, it remains valid if the principal obligation is annullable (can be annulled) on grounds personal to the debtor.
- The law, this is a bit unclear but the law mentions the case of minority or interdiction, let us take this hypothesis.
- The bottom line of all this is that if the principal obligation is annulled or annullable on grounds of minority or legal incapacity.
    - For example interdiction.
- This does not annul the validity of the suretyship because the annullability of the principal obligation is on grounds personal to the debtor.
- The point is that because the principal obligation is annullable on grounds personal to the debtor (minority, interdiction, incapacitation) then the suretyship remains valid.
- To anticipate, the programme of discussion on suretyship is today we will discuss the relations between the creditor and the surety, ambitiously the relations between the debtor and the surety (we probably wont finish the second part) then the next will be relations between co-sureties and finally the grounds for termination and extinguishment of the suretyship, the arch is how surety is constituted, how it works. Bear in mind that there are relations always creditor-debtor-surety, a tripartite relationship then the arch completes its extinguishment.
- When we come to the conclusion and extinguishment of sureties we are going to distinguish between real (res) and personal pleas. Personal pleas are those pleas which relate to the debtor as we have seen minority, majority, interdiction, incapacitation etc. Real pleas are those pleas inherent in the debt.
    - For example payment, set off, prescription etc.
- Why are we mentioning this? We are mentioning this to distinguish between real and personal pleas. The suretyship which can be annulled on real pleas, let us say on the moment of stupidity one signs up to a suretyship guaranteed but then later I realise that the principal obligation was subsequently terminated does it mean automatically that the claim of the creditor against me is terminated. It’s not annulled it’s fulfilled. There is a separate discussion there. What happens when the principal obligation is fulfilled? We will see that it could extinguish the suretyship but it could not extinguish the suretyship.

- We are anticipating and (distinguish between pleas personal to the debtor and the objective pleas in the debt - the objective pleas are the real pleas, the pleas which extinguish objection to payment, set off etc)
- The other point which we did not mention yesterday is that we did mention that suretyship is an accessory contract and extends to costs and expenses however here we have to say that (we refer to a specific article which is article 1930)
  - Article 1930.
  - **1930**. (1) A suretyship contracted for a principal obligation, in general terms, extends to all accessories of the debt.
  - (2) It also extends to the expenses necessarily incurred for obtaining payment provided the creditor, before commencing the proceedings giving rise to such expenses, gives notice thereof to the surety, by means of a judicial act.
  - (3) The expenses of such act are included in the expenses to which the suretyship extends.
- Article 1930 says that suretyship extends in general terms to all accessories however 1930(2) says that if the creditor is incurring for example legal costs, expenses, interests, 1930(1) is to the effect the suretyship will extend to all accessories, to all costs, however 1930(2) is in the sense that if the creditor starts to incur additional costs, such as legal costs, potentially interest depending on the language of the document (we know in commercial matter interest runs ipso jure) but let's say additional costs, the creditor has to inform the surety to be able to recover these costs from the surety, it is not an open cheque. If the creditor is increasing the burden on the surety even though the terms are wide the surety is to be informed in advance, and this is something very important because (we'll go into it later) a surety before paying has always to inform the debtor. Not only good practice, not only prudence but there are legal reasons. The rights of the parties here are structured in a way that one has to be careful.
- Before leaving this we will make two comments;
  - The first is the sources, the original sources of lease are the provisions of the 1804 French code but the original sources and they haven't changed much since 1868 are the sources of the article of the old French code of 1804 the codes Napoleon. However in 2021 effect 1st January 2022 France has had important modifications in the law of suretyship and guarantees,
  - For example many of them not the substance but some are consumer orientated (a result of lobbying against the bank and in favour of the bank where

there is a guarantee every year the bank has to give a statement to the surety, not to the creditor of the amount which is guaranteed).

- If we need to look at some French rules/books or Italian 1865 French model that is fine just to be aware that contemporary French law as of today books published in 2022 will reflect this change.

- In 2021 France emended important provisions on the law of suretyship and therefore whereas in the past our articles were a replica of the old French 1804 code now this is no longer the case, France have introduced changes to its codes civil we do not find here.

  - In the same way for examples as our articles on prescription putting under one title exquisite and extinctive no longer reflect the French code today as the French 9 years ago (in 2014) decided to divide them.

- The second point before leaving this is more difficult to answer in the sense that as you will understand each suretyship argument is tailored made to fit to the contractual agreements of two parties.

- The question is the difficulty, the usual difficulty of identifying which articles are mandatory, therefore cannot be modified by consensual accord by negotiation and agreement of the parties. Which are of public order cannot be derogated from/deviated from and their result.

- That is not an easy question, the tentative reply would be that as long as the general structure and nature of the contract remains respected the code wisely allows a lot of contracting liberty to the parties.

- The indication of the code is saving the general principles of the structure there is room for agreement and consumer guarantees are not only special law and a question which lobby and consumer organisations will address. That is the nature of the contract of suretyship.

- We are going to come to the relationships the effects of suretyship and the first is between the creditor and surety and the relevant articles for ease of reference are articles 1934-1941. We’re looking here at the effects and relations between the creditor and the surety.

- Let us say that there has been an event of default because suretyship invariably being an accessory obligation is triggered by what is known as an event of default.

- This is contractual language, event of default and typically it would be non-payment, late payment, restructuring, going into dissolution, a significant loss in assets, the debtor becoming insolvent, so there has to be when the contractual

agreements are being respected by definition there cannot be no event by default and suretyship as an accessory is triggered where these terms are not kept to it.

- In this scenario we are looking at a context when the creditor acts against the surety. Suretyship can be simple suretyship and it has its effects, or joint and several suretyship.
- Simple suretyship is that the creditor can only go against the surety in the event that the debtor defaults, meaning does not keep up to the obligations, terms agreeable. That is simple suretyship.
- Joint and several suretyship means that debtor and surety are bound together and in solidum in favour of the creditor such that the creditor can act against at the choice of the creditor either the debtor or the surety normally the one who has more deep lined pockets, go against the person who is more financially soluble. There are many similarities, where you have co-debtors in solidum, a creditor can go against another co-debtor, any one of them for the entire amount. Where you have co-sureties in solidum it depends whether solidarity is only between themselves or together with the principle debtor, normally it is between both with the principle debtor and between themselves. There are levels of subrogation but in other words.
- Many rules of joint and several sureties apply also in the case of joint and several debtors however the essential difference is that at the end of the day the surety is not a directly interested party. A surety, this is most important has a right of subrogation against the debtor if it has paid him. Whereas in the case of joint and several debtors the right of relief is divided between the joint and several debtors.
- As we said, there is simple suretyship and joint and several suretyship.
- The surety has within the terms we are going to discuss two fundamental defences.
- These are the benefit of discussion and the benefit of division.
- What is the benefit of discussion? We will come to the detail of the benefit of discussion in a moment, it basically means that the surety can plead, defend with the creditor saying to go after the assets of the debtor first. The benefit of discussion is in simple terms the surety pleads and defends against the creditors discuss go after first the assets of the debtor, discuss first the assets of the debtor. Before coming after me go after the debtor and to the extent that you are unsuccessful against the debtor then come to me. Discuss first the assets of the debtor.
- This benefit of discussion does not apply in four scenarios.

- Article 1935.
- **1935**. The benefit of discussion shall not apply -
- (a) if the surety has renounced such benefit;
- (b) if the surety has bound himself, jointly and severally, with the debtor;
- (c) if the debtor can set up a personal plea, such as those mentioned in article 1926;
- (d) if the debtor has become insolvent.

- The first is obviously 1935, there are four situations where this does not apply, this is 1935, the first is if the surety itself has renounced to the benefit of discussion. Once renounced it is irrevocable.
- The second is if the surety is bound jointly and severally with the debtor, we mentioned earlier the distinction between simple suretyship and joint and several suretyship, therefore what we're saying is that in the event that there is joint and several suretyship, the surety cannot plead the benefit of discussion.
- Likewise, this is the third, the third is where there is the possibility that the principal obligation can be/is annulled on a plea personal to the debtor (we are/should be familiar with this) example minority, interdiction.
- In other words where the principal obligation can be challenged by the debtor for example on minority it is no escape for the surety to plead the benefit of discussion. We're saying, this third exception that the benefit of discussion cannot be pleaded where the principal obligation can be annulled on grounds personal to the debtor for example minority and interdiction and if the principal obligation, the guaranteed obligation is annulled on grounds personal to the debtor as we know the suretyship remains and in this case what were saying is benefit of discussion cannot be raised.
- The fourth which is more straight forward is that the benefit of discussion is in-administrable where the debtor is insolvent. In other words, the surety deals with the creditor, go after the debtor, this doesn't apply if the debtor is insolvent. It can give a simple surety, had it not been in this way it could give the simple surety a way to postpone the question, and establish. It is obvious in the sense that if the debtor is insolvent there is nothing to do but at the same time it could allow the avoiding surety the possibility to show that you have tried but unsuccessfully recovered, this is a shortcut.

- What is this plea of benefit of discussion? We will mention it again in civil procedure in the year but basically it is amongst those pleas, which are known as dilatory pleas.

- There is a distinction in simple terms between peremptory and dilatory pleas (defences) a peremptory plea is one which goes against the merits (perimere is to cut) for example payment, if you prove payments thats end of story, prescription, end of story, res judicata, end of story, set off, end of story. Then there are those pleas which are in their nature dilatory (dilare is to postpone), dilare, delazzione, di pagamento, dilazzjoni in Maltese. They don't address the issue but postpone the issue.

- This benefit of discussion is a dilatory plea. It is a plea which has to be raised in limen elites (limen is threshold to the door) in limen elites (at the beginning/outset of the litigation) you cannot allow in other words the case to continue and wake up and say there's the benefit of discussion, if not raised it's deemed to have been renounced to and if raised it can be withdrawn.

- The effect is that let's say the surety raises the plea of discussion. The surety then has the following duties to prepare a list of assets within jurisdiction (within Malta and Gozo) over which execution can take place. The surety has to say, the debtor has these properties, these assets, these investments, go after those first. You shouldn't subject a creditor to inconvenience.

- Also the surety has the duty to deposit in court a sum of money which is sufficient to guarantee the costs of the execution on the property of the debtor. The surety has to plead the benefit of discussion has to deposit in court a sum of money which is sufficient to guarantee the costs of the execution on the property of/against the debtor.

- When this is done there is a very important rule which comes into operation. This is that the burden of responsibility is shifted onto the creditor for timely and diligent execution and pursuing of proceedings. When this process has been completed the plea of discussion and the deposit the burden of responsibility is then on the creditor to pursue proceedings against the property indicating diligently and in a timely manner. Such that if the surety can show that as a consequence of lack of proper diligence or timely action by the creditor the surety is prejudiced, if as a result of lack of diligence or timely action by the creditor against the indicated property the surety is prejudiced in the sense that recovery otherwise possible is lost then the surety may escape responsibility.

- So if the creditor is lazy or not diligent and doesn't do what they should do and thereby the surety is prejudiced in the sense that what could have been, lets say

a prescription has not been done in time, or execution is delayed and other creditors come in, the surety can say had you been diligent and followed up what you should have followed up, you could have been paid, the surety is released least pro-tanto (to the extent of the prejudice).

- We will not go into more procedural details but basically it works that the court if the plea of discussion is raised will say okay we will meet in six months time to get a progress report over execution. Proceedings are suspended, execution proceedings against the surety are suspended to allow the creditor to act on the indicated discussed property.
  - Example basically we'll meet in six months time.
- This is discussion.
- Now division, division is obviously, division first of all only comes into effect and operation where there are more than one surety. You cannot divide if you're the sole surety, this is again as we say obvious.
  - Article 1937.
  - **1937**. (1) When several persons have become sureties for the same debtor and the same debt, each one shall be liable for the whole debt.
  - (2) Nevertheless, each one of them may, unless he has renounced the benefit of division, or unless he has bound himself jointly and severally with the debtor, demand that the creditor should divide his action and reduce it to the share due by each surety.
- Article 1937, makes and highlights an important distinction (we should have mentioned it before) that when we are; the rule that there is joint and several liability, between debtor and surety in favour of the creditor but then there could be joint and several liability between the debtor and surety.
- It can take one of two forms ; normally, it is joint and several liability in favour of the creditor of both the debtor and the surety. We have to be clear that joint and several liability can exist in one of two ways.
- The first is creditor in favour the creditor against the debtor and surety between themselves in favour of the creditor, that's obvious. There is however not always expressed a joint and several liability between the debtor and surety, now this becomes relevant where there are more than one co-surety (co-sureties). That is why we preambled the discussion where the vision can arise if there are more sureties.

- We are speaking about the benefit of division as a defence to a surety and the article which contemplates this is 1937 and the hypothesis is here a number of sureties together guaranteeing the principle debt of the same debtor. One debtor, same debt, guaranteed by a number of co-sureties.
- The rule of division (saving the obvious exceptions which we will mention) the rule is that a surety is entitled to demand the division of the amount guaranteed by the various co-sureties for the same debt and the same debtor.
- A co-surety, in other words guaranteeing with others the same debt and the same debtor is subject to the exceptions we are going to speak about entitled to demand the division with the other co-sureties of the amount claimed, in the sense I owe you ⅕ or ⅓.
- This does not apply where there has been joint and several assumption of responsibility between the principal debtors or where the surety has renounced to the division.
- This right of division does not apply either where there has been renunciation to it or where there is joint and several liability between the co-sureties
- More problematic is the right of regress of the surety. We will come to this later but the question is, let's say a co-surety has paid the entire debt, is there a right of regress for the entire amount against the principal debtor? To Dr. Galea it is axiomatic that there exists the right of regress against the principal debtor for the entire amount because as we said earlier the surety is not directly interested, has paid the debt of another and therefore has to claim, recover, the debt from the one whose debt has been paid.
- The co-surety who has paid the entire amount obviously wants to get reimbursed for a debt which is not his or hers, against whom is a right of action for reimbursement? Against the principal debtor, against the other co co-sureties but in what manner? Regarding the first question it is axiomatic although the articles are not entirely clear but it seems to be axiomatic that a co-surety who has paid the entire debt is entitled to reimbursement for the entire debt from the principal debtor.
- We said that the question is divided into two parts, the first is against the principal debtor and the other is the extent against the co-sureties, it seems clear that although the articles do not give any necessary comfort to this view, that the co-surety who has paid the entire amount is entitled to go against the principal debtor whose debt they have paid.

- Coming to the second point, yes the co-surety who has paid the entire amount also has (in addition to the first point) the right of regress against the other co - sureties for their respective contribution.
- There are some rules we need to be aware of regarding division of the claim of the creditor against the co-surety.
- There are rules that we need to be aware of regarding the division of the claim of the creditor against the co-surety. These are articles 1938/1939.
  - Article 1938.
  - **1938**. If, at the time when one of the sureties has obtained such division, some of them are insolvent he is liable proportionately for the shares of those who are insolvent; but no claim can be made against him in respect of the share of any other surety who becomes insolvent subsequently to the division.
  - Article 1939.
  - **1939**. If the creditor has himself voluntarily divided his action, he may not repudiate such division, even though there were insolvent sureties previously to the time when he consented to such division.
- Article 1938 read it carefully because prima facie it could be tricky but it is not. It's sense comes out towards the end of the article. Basically let us say there has been a division, and not withstanding this division it results that prior to this division by the creditor against the co-sureties, the scenario is the division by the surety of the claim against the co-sureties, you are five give me ⅕ each now if prior to this division which is pleaded and defended, it results that one of the sureties was insolvent because the insolvency existed before the plea of division then the sureties (co-sureties at least) have to bear and assume responsibility and pair responsibility in favour/vis-a-vis of the creditor of the insolvent sureties.
- Co-sureties are not always jointly and severally liable. There is this benefit of division where there is joint and several liability it cannot be pleaded. It can only be pleaded when there is no joint and several liability. This plea of division can be pleaded only if and when there is no joint and several liability. The meaning of this division is that each one bares whatever proportion divided by the number of shares however this also includes existing insolvency prior to the division.
- Where there has been a division pleaded successfully and subsequent insolvency (happening after the division) then this rule does not apply and the co-sureties do not have to assume responsibility for the insolvent co-sureties because insolvency is supervening, it happens after the successful defence of division.

- If there is division and insolvency happens after division, after the plea is successful, what happens if it happens during the division? Dr. Galea would say that the relevant moment is when the moment of division happens. If at the moment of division there was no insolvency, but insolvency happened after then it's okay but if it is an interim process or existed up to the moment of division (these situations are rarely clear and there would be various discussions)

- What we said does not apply in the case of the sureties dividing and assuming responsibility, it does not apply if the creditor has voluntary divided the action.If the creditor has given consent not by way of defence plea, but by voluntary accord, it is one thing pleading a right, one thing agreeing by voluntary accord. If there has been voluntary accord that is final and irrevocable because there has been voluntary division. It does not change the division. We know naturally that in commercial situations joint and several liability of debtor and surety is presumed, we know this from commercial law.

21st February 2023

Lecture 3.

- So, we continue on suretyship, and now the lets go to the second order of relationship which is between the debtor.

- Let's go to the next order of relationships, in the creditor debtor and surety triangle, last time we spoke about the creditor surety the defences of the surety against the creditor, the benefit of discussion, where it applies and where it doesn't apply the benefit of division where there is more than one surety. Then we contemplated a situation where there are more than one surety in respect of one and the same debt and the right of relief of the surety.

  - Today, we're looking at a situation between the debtor and the surety, and if we were to summarise the principle effect subject obviously to what we're going to say of the effect of payment by the surety is the right of relief against the debtor, the surety who has paid has a right of relief turning against the debtor. The surety who has paid has a right of relief turning against the debtor whose surety has paid because ultimately that is the basic and fundamental distinction between co-debtors and co-sureties. The surety is an ancillary subsidiary party and the surety succeeds is subrogated with the same rights and ranking of the creditor against the debtor, the surety is subrogated in the same manner and ranking as the creditor had against the debtor.

    - An example would be, it's quite simple, the creditor is for example first ranking against the debtor, the surety because the surety has to pay the creditor and succeeds in the rights of the creditor against the debtor, by subrogation and

enjoys the first ranking. What we're saying is that, the surety who has paid, succeeds by subrogation into the shoes of the creditor because the surety has paid the creditor for a debt of the debtor and this stepping into the shoes of the creditor includes any ranking etc, any preferential ranking any guarantees. The creditor would have been paid by the surety so the creditor is no longer a creditor.

- We will summarise, first of all we have the general rule that the creditor who has paid has a right of relief against the debtor and this right of relief comes on two basis, one the general rules of subrogation.
  - Article 1166.
  - **1166**. Subrogation takes place by operation of law in favour of -
  - (a) any person who, being himself a creditor, satisfies another creditor having prior rights, by reason of privilege or hypothec;
  - (b) any person who, having acquired any immovable property, employs the price in paying the creditors having hypothecary rights thereon;
  - (c) any person who, being bound with others or for others for the payment of the debt, had an interest in discharging it;
  - (d) any heir with the benefit of inventory who, with his own money, has satisfied debts of the inheritance.
- If you look at article 1166(d) on the general rules of subrogation by operation of the law. A person who pays the debt of another with whom such person is bound, succeeds to the rights of the creditor by operation of the law. We may recall on subrogation as a mode of extinction of obligations and we have payment by subrogation it can be either by agreement, by convention or by operation of the law).
  - Article 1945.
  - **1945**. A surety who has paid the debt succeeds ipso jure to all the rights which the creditor had against the debtor; saving always the provisions of article 1167 where a part only of the debt has been paid.
- However there is also a specific subrogation arising from the provisions of the law and this is article 1945. Article 1945 is a specific article beyond and in addition to the general rules on subrogation by operation of the law which grant the surety who has paid the right of subrogation.

- Now, this right of subrogation extends to interests and ancillary expenses/costs such as legal and other expenses incurred by the surety, however the surety is only entitled to collect from the debtor whose debtor the surety has paid such interests and expenses, incurred in connection to the suretyship if the surety has previously before paying informed by a judicial act. If prior to paying and incurring these costs and interest the surest has informed the debtor there has to be prior notification advanced information by means of a judicial act, failing this the rights to collect the surety can be at risk because the entitlement arises only for these ancillaries, interests and expenses if there has been prior advance notifications.

- We're saying that suretyship, we may recall our first session extends to costs, interests and expenses. Let's put us into situations where the surety has incurred costs, interests for the debtor the surety has guaranteed. For this right of action to collect, to be validly exercised by the surety against the debtor whose debt has been paid in respect of interest and expenses, the surety is required to have informed by judicial act in advance the debtor of the intention to pay costs and expenses, in other words if I am a surety and I am called up on to pay not only the debt but also the interest and costs prior to paying I have to inform the debtor.

- So fundamental is this right of obligation of the surety, is that if subrogation or ranking thereof cannot take place due to some failing of the creditor, or even the debtor, this right of indemnification against the debtor, of course, means that. This right of subrogation is fundamental and therefore the right of the creditor against the surety is lost if due to some fault or omission of the creditor.

- So fundamental is this right of subrogation of the surety who has paid against the debtor, if the creditor through fault or omission, prejudices this right of subrogation the right of action of the creditor against the surety is lost.

- We're saying that the right of subrogation of the paying surety against the debtor is fundamental, that is the first point, so central it is that if through fault or omission of the creditor the right of subrogation of the surety is in some way prejudiced or lost, the creditor loses the right of action against the surety.

    - For example let us say there is a hypothec or a privilege (we will speak about them) which is up for renewal and the creditor does not renew them.

    - Let us say there is a prescription which needs to be renewed/interrupted and the creditor against the debtor does not renew or interrupt prescription but the creditor then goes after the surety. The surety can defend against the creditor, saying but you didn't renew that hypothec so I'm going to be privileged in my collection from the debtor and I plead that I am not liable to pay because my right of subrogation is prejudiced.

- Let us assume by way of example that the creditor does not renew a hypothec which is up for renewal or does not interrupt or renew prescription. That is the scenario. The creditor acts against (takes proceedings) the surety, the creditor demands payment from the surety for the amount the surety has guaranteed, the surety can defend and plead to escape/avoid the suretyship obligation on the ground that the right of subrogation has been minimised or prejudiced.

- It is very important, that the surety does not pay on demand (what we're saying is subject to contractual documentation) because many bank guarantees say that the bank will pay on first demand without being bound to enquire whether the amount is due.

- What the articles of the law say is subject to contractual modification but subject to this, if the surety has paid the creditor where the debtor has already paid, without prior to payment informing the debtor, without first informing the debtor there is no right of subrogation against the creditor.

- In other words it is necessary for this right of subrogation to be maintained that prior to payment the surety informs the debtor. If the surety pays a debt which has already been paid by the debtor, without prior notification to the debtor there is no right of relief and subrogation. If the surety pays when the debt has not already been paid, there and it applies to part of rule settlement/payment and the surety retains unprejudiced the right to act against the creditor for double recovery. The creditor has been as is validly pointed out paid twice, but it is the risk of the surety whether or not it collects, if the surety doesn't collect from the creditor for double recovery then you cannot blame the debtor.

- Another illustration of this rule is a situation where the debtor could have the debt declared extinguished. For ease of reference we are looking at article 1947.

  - Article 1947.

  - **1947**. (1) A surety has no right to relief against the principal debtor, if the latter, not having been notified by the surety of the payment made by him, pays as well.

- Article 1947, if the surety pays the creditor without first having informed the debtor, the surety has no right of relief against the debtor, if the debtor can show that had the debtor been informed, it had the legal or factual means to have the debt declared extinct.

- In the event that the surety Pais without first prior informing the debtor, the surety has no right of relief against the debtor, if the debtor can show that had it been informed prior to payment it had the legal or factual defences to have the debt

declared extinct, for example payment, for example novation, for example there has been a set off etc.

- What we're saying is if the surety pays without first informing the debtor and the debtor can say listen have you informed me? Could have shown that this was not due then the surety has no right of relief against the debtor because the debtor had means to have the debt declared extinct/made/time barred and therefore this is a full attributable to the surety.
- A short comment on article 1946.
- This is again not entirely easy, the scenario, article 1946 is a situation of co-joint and several debtors, for one and the same debt guaranteed by one surety.

  - Article 1946.

  - **1946**. When there are several principal debtors jointly and severally bound for the same debt, the person who stands surety for all of them, has against each one of them a right of relief for the whole of the amount he has paid.

- A hypothesis of joint co-debtors in solidum, for one and the same debt guaranteed by one surety. This is different from the hypothesis we spoke about last time where there is one debtor, same debt but number of co-sureties.
- Here we're looking at a number of co-debtors with the same debt but with one co-sureties. We are looking at article 1946 which is a scenario where there are joint co-debtors in solidum for one and the same debt guaranteed by one surety.
- We're looking at a situation where there are co-debtors, principal debtors jointly in sodium between them for one and the same debt supported, guaranteed by one surety. The surety who has paid has a right of relief for the entire amount against any one of these co-principal debtors bound in solidum.
- The surety who has paid a right of relief against anyone of these principal co-debtors in solidum for the entire amount.

  - Article 1948.

  - **1948**. A surety, even before paying, may proceed against the debtor to be indemnified by him -

  - (a) if he has been sued for payment;

- (b) if the debtor has become bankrupt or insolvent, or his condition has altered and there is a reasonable apprehension of insolvency;
- (c) if the debtor has undertaken to release him from the suretyship within a specified time, and such time has elapsed;
- (d) if the debt has become due by the expiration of the time agreed upon for payment;
- (e) if the debtor is in default for delay in payment;
- (f) at the expiration of two years, where no time has been fixed for payment, and the obligation is not, of its nature, such that it cannot be extinguished before a longer time.

- Article 1948, in jargon known as the extraordinary remedy. Why is it called the extraordinary remedy? Because the normal process is, the ordinary process is that the surety pays and is subrogated and acts against the debtor. This is exceptional/extraordinary because we are looking at a situation/ there is a situation where the surety can act against the debtor before paying, that is the exceptionality, that is the extraordinary nature of it. The ordinary is that the surety pays and goes after the debtor. The exceptional extraordinary concept is where a surety has a right against the debtor before paying. The situation is not made any easier by the term indemnified.

- Article 1948 uses the term indemnified, the French original text indemniser. To indemnify normally means to make good, if I give you an indemnity it means that if you are found liable you have the right to act against me. These are the specific exceptional instances which trigger the right Indemnification means that the surety acts against the debtor.

- In general terms, there are a number of instances in article 1948 which trigger this right. This depends on ranking, a number of factors, solvency, insolvency etc. but in a normal scenario where there are not these difficulties there is the right of the debtor indemnity (to get paid). Indemnification means that the surety acts against the debtor. (You could get a surety to get liquidity and if you stick to the terms of the principal agreement, there is an agreement which is being honoured so there is nothing exceptional).

- The triggers of article 1948 is that the debtor has been sued for payment, if the debtor becomes insolvent or the financial condition of the debtor has deteriorated very significantly. Other instances you can read them they are more or less straight forward, are that the principal debt is up for payment, another trigger of

this extraordinary remedy is where the debtor has undertaken to release by a certain date the surety and has not released the surety.

- So, the point we're making here is that when advising etc, we have to be aware that any prejudice, any change in the circumstances of the debtor will require a review of the position of the surety with the right of the surety to act even if the contractual documentation perhaps says first you pay then you claim (then go against the debtor).

- This concludes our discussion of the relations between the debtor and surety.
- The next discussion is of course of the effects and relationships between sureties between themselves.
- The first was between creditor, the next discussion is the relationships between sureties between themselves.
- The first is the relationship between a creditor, the first we saw was between the creditor and the surety, a while ago we have seen the debtor and surety now obviously the third is sureties between themselves.
- This is in line with as we said in our introduction the tri-part nature of the relationship which we always have to bear in mind.
- Unsurprisingly, where there are a number of persons, sureties for the same debtor and the same debt, the surety who has paid and is in a situation of co-suretyship has also the right of relief against the other co-sureties.
- This is of course in addition to what we have seen and discussed in article 1937
  - Article 1937.
  - **1937**. (1) When several persons have become sureties for the same debtor and the same debt, each one shall be liable for the whole debt.
  - (2) Nevertheless, each one of them may, unless he has renounced the benefit of division, or unless he has bound himself jointly and severally with the debtor, demand that the creditor should divide his action and reduce it to the share due by each surety.
- In the sense that there is the benefit of division, the benefit of discussion and where these do not apply the paying surety has a right of relief against the debtor.
- So here we are looking at two levels of regress of the surety, that against the debtor and that against the co-surety.

- Therefore this provision and the provision we're looking at, article 1949
  - Article 1949.
  - **1949**. (1) Where several persons have become sureties for the same debtor and for the same debt, the surety who has paid the debt, has a right to relief against the other co-sureties for their respective shares.
  - (2) The surety is entitled to such relief only if he has paid in any of the cases mentioned in the last preceding article.
- Has to be read in conjunction with the rules of division and discussion, where mostly division when there are more than one surety. This is unsurprising however what Dr. Galea finds a bit hard to rationalise are article 1949(2) which tends to suggest that the relief of the co-surety against the other co-sureties applies in the extraordinary circumstances of article 1948.
- Why does this apply? The surety is entitled to such relief only if he has paid in any of the cases mentioned in the last preceding article. So to Dr. Galea this is a bit difficult to rationalise, because this is already catered for in the provisions of articles 1937-1939.
- Let's come now to the final act of suretyship which is the extinguishment of suretyship. We have seen how suretyship is formed, we have seen the nature and character of suretyship, it is ancillary, it cannot be beyond, it cannot be presumed, it has to be expressed, it has to be in writing, then we went to the three levels of relationships now we come to it's conclusions.
- The first is that the obligation that arrises from suretyship is extinguished in the same way as all other obligations. We know how obligations are extinguished, payment, novation, merger, set off, subrogation, remission.
- Therefore the general principles of extinguishment of obligations also apply in the case of suretyship.
- There is a first ground which is the merger in the person of the principle debtor and the surety.
  - Article 1957.
  - **1957**. The merger which takes place in the person of the principal debtor and his surety, when the one becomes the heir of the other, shall not operate so as to extinguish the right of action of the creditor against the person who has become surety for the surety.

- Now this, to be clear, we're looking at article 1957, extinguishes the suretyship but not the principle credit of the obligation, the merger of the debtor and suretyship extinguishes the suretyship but not the credit. (Merger of a person means when for example the surety inherits the debtor).
- Also an extinguishment of the contract of suretyship is the entitlement of the surety to set up by a way of defence all those objective pleas inherent in the debt.
- A defence of the surety is to plead and set up all those pleas which are objective and inherent in the debt. Inherent in the debt means those which refer to the debt itself, inherent and objective are used interchangeably.
  - For example payment, set off, prescription.
- Inherent in the debt means all those pleas which refer to the debt itself, such as payment, set off and prescription.
- This is to be distinguished from those pleas which are subjective to the debtor and we may recall this, such as minority incapacitation. These are not objective pleas.
- We were saying that the defences which are subjective to the debtor for example minority interdiction cannot be pleaded by the surety. The surety cannot plead by defence insecurities of the debtor.
  - Article 1171.
  - **1171**. Subject to the provisions of the foregoing articles, where no appropriation is made in the act of payment, the following rules shall be observed:
  - (a) the payment shall be applied to an undisputed debt in preference to a disputed debt;
  - (b) in case of several undisputed debts, the payment shall be applied to the debt already fallen due at the time of payment in preference to the debts not yet fallen due, unless amongst the latter debts there is a debt for which the debtor is liable to personal arrest, in which case the payment shall be appropriated to such debt, provided the time for payment was not agreed upon also in favour of the creditor;
  - (c) with regard to debts fallen due, the payment shall be appropriated to a debt for which the debtor is liable to personal arrest, or, in the absence of any such debt, to a debt bearing interest, in preference to other debts;

- (d) the payment shall be appropriated to a debt secured by suretyship in preference to another debt not so secured; and to a privileged or hypothecary debt in preference to a debt not secured by privilege or hypothec;

- (e) the payment shall be applied to the debt which the payer owed as the principal or the sole obligor in preference to a debt owing by him as surety for others or as a joint and several debtor;

- (f) in any case not expressly provided for in the preceding rules, the appropriation shall be made to the debt which, at the time of payment, the debtor had the greatest interest in discharging;

- (g) where the debtor has no interest in discharging a particular debt in preference to another, the appropriation shall be made to the oldest debt: and in the case of several debts contracted on the same day, and falling due at different times, the debt first fallen due shall be deemed to be the oldest;

- (h) if all things are equal, the payment is applied in discharge of each debt proportionately.

- Please note article 1171(d) on appropriation of payments, first the expenses, the interest then the capital. The rule is that where there is a debt which is partly secured and partly unsecured it is applied for payment against the debt which is not secured, the payment shall be appropriated to a debt secured by suretyship in preference to another debt not so secured. Where there is suretyship this is preferred.

- Where there is a debt which is partly guaranteed/secured by a suretyship and partly not guaranteed/not so secured and there is a part payment and the question arises against which part of the debt secured or unsecured is this going to be appropriated/paid, the suretyship secured payment is preferred. In other words the part payment goes to extinguish debt guaranteed by the suretyship.

  - Article 1959.

  - **1959**. A surety, even if jointly and severally bound, is released, if the subrogation to the rights, hypothecs, and privileges of the creditor cannot take place in his favour owing to the fault of the creditor.

- In article 1959 we have the rule that we have spoken about, if subrogation cannot happen the surety is released.

- The voluntary, where there are in the next article

- Article 1960.

- **1960**. If the creditor releases one of his sureties without the consent of the others, such release operates in favour of the other sureties to the extent of the share of the surety so released.

- Where there are a number of suretyship/sureties, and the creditor voluntarily releases one of the sureties without the consent of the others, the remaining co-sureties, are discharged/released to the extent of the amount of the released surety.

- Finally, article 1961.

  - Article 1961.

  - **1961**. Where the creditor voluntarily accepts immovable or other property in discharge of the principal debt, the surety is released, even though the creditor is afterwards evicted from such property.

- Finally there is again a strange provision which contemplates payment in surety by datio in solutum (I give you something to pay, instead of money I pay you by a tangible object dare per solvere).

- This is the last article we're discussing, where there is a voluntary datio in solutum, dare per solvere, you pay by giving something, I owe you and I give you a property, the discharge of the suety remains valid even if the creditor who has voluntarily accepted the datio in solutum is subsequently evicted and loses the property.

- Let us say that the creditor is paid by the surety by an immovable and the creditor who has accepted in settlement of the debt of the suretyship of the immoveable is suddenly evicted, the extinction, the discharge stands.

23rd February 2023

Lecture 4.

- Today we commence our discussion on pledge.

  - Pledge, pinius, in maltese rahan. Pledge is a guarantee, in the sense that like suretyship it assumes the existence of a valid obligation.

  - However, in the case of pledge, an object being either a moveable by nature or a moveable by regulation of the law, in the case of pledge a moveable by nature or a moveable by regulation of the law is given as a security.

- Let us take the classical example, you pawn your watch to get a loan.

- So, therefore pledge is a real guarantee in the sense that there is a specific object which is given as security, a further subdivision of securities/guarantees are possessory, non possessory guarantees.

- In the case of a pledge it is a possessory guarantee, because the object is handed to the creditor and is in the control of the creditor. In other words, the debtor in the case of pledge is divested of control.

- Contrast, the situation of a hypothec where this is a non possessory guarantee, in the sense that the object over which normally but not invariably but normally it is an immovable, the object over which the guarantee is given remains in the control of the debtor.

- Pledge may be either given by a debtor for the amount that the debtor itself owes, or it may be given by a third party to guarantee not the debt of a third party but to guarantee the debt of the debtor.

- A pledge may be given either by a third party to secure a liability of a debtor in which event of course the liability of the third party is simply placing the pledge and not beyond, or it may be given by the debtor itself.

- Please understand that pledge refers only to moveables, either by nature or by regulation of the law and therefore we cannot talk of the pledge of an immoveable.

- What would typically be pledged, moveables would be business talk, merchandise. Moveables by regulation of the law typically again let us call them broadly financial assets.

- To really understand what Dr. Galea means, go to the investment services act in the second schedule there is a list of financial assets but typically it is bank deposits, shares, bonds, insurance policies, holdings in investments etc.

- Our articles were partly amended in 1975 where at the time they looked at the current Italian code, the 1942 Italian code as a matter of sources. It is a mix of the old French articles and the contemporary Italian law.

- We will be looking at pledge of securities under the companies act, pledge of receivables (when there is a collectable, it is an asset that can be pledged, an amount it is an asset) and pledge of life insurance policies.

- Now, again needless to say, the levels of engagement and the events of default and the enforceability of a pledge, depends of course on the contractual terms, and Dr. Galea believes that a proper reading of the pledge articles which are

articles 1964 to 1986. Clearly allows for and probably assumes an underlying contractual framework.

- The articles on pledge, therefore regulate the nature on contracts and certain rules. Now, whilst it is in this day and age probably unthinkable, to have a pledge which is not reduce to writing, there is no formal requirement of writing, what Dr. Galea will say about the companies act and the pledge of credit is excluded but at least in the traditional rules it is not a necessary requirement to have the document in writing. A public form is not required but they have to be in paper writing. Perhaps to understand the centrality and importance of a pledge one has to be aware of its ranking.

- Soon we will start discussing privileges, hypothecs and their ranking and when it comes to securities over moveables, we are told that in the case of privileges both over immoveables and moveables, ranking is according to the order listed in the law and pledge is at the top, first ranking (at the head of) in the case of ranking over moveables. To understand the strength of pledge we have to be aware that pledge is first ranking, meaning also, that in the event, there is a sale/a disposal of the moveable asset pledged, the pledgee is the first ranking (is first so ranks first) from the process of the sale.

- This is today no longer invariantly the case but historically there has been a reluctance or resistance to the right of appropriation, the jus distrahendi (the right to take) the object pledged.

- Why was this? Because traditionally where the focus of the object of pledge was on corporeal moveables (tangible moveables) as distinct from incorporeal moveables, (that is to say intangible assets), the concern related to the value to be placed on the corporeal object/moveable held in pledge. Why? Because there was no control over the value over the object pledged and the credit and to allow the creditor to simply take the object pledged, created a possibility of abuse that the object pledged and the potentially taken by the creditor would be much more than the actual credit.

    - Let’s say, you pledge a painting or a watch to secure a claim but the watch/painting is significantly more valuable than the credit so there was this concern, there was no control. Second, there was also a tradition on the fairness of the procedure in the sense that ultimately the asset is worth what the market decides to give you, there’s a lot of truth in this and therefore the procedure was try and sell the object.

- This is not applicable due to more recent amendments, in the companies act and the civil code. In the case of life insurance policies and in the case of

shares/securities subject to a process of valuation the creditor is entitled to take appropriate the thing in settlement or part settlement of the debt security/secured by the pledge.

- Article 1964.

- **1964**. (1) Pledge is a contract created as a security for an obligation. The pledge may be given either by the debtor himself or by a third party for the debtor.

- (2) The things that may be given as a pledge are movable things and debts and other rights relating to movable things.

- This is quite a wide formulation because it raises the question what are rights related to moveable things. In Dr. Galea's reading, this was written to include documents of title for example a bill of lading or an airway bill. This is the receipt given by the carrier or the aircraft for the object, this can be endorsed and in cargo pledged.

- One can elaborate on what can be pledged, (we won't go into the discussion) securitisation rights, when in improper terms an asset is monetised.

  - For example you have an asset against which the public or investors can subscribe, recently there was a story of a Scottish/Italian violinist who wanted support for her Stradivarius (a violin), she got her Stradivarius, obviously sold on credit and she created what is known as paper, business people who have money invested in the issue to finance this violin as an investment and she paid the investment and the people who bought the instruments from her work/concerts/music etc.

- That is known as securitisation. When you raise money today against future royalties. It's a structure, it got a very bad name during the financial crisis of 2008, because obviously the paper you have is really worth the asset behind it and a lot of paper was issued which had no asset behind it but there can be various financial assets which can be pledged.

- How does one ensure that the thing pledged does not become part of a warrant of seizure of another creditor? That is always a risk because the thing pledge remains the ownership of the party giving the pledge.

- The parties are the pledgor is the party giving the pledge, the pledgee is the person in whose favour the pledge is given.

- Now, to come to the question it is a risk because if it were seized one has to see in whose control it is whether it will remain in control of the creditor, the pledgee or whether it would be under effect of the court control or whether the pledge will

be lost but seizure per se does not create ranking. It's a normally an obligating question. Dr. Galea would say that if there has been a prior pledge, and even if there is a court order the pledge is not lost because it is by court order. The pledgee is responsible for the maintenance of the thing unless agreed otherwise.

- The difficult question to which Dr. Galea can give a clear answer is how Farr can you pledge intellectual property? Can you pledge a trademark? Say Dr. Galea thinks an unclear question, certainly it can be assigned and the difficulty is that in the case of pledge, delivery is of the essence.

- Now how can you deliver a trademark? How can you create a right over a trademark? Dr. Galea thinks that you can create some form of security because a trademark is a proprietary asset, but it will take some creative construction to create a sense of delivery. The next article 1965.

  - Article 1965.

  - **1965**. (1) The pledge of movable things is constituted by the delivery to the creditor of the thing pledged or of the document conferring the exclusive right to the disposal of the thing.

  - (2) The thing pledged or the document aforesaid may also be delivered to a third party selected by the parties to the contract or placed in the custody of both parties in such a way that the party giving the pledge may not dispose of it without the co-operation of the creditor.

- How can you deliver the asset? We asked the question can you lease a trademark? No you can license a trademark because it's not a corporeal thing but the question is how do you deliver a trademark? You can't its not a corporeal moveable. But the thing is how do you, (this is the point) deliver a credit/pledge a share/pledge a receivable. That is a strong argument militating in favour there has to be properly written that delivery at least some form res in mano is created of the trademark

- Article 1965 of the code says that pledge is created by delivery and this is entirely consistent with the idea that the pledgee has to have material control, that is why it is a possessory guarantee. The pledgor loses control. We're saying that the pledgee requires delivery, requires control by the pledgee.

- Pledging of a trademark can be a bit tricky, because on the one hand it is a proprietary moveable asset which can be sold/transmitted in all the normal ways that ownership is transmitted, but on the other hand we can acknowledge the difficulty of creating the delivery.

- Pledgor is the debtor, the pledgee is the creditor.
- The question of a pledge of a trademark, we said that it is of the essence of the contract of pledge that there is a delivery can be physical it can be brevi manu, delivery can be entrusted in the hands of a third party custodian.
    - For example a bank or a trustee, a security trustee for example who holds the object in trust subject to the terms of the pledge, very often in the case of pledge of stocks this is constructed in the following manner. Let's say a bank finances for stock purchase, very normal. Now, the stocks are placed In a warehouse to which there are two keys, pledgor and pledgee, separate keys so that both parties have to co-operate for the stock to be released. The important thing is two separate locks and the warehouse cannot be opened unless the both locks are open, both have to cooperate and the bank will tell you deposit in advance and I will come and open it for you. Together they have to be opened neither party has access alone to the stock. There are two keys and they have to be opened together requiring collaboration.
- Coming back on the pledge of a trademark a method has to be found to create delivery.
- These are considerations relative to a trade of a trade mark, we agree it's written in the law, it is a proprietary asset which is marketable, which can be sold, transferred, assigned etc, and there is no reason why it should not be given as a guarantee subject to the appropriate structure .
- The difficulty is here how do you create delivery? On the one hadn't we see that material physical devilry is impossible. On the other hand, can u deliver shares? You can't. Can you deliver an insurance company? You can't. Can you deliver an IOU? You cannot so there is a creation whereby delivery is created by agreement and probably this delivery will give the pledgee obviously first ranking but subject to the terms of agreement the exclusive control under the terms of the pledge of the trademark.
- Remember we won't discuss it but there is of great value in securities the irrevocable power of attorney, powers of attorney are by nature as we say irrevocable, however it's possible to create an irrevocable power of attorney for executing certain transactions.
    - For example parties choose an agent receiving the cash releasing the asset, for example a trustee, and obviously in the past it was seen happen that parties would give a power of attorney to a person receiving the cash and releasing the asset simultaneously but then at the last moment someone withdraws the

power of attorney or worse the money has passed and the authority to release is withdrawn.

- That is the idea of irrevocable power of attorney.
- Let us keep in mind the distinction between pledge and assignment, assignment is the transfer of an intangible incorporeal right, a credit for example. I am owed money, I owe you money, I transfer my right to collect to you, you collect from him. That is assignment, pledge is something different because in pledge the constitution of a pledge per se is not a transfer of ownership as distinct from the assignment but its good to be aware of this difference.
- Pledge is the creation of a guarantee, which has a ranking, but there is no transfer of ownership per se. Assignment is the sale of an intangible right.
- The relevance is to the pledge to a trademark, we were saying that a trademark has wide powers to control markets, that is why then the pledge agreement has to be very well carved out in the sense that you limit what the pledgee of the trademark can do, then we linked it and it is used widely in securities the irrevocable power of attorney, when something has to happen simultaneously.
- The last points relate to the pledge of debts, and here we have something similar to the delivery of the document of debt, in other words there's this symbolic delivery that either a copy is delivered or a reference is made. If you're pledging a debt, so 'C' owes 'B' and 'B' owes 'A'. 'B' can pledge in favour of 'A', the amount which it is owed by 'C' to 'B'. ('C' pledges 'A'). In this event, 'A' as the pledgee creditor is entitled to enforce the credit that 'C' owes 'B', according to its terms/conditions (take what is due and return the difference).
- There is a presumption that where there is between two parties a debt which is pledged, there is a presumption created by the law, a juris tantum presumption that subsequent debts between 'A' and 'B' also include the pledge which 'C' owes 'B'. So, the opening scenario is 'C' owes 'B' and 'B' owes 'A' and 'B' pledges in favour of 'A' what is owed by 'C', now if 'A' and 'B' contract subsequent debts (subsequent to the debts secured by the pledge, to the first debt/the pledge), there is a presumption, a juris tantum and negotiable presumption/which can be negotiated and excluded, that the original pledge extends to the subsequent debts.
- 'A' and 'B' have a loan dated 1st January, secured by a pledge then later 'A' and 'B' contracts subsequent debts, there is a rebuttable excludable juris tantum presumption that the subsequent debts are also secured by the pledge. ('B' is the pledgor and 'A' is the pledgee)

- Finally, there is also the entitlement again, this is something which can be excluded by negotiation, that the pledgee demands assignment in its favour, there is also the right that the pledgee demand in its favour the assignment and not the pledge of the amount that 'C' owes 'B'/the creditor owes the debtor.

28th February 2023

Lecture 5.

- Last time we finished a discussion on article 1968 of the civil code and we distinguished between the pledge of a debt and an assignment of a debt.

  - Article 1968.

  - **1968**. (1) Where the thing pledged is a debt, the pledgee shall be responsible for the collection of such debt on maturity, and shall place the moneys or other things received either as agreed or, failing such agreement, as the court may determine.

  - (2) If the debt secured by the pledge is due, the pledgee may retain, from any moneys received as aforesaid, an amount sufficient to satisfy his rights and shall deliver the remainder to the pledgor; and if the thing received is not money, he may proceed with the sale of the thing as provided in article 1970.

  - (3) The creditor of a debt secured by the pledge of another debt may, at any time after his debt becomes due, demand that the debt pledged in his favour be assigned to him in payment up to the amount of his debt.

  - (4) The debtor of a debt given in pledge may oppose to the creditor of the debt secured thereby all the pleas which he could have set up against his own creditor; but if such debtor has himself accepted without reservation the giving of the debt in pledge, he may not oppose to the creditor of the debt so secured any compensation that may have taken place before the giving of the pledge.

- Whilst the distinction should be obvious, in the case of an assignment there is a transfer of a debt. 'B' owes 'A' and A is a creditor of 'C', and 'A' transfers to 'C' it's credit against 'B'. 'A' is a creditor of 'B' and 'A' transfers to 'C' it's entitlement against 'C' such that on the same terms and conditions now 'B' owes 'C' instead of 'A'

- In the event that it where a pledge, 'A' would not divest/lose ownership of its credit against 'B' however normally due to an amount owing by 'A' to 'C', normally it happens because

- We’re discussing where we stopped last time on the distension between the assignment and the pledge of a debt. So in this example normally due to some liability of ‘A’ towards ‘C’, ‘A’ pledges as a guarantee in favour of ‘C’ the credit of ‘A’ against ‘B’.
- It’s important to understand this and maybe today when we speak about pledge of receivables, of collectibles.
- The point in 1968(3) is that ‘C’ in our example, in the event that the amount due by ‘B’ to ‘A’ becomes due, is entitled to request that ‘A’ assigns in favour of ‘C’ the claim that ‘A’ formerly had against ‘B’. That is the point.
- Finally a more difficult point, where there is an assignment, this is article 1968(4), the point/question is which pleas can the debtor of a debt which has been assigned raise against the new creditor/assignee. In our example ‘A’. ‘B’ has assigned to ‘A’, how far can ‘C’ raise these defences against ‘A’.
- As a rule, the debtor may raise against a new creditor, this is article 1968(4), the debtor may raise against the new creditor/assignee all the defences which the debtor could have raised against the original creditor ‘B’. The debtor ‘B’ may raise against the new debtor/assignee ‘C’ all the pleas that it could have raised against the original creditor ‘A’. However there is a very serious exception in the sense that; let us assume that there has been set off/compensation between ‘B’ and ‘C’ prior to the assignment.
- The original creditor is ‘A’, the debtor is ‘B’, the new assignee is ‘C’
- In the event that a set off compensation took place between the debtor and the first creditor, and there has been a subsequent assignment of the debt/credit, unless the debtor has opposed or raised the question of set off, which happened between the debtor and the first creditor, failing this, the debtor may not plead compensation with the new assignee/new creditor. How far can the debtor defend against the new assignee with a set off which took place with another person. If set off happened automatically, (set off is between two parties).
- The next articles tend to illustrate the enforceability of the pledge let us never forget that as a rule in the civil code and there are exception; pledge of securities, pledge of life policies there is no right to appropriate in other words to take in payment the thing pledged in the event of default it has to be sold; so auctioned or through a market.
- What happens if an object is pledged by a non-owner a non-domino, there is a separate regime which is found under the Monte di’ Pieta act (it’s something historical founded by the knights it’s on the fourth floor on the capital transfer

branch in Merchant street Valletta, and they generally perform a function of valuation and a function of (Dr. Galea doesn't think it happens much) advancing money in forma pauperis etc, but the Monte di Pieta Act enacted around 1976 (Cap 269).

- Apart from this which has it's second regime, the pledge of something which does not belong to the owner is subject to what we're going to say valid. The question is, let's put it in context how do you protect third parties in good faith when there is no formal registrations. When we spoke a while ago about possession of moveables, we said that possession of moveables in good faith by an acquirer generally produces title. (Article 596) and we said then that obviously this does not apply if the person in possession could not have been presumably been the owners and possession was acquired in dubious circumstances.

  - How did I get my watch? it's one thing buying it from a high street dealer, its another buying it from the backstreet.

- This is also part of the discussion here. The idea is how to protect a third party in good faith? A pledgee in good faith. Subject to the two exceptions, the pledge of (obviously a moveable thing/right) a non domino is valid even vis a vis the legitimate owner unless these circumstances are established.

  - <u>Article 1969.</u>

  - **1969**. (1) The thing given as a pledge by a person to whom it does not belong is validly pledged, and the owner cannot recover it, except on payment of the debt in respect of which it was pledged.

  - (2) This provision except as regards Il-Monti shall not apply in the following cases:

  - (a) when it is shown that the pledgee was in bad faith;

  - (b) when the thing pledged is proved to have been stolen, and the pledgor could not, presumably, have been the owner thereof.

- These circumstances, we are looking at article 1969(2), and they are alternative not cumulative, either or is sufficient not both have to be fulfilled. So the pledge, a non domino is valid unless either it is shown that the pledgee, in other words the party in whose favour the pledge was created was in bad faith, or alternatively where two conditions are established.

- The object pledged has been stolen and the pledge could not presumably have been the owner. The condition which invalidates the a non domino has these two requirements. Therefore if the object is stolen (going back in the past when pledge were corporeal moveables) and the second condition which has to be fulfilled is that presumably the pledgor was not the owner.
- Now this statement, the pledgor was not the owner raises some questions in the sense that one also has to look at such circumstances such that the pledge could have legitimately been the owner.
    - An example is when someone goes to an auction buys normally in public and then it is found to be stolen.
- The question is you're in good faith, you've paid money, you've paid whatever it's value is on the market at a public auction how do you know it has been stolen. The second part could not presumably have been the owner requires some comment in the sense that there could be circumstances where really an owner of something stolen could be unaware and in good faith.
- In court auctions when you buy a subbasta, this is a tradition, that in withdrawing money let's say I went to bid at a court auction and acquired through court auction pay, the party withdrawing, the creditor withdrawing the money will guarantee against evictions.
    - Let's say I pay money in court in good faith and subsequently there was a challenge to title. The party withdrawing from court, the creditor will sign a paper guaranteeing against eviction, whether it's valid or unavoidable Dr. Galea will not comment but it was written a century and a half ago and the italian origin still survives.
- So, this is a question of the pledge a non domino.
    - <u>Article 1970.</u>
    - **1970**. (1) The creditor, unless such creditor be Il-Monti, cannot dispose of the thing pledged in case of non-payment: but he may cause the thing to be sold by auction under the authority of the court.
    - (2) The demand of the creditor for such sale may be made even by means of an application and it shall be lawful for the court upon such application to order the sale of the thing pledged, if the debtor or his lawful representative, duly served with a copy of such application with a time of three days within which to file an answer, fails to file such answer or makes no opposition to the demand.

- (3) It shall be lawful for the court, on good cause being shown, to abridge at its discretion the times fixed in articles 256 and 312 and in the latter part of sub-article (3) of article 314 of the Code of Organization and Civil Procedure.

- (4) If the thing pledged has a stock exchange or market price, it shall be lawful for the court, on the application of the creditor, to be served upon the debtor or his lawful representative, to order that the sale of the thing pledged, even though such sale be in execution of a judgment, be carried out, instead of by auction, by means of a public broker or a bank or other banking institution to be appointed by the court.

- (5) The application referred to in the last preceding sub-article of this article may not, except where the sale of the pledge is in execution of a judgment, be made by the creditor until after the lapse of three days from the service of an intimation, calling upon the debtor or his lawful representative to pay the debt within the said time and warning him that in default of payment, proceedings will be taken for the sale of the pledge.

- (6) In no case shall the opposition of the debtor to the sale of the pledge as provided in sub-article (4) of this article operate so as to prevent or delay such sale, saving the right of the debtor to maintain an action for damages, where competent.

- (7) In the case referred to in sub-article (4) of this article the court may, if the creditor is a bank or other banking institution, authorize such creditor to sell the pledge at the current price, saving the right of the debtor to maintain an action for damages, where competent.

- (8) The public broker, or the bank or other banking institution referred to in this article shall, within twenty-four hours from the receipt of the proceeds of the sale of the pledge, pay such proceeds into the court by which the sale was ordered, after deducting therefrom any expenses and commission which may be due.

- Article 1970 is a very strong statement that the creditor may not appropriate or dispose of the thing. The right of the creditor is to cause the sale of the object pledged under court authority.

- One can understand that (we’re not going to go into much detail) but we are told here that to enforce a pledge (forget registered securities, forget shares) but in the case of moveable, you have an expensive ring or a car pledged it has to go to court with the delays, publicity and the risk of the court auction because this is not like when there is something on the stock exchange there is a market which

functions everyday which has a value, this is contingent on what the court order gives you.

- In other words creditors normally organise bidders to raise the bids, to raise the price because there is no minimum, in case of immoveable there is a minimum. Situations have happened where things go at a pittance far below their real value. So one has to be aware of this risk but the principle is that any moveable object not the security etc has to be sold through court.

- The next part of the civil code title on pledge refers to the rights and obligations of pledgor and pledgee.

  - Article 1971.

  - **1971**. The debtor also may, after the debt has fallen due, or even before if the time for payment was not stipulated in favour of the creditor, demand in the manner prescribed in the last preceding article the sale of the pledge in order to pay the debt in respect of which the pledge was given.

- First of all, strangely, not perhaps article 1971 entitles the debtor not only the creditor, the creditor we have just seen but the debtor also has an interest that the object pledged is sold to avoid incurring additional interests, charges etc. Therefore the debtor of a debt which has fallen due is entitled to request the sale of the object pledged. I say listen this debt is due I can't sell it the creditor may be comfortable charging me interest but I want to stop interest and I want this thing to be sold, so this is a right of the debtor. The creditor has the right to ask to get paid but the debtor also has the right to request the sale.

- Where there is a risk of deterioration, either creditor and debtor (pledgor or pledgee) have the right to request that the object is sold.

- Now, we have also an indication here where the limits of party negotiation cannot exceed and the rule that to get paid a creditor has to ask for a court sale that the debtor may demand the sale of the pledge and the right of either creditor or debtor to demand the sale cannot be excluded by agreement.

- You will recall that in our introitus (the entry of discussion) we said that as a rule there are certain boundaries which cannot be crossed for example the delivery, the control, the loss of control pleading special privilege, the special privilege of the moveables and here again we have three rules which are of public order.

- We will recall that when we were discussing the preliminaries we said that there are certain rules, we asked the question what can be negotiated and the subject of a negotiated contract and what cannot be contracted out or modified. In the

initial discussion there is delivery, there is loss of delivery and control and the rule that each comes at the top of the ranking of the moveables.

- Now here we have another three mandatory rules which are the prohibition of the creditor to appropriate.
  - The right of the creditor is to sell at a court auction, the corollary is that until the object is sold the debtor is not divested of ownership. The debtor remains the owner until the sale.
  - The second rule which cannot be contracted out is the right of the debtor to demand the sale of the object when the debt falls due (we've mentioned it)
  - The third rule which cannot be contracted out is the right of either creditor and debtor (pledgor/pledgee) to demand the sale when there is a risk of deterioration. This happens very much in stocks, particularly either food stocks when you have a container, or fashion (clothing fashion) which holds a quick market expiry.
  - Very often rather than let food rot in a warehouse it makes much sense to have this sold and the contestation goes in later.
  - Also, we did not speak much about events of default. Events of default, are normally a very important portion of a pledge, a loan, a security agreement, when you go, even at the most basic level you get a home loan, you have three pages loan constituting event of default in this case one sided even if I'm regular and there's market disruption.
  - The point is whatever the event of default there's something to be said, it has been consistently held jurisprudentially that in the event of disagreement between the parties you say I'm in default I say I'm regular, the payment between the parties the event of default has to be judicially established (3-4 years in court).
  - So this is a bit of a weakness in Dr. Galea's opinion and there are some judgements, we may agree or disagree, let's say I go to the bank and as security I offer cash, cash collateral, fixed deposit shares, the drift of the judgements is that the bank as it used to be in the past but now the courts have been having second thoughts, the bank thinks you're in default and simply cashes the deposit you have pledged in favour of the bank/takes it.
  - In the past it was clear that if the bank, we're not suggesting the bank be unreasonable but let's say the bank decided in its judgement that you are in default, that for example your financial situation has deteriorated. In the past it was clear that the bank would simply cash, take your deposit, transfer your deposit you sign a paper I authorise the bank to take my deposit and place it against what I owe in the. Event that the bank contempts that a debtor is in default.

Now that view is being challenged and here again it is being held that the bank has to first establish default then be entitled to take it/cash the money guarantee based in its' hand.

- Today the drift is changing because an event of default has to be judicially established. Now, if you look at international agreements there is the Lender Credit Market Association whose business it is to produce documentation inter alia, this is not the case the bank is given a discretion acting reasonably well aware that there is a growing development of law and judgements on lenders liability.

- This is the practice here however, know that there is a trade association based in London, the lender markets association LMA, whose business it is inter alia (its a trade body of ranks but they produce documentation which are centred and if you see international loans there are quite a considerable amount of uniformity which is good as one knows what an article means). The language here and the concept here of the LMA is that the bank is entitled to enforce security subject of notice and clear times of default without the need to go to court. The lender is only enjoyed to act reasonably, well aware of the growing development of what is known as lender's liability. In other words even a lender can be held liable for destroying a business if it is shown that the lender acted unreasonably or unfairly or that there could have been ways to save the business. This was an aside.

- We are speaking or were speaking of abuse of pledge and we said that use without the consent of the creditor or sub pledge is considered an abuse of pledge.

- Now, this abuse of pledge has two principle consequences. The first is the entitlement of the debtor, to save guard the object, to request on the basis of entitlement, there is a right not merely a request that the object be placed in the custody of a third party for proper safekeeping. Let us not forget that the debtor is not entitled to recover the control of the object given in pledge before the entire amount has been paid.

- Now we'll come back to this after another point.

- The second consequence of an abuse of pledge is that the abusing pledgee assumes responsibility for force majeure. Whereas the normal as we have said level of diligence of the pledgee is the bonus paterfamilias, where there is an abuse of pledge the abusing pledgee is responsible even for loss due to an irresistible force, force majeure unless the only defence that the abusing pledgee can show, it can show that the object would have for example perished or deteriorated anyway.

- Now we come to the final article on this subtitle and we go back to the point Dr. Galea mentioned earlier, that the debtor is not entitled to the release of the object pledged unless the entire amount has been paid.

- The concluding article in our discussion is article 1985.

  - Article 1985.

  - **1985**. (1) A pledge is indivisible, notwithstanding the divisibility of the debt between the heirs of the debtor or the heirs of the creditor.

  - (2) The heir of the debtor who has discharged his share of the debt cannot demand the restitution of his share of the pledge until the whole debt has been discharged.

  - (3) On the other hand, the heir of the creditor who has received his share of the debt, cannot return the pledge to the prejudice of the unpaid co-heirs.

- Dr. Galea remembers of situations where parents had deposited their jewels, their jewellery or whatever in a safe deposit with a bank. The parents passed away and one of the heirs had a liability with the bank and the other heirs said listen I want my share of my parents inheritance I owe nothing to the bank its my sister who owes. Here, the rule comes into operation that a pledge is indivisible, this is article 1985. The pledge is indivisible not withstanding the indivisibility of the debts of the heirs of the debtor or the heirs of the creditor.

- In other words this can put a situation, let us say that a debt is inherited and is divided between the heirs. The question is can the paying heir of its share request its share of the object pledged if it is something that can be divided or asked that it is sold to get paid, the answer is no. This is article 1985.

- So we are looking at this strange perhaps rule, but Dr. Galea's point and that is why we're coming back to the original question, there are two questions here and in fact it hasn't been changed since 1968. Does this refer to the pledge of something tangible, a corporeal moveable or does it extend to fungibles for example liquid investments which can be divided? The second question is can this be modified by consensual negotiation? If I borrow €100,000 and pledge because the bank would be over secured €150,000 and out of the €100,000 I have borrowed I pay €80,000 a reasonable bank would release the security but the question is is there an entitlement to demand the release because of the rule we have spoken of earlier that the debtor cannot recover the object pledged unless they have paid the entire amount and can they recover the object pledged?

- The questions here are two, does it refer to money assets? Which are easily decidable and second can this be negotiated by consent can it be excluded or modified. Dr. Galea's opinion is that where as it used to be in the past people used to pledge valuables (family silver) to get in advance he thinks that this view holds but he thinks that this can be tested and challenged where there is an asset which is liquid, where there is a market and an asset can be turned easily into cash but this is just his view.

- The point is that let's look at article 1979.

  - Article 1979.

  - **1979**. The debtor cannot claim the restitution of the thing pledged until he has wholly paid the principal, interest and expenses of the debt for which the pledge is liable.

- Here it is evident that we are looking at something corporeal, tangible, moveable. That is it on pledge.

- Now we are going to look at something else which is the pledge of receivables. Article 1484A of the civil code.

  - Article 1484A.

  - **1484A**.(1) In the case of an assignment of one or more debts where:

  - (a) the assignor is a trader;

  - (b) the debts being assigned arise out of or in connection with the trade or business being carried out by the trader; and

  - (c) the assignee is a person licensed to carry out the business of banking or the business of factoring under the applicable laws of Malta, or the equivalent laws in a jurisdiction recognised by the competent authority appointed in terms of the Banking Act, such assignment of debts shall be governed by the provisions of this Sub-Title, as varied by this article.

  - (2) Classes of existing debts may be assigned provided that the debtor be identified in the contract of assignment.

  - (3) Future debts, or classes thereof, may also be assigned provided that the debtor and the latest date by which the future debts shall come into existence be identified in the contract of assignment. In such cases an assignment is effective at the time of the conclusion of the contract without a new assignment being required when such debt comes into existence.

- (4) In the case of the assignment of debts referred to in this article, the assignee may not, in regard to third parties, exercise the rights assigned to him except after due notice of the assignment has been given to the debtor by the assignee himself or by the assignor and, in the case of an assignment of future debts, or of classes thereof, no further notice shall be required when the future debt comes into existence.

- (5) Notice of an assignment may be evidenced in writing by any means, including by a notice sent to the debtor together with the document evidencing the debt and need not be signed by the assignor or the assignee.

- (6) The assignment need not state a fixed price nor need the price be in money. The price may also be determined by reference to any formula or method agreed between the parties.

- (7) The assignor shall be answerable for the solvency, whether present or future, of the debtor, to the extent of the price of the assignment, unless the assignee renounces to such warranty in whole or in part.

- (8) In the event of insolvency or bankruptcy of the assignor, the assignment of future debts which have not yet come into existence on the date a winding-up or bankruptcy order is made by a Court, may be rescinded by the liquidator or the curator of the assignor. The right of rescission of the assignment of future debts shall be conditional on the refund of any consideration paid by the assignee to the assignor for such future debts.

- (9) Articles 1483(1), 1506(1), 2013(3) shall not apply to assignment of existing or future debts, or classes thereof, governed by this article.

- (10) All the above provisions shall apply mutatis mutandis to the pledging of debts referred to in this article and the provisions of Title XXI of Part II of Book Second of this Code shall be construed accordingly.

- (11) Articles 1980 to 1984 of this Code shall not apply and an assignee shall have a right of use over, and the right to sub-pledge, debts which have been assigned to him.

• Before starting factoring, the negotiation of debts, bear in minds the distinction between the pledge and the jus retenziones. I don’t pay my mechanic he doesn’t give me my car, I don't pay the freight but the freight isn’t released. That is the right of retention. Obviously pledge has control like the right of retention but the right of retention may give me the right to sell, if I don’t pay my mechanic ultimately

he has a right to sell the car but if I have a lot of creditors the mechanic has necessary priority which is the case of pledge, the strength of pledge is its ranking.

- The right of retention, the jus retention's is a primitive, unsophisticated, unrefined, crude mechanism of self help you don't pay me you don't get your object but again it carries no strength of ranking as distinct from pledge.

- Back to article 1484A, this was designed to facilitate the business, was very popular before the financial crisis and in fact we did have a number of companies set up in Malta to carry out this business, this is a sophisticated business of trading in debt where this traders balance sheet, is the assets of receivables, a receivable is an asset. People owe me is an asset.

- It was also set up to facilitate the business of discounting of debt. What does it mean? There are companies who obviously know what they are doing or should know what they are doing here you are owed €100, they will say okay I will give you €98 in cash and then I am responsible for its collection. It's called sometimes invoice discounting. There is a company/companies, licensed regulated companies you cannot do this unless you have a banking or services license, where let us say you have a debt of a €100 from X you sell them the debt at €98 and then they will collect a €100 and their profit is a margin of 2%

- This article however intended to address one basic problem and this stems for also to bring us in line with international law conventions. Companies, businesses have receivables.

  - For example a hotel has a book of bookings, consumer companies may have many clients who are paying by instalments, whatever computers, cars, white goods, domestic things. You have 100 clients who pay so much every month.

- So, this was introduced to facilitate the granting of security against this trade receivable book. it's called book in the jargon of the trade, what you are owed. A company has 500 customers for white goods, needs finance, can it offer to the bank these receivables from their customers as a security? I need cash to finance my business what do I offer as security? Listen I have a book where every month I receive so much from my customers and therefore can this be offered as a security? Can I go to the bank and say listen this is what I can offer (collectible/receiver are used for the same reason), what you are entitled to collect. The Maltese have been buying debt for centuries the point is here that it is regulated.

- The crux of this amendment is first of all it is possible, Dr. Galea will talk to us about assignments however, the end line is that the provisions of assignments apply to the pledge of debts. We are going to talk about the assignment of debt

of receivables however by virtue of 1484A(10), the provisions of title XXI on pledge shall be applied and interpreted accordingly. What we're going to say about assignment of debts applies on pledge of debts.

- First of all it is possible to pledge/assign classes of debts. You could have different categories of debtors. Second it is possible to assign/pledge future debts.
- The crux of all this is that if you take your mind back to the Civil Code on assignment of debt or pledge of a debt, there has to be either noticed by judicial act of the assignment or pledge, or acknowledgement by the debtor. I. Acknowledge that what I owe you has been pledged in favour of another party. The crux of this discussion is those articles of the civil code of assignment or pledge which in the case of assignment/pledge of a debt require either judicial notice by judicial letter of the assignment/pledge or the. Acknowledgement of the debtor of assignment/pledge the debtor has to sign and acknowledge it.
- It is clear and this was one of the reasons why this business could not really be satisfactorily developed that if you have 500 debtors you cannot call 500 debtors to acknowledgement or send a judicial letter to 500 debtors. So these rules of either judicial notice or acknowledging of the debtor do not apply in the case of assignment/pledge of classes or debts and these provide that a notice in writing as seen in 1484A(5). Here saving obviously manifest bad faith, what is required is a simple notice in writing of the assignment/pledge and when you have the assignments in certain classes of debts in this regulated industry of factoring of debts, of the trading of debts, of the purchasing of debts, of the financing of debts the bulk can be informed by simple letter, by simple notice in writing.
- As one can imagine after the financial crisis this was seen in a very different persecutive because what used to happen was this bundle of debts was put together and sold off as a package without any real investigation on the underlying value of the asset and obviously the underlying value of the asset is the credit worthiness of the debtor. So, this is on factoring.
- Now we start our conclusion on something different, pledge, which is the pledge of securities, go to article 122 of the companies act, Chapter 386.
    - Article 122.
    - **122**. (1) Securities may, unless otherwise provided in the memorandum or articles of the company or under the conditions of issue of those securities, be pledged by their holder in favour of any person as security for any obligation. The pledge of securities shall be constituted by means of an instrument in writing entered into between the pledgor and the pledgee:

- Provided that in the case of a private company, securities may not be pledged unless the memorandum or articles of the company specifically so provide; and in relation to transfers of shares by members of the company any restriction resulting from the memorandum or articles of the company shall, subject to the provisions of sub-article (10), be deemed not to apply to transfers by the pledgee in terms of sub-article (6) or resulting from any judicial sale.

- (2) Notice of the pledge shall be delivered by the pledgor or the pledgee to the Registrar for registration within fourteen days of the granting of the pledge. The company whose securities have been pledged, shall also be notified of the pledge in writing within the said period and the company shall record that fact in the register of holders of the respective securities.

- (3) The pledge of securities shall be effective in relation to a third party only after the registration by the Registrar of the notice referred to in sub-article (2).

- (4) Saving the provisions of sub-article (3), during the existence of a pledge of securities, any transfer or other assignment, made by the pledgor, whether by onerous or gratuitous title, of the pledged securities shall be null and void.

- (5) Notwithstanding the provisions of sub-article (4), any transfer or other assignment of securities made with the consent of the pledgee shall be valid and the securities to be transferred shall continue to be subject to the pledge.

- (6) Without prejudice to the right of the pledgee to apply for the judicial sale of the securities and notwithstanding the provisions of the Civil Code or of the memorandum or articles of the company, in the event of a default under the agreement of pledge and upon giving notice by judicial act to the pledgor and the company, the pledgee shall be entitled to -

- (i) dispose of the securities which are pledged in his favour; or

- (ii) appropriate and acquire the securities himself, in settlement of the debt due to him or of part thereof.

- (7) For the purposes of sub-article (6) the value of the securities may be established by agreement between the pledgor and the pledgee after notice of default has been given by the pledgee to the pledgor in terms of the said sub-article (6), and no prior agreement thereon shall be valid:

- Provided that, in case of disagreement, the fair value for the sale or appropriation of the securities shall be determined by a certified public

accountant or a certified public accountant and auditor appointed by the Civil Court, First Hall, on the application of the pledgee.

- (8) For the purposes of sub-article (7), the fair value of the securities shall be that obtaining on the date of the notice referred to in sub-article (6).

- (9) The pledgee shall, in selling the securities in accordance with the provisions of sub-article (6), be obliged to seek the best price being not less than their fair value as determined in accordance with sub-article (7). In the event that a buyer cannot be found for the securities at their fair value, the pledgee shall apply to the court for the securities to be sold at less than their fair value as aforesaid subject to such conditions as the court may deem fit.

- (10) In the case of a pledge of shares in a private company, the pledgee shall be obliged, prior to the exercise of the right granted by sub-article (6), to offer the shares to other shareholders of the company in accordance with any pre-emption rights relating to the transfer of shares as laid down in the memorandum or articles of that company, and, failing such pre-emption rights, to all the other shareholders of the company in proportion to their holdings. In either case the shareholders shall be entitled to purchase the shares at the price determined in accordance with sub-article (7). Such offer shall be kept open for at least ten working days.

- (11) In the case of a pledge of shares in a public company the memorandum or articles of which require any shareholder wishing to transfer shares in the company to offer them on a pre-emptive basis to other shareholders of the company, the pledgee shall accordingly be obliged, prior to the exercise of the right granted by sub-article (6), to offer the shares to those shareholders, who shall be entitled to purchase the shares at the price determined in accordance with sub-article (7). Such offer shall be kept open for at least ten working days.

- (12) (a) In the case of a pledge of securities in a public company which are quoted on a Maltese regulated market and in respect of which securities arrangements have been made for the maintenance by such Maltese regulated market of the relevant register of holders thereof, the provisions of sub-articles (2) to (11) and (15) shall not apply for such quoted securities. The following provisions shall apply instead:

- (i) the pledgor or the pledgee shall deliver within fourteen days of the granting of the pledge of a quoted security a certified copy of the signed pledge agreement to the Maltese regulated market, which shall also be served with a notice of termination of the pledge by the pledgee within fourteen days of the termination of the pledge;

- (ii) the company whose quoted securities have been pledged shall also be notified of the pledge or of its termination within the said periods and the company shall record that fact in the register of holders of the respective securities;

- (iii) such pledge of securities shall be effective in relation to a third party only from the date of delivery of the signed pledge agreement to the Maltese regulated market and any transfer or other assignment made therefrom by the pledgor, whether by onerous or gratuitous title, of the pledged securities shall be null and void; and

- (iv) the pledgee shall, in the event of a default under the agreement of pledge and upon giving notice by judicial act to the pledgor, the Maltese regulated market and the company, have the securities sold through a person duly licensed under the Investment Services Act.

- (b) In the case of a pledge of securities in a public company which are quoted on a regulated market other than a Maltese regulated market or on an equivalent market in a non-Member State or non-EEA State, the provisions of sub-articles (7) to (11) shall not apply and in the event of a default under the agreement of pledge, the pledgee shall, upon notice to the pledgor and the company in accordance with sub-article (6) have the securities sold through a person duly authorised for this purpose.

- (13) In the exercise of his rights under this article, the pledgee shall only sell or appropriate such number of securities as are needed to raise sufficient proceeds to repay the debt due. All remaining shares shall be released to the pledgor.

- (14) It shall be lawful for the parties to an agreement of pledge of securities to agree on the person or persons who shall exercise all the rights belonging to the holder of securities including voting rights and the right to receive dividends and interest payments:

- Provided that, should the agreement between the parties not make provision for such matters, all rights pertaining to a holder of securities shall, for the duration of the pledge, be exercised by the pledgor until such time as he defaults under the agreement of pledge or until the pledgee enforces his security; and in any such case, upon giving notice by a judicial act to the pledgor and the company, all the rights belonging to the pledgor shall immediately become exercisable by the pledgee:

- Provided further that, unless the pledgor and the pledgee have otherwise agreed in the pledge agreement and notice thereof has been given to the company, dividends or interests payments due on securities which are pledged shall, during such time as the pledge is registered in the register of holders of the respective securities, be paid by the company to the pledgee who shall appropriate any such amounts received to the interest due on the debt secured by the pledge, and, if there is an excess, to the capital.

- (15) Notice of termination of the pledge shall be delivered by the pledgee to the Registrar for registration within fourteen days of the termination of the pledge. The company, securities in which have been pledged, shall also be notified in writing of the termination of the pledge within the said period and the company shall record that fact in the register of holders of the respective securities.

- (16) Subject to the provisions of sub-articles (6) to (9) and (13), the terms and conditions of the pledge of a debenture warrant shall be determined by agreement between the pledgor and the pledgee. The pledge f a debenture warrant shall be effective in relation to a third party from the date of delivery of the share warrant or debenture warrant to the pledgee.

- Now, this again was a good innovation, it has been updated regularly the last amendment was in 2020 where because of anti-money laundering rules the possibility was removed to pledge shares together.

- We are invited to read the definition of securities, in the definition section of the companies act, which is a very wide definition it includes shares, debentures and any type of paper issued by a company, indebtedness issued by a company so it’s not correct to refer to this article as pledge of shares, it is pledge of securities and to understand one needs to read what securities means.

- The rule is that subject to what we’re saying, pledge of securities is as a general rule, subject to the usual caveats, the pledge of securities is allowed unless prohibited by the company’s memorandum and articles of association.

- Pledge in this case as distinct from the other articles of the civil code has to be made in writing between the pledgor and the pledgee, and in the case of a private company, the memorandum and articles (either or the memorandum or the articles) in the case of a private company have to specifically allow and provide that the shares may be pledged.

- Now, there is a form, (Form T-2) which is found on the MBR registry/forms but there is a form which is to be sent to the MBR (Malta Business Registry) which sets out details of pledgor, pledgee and the shares pledged for example 500

ordinary shares but no further detail, obviously the detail and the terms and conditions will be in the instrument in writing. Dr. Galea wouldn't say that it is a public deed here but a private writing with wet paper and ink is necessary. Soo ne cannot do an electronic exchange.

- The company also has to be informed of the pledge because I can pledge my shares and the company doesn't know so I have to inform the company, the board secretary, the pledge has to be notified therefore to the MBR either by the pledgor or pledgee in the appropriate form and also the company has to be informed of the pledge and it is a duty of this board secretory/director to note and record the fact of the pledge in the register of shareholders.

- We know well that the company has to have a register of shareholders, who are the shareholders, what are their holdings, and where a company is informed it has to note it in the register of shares. I have a 1000 shares which is pledged in favour of whoever.

- Once this notice has been delivered to the registry (the MBR - the notice of pledge), we're looking at 122(4) of the Companies Act. 122(4) is any transfer or assignment by honorous or gratuitous title of the pledge security, by donation, by sale or by transfer is null and void.

- Dr. Galea's reading on this is that (4) does not prohibit the transfers causa mortis, by death through inheritance but prohibits the transfer inter vivos by whichever title. That is why there is the term honorous or gratuitous any transfer.

- Now, historically and that is why this was a good amendment, the problem and relative lack of popularity in private companies of pledging of shares was what is known as the preemption rights. Put simply, according to criteria of valuation established in the company's memorandum and articles an exiting shareholder in a private company who intends to dispose of inter vivos not causa mortis his or her shareholdings in the company, has to first approach and offer to the other shareholders the shares it intends to sell. In other words we cant just go out on the market and find someone who gives me so much for the shares, I have to offer in preemptive basis in proportion normally to the shares held to the other shareholders.

- The difficulty here was to find a way to deal with this problem of preemptive rights, naturally in the case of private companies it always remains a bit messy and difficult because the truth is that in private companies shares are worth in practice what the other share holders want to give you. There's no market you go to the stock exchange ask a broker I want to sell, but none the less there is a mechanism.

- Now, let us look carefully at sub-article 6 of article 122 of the companies act. we'll discuss sub-article 6 and stop.

- The language is rather interesting in the sense that without prejudice to the right of the pledgee to apply for the judicial sale of securities in other words without prejudice to this right but not withstanding the provisions of the civil code or the memorandum and articles, so article 122(6), says that what it provides for is without prejudice to the right of the pledgee in the event of a default to ask for a judicial sale but overriding what is provided for in article 122(6), overrides and prevails over, the civil code and the memorandum and articles of a company so this is a good example of mandatory provisions, non-derogable, in the event of a default, again we can recall what we spoke about that a default has to be judicially established, in an event of default, on notice to the pledgor, the pledgee is entitled either to dispose of the securities pledged in its favour or appropriate take acquire ownership, the securities pledged.

- Let us just recall and recapitulate this convoluted expression. Without prejudice to the right of the pledgee to ask a judicial sale but overriding the provisions of the civil cod and the memorandum and articles of association in the event of a judicially established default and on prior notice being given to the pledgor by the enforcing pledgee, the pledgee is either entitled to dispose of these securities, get them transferred not therefore judicially transferred or take appropriate the securities.

1st March 2023

Lecture 6.

- To recapitulate, we were discussing the pledge of shares under the companies act and we said that as a rule unless prohibited by. A company can as a rule unless prohibited rather shareholders can unless prohibited by the memorandum and articles pledge the shares in a company.

  - In the case of a private company it has to be expressly allowed, we said that a pledge agreement by the shareholder as pledgor in favour of someone else as a pledgee has to be in paper writing an appropriate form has to be transmitted into the business registry and also at the instance of either the pledgor or pledgee and also the company has to be informed of the fact of the pledge.

  - From the moment there is the registration of the notice at the registry of companies then any transfers by any title inter vivos, is null. It does not exclude causa mortis transfers by inheritance, naturally the shares will be inherited subject to the pledge.

- Also, we said that the pledgee in event of default (the jurisprudential tendency is to require a judicial establishment if there is a contestation where default has happened) in the event that there has been event of default a notice has to be served on the pledgee, the company in copy (the company being copied in the notice) putting the pledgor in the fault.
- A notice has to be served by the pledgee on the pledgor, the creditor against the debtor, putting on notice and in default the pledgor, with the company in copy after which the pledgee has one of two options, either sell the shares, or take the shares in payment of the debt.
- We also said that this provision is without prejudice to the right of the pledgee to ask for the judicial sale in other words not what happens in practice is that the pledge approaches a stock broker or an investment advisor and these businesses will have normally parties and requests of people who are interested who are looking around for opportunities to invest. This is a way to sell the shares
- What we're saying here is that this possibility to sell the shares or appropriate them is without prejudice to the power and right of the pledgee to sell the shares not through a court auction, as distinct from the right to sell to sell the shares privately.
- Without prejudice to the right and power, what we're saying is that this is first of all, the articles give the pledgee the right to either sell the shares (let's call it) privately by going to a stock broker or calling colleagues or friends or people in business, I have these shares are you interested, or take the shares. What we're saying is that these two possibilities exist but a third possibility which is to sell the shares through court process still remains.
- So actually the pledgee has three options either to take the matter to court or to try to sell these privately or to take the shares but the provisions of the companies act override the civil code. This is where we stopped yesterday.
- Now, there are two immediate questions.
- The first is the value to be attributed to the shares because the value attributed of course is linked with payment, the value of the shares, whatever is relevant for the payment and may be relevant to sale or it could influence the potential buyers or the other shares holders, first is fare value.
- The second is in the case of a private company and as we shall see later in a public company which is not listed, so the second question is in the case of a private company and a public company which is not listed, the preemption rights, (we said yesterday, that in variably private companies but it is also possible to

have these in a public company which is not listed, that the existing shareholders have an option on the same price and condition to be preferred and imposes an obligation on the exiting shareholder, to approach and offer the existing shares as to price and conditions.

- As to fair value, the relevant moment because shares can fluctuate, price of securities can fluctuate, as to fair value the relevant moment is the notice we spoke about a while ago whereby the pledgee has to place in default the pledgor copying, informing also the company, that is the relevant moment.

- Now, if parties do not agree on fair value, obviously we're not going into the methods, there are various methods, an accountant or an auditor will tell you the various criteria, we are not here to discuss that. The court is empowered to appoint a certified public auditor, locally warranted to establish fair value. This is linked with a minimum selling price of the shares, such that here there are two additional relevant points.

- The first is that the shareholder who is seeking to sell the shares cannot sell below fair value. We're saying that this concept of fair value has a number of relevant considerations the first is that the shareholder who is seeking to sell whether privately or to the other shareholders, cannot go below fair value. The fair value sets the minimum threshold for the same price and possibly conditions.

- In the event that the exiting transferring shareholder, does not manage to and has to show that he or she did not managed to get the minimum fair value, the sale cannot go through. In the sense that the creditor (pledgee) cannot force the pledgor to transfer the shares either to an external extraneous third party, or an existing shareholder, the shares below fair value.

- In this event, the creditor pledgee will have to apply again to court or will have to apply to court, and show and convince the court that there is a phrase in contractual language which some look at with some humour which is to use all reasonable endeavours because it can mean everything or nothing. I have used my best endeavours.

- The pledgee will have to show that it did all that is reasonably possible according to best practice to get the fair value and was unsuccessful. Dr. Galea would suggest that the enforcing creditor pledgee has a heavy burden of proof to show this, it's not I tried and did my best and the court would look at it more discreetly and discretionary, and the court has a discretion without being bound to allow the sale to go through at a lessor price than the fair value. It does not appear to be a certainty, and the court has the ability to disallow the sale.

- That is the first point about the transfer of shares, fair value going on the market and getting less and not getting less than fair value.
- The second point is the question of preemption right, as you know these pre-emption rights were historically until this amendment came into effect in the company's act, an obstacle where pledge of shares were an efficient security mechanism. This has been addressed and it was satisfactorily addressed that subject to the fair value considerations we have made, in the event that the enforcing pledgee does find a willing buyer, at a price fair or below fair value as potentially authorised by the court, the enforcing pledgee has to inform the existing shareholders of the fact that there is an interested buyer on these terms and conditions (price terms and conditions) and give the existing shareholders in proportion to their shareholding the possibility to exercise their preemption right by purchasing at the offer in proportion to the shareholdings the shares up for sale.
- So this offer has to be kept open for at least 10 working days, and therefore then it is then and only then that if the existing shareholders decline to exercise their share preemption rights then the sale of the pledged shares can go through. When this is done of course, the MBR (Malta Business Registry) and company registers have to be updated accordingly and naturally the debt secured adjusted accordingly by the value of the shares.
- Now there are remaining on this topic before we go through other points three other possibilities, the first is the one which we have already mentioned which is the pledge of shares in a public company (PLC) which is not listed.
- Now, we know what listed means that the shares, securities and bonds are listed, traded on a Stockmarket, there is an existing market and you can make and find the calibrating price so the market exists.
- For a company to be admitted to this obviously there is a regulatory process, but from the formal company point of view it has to be a PLC. Not every PLC is listed but to list it has to be a PLC.
- The possibility exists that a company, a public limited company has shares which are subject to preemption rights aside, by way of aside, (not really relevant) it is also possible for a listed company to have a category of shares which are traded and others the controlling shares which are kept normally by the issuing family. You have part of the shares are listed in the exchange then there are another class and category of shares retained by the owner, who have normally devoting rights, the control of certain entrenched rights, so when a company wants to raise money for a company, it retains control not floats other shares.

- In the case of a PLC which is not listed and preemption rights have been created the process is the same as in the case of private companies. There is not much here to add, that here there are shares in a non listed PLC who have promotion rights the same process as the private company applies.
- The first is the company, the PLC shares not listed is the second, three is pledge of shares in a maltese exchange, four is the private companies.
- The first is the pledge of shares in a private company. We spoke about fair value and preemption rights
    - The second is the pledge of shares in a public non listed company where a right of preemption exists. We said that what goes for a private company applies here.
- The third is the pledge of shares in (using the inappropriate wrong non appropriate term) a maltese exchange because the financial services law and the stock markets law call it a locally regulated exchange. So we are calling it a local stock exchange. The pledge of listed shares traded on a maltese exchange.
- There are very few but it could exist, the question is the listing. Now the process is that the listed PLC has to be informed of the fact of the pledge the pledgor and the pledgee have to be of course parties to the agreement and both the MBR and the local Malta Stock Exchange have to be informed so in the electronic register held by the stock exchange on notification there is an annotation that the shares are pledged, which means that trading cannot happen unless (now we are going to see) you enforce the pledge.
- Here again any transfer therefore cannot happen inter vivos. In the event that the pledgee, the enforcing creditor pledgee wishes to enforce the sale, enforce the pledge rather, there is the customary notice, pledgor, pledgee, company and stock exchange, giving notice of default and enforcement, but as different from the case of private companies or public companies which are not listed there is no minimum fair value threshold and a licensed stock broker is engaged to sell at best market price.
- Why is it minimum fair value? Because there is an existing market and the value is what the market says, the way the shares or the securities or bonds are trading today or over a week or a period for fairness, the can fluctuate. This is relatively straightforward.
- Now the fourth is where there are shares traded on a non-domestic but a foreign exchange. Rather, more technically we’re looking at article 122(12)(b) of the companies act.

- In this event and a non-domestic exchange, a non-domestic exchange means an exchange which is out of EU, out of the European Union and Dr. Galea believes out of the European Economic Area. That would include Switzerland and Denmark.
- Where the shares are not listed here, there is not much detail or procedure except that the enforcing rights are broadly similar to those in a local exchange. This is about the enforcement of the share.
- Now, the final question apart from of course then cleaning up the aftermath registration, correction, release surrender etc, if you've paid you expect your shares to be released or if you sold your shares and got paid a new enquirer is entitled to the register but that's formality.
- The remaining questions relate to first the exercise of voting rights.
- The two outstanding questions relate first to the exercise of the articles, the rights of the shareholders but principally this refers to voting rights during the period where the shares are pledged and the second is entitlement to interests, dividends, royalties, from the securities from the shares or securities.
- The articles of the Companies Act allow for flexible negotiations, in other words the articles of the companies act expressly acknowledge the flexibilities of negotiations but failing agreement there are default provisions and the presumed provision (which can be modified etc) assume that unless and until there is a notice of default, voting rights continue to be exercised by the pledgor, where there is a notice of default this presumptive provision provides that on notification of a claim of default voting rights pass to the pledgee.
- As to entitlement, dividends and royalties there is the presumed right of entitlement of the pledgee obviously the rules of appropriation of the creditor apply in the case of interests etc, in other words first expenses, interests and dividends, if you get income from a bond or a share or a dividend from a share you apply it against the loan in the order established by the law.
- Finally, of course there is a process of de-registration, all competent registers have to be notified when there is the registration and termination of the pledge.
- We will move on to something different which is the discussion is about the pledge of life insurance policies and the article is 1712M of the Civil Code.
    - <u>Article 1712M.</u>
    - **1712M**. (1) Rights under an insurance policy may be pledged by the policyholder in favour of any person as security for any obligation. The pledge

of a policy shall be constituted by means of an instrument in writing entered into between the pledgor and the pledgee.

- (2) The said pledge shall be binding on the insurer and third parties and the privilege as provided in Title XXIII shall arise only after notice of the pledge shall have been given in writing by the pledgor or the pledgee to the insurer or the insurer shall have acknowledged the pledge in writing.

- (3) During the existence of a pledge, any assignment of the policy shall be subject to the pledge in favour of the pledgee. The rights of a pledgee are however subject to the rights of a designated beneficiary who has accepted the designation prior to the pledge. When a pledge is granted, the insurer shall be bound to inform the pledgee of any prior rights notwithstanding any duty of confidentiality.

- (4) Subject to any prior rights, the pledgee of an insurance policy shall enjoy all the rights of the policyholder to receive notices under the policy, to receive any proceeds of the policy, when due, on maturity or earlier surrender and the right to exercise all options of the pledgor under the policy, except the designation of a beneficiary, but shall not be liable for the performance of any obligations of the policyholder towards the insurer unless otherwise expressly agreed in writing.

- (5) Without prejudice to the right of the pledgee to apply for the judicial sale of the policy and notwithstanding the provisions of this Code, in the event of a default under the agreement between the pledgor and the pledgee and upon giving notice by judicial act to the pledgor and the insurer, the pledgee shall be entitled to:

- (i) dispose of the policy to a third party; or

- (ii) appropriate and acquire the policy himself, in settlement of the debt due to him or of part thereof, or at the best achievable price being not less than the fair value.

- (6) For the purpose of the preceding sub-article, the value of the policy may be established by agreement between the pledgor and the pledgee after notice of default has been given by the pledgor to the pledgee and no prior agreement shall be valid:

- Provided that, in case of disagreement, the fair value for the sale or appropriation of the policy shall be determined -

- (a) by a certified public accountant appointed by the Court or an arbitrator, if so agreed by the parties, on the application of the pledgee; or
- (b) in such other manner as may be expressly agreed between the parties:
- Provided that if the fair value cannot be obtained the pledgee can apply to the Court or the arbitrator for approval for a sale or appropriation at a price which is less than the fair value as aforesaid, subject to such conditions as the Court or arbitrator may determine.
- (7) In cases where there is a surrender value of the policy, the pledgee may also give notice to the pledgor and insurer requesting the surrender of the policy and the payment of the surrender value to the pledgee. The surrender value shall be that established by the insurer in accordance with the terms of the policy and notified to the parties.
- (8) For the purposes of sub-articles (7) and (8), the value of the policy shall be that obtaining on the date of the proposed sale, appropriation or surrender.
- (9) Any proceeds of the policy which exceed the debt due to the pledgee shall be returned to the pledgor.
- (10) It shall be lawful for a policyholder to enter into more than one pledge agreement in relation to the same policy and the rules stated in this article shall apply to a second and further policy in the same way as they apply to the first policy but a subsequent pledge shall rank subject to previous pledges and other prior rights. In such case, a subsequent pledge shall be conditional on the existence of the prior pledge and no rights shall be exercisable by the subsequent pledgee until such time as the prior pledgee's rights have been satisfied and, or terminated.

- To place ourselves in context please note that from the language of the article it is clear that here it is referring to a life insurance policy obviously life policies vary according to the terms. The parties are the policy holders, the party who is purchasing the policy, who pays the premium, obviously there would be the party whose life is assured and there is a designated beneficiary.
- The parties are the policy holder, the party purchasing the policy, obviously the insurer, there is obviously in the contract it is indicated whose life is assured, and the insurance policy contract will indicate the designated beneficiary.
- Now the designated beneficiary is the party who in the event of the happening of the life policy, is entitled to receive the proceeds.

- As we said what is loosely termed as life insurance policies can come in carious form and contact, in the sense you could have an endowment policy or for example you get a sum of money if you attain a certain age, if you make so much contributions but also the designated beneficiary will get a sum of money on the decease of the insured's life. This is the scenario.

- The policy holder is the owner of the asset and the risk. Therefore, the policy holder owns the policy in the sense it can assign it, it can sell it, it can surrender it as as we shall see an insurance policy has what is known as a surrender value, you go to the insurer, tell the insurer listen I've paid 15 years of premium, in contribution, I want to surrender it what will you give me? Normally the insurance company will jump to this opportunity give you half of it and sell it.

- That is the first point and therefore as part of this intangible proprietary asset, we can recall that when we introduced pledge we said a pledge can happen on incorporeal moveables and also of financial and intangible assets which are moveable and we mentioned insurance policies.

- Obviously what we're speaking about is the pledge of a life policy here, but of course it doesn't mean that you can't pledge for example a policy of insuring against transport, freight risks, transit risks, that is normally also pledged in favour of a lender like wise very often a lender in a construction project will normally request or insist in both the pledge and in the assignment, of what is known as an LCAR, a contractor's and risks policy. These are standard policies, for example a shopping mall will have a public liability or risk policy there are products tailored and structured for each.

- Therefore in line with this reasoning that an insurance, a life policy is a proprietary asset of the policy holder the policy holder can pledge it to secure its own liabilities which means subject to the all important and defining caveat (we'll be speaking about very shortly), the policy holder can pledge/assign the insurance policy and what happens is that if and when the insurance policy is up for payment, as any other pledgee, the pledgee is entitled to collect the proceeds.

- Now of course, what happens with the designated beneficiary? That is the caveat we mentioned before. This all important defining caveat is that the rights of the pledgee, shall be subject to, that is defeated by (trumped) understand the language, the prior rights of a designated beneficiary, so if there is a prior designated beneficiary the pledgee the assignee will not be entitled to receive the proceeds. So if we are advising we have to be careful about this that you do not simply accept a life policy as a guarantee because if there is a prior designated beneficiary, then this prior designated beneficiary will prevail over the pledgee. Unless this is again very important the designated beneficiary consents, which is

fair, that the proceeds to which this beneficiary would otherwise be entitled would go to the pledgee.

- In this event both the pledgor, policy holder, the pledgee, creditor, the insurance company, have to be informed of the consent of the prior designated beneficiary, the insurer most of all. If the prior designated beneficiary consents it makes plain logical sense for the insurer to be informed.

- Now we are told in article 1712M (4) that subject to any prior rights, the pledgee is entitled to exercise the rights of the policy holder, such as maturity, earlier surrender, so the pledgee is entitled to all the rights and benefits of the policy holder subject to any prior rights (very important). Subject to this, as a general rule and subject to prior rights the pledgee is entitled to exercise and collect, has been validly pointed out subject to the pledge agreement, all entitlements, arising out of the insurance policy.

- It could be and the pledge agreement would have to talk about this that a policy matures, it’s surrendered but there's no event of default and obviously careful drafters would think of the proceeds as a means of security.

- Let us say that there is a loan which is secured by an insurance policy and the pledgor/creditor pledges the insurance policy to secure this loan. Now for some reason this life policy matures during the currency of the loan, but the debtor/pledgor has been regular, regular in the sense that they keep to the agreement so there is no default, the policy can only be enforced if there is default.

- Now what Dr. Galea said earlier is that a careful drafter will think and consider this possibility and create the scenario for an alternative security very likely based on the proceeds of the policy, to substitute this insurance policy.

- So, the next point is straightforward that, there are identical or almost identical provisions on the enforcement of an insurance policy in the event of default, which means fair value appropriation or sale of the policy.

- Sale of the policy is a bit problematic because there is no sort of open market, there is a market but it is a limited market, there is no sort of regulated market like a stock exchange, there is no stock market of policies, there is a market but it is normally an auction between insurers who are interested in this business.

- Now, the final two points are that we mentioned earlier what surrender value is, you just give it back (there are criteria when you buy the policy), you are told if you’ve paid for 15 years you are entitled for so much and there’s a formula of how to calculate it. In the event of surrender value, obviously the surrender value shall still remain subject to the pledge.

- Let us say a life policy is surrendered and the policy holder gets a sum of moony, this sum of money in exchange of surrendering for the policy, the surrender value of the policy will still remain subject to the pledge of the policy. It's a very interesting case of real subrogation because normally we are used to personal subrogation (I step in your shoes and you step into mine) but this is an interesting where there is a subrogation a substitution in the asset.

- Finally on this, it is possible for a policy holder to enter into successive and subsequent pledges in theory I can pledge my life policy I own on the life of someone else and a designated beneficiary to 1 to 3 creditors on the consideration the rule of the prior designated beneficiary prevails always, and the subsequent pledgees naturally rank after the earlier pledgees.

- Now two final points before we go, Dr. Galea does not think that we need to repeat but look at subsidiary legislation 386.02 which is the SICAV regulations, investment companies with variable share capital. Basically a company as we know has a share capital which is established, to increase it there is a procedure to decrease it there is a number of steps the creditors cannot change. In the case of SICAVS it can be, it is normally a special purpose vehicle, it can be either a consumer vehicle, you have €10,000 to invest so a detailed prospectus because it's an unrefined investor and then there are the professional investment funds where there are experienced people in investment who have normally declined pockets and invest in these professions, a few people with money get together to do this project and they use this SICAV.

- The SICAV is in many ways like a company, in many ways, has other possibilities such as the creation of possibly of some funds but for our purpose it is a company with variable share capital. What does this mean? That when you enter a fund there may be and normally is an entering period, you're locked in you can't get out before say three years, you have to commit to stay for three years but after three years you can either ask back for your money as an investor and if the fund can afford it it will give it to you if it strains it's liquidity it will not, it's provided for or obviously you can sell your quota.

- The point is that if the fund pays you back, there is subject to importing of course a sale because it's regulated and the MBR, the condition share capital will increase, if I go and ask for my money back on the conditions obviously of the document then if the fund faced the bank the share capital is decreased or if we find four and another two people are interested the share capital will increase.

- If we are four and the share capital is two million or four million and we get on board two people who put in a million obviously it will be four to six, but if we are four and I want my money back, I will get back my one million and the share capital

decreases. It's about a SICAV. Article 14 of the Subsidiary legislation 386.02 because it speaks about the pledge of shares in a SICAV, it is basically a replica of article 122.

- Article 14.

- **14**. (1) The provisions of article 122 of the Act shall not apply to a SICAV and the pledge of securities in a SICAV shall be subject to the provisions of this regulation.

- (2) Securities may, unless otherwise provided in the memorandum or articles of the SICAV or under the conditions of issue of those securities, be pledged by their holder in favour of any person as security for an obligation. The pledge of securities shall be constituted by means of an instrument in writing entered into between the pledgor and the pledgee:

- Provided that in the case of a private SICAV, securities may not be pledged unless the memorandum or articles of the SICAV specifically so provide.

- (3) Notice of the pledge shall be delivered by the pledgor or the pledgee to the SICAV within fourteen days of the granting of the pledge. The pledge of securities shall be recorded in the register of the holders of the respective securities.

- (4) The pledge of securities shall be effective in relation to a third party only from the date of the recording of the pledge in the register of the holders of the respective securities referred to in subregulation (3):

- Provided that the SICAV shall, upon a request in writing made by a third party who may show an interest therein, disclose whether a pledge of securities has been recorded in the register of the holders of the respective securities, including the name of the pledgor and the pledgee, the amount of securities pledged and the date of the recording of the pledge.

- (5) Saving the provisions of subregulation (4), during the existence of a pledge of securities, any transfer or other assignment of the pledged securities made by the pledgor, whether by onerous or gratuitous title, shall be null and void:

- Provided that any such transfer or other assignment made with the consent of the pledgee shall be valid and the securities to be transferred or assigned shall continue to be subject to the pledge.

- (6) Notwithstanding the provisions of the Civil Code or of the memorandum or articles of the SICAV, in the event of a default under the agreement of pledge

and upon giving notice by judicial act to the pledgor and the SICAV, the pledgee shall be entitled to -

- (i) dispose of the securities which are pledged in his favour; or

- (ii) appropriate and acquire the securities himself; or

- (iii) request the SICAV to purchase the pledged securitiesin settlement of the debt due to him or of part thereof; and for this purpose, the value of the securities which are pledged shall be their current net asset value: Provided that in the case of a public SICAV the memorandum or articles of which require any shareholder wishing to transfer shares in the SICAV to offer them on a pre-emptive basis to other shareholders of the SICAV, the pledgee shall be obliged, prior to the exercise of the rights granted by this subregulation, to offer any such shares at their current net asset value to those shareholders, which offer shall be kept open for at least ten working days.

- (7) In the case of a private SICAV, any restriction on the transfer of shares by members resulting from the memorandum or articles shall be deemed not to apply to the rights granted to the pledgee in terms of subregulation (6):

- Provided that the pledgee shall be obliged, prior to the exercise of the rights granted by subregulation (6), to offer any such shares at their current net asset value to other shareholders of the SICAV in accordance with any pre-emption rights relating to the transfer of shares as laid down in the memorandum or articles of the SICAV, and, failing such pre-emption rights, to all other shareholders of the SICAV in proportion to their holdings, which offer shall be kept open for at least ten working days.

- (8) In the exercise of his rights under this regulation, the pledgee shall only dispose of, appropriate and acquire or request the purchase of such number of securities as are needed to raise sufficient proceeds to repay the debt due. All remaining securities shall be released to the pledgor.

- (9) It shall be lawful for the parties to an agreement of pledge of securities to agree on the person or persons who shall exercise all the rights belonging to the holder of securities including voting rights and the right to receive income, dividends, interest or any other payments due on such securities:

- Provided that, should the agreement between the parties not make provision for such matters, all rights belonging to a holder of securities shall, for the duration of the pledge, be exercised by the pledgor until such time as he defaults under the agreement of pledge or until the pledgee enforces his

security; and in any such case, upon giving notice by a judicial act to the pledgor and the SICAV, all the rights belonging to the pledgor shall immediately become exercisable by the pledgee;

- Provided further that, unless the pledgor and the pledgee have otherwise agreed in the pledge agreement and notice thereof has been given to the SICAV, income, dividends, interests or any other payments due on securities which are pledged shall, during such time as the pledge is registered in the register of the holders of the respective securities, be paid by the SICAV to the pledgee who shall appropriate any such amounts received to the interest due on the debt secured by the pledge, and, if there is an excess, to the capital.

- (10) Notice of termination of the pledge shall be delivered by the pledgee to the SICAV within fourteen days of the termination of the pledge. The termination of the pledge shall be recorded in the register of the holders of the respective securities.

- (11) (a) In the case of a pledge of securities in a public SICAV which securities are listed and traded on a Maltese regulated market and in respect of which arrangements have been made for the maintenance by such regulated market of the relevant register of the holders thereof, the provisions of subregulations (3) to (7) and (10) shall not apply to such listed and traded securities. The following provisions shall apply instead:

- (i) the pledgor or the pledgee shall deliver within fourteen days of the granting of the pledge of a listed and traded security a notice of the pledge to the Maltese regulated market, which shall also be served with a notice of termination of the pledge by the pledgee within fourteen days of the termination of the pledge;

- (ii) the SICAV whose listed and traded securities have been pledged shall also be notified of the pledge and of its termination within the said periods and the SICAV shall record that fact in the register of the holders of the respective securities;

- (iii) such pledge of securities shall be effective in relation to a third party only from the date of delivery of the notice of the pledge to the Maltese regulated market and any transfer or other assignment made therefrom by the pledgor, whether by onerous or gratuitous title, of the pledged securities shall be null and void; and

- (iv) the pledgee shall, in the event of a default under the agreement of pledge and upon giving notice by judicial act to the pledgor, the Maltese regulated

market and the SICAV, have the securities sold through a person duly licensed under the Investment Services Act.

- In the case of a pledge of securities in a public SICAV which are listed and traded on a regulated market other than a Maltese regulated market, or on an equivalent market in a non-Member State or non-EEA State, the provisions of subarticles (3) to (7) and (10) shall not apply and in the event of a default under the agreement of pledge, the pledgee shall, upon notice in writing to the pledgor and the SICAV have the shares sold through a person duly authorised for this purpose.

- References in this regulation to the maintenance by a regulated market including a Maltese regulated market or an equivalent market as referred to in paragraphs (a) and (b) of this regulation of the register of the holders of the respective securities shall be deemed to include a reference to the maintenance of the said register by a duly authorised central securities depositary and the delivery of the notices referred to in this regulation shall be construed accordingly.

7th March 2023

Lecture 7.

- The discussion today moves to something else, title XXIII of privileges and hypothecs.

  - Here, the focus will be on ranking, so privileges and hypothecs are about ranking. You will recall that we had initially said that there is a procedure known as competition of creditors whereby the court will give ranking.

  - You will recall that earlier on at the beginning of our discussions we had mentioned a procedure called a competition of creditors whereby a court will establish ranking. This situation typically operates in insolvency scenarios because of course if payments are regularly kept up there is no need for the question of ranking to arise.

  - So the point to know is that privileges and hypothecs establish ranking, they are rules of ranking which emanate from the civil code, there are other situations, legal situations which create ranking typically, perhaps most important of which is the mortgage, a mortgage which is a maritime security it also applies in the case of aircraft but it is not a civil law ranking.

  - What we are looking at here is those rules and bases of ranking which come from the civil code. To recapitulate, we are now examining privileges and hypothecs which create ranking.

- Please note that privileges and hypothecs are not per se executive titles, in other words what is an executive title? Typical executive title is a judgement, an arbitrary ward, an enforceable bill of exchange, an enforceable judicial letter which creates an executive title.
- Privileges and hypothecs are not executive titles, often they operate together (with an executive title) because an executive title can be created (one of the possibilities) is by a public deed and at the same time it is possible to create a hypothec by a public deed.
- Before proceeding on our introduction and discussion let us mention the strength of set-off/compensation. In other words, if a creditor can engineer/manoeuvre a situation where the debtor also becomes it's creditor. So 'C' is the creditor which is owed by 'B' but he creates a situation where 'B' owes 'C' so that there is a set off
- The rules of set off leapfrog, beat the rules of ranking because set off compensation creates an automatic cancellation of the two debts credit and debt subject to the requirements of set off mutually extinguish each other and therefore potentially for example a third ranking creditor because such third ranking creditor can put itself in a situation where its debtor owes money to this creditor beats those who come before him.
- Let's say there's a third ranking creditor who ranks after 1 and 2 and therefore if there is a competition of creditors, such creditor will rank number 3.
- If therefore, the creditor can create a situation where its debtor is owed money in the sense that creditor has a claim against the debtor and the debtor has a claim against the creditor. This compensation extinguishes the debt, as we know a compensation is a mode of payment and the effect is that the creditor has managed to get paid in advance of those two ranking before them.
- Let us go back to basics and the first article 1994 lays down the rule with which we are familiar, we mentioned this again in these sessions, that whoever is bound personally is obliged to fulfil its obligations with all property present and future. This takes us back to a first year discussion that the assets of a person are indivisible cannot be segregated and respond without distinction present and future assets to present and future liabilities.
- The second rule is that article 1995, unless there is a lawful reason of priority, the articles of the law speak of a lawful cause of preference creditors rank pro rata.
- Here we are speaking about ranking and there is a window here which speaks about security transfers. Security transfer takes place in one of two methods it is

either the old traditional fiducia cum creditore that as a matter of security an asset is transferred to the creditor by the debtor on the understanding that the creditor although the asset may be registered in its name and held in the name of the creditor, holds the asset as a security. Fiducia cum creditore, such that in the event that the debtor pays off the debt, the creditor is bound to retransfer the asset to the debtor who has paid its debt.

- The second is a security trust this is a bit more of a complicated instrument and a risky one because this is a scenario where a debtor transfers by way of trust to a creditor who holds with two hats, the hat of a creditor and the hat of a trustee. A debtor transferred an asset to a creditor transfers by way of trust and the creditor who is obviously owed money is also the trustee. The creditor is both the trustee, holds on trust for the debtor but is a creditor at the same time.

- The risk here is that the creditor trustee may be challenged for on the one hand breach of trust, and for failing to observe impartiality where there is an obvious risk of conflict of interest. That is also a possibility of security trust.

  - Articles 2095E.

  - **2095E**. (1) Security may be created in favour of a trustee, called a security trustee, for the benefit of any creditor or creditors, present or future, or in favour of a class or classes of creditors by either constituting security in favour of the trustee in the manner provided for by applicable law of Malta relating to particular types of security, or, by the settlement of property in favour of the trustee under written terms governing the trusts intended to operate for the purposes of providing security.

  - For the purposes of article 2042 and other provisions under special laws which may be applicable to security, the trustee shall be treated as a creditor and shall be entitled to be registered as holder of the security, indicating his position as trustee.

  - (2) The security trustee shall enjoy all such rights and be subject to such obligations as may be stated in the instrument in writing regulating -

  - (a) the appointment of the security trustee, and

  - (b) the security granted to the security trustee for the

  - benefit of the creditor or creditors.

  - (3) Security, for the purposes of this article, means any arrangement whereby the rights of a creditor are legally protected including any undertaking,

guarantee, mandate, pledge, title, transfer, grant, privilege or hypothec or the placing of property in possession or control of the trustee with rights of retention and sale as may be agreed.

- (4) When a hypothec is created in favour of a security trustee which is a bank or other entity which is authorised in terms of the Banking Act or in terms of equivalent legislation overseas, such hypothec may, notwithstanding any other provision of law, be granted to secure future debts by the same debtor to the security trustee or the beneficiaries of the security trusts, present or future, as may be defined in the trust instrument. Such a hypothec shall be valid on condition that the deed constituting the hypothec expressly states that it secures future debts of the same debtor and limits the effects of the hypothec to a stated maximum sum. Such information shall form part of the relative note of registration for the purposes of article 2042 in lieu of the requirements of article 2042(c), (d) and (e).

- (5) The Minister may make regulations to regulate the operation of security granted in favour of a security trustee to secure future debts.

- (6) When security is granted to a security trustee, such trustee shall have the power and legal interest to file any legal proceedings for the enforcement thereof even where under the terms of the deed of trust and the security -

- (a) the trustee is not the creditor of the principal debt or obligation; or

- (b) all creditors enjoy the right to sue, jointly and severally, for the enforcement of the debt:

- Provided that payment by the debtor either to the security trustee or to the beneficiaries, if also creditors, shall discharge the obligations of the debtor to the extent of the payment made.

- (7) Subject to the preceding sub-article, nothing in the Code of Organization and Civil Procedure shall hinder the action of a security trustee for the benefit of the beneficiaries under a trust on the basis of any simultaneous judicial or other action by any beneficiary under the trust.

- (8) A security trustee shall not be subject to any of the obligations of the creditors for whose benefit he may hold security except to the extent to which he has expressly agreed in writing.

- (9) A security trustee may resign, retire or be substituted in accordance with the terms of the trust and in such case the original security trustee shall assign any

security held by him to the substitute security trustee in the form required by law for the particular security held.

- (10) Beneficiaries of a security trust who may be vested with the debt, may assign the debt to third parties and the provisions of article 1475 shall apply to the security for such debt even when held by a security trustee and in such case the assignees of such debt shall enjoy the rights of beneficiaries under the security trust upon notice to or acknowledgement by the trustee without the need of a separate assignment of the beneficiary rights under the trust deed.

- (11) The appointment of a security trustee to hold security, his removal or his substitution by another trustee and any related transactions shall not operate as a novation nor shall they affect the security validly constituted in any manner.

- (12) A security trustee may also act as an agent or mandatory for the beneficiaries of the security trust and may carry out functions under such contract in accordance with its terms.

- (13) In the exercise of any right relating to the enforcement of any security, the security trustee shall be bound by the legal provisions relating to the particular type of security and in any case where the security arrangements are not subject to rules as to its enforcement, the security trustee shall act in a fair and reasonable manner in relation to the debtor.

- (14) The provisions of article 1967 shall apply mutatis mutandis where a pledge is granted by the debtor or a third party for the debtor, to a security trustee, for the benefit of any creditor or creditors, present or future, or in favour of a class or classes of creditors.

- Article 2095F.

- **2095F**. (1) Security by title transfer is a contract whereby the debtor, or a third party for the debtor, transfers or assigns movable things, whether by nature of by operation of law, so as to secure a present or future obligation, to:

- (a) a creditor or creditors, present or future; or

- (b) to a third party, who shall thereby be considered to be a trustee for the benefit of a creditor or creditors, present and, or future and subordinately for the debtor in accordance with article 2095E.

- In this title:

- (i) the term "creditor" shall include both the creditor and a third party security trustee for the creditor; and

- (ii) the terms "debtor" and "transferor" may refer to the same person or to different persons depending on the circumstances and the term "debtor" shall include the transferor unless the context requires otherwise.

- (2) Subject to the observance of such formalities as may be required in case of particular types of movable property, ownership of the property is acquired by the creditor as soon as the debtor and, or the transferor and the creditor enter into an agreement in writing designating:

- (a) the property being transferred;

- (b) the secured obligations, which may be existing or future obligations; and

- (c) the rights of the transferee in case of default as stipulated in the agreement.

- (3) For the purposes of the preceding sub-article -

- (a) when the property being transferred consists of debts and other monetary obligations the inclusion in the agreement of a list of debts arising from a written or legally equivalent instrument shall be sufficient;

- (b) when the transfer of property refers to a large amount of debts or to a class or classes of debts, present or future, the provisions of articles 9 to 14 of the Securitisation Act shall apply mutatis mutandis with such amendments as are required paying regard to the fact that in lieu of a transfer for the purposes of a securitisation, the parties may agree to a transfer of the same assets for the purpose of security.

- (4) Such agreement may also designate:

- (a) the rights of the transferee in the event of a breach of the secured obligations; and

- (b) the rights of the transferor in case of payment or other extinction of the secured obligations; and

- (c) the manner in which the property is to be valued when rights of sale or set-off are exercised by the creditor,

- and such agreement shall take effect in accordance with its terms. In the absence of terms of agreement on the matters stated in this sub-article, the provisions of this title shall apply.

- (5) Where the property being transferred by way of security is of a kind which may be transferred by mere delivery, an agreement in writing as provided for in sub-article (2) shall be required for the transfer of such property. Without prejudice to the rights of third parties acting in good faith, the creditor may agree that the debtor use the property so transferred.

- (6) A transfer by way of security of debts and other rights shall be operate between the parties from the moment when the agreement referred to in sub-article (2) is made.

- (7) A transfer by way of security shall operate as a transfer with regard to third parties:

- (a) in the case of debts and rights against an obligor, when notice is given in accordance with the article 1471 or the obligor of the assigned right has acknowledged the assignment; or

- (b) in the case where the rights consist of property, where there is no obligor and where the title to which is registered in a public registry, the effects of the transfer shall arise when the transfer is registered in the relevant register.

- For the purposes of article 1471, notice in writing may be given by any means, including by electronic means, and it shall not be required that notice be made by judicial act.

- (8) Apart from the case contemplated in article 1472(b), when a further assignment of a debt or other right is made by way of security and is notified to the debtor or registered in accordance with sub-article (7), the effects of the subsequent assignment shall arise only on the termination of the effects of the prior assignment and the rights of the subsequent assignee are conditional thereon. Except where the subsequent assignment is made with the written consent of the prior assignee and subject to the terms of such consent, the prior assignee shall have no obligations towards any subsequent assignee.

- (9) The consideration for a transfer by way of security shall be the grant and acceptance of security, and the provisions of Title VI of Part II of Book Second as to "price" shall not apply to such transfers.

- (10) For all effects and purposes, the creditor to whom the property has been transferred shall be considered to be the absolute owner of the property so transferred and such property shall not form part of the patrimony of the debtor.

- (11) A transfer made in accordance with the provisions of this title:

- (a) shall not be subject to re-characterisation as any other contract and shall take effect in accordance with its terms; and

- (b) shall be enforceable in accordance with the terms of an agreement made in accordance with sub-article (2) and the provisions of this title notwithstanding the bankruptcy or insolvency of the debtor of the debt or the grantor of security by title transfer or the commencement or continuation of any insolvency or winding up proceedings or re-organisation measures.

- (12) The fruits of the property transferred by way of security shall be deemed to form a part of the property and shall be subject to all the rights of the creditor as stated in this Title.

- Article 2095E and Article 2095F, 2095E is security trustee/security trusts, 2095F is security transfer, title by security transfer. These were introduced when the law of struts were being developed and alternative securities were being explored and developed. Now the next point again this was developed to bring our civil code in line with international practice, many international loans banking loans financial loans etc will require prior creditors.

  - Let's give an example there is a supplier on a ship or an aircraft and the owner seeks bank finance, the owner says fine I'll take the risk but you have to get me the signature of the supplier/manufacturer for him to rank after me, the bank will rank first. The supplier will have to accept to become second ranking after the bank.

  - Scenario, a vessel/aircraft has a mortgage in favour of the supplier/manufacturer. It aircraft or vessel owners approach the bank. The lender/bank will impose a condition that the supplier/manufacturer will accept to rank after the bank in other words the supplier/manufacturer has to accept to rank after the bank otherwise the bank would say sorry I am not sufficiently guaranteed an I'm not prepared to risk financing and debt. This is called in jargon subordination.

- You hear of subordinated loans and basically subordination is a scenario where someone accepts to be a subordinate to another creditor. Now, this right of subordination always existed but has. Now been codified. In theory there is no

particular formality, of course nobody will not do anything in the proper form and writing and there is the right form of the entry of subordination in the appropriate register, the immovable property register, the ship register, the aircraft register. It will be annotated there and written that the creditor, the manufacturer or seller has accepted to be in subordinate with the bank. In other words it would be not only a triparty agreement between the first and second creditor and the debtor but it will be put on public register. That is the point, there will be public information.

- This is the entry to privileges and hypothecs. We will look at the specific articles, individually where some are relevant and others interesting historically but as a general rule privileges rank before hypothecs. Privileges between themselves rank in the order listed in the law, there is a list of privileges over moveables, top of which is pledge, there is a list of immoveables and hypothecs rank by date of registration and those registered on the same day rank pro-rata.

- There are two pre-considerations and we will start talking about privileges in some detail.

- The first is there has been quite some transposition of the civil code securities to special laws.

  - For example the commissioner for revenue almost invariably thinks, it is written in the law that tax enjoys a special privilege, taxes, VAT, duty on documents, income tax etc.

- At the same time we do not have an organic clear law on ranking because each specific particular law creates its own ranking so you may have special privileges for different reasons.

  - Example let us say you are a liquidator or an administrator and have to decide who is to be paid in advance and who is not to be paid in advance and who is not to be paid in advance all laws creating a special privilege.

- Practice, and were not saying it’s risk free has developed certain rules and criteria, generally wages to an amount rank first then taxes with the social security income tax and VAT trying to argue between themselves who is going to collect, if there are insufficient assets, a liquidation has to decide who is to be paid and who is not, there are various laws which create special privileges, disparate but in the most disparate and uncoordinated matter.

- So there is no law which systematically states 1,2,3,4, it is practice with the risk involves in going by practice which has evolved certain rules.

- Of course, the liquidator fees and court fees come first because otherwise no one would accept as a liquidator, liquidators require a hefty deposit, but after this there are wages limitedly, and it comes from the employment and industrial relations act, then you get the taxes, from the social security act, from the income tax act, from the VAT act, and as we said the commissioner then has three hats, because each department will try to collect for itself. Although obviously each goes to the consolidated fund in the end, then normally it is financiers, lenders, unpaid suppliers and then the question of more ranking comes in.

- The point that Dr. Galea is trying to make is that there has been a transposition of these articles of the civil code in various other special laws without any clear and systematic rules. This was the first point.

- Second point is that privileges arise because of the nature of the debt, the only justification for the existence of privileges and hypothecs is probably historical but the reason for privileges is that the nature of the debt, of the claim was felt to be socially and commercially justified. The same reason for hypothecs. One has to bear in mind that these have a long history, if you walk around and have a specific sharp eye, in certain historic european capitals, Amsterdam, Antwerp, Prague you will see that historically hypothecs were written on a house. There was no central system of legislation, what is implied is that ranking has a long becoming and has again a long history. There is one house in Valletta which has an ipoteka number on it.

- The third point is a pivotal factor in securities which is what is known as the droit de suite, coming from suivre, to follow diritto di servito. This means that a security which enjoys a droit de suite, remains attached to the asset, in whosoever hands the asset passes. In other words, if the asset is transferred, exchanged, inherited, it will still be subject to this droit de suite.

- Now, this is especially powerful in immoveable property, where an acquirer who has paid money but not for any reason seen to determination and cancellation of the credit enjoying the droit de suite acquires subject to the security. This is the strength of the droit de suite, the strength of the hypothec, special hypothec and the strength of the special privilege because no buyer in its senses will part with the money unless the creditor is called to get paid and cancelled.

- Also we will speak of an important action called the actio ipotecaria, whereby a creditor with a droit de suite, may sell off an asset, an immoveable property asset which is burdened by a droit de suite, even though the asset is in the hands, is owned by a party who has no liability towards the creditor.

- An elementary example, I buy a property with a special privilege and a special hypothec, I pay my normal price, I pay what I have to pay but for some reason the creditor is not paid, either researches were not done property usually that is the case or whatever. Now I owe nothing to the creditor but because I am what is known as a third party in possession I am liable for the registered droit de suite by simple virtue of the fact of being the third party owner burdened by the droit de suite. Because I am in possession of the property over which there is a registered privilege or hypothec the property is liable to be sold by the creditor.

- Let's give this example there are three parties involved, there is 'A' who has a registered credit against 'B', 'B' sells to 'C' for value, 'B' receives money without the registered droit de suite being cancelled. We have a situation where 'C' has acquired subject to the registered debt originally owed by 'B' to 'A' because,

- We have a situation where 'C' has acquired subject to the debt registered originally by 'B' in favour of 'A'. The resultant situation by operation of droit de suite, and it is known as actio ipotekarja, is that 'A' who is unpaid is entitled to sell the property acquired by 'C' even though 'C' owes 'A' nothing personally. 'C' has various defences, he can pay off the debt and go against 'B', or he can surrender the property have nothing to do with it and go after 'B'. It does happen that 'C' knowingly acquires because it is seen in the price.

- How can a droit de suite be cancelled? The creditor appears on the deed of sale, is paid and signs off cancellation.

- Those are the three main introductory points. Let us have a very brief discussion on general privileges.

- General privileges are again interesting historically, there is no droit de suite over the general privilege. We are told that general privileges extend over all assets indiscriminately of the debtor, but if an asset leaves the patrimony of the debtor, then there is no effective droit de suite on the asset.

- For the droit de suite to be retained, there have to be execution proceedings commenced, to first establish ranking, and second to stop the asset from moving. The moment an asset moves then it's an up hill struggle of the actio pauliana which is not that easy.

- These are interesting historically because they portray an 18th/19th Century which today are no longer with us not least because of social security nets.

  - Judicial costs incurred for the common benefits of the creditors and the administration of the estate, that is fair enough but then we have, funeral

expenses, last illness expenses, death bed expenses, who will pay the doctor, and wages of servants up to €3,500. We are mentioning these, the general privileges which extend over all the assets of the debtor are those listed in the law.

- Note, what we said earlier that it is the cause behind the credit which was given let's say legislative priority, if the undertaker wasn't sure it would be paid nobody would accept to bury the dead. This is an 18th and 19th century society and we find these in the old version of the code. The observation is look behind the cause of the death because accorded privileged status because of the society etc.

- We now pass to special privileges, we have spoken initially about general privileges which extend over all property, present and future and secure certain claims and debts considered important and now we pass through special privileges, a special privilege is over an object. So it's not over all assets in general present and future it is about and is linked to a specific object. As a rule there is no droit de suite

- We are now going to speak about special privileges, before the break we spoke about general privileges, which extend general privileges to all assets present and future we are not speaking about special privileges, and special privileges refer to and grant preferential ranking in respect of an object.

- It can be moveable, or immoveable. So it is linked to an object, and where twos object is sold particularly in but not only however in a ranking of creditors the privileged creditor is entitled to be paid first.

- We are reminded that in the case of privileges, privileges rank between themselves in the order listed in the law, so the order listed here, and we are going to look at article 2009

  - Article 2009.

  - **2009**. The privileged debts over particular movables are:

  - (a) the debt due to the pledgee, over the thing which he holds as a pledge;

  - (b) the debt due to a hotel-keeper for accommodation provided or supplies furnished to a guest, over the effects of such guest, so long as such effects exist in the hotel or house of the hotel-keeper;

  - (c) the debt due for the carriage of goods, over the goods carried;

- (d) the debt due in respect of the price of a thing, whether the sale has been effected with a stipulation as to credit or without such stipulation; and the debt due for labour, supplies or expenses, bestowed, furnished or incurred in the production or for the preservation or improvement of a thing, over the thing itself, saving, with regard to the seller, the provisions of article 1439. This privilege applies also to the debt due to the advocate and legal procurator for their fees in respect of the action for the recovery of a thing, over the thing itself, if recovered; as well as to the debt due to the person disbursing the expenses incurred in such action;

- (e) the debt due to the dominus for ground-rent, and the debt due to the lessor for the rent of an immovable, over the fruits, and over the value of all things which serve for the furnishing or stocking, or for the cultivation of the tenement, to whomsoever such fruits or other things may belong: Provided that such privilege shall not be available to the proprietor or the lessor if the said products or things belong to or are held by or on behalf of any department of the Government of Malta in any case in which such department is not itself directly liable for the payment of the debt.

- This privilege applies also to indemnities due to the dominus or to the lessor for the repairs which the emphyteuta or the lessee has failed to carry out, and for the non-performance of any other covenant of the contract.

- It shall be lawful for the dominus and the lessor to seize, or attach by a garnishee order the movables with which the tenement was furnished or stocked or which served for its cultivation if such movables have been removed elsewhere without their consent, and they preserve their privilege over such movables provided they make the demand for the issue of the warrant within fifteen days from the day on which the said movables have been so removed.

- The order of this thing in the law determines priority, privileges rank before hypothecs, in the order listed in the law, hypothecs order in order/by date of registration.

- We arguing to speak in 2009 about privileged debts over particular moveables, here note particular moveables, it is specific. The first is the debt due to the pledgee over the thing which he holds as a pledge 2009(a), top of the list is the debt due to the pledgee over the thing which he holds as a debt. Therefore this preferential ranking is limited to and does not extend beyond the thing held as a pledge. Therefore the fact that there is a pledge over a specific particular asset does not extend preferential ranking over other assets which are not the pledge moveable. It explains the strength of the pledge, why when we were reviewing the articles on pledge there is a specific reference to control and delivery it explains

why when we were reviewing the articles on pledge there is a reference and delivery to control by pledgee and there is also the statement under the articles of pledge that the first ranking we are mentioning here, is lost in the event that the pledgee is no longer in control, we are speaking about here.

- The next are some relevant others of historical relevance, the next is the debt due to the hotel keeper over the effects of a guest, luggage basically, for accommodation and supplies. Of course this is again an old article where credit card information in advance did not exist.

- The other is the next article 2009(c) is relevant in that it refers to a special privilege enjoyed by a transporter (for carriage) it is the privilege over the goods carried enjoyed by a transporter for the carriage of goods.

  - This is a good example of where the special privilege over immoveable often operates in conjunction with the right of retention.

- It is obvious that, a lorry transporter, a container transporter, will not deliver goods unless there's payment and therefore there's both the right of retention, you don't pay you don't get the merchandise and also there is a special privilege.

- The next important (and it is relative) special privilege over moveables is the object sold with or without credit over the price or unpaid balance of price. If there is credit why should there be a special privilege, the answer is the financial condition of the debtor has deteriorated or there is a rush on the goods acquired and here, it is very important that certain documentations makes reservation of title or recall of title, recall of title may be iffy if there is insolvency, in situations of insolvency there is who grabs normally remains what has been grabbed but at least there will be half a leg where there is retention of title by the seller.

- This special privilege over the/limited to the object sold extends also to any improvement or expenses incurred in respect of the object.

- Now, there is a reference to article 1439.

  - Article 1439.

  - **1439.** If the sale of a movable was made without any stipulation as to credit, the seller may, in default of payment, take back the thing sold, if it is still in the actual possession of the buyer, or restrain the buyer from reselling the thing, provided the demand for the recovery of the thing be made within fifteen days of the delivery and the thing be in the same condition in which it was at the time of the delivery.

- It is the reason why earlier on we said generally there is no droit de suite.

- Article 1439 as we may recall is a remedy given to the unpaid seller to take back an object within 15 days and even from a third party provided the object is identifiable and the seller acts within 15 days. So, there is a specific reference that the special privilege here is without prejudice to this remedy under article 1439. The same privileges (this interests us directly as lawyers) lawyers have a privileged claim for their fees and expenses, for the recovery of a thing and the special privilege is over the thing recovered. You act to recover something you're not paid, you sell the object, it's a bit far fetched but that's the way it is. The drafter was thoughtful for lawyer fees.

- The last special privilege, we may recall from roman law the claim super invectis et ilatis, which means the objects which are found in a premises which is leased. Super invectis et ilatis means the furniture, the furnishings, in a premises which is leased.

- Both the lessor in a contract of lease, and the dominus in emphyteusis, enjoys a special privilege over the moveable things which are found in the premises leased or on emphyteusis, and this special privilege extends to unpaid rent or ground rent or non performance of contractual obligations.

- So this is what we have to say on special privileges over moveables.

- Let's come to an all important article.

  - <u>Article 2010.</u>

  - **2010**. The privileged creditors over immovables are:

  - (a) the dominus, over the dominium utile of the emphyteutical tenement, for the debt due to him by the emphyteuta in respect of ground-rent and for the performance of the other obligations arising from the emphyteutical contract;

  - (b) architects, contractors, masons and other workmen, over the immovable constructed, reconstructed or repaired, for debts due to them in respect of the expenses and the price of their work.

  - The same privilege is competent to the person who has, by means of a public deed, supplied money or materials for the construction, reconstruction or repair of the immovable, or for the payment of the workmen employed on such work, provided it is shown by the said deed that the supply was made for that purpose, and it is proved that the work was carried out or the payments to the workmen made, with the materials or out of the money supplied.

- The same privilege is also competent to a third party in possession, over the immovable of which he has been dispossessed, for the repairs and improvements made in or on such immovable.

- The said privilege, in case of repairs necessary for the preservation of the immovable extends to the whole amount of the debt; in any other case, it is limited to the sum corresponding to the increase in the value of the immovable resulting from the works or expenses;

- (c) the vendor or any other alienor, whether under an onerous or a gratuitous title, over the immovable sold or alienated by means of a public deed, for the whole or the residue of the price, or for the performance of the covenants stipulated in the deed of sale or alienation.

- The same privilege is competent to the person who has, by means of a public deed, supplied in whole or in part the money for the payment of the price agreed upon, provided it is shown by the deed of loan that the money was supplied for that purpose, and it is proved that the money taken on loan has been paid to the vendor or other alienor.

- If there are several successive alienations, the first alienor is preferred to the second, the second to the third, and so on;

- (d) co-heirs and other co-partitioners, over the immovables which were the subject of the partition, in case of eviction of the immovables divided between them, and for any compensation or owelty of partition;

- (e) the advocate and the legal procurator, for the fees due to them for their services in the action for the recovery of the immovable, and the person disbursing the expenses of the said action, over the immovable, if recovered.

- Article 2010, which is one of the backbones of lending in construction, in home loans, in security, this refers to special privileges over immoveables.

- As a rule these special privileges over immoveables are registrable and they have a droit de suite. So these are very strong special privileges.

- The first is the special privilege of (ranking is in the order listed in the law), article 2010 (a) is at the top and it is the special privilege of the dominus in an emphyteutical concession over the object in emphyteusis for payment of ground rent and in guarantee of the conditions of the emphyteutical concession. Invariably, in an emphyteutical concession there is this retention of a special privilege and as such it is not a red flag when there is a transfer, but a a prudent enquirer, its a normal practice, the thing to do. A proper enquirer and a lender will

ask for ground rent receipts for the past 5 years, why for the past 5 years? Because ground rent except in the case of government is 10 years is time barred by 5 years.

- Sometimes and Dr. Galea is not saying a good practice, a lender will ask you for the last receipt only because there is a presumption (only a presumption), that payment of the last receipt raises a presumption that the preceding ground rent was paid, but it is only a juris tantum presumption.

- The next is a very important special privilege, how it is registered we speak about later, in a 2 month period but it depends from when and this is first to contractors, builders, architects, given to those who have worked on, made supplies or made improvements over an immovable property. This is a special privilege due to the builder, kaħħal, etc, anyone who has added value to the immoveable is entitled to this special privilege and in fact it is rather wildly cast. Architects, contractors, masons and other workmen, over the immovable constructed, reconstructed or repaired, for debts due to them in respect of the expenses and the price of their work.

- So, the same privilege ranking pro-rata, is in respect of a lender who has by public deed advanced money for building construction/reconstruction, improvement, it has to be by a public deed, it has to be declared on the public deed and shown that the money was utilised to this effect; so in the event that a financier has advanced money by public deed for the purpose we have said and it results that the money was utilised in this manner then there is a special privilege over the immovable ranked at 2010(b). Those under article 2010(b) between themselves, let's say there is the architect, builder and third party, this ranks pro rata and it is for this reason that normally it doesn't always happen, a lender will insist or paying or making progress payments to the contractor itself so it is shown that the money was utilised for this purpose and gets the contractor to subordinate, to rank after the lender.

- The same privilege, we're speaking still on 2010(b) is to the third party in possession over the immovable over which such third party in possession has been dispossessed for repairs and improvements.

- Let's cast ourselves back, we will recall the actio ipotekarja, we will recall the third party in possession who is liable by simple virtue the third party owning but owes the creditor nothing, the case we spoke about 'A', 'B' and 'C'

- In the earlier example it is 'C', 'C' has put money on the property and the property is sold by 'A' for a debt which existed between 'B' and 'A'. Now 'C' as the dispossessed third party in possession who has dispersed money is entitled to a special privilege ranking therefore, 'C' who has been the third party in possession

dispossessed, is entitled to a special privilege over the immoveable which ‘C’ has lost, for money put in repairs and improvements over the immoveable.

- ‘C’ is the dispossessed third party in possession, ‘C’ has put money in the property, ‘C’ is entitled to a special privilege over the immoveable of which ‘C’ has been dispossessed and over which ‘C’ has put money for repairs and improvements.

- Now in the case of these three scenarios, the contractor/bennej, the financier, and the third party in possession since they all rank under article 2010(b) if a question where to arise as to priority between them, these would rank between themselves pro-rata because they are at the same level in the list.

- Now, the next special privilege over immoveables 2010(c) is in respect of a vendor or transferor whether by onerous or gratuitous title for payment of the price, if it’s gratuitous why would there be a payment of the price if it’s donated. The reason is that the special privilege is for the payment of the price or performance of the covalence of the alienation. Let’s say it is a donation, you cannot speak of balance of price in a donation it doesn’t make sense but a condition makes modalities, the special privileges exists in respect of the performance of these conditions.

- The same privilege and this is very important to the banks exists, the special privilege over immoveables for the banks and this exists and it is very important to the banks/for the banks in respects of a lender, for a lender financing the purchase of an immovable and for this special privilege to arise this special privilege to arise the advance of money has to be made by public deed and as in the case of construction it has to appear that the money was used and actually used for the purchase.

- That is why in deeds of loan and purchase it is one deed the preamble is normally the loan with the special privilege being taken by the bank and then there is the transfer, but it is one deed.

- The next special privilege, 2010(d) arises in the case of a partition, a division between co-heirs and co-owners. Co-heirs reciprocally warrant in a devision and co-divisioners good title in respect of the property being divided and each co-partitioner is entitled to a special privilege and it is normally written in a division, in a partition deed that the co-partitioners reserve against each other a special privilege over the moveables so divided. Each co-partitioner has a special privilege over the other immoveables divided and of course assigned to the other parties, in the event that a co-partitioner is evicted from the immoveable which was assigned by division, partition to the co-partitioner.

- We have divided and I get evicted for any reason I can claim in preference against the other co-partitioners and have a special privilege over the proceeds because when you divide you reciprocally warrant, if we are co-heirs and we divide I am guarantying that what you get is good and you guarantee to me that what I get is good, good title and if I am evicted I have a special privilege over the other immoveables assigned to the other parties or divided.

- Finally, this is again in our favour, that lawyers who have worked for the recovery of an immoveables, 2010(e) have a special privilege over the immovable for the recovery of their fees and expenses.

- We can stop here today, we resume tomorrow.

8th March 2023

Lecture 8.

- An addendum to yesterday's discussion but we mentioned it for completeness because it is not yet in force, but we are mentioning it for completeness, is the existence if the amendment were in force which it is not of a droit de suite over designated moveables.

  - This was an initiative at the time where there was a certain lobby from principally banks that you can banks can lend against a piece of heavy construction or plant machinery which can run into millions, such as a big crane and there was therefore the amendment which created a droit de suite over these designated moveables but this has never been an act put into force.

  - In other words the way the civil code is cast is that the minister has power to designate a certain moveables over which there will be a special droit du suite.

  - Let's start our discussion on hypothecs, hypothecs commence in article 2011.

    - Article 2011.

    - **2011**. (1) Hypothec is a right created over the property of a debtor or of a third party, for the benefit of the creditor, as security for the fulfilment of an obligation.

    - (2) Hypothec is of its nature indivisible, and it exists in its entirety over all the things so charged, over each of such things and over every portion thereof.

  - Just to remind us, first there are privileges then there are hypothecs and hypotheses rank from date of registration.

  - A hypothec is said to be a guarantee for an obligation entered into by a debtor or given as a guarantee by a party for a debt of a third party. In other words they

hypothec is a guarantee which either the debtor itself can give or a guarantor. Now the strength of the hypothec is its ranking, and in the case of a hypothec the scenario is familiar, that there has to be a principal obligation and the hypothec is the supporting guarantee guaranteeing the principal obligation.

- A hypothec is a non-possessory guarantee, this is distinct from pledge in the sense that as we have seen in the case of a pledge the pledgor divests itself of control but in the case of a hypothec the party granting a hypothec remains in enjoyment, does not divest itself of enjoyment.

- Obviously, a hypothec is a ranking over the disposal price of an asset as always, the discussion leads to the sale of an asset and the competition of creditors in insolvency, this is so to speak the alpha and omega of the discussion, the beginning and the end and therefore that is the context.

- Another recurring theme again this is not specific to hypothec is, that there has to be a principal obligation and it is the default in the principle obligation which triggers the possibility of the sale of secure assets and therefore the role of a hypothec in ranking.

- A hypothec can be created also in favour of an unquantified the articles of the law referred to indeterminate obligation for example you can guarantee a hypothec can be created over an unquantified, the articles of the law say an undetermined obligation you can give a hypothec for a €100 maximum but the exact amount depends on the extent of default. Let us say that there is a loan on the creditness, the hypothec is over a hundred but the indebtness is what it is. It may not be 100, it may be 20.

- Also a hypothec can be created over an obligation which is conditional, in other words it is created over an obligation which is not yet in existence but if certain conditions are verified, the obligation comes into existence, it can also be created in favour of an obligation which is subject to a resolutive condition meaning that if this condition is verified then the obligation is ex tunc (from the moment the obligation came into existence) from day one annulled ‘A’ sells to ‘B’, ‘B’ sells to ‘C’ the title of ‘A’ is for any reason challenged successfully and then ‘B’ cannot transfer title to ‘C’ and ‘C’ ’s title will resolve from the day ‘C’ bought from ‘B’ so it’s ‘C’ against ‘B’.

    - For example there is the right to a sale agreement subject to redemption or an emphyteusis in respect of which there is a guarantee and the emphyteusis is terminated, if it happens then the hypothec security is terminated, the point is that it is possible to create a hypothec over an obligation which may be terminated or which would come into effect if and when.

- Now there are various categories of hypothecs, we will mention them and discuss them in turn;
  - General hypothec
  - Special hypothec
  - Legal hypothec
  - Conventional hypothec
  - Judicial hypothec
- So, a general hypothec is one which effects and gives ranking over all assets present and future of the party giving the guarantee but it does not have a droit de suite.
- Therefore going back to the first statement, to state the obvious sometimes a guarantee is given, by means of a hypothec and if in the future after the giving of the guarantee additional assets form part of the patrimony of the party giving the hypothec then these additional assets acquired later are affected by the general hypothec. In this thought that there are additional assets added to the patrimony of the guarantor after the giving of the general hypothec, there is no need or reason for the assets to be connected for the purpose of the guarantee.
  - In other words, example, if there is a loan for a business purpose secured by a general hypothec and subsequently, assets not related to the business, are acquired by the party giving the business hypothec guarantee, these additional assets are also subject to the general hypothec even though such additional assets are unrelated to the purpose of the hypothec developing, the moment an asset moves from the patrimony of the party giving the guarantee, it is no longer subject to the effects of the general hypothec.
- The relevant moment is therefore when has execution commenced? Now in practice if execution has been commenced and somehow an asset splits by it would be a complicated procedure to follow it and trace it we have to either argue in favour of a constructive trust or a breach of trust or a pauliana which is of course not an easy process. Let us say not withstanding the commencement of enforcement proceedings an asset disappears, it’s not easy then to recall it, to get it back to the list of assets.
- The key is precautionary warrants locking the sale and the matter will be complicated if the matter is sold for market value, the tracking/recalling process is

complicated if the asset is sold for market value to a third party in good faith because it's difficult to argue for them.

- Because here there is the principle of protection of third parties in good faith there is the principle in the case of a Pauliana you have to bring allege proof of both parties.

- The point is that a general hypothec is very powerful in so far as it affects everything and is nasty in this sense, everything, anything you have anything you will have. It's not limited to certain assets, and when we say anything, everything is every category of assets. moveable, immoveable, corporeal, incorporeal, data assets, crypto assets, everything but it has this weakness, this is the general criteria.

- This was not the situation prior to 1975, up to 1975 a general hypothec created also a droit de suite over all assets so it was a bit unreasonably nasty. It affected everything and had the potential of recall over everything, this was removed and recasted in 1975 as it was thought to be excessive and unreasonable and of course it was not the trend of general hypothecs in the civil law works, we were a bit medieval at the time. This is the general hypothec.

- Special hypothec

  - Now, a special hypothec, a special hypothec effects immoveable property, we know what immoveable is, by nature and by destination of the law, it also includes usufruct, dominus directus and utile (utilista) dominium (the two parties in an emphyteusis/emphyteutical concession).

  - A special hypothec refers to immoveables, we know what immoveables are, by regulation of the law, immovables by nature, we know what these are in the introductory articles of the law.

  - This is the law as it is, as in the case of moveables there is an amendment not in force to create a special hypothec over designated moveables, there is written in the law the possibility that a special hypothec with a droit de suite being created over designated moveables but these moveables have never been designated and therefore the provision has never been brought into effect.

  - Now when in 1975, the law of emphyteusis was modernised there was some concern among the banks that they would be generally inadequately protected and therefore and this is article 2016,

    - <u>Article 2016.</u>

- **2016**.† (1) The creditor of a debt secured by a general hypothec and whose rights are not otherwise already adequately secured, shall have, and may cause to be registered, as a further security of the same debt, a special hypothec over such of the immovable and movable property of the debtor which are of a kind referred to in article 2012 and which are of a value sufficient to secure the debt as provided in article 2063.

- (2) The right conferred by sub-article (1) of this article shall be exercisable by means of a note presented to the Director of the Public Registry for registration and signed by any person who, according to article 2045, could have signed the note in respect of the general hypothec and in the case of debtors resulting from a public deed by means of a note signed by any notary public; but the exercise of such right shall be without prejudice to the rights of the debtor to demand the reduction or cancellation of the registration in accordance with the provisions of Sub-title V of this Title.

- (3) Where the immovable property of the debtor over which is to be registered the special hypothec referred to in sub-article (1) of this article is situated in an area declared to be a land registration area in accordance with the Land Registration Act, or is otherwise registered in accordance with the provisions of that Act, the right conferred by sub-article (1) shall be exercisable by the registration in accordance with that Act, of a charge or a cautionary charge as the case may be.

- † This article, as substituted by Act LVIII of 1975, applies to all hypothecs arising or contracted before 1st January, 1976. However, until the expiration of ten years after the said date, and subject to all other provisions of this Code, a general hypothec registered before the 1st January, 1976 shall continue to attach to immovables charged therewith, even if such immovables are acquired after the 1st January, 1976, as if the provision of this Code were still operative as in force prior to the substitution effected by Act LVIII of 1975.

- Which creates the possibility for a general hypothec over all assets in general present and future, article 2016 creates the possibility of the conversion of a general hypothec over all assets into a special hypothec over chosen indicated moveables.

- Let’s explain clearly the scenario, this right arises from the subjective opinion of the creditor that it is not adequately secured, it is a unilateral option granted to the creditor and is exercised by the filing of a note in the public registry and where applicable the land registry converting and reducing a general hypothec into a special hypothec over one or more indicated immoveables.

- If this does not require the intervention or cooperation of the party giving the hypothec in other words, the creditor normally goes behind the back of the party who has given the hypothec converts there is no obligation to inform the debtor, and the debtor gets the shock when they see updated searches.

- Now there is a discussion on ranking and whilst it is an open discussion, the better view seems to be that whereas the general hypothec ranks from its date of original registration the converted and reduced special hypothec ranks from date of conversion.

- So, if you convert a general hypothec of 20 years ago you have ranking going back to 20 years, but you will rank as you are today you could for example convert today and you would rank no 3 today. Of course, this happens in one of two ways, one is a clearly thought out exercise, but if normally one has to weigh everything, one has to see what is the better risk option to remain with the original ranking and capture everything going back to ranking day one or choose as of today, another option is what you can go a carpet bombing you find a pre-moveable and you can convert, sometimes when banks panic they do the second option, carpet bombing they find every moveable, whatever the ranking and go on the immoveables today.

- There are two methods, how normally this happens either is a carefully weighed exercise where one decides either to keep with the original ranking of 30 years ago or go for whatever ranking number it is today, or what you know you can call carpet bombing too find a pre-moveable and convert, sometimes when banks

- Now, maybe we should have clarified that even though a general hypothec does not have a droit de suite, if a general hypothec attaches to an immoveable, in other words if enforcement is commenced on immoveable over which there is first a general hypothec including this moveable.

    - Let us imagine a scenario, that there is a general hypothec ranking from 2010 (general hypothec have a 30 year life). Let us say that there was a general hypothec registered in 2010, and therefore is still alive, and a special hypothec which was registered in 2020.

- Now this and enforcement proceedings attachments etc, have commenced on the basis of the credit guaranteed by the first hypothec which is a 2010 hypothec. Because ranking in hypothecs goes by date of registration, it matters not that there was a subsequent special hypothec.

- In other words it is the old principle primus in tempore, potius in jure. In other words, the earlier the founder, because there is a subsequent over a specific immovable it does not have priority over a prior general hypothec if enforcement

over the same immovable had commenced and the general hypothec is therefore brought into effect. The subsequent general hypothec will not prevail over the earlier one.

- Now we have spoken about general and special hypothecs. Now there are three subsequent categories, classifications over which we need to have a discussion.

- The first is a legal hypothec, a legal hypothec is a general hypothec which can be converted to a special hypothec over renewal. There are two basic categories of a legal hypothec, the first is in those situations where shall we say there is potential of risk and abuse of a party considered vulnerable, curator in favour of the interdicted person, so just in case you ever are requested or approached to act as a curator of somebody interdicted or a family member, know that you will have to stick a hypothec with you. That is a legal hypothec which curators/tutors have to give in favour of the party whose affairs they administer, they're registered in the public registry. in favour of the interdicted person for the guaranteed obligation of the proper administration and giving of accounts, the creditor is the interdict or the minor and you won't get rid of it before you submit an account of your administration, submit accounts which can be audited by the second hall so it's not so easy.

- Another two other relevant points on the legal hypothecs let us not forget on the archaic, but if a spouse is widowed with children from the first marriage and passes onto a second marriage. The spouse passing onto the second marriage will use the administration, patria potestas, parental authority, over its own children unless it gives a legal hypothec over its assets, and also (Dr Galea cannot see how this can happen), if the second spouse second husband or wife, is involved in the administration of the assets of the children from the first marriage potentially this general legal hypothec attaches to the spouse who is involved in the children of the wife or husband form the first marriage. This is a nasty one.

- The second point on legal hypothec is, we shall soon see that the special privileges of the contractor, of the dominus etc, to have the droit de suite (yesterday we spoke about special privileges etc) to retain, to have the droit du suite, in the case of a transfer have to be registered within two months from these termination of works.we shall soon see that in the case of 2010 (a) and (b), the privilege of the domains, the privilege of the contractor etc, over the moveable have to be registered within two months from termination of works.

- Now, the relevance of legal hypothec is that a general legal hypothec attaches and this is article 2022 over an immovable in those situations where a creditor has a special privilege over the immoveable.

- Article 2022.

- **2022**. The creditor who has a privilege over an immovable, has a special legal hypothec over the immovable subject to the privilege

- In other words, where a creditor has or would have a special privilege over an immoveable, the creditor also has entitlement to a general legal hypothec. In repeat, in those instances where a creditor has or would have entitlement to a special privilege over an immovable.

  - For example, the typical case is the contractor does not or forgets or is late in registering the special hypothec within the two month period.

- This provision, 2022 comes in useful here, clearly it does not have the same strength and ranking had the special privilege been registered when it should have been registered because as we know privileges rank before hypothecs and hypothecs rank from date of registration but at least it is as we say a consolation prize.

- Now let's say a few words about judicial hypothecs.

  - Basically a judicial hypothec is a general hypothec and therefore it can be converted to a special hypothec and it arises in three instances, two are in the civil code the other is in the arbitration act.

  - The first is a judgement of the local courts, courts of Malta. In other words, you have a judgement you go to the public registry file a note creating a judicial hypothec against the debtor by virtue of the judgement and sometimes it works when a situation is difficult years later it may improve or surface, a judgement of foreign courts but here there is a difficulty of as we call in the exequatur, that there is prior authorisation of the registration of a judicial hypothec, pursuant to a judgement of foreign court however this requires a prior judgement of the courts, in other words let's say you have a judgement of a foreign court you can't do it go to the public registry take a copy of the judgement and register it you will first have to file proceedings which are called the executor which will authorise the registration of a judicial hypothec pursuant to and consequent to the foreign judgement and the second maltese judgement authorising the registration is the exequatur. In the past, before we had Brussels I it was almost necessary when you have a foreign judgement, before Brussels I you had to take the matter to court argue a lot over competence to have it registered

  - The third instance arises from the arbitration act that without any formality a domestic and international arbitration gives rise to a judicial hypothec. The third is the judicial hypothec which arises from the arbitration act, which means that

without any further, you don't need an exequatur, in the case of a domestic or foreign arbitrary court, in the case of a foreign or domestic arbitrary ward, in the case of the arbitration award there is the right to register a judicial hypothec. The third is conventional, before we closed judicial hypothecs it is possible to register a judicial hypothec following a judgement of first instance, which is subject to appeal, you can register but obviously it would not be final.

- Now conventional hypothecs.
  - These are by far the most common method of registering hypothecs because they involve conventional means by consent and it means that both parties have to consent, sit down and enter into a public notarial deed. This is the province of the notaries. The notaries have the software etc. It is where parties give consent, this is the essence of it conventional hypothec. obviously if it is general it is general, if it is special the immovable has to be designated, and the amount for purpose of registration has to be indicated.
  - Now, in the case of a legal hypothec it may be possible for example in the case of a curator granted for the minors to leave the hypothec open ended which is worse, In the case of a judicial hypothec normally the perimeters are indicated by the judgement. The value in the judgement is the value in a hypothec, but in the case of a conventional hypothec it is necessary to indicate an amount for the purposes of registration. In the case of a conventional hypothec you need to indicate a value.
  - A concluding interesting legal quirk is that it is possible to, the quirk is that, in the Maltese embassy in Rome or Paris or high commission in London a Maltese notary can receive a contract provided it is published in the embassy or by commission over property in Malta. This is article 2026
    - <u>Article 2026.</u>
    - **2026**. Contracts made outside Malta, by any public or authentic instrument, according to the laws of the place, or before the diplomatic or consular representative of the Government of Malta in that place or a person serving in the diplomatic, consular or other foreign service of any country which, by arrangement with the Government of Malta, has undertaken to represent that Government's interests in that place or a person authorized in that behalf by the President of Malta, can create a hypothec over property existing in Malta, if the competent civil court, on the demand of the creditor, by sworn application, shall have ordered the registration thereof.
  - It is possible to have a contract, a public deed received and published by a Maltese notary in maltese consulate officers or embassy offices outside and

register a conventional hypothec, special hypothec of course, over property in Malta.

- You do the contract with a maltese notary in a foreign maltese embassy. Sometime it's more convenient and a hypothec registers special hypothecs over maltese property. Sometimes it's more convenience where for example inheritances there are a number of foreigners having an interest and it's better that two parties go and getting 20 people, and it can be done, a special hypothec registered over a maltese property.

  - There is the lawyers directive, lawyers in theory can practice anywhere within the EU notaries no.

- To complete the point there was a talk of european hypothecs a few years ago and it was shot down by the local councils of notaries. You can't have the idea of a European judgement that you have in Brussels I and Brussels II you have to go to the local notary.

- Let's conclude by having a look at subtitle III, how privileges and hypothecs are reserved. Basically, the sense of these articles are that in the case of special privileges over immoveables and it doesn't apply, special privileges over moveables because it is not in force, so in our purposes looking at article 2029.

  - <u>Article 2029</u>

  - **2029**. Special privileges over immovables and over those movables as specified in articles 2002(2) and 2012(1)(b) are ineffectual unless they are registered in the Public Registry within the time of two months.

- Two months we can read the articles in respect of the contract of emphyteusis, the dominus, in respect of the lender and in respect of the vendor or the finance of the sale from the date of the deed. In the case of special privilege due to the dominus, to the contractor.

- In the case of the special privilege to the dominus in respect of special privilege of the vendor over the balance of price and in respect of the financier of the sale or the balance of price, from the date of deed/sale and in respect of the special privilege due to the architect, contractor etc from the date the works are completed.

- Obviously, this date of completion of works is a bit subjective and it is a unilateral registration you take a paper to the public registry saying I have special privileges, the works were completed three weeks ago and then it will be challenged saying the works were finished a year ago.

- If there was no timed registration the special privilege is lost and the droit de suite is lost, article 2032, general privileges we read that saving that on designated moveables, which is not in force, there is no droit de suite in the case of general privileges and special privileges over moveables and these general privileges and special privileges over moveables are all subject to registration.

  - Article 2032.

  - **2032**. Except for those special privileges specified in articles 2002(2) and 2012(1)(b), general privileges and special privileges over movables are not subject to registration.

- Now finally article 2033, which establishes the principle that a hypothec whether legal judicial or conventional, is not effectual unless it is registered in the public registry and ranking is only from date of registration, so if you have debts and register a year later, ranking is a year later, and in the meantime if there are other hypothecs which have been registered they rank before the registration.

  - Article 2033.

  - **2033**. (1) A hypothec, whether legal, judicial, or conventional, is not effectual unless it is registered in the Public Registry, and it does not rank except from the date of its registration.

  - (2) Nevertheless, the hypothec for the dowry settled before marriage shall rank from the day of the celebration of the marriage provided it is registered within one month from such day: and in such case the said hypothec shall not be affected by any alienation, or hypothec, or burden, made or registered during the course of the aforesaid time.

- We can stop here.

21st March 2023

Lecture 9.

- So, two relevant articles which are 2040 and 2041.

  - The principle here is that the registration of a hypothec or a privilege against a debtor who is in a state of insolvency is ineffectual. The registration of a hypothec or a privilege against a debtor who happens to be insolvent is ineffectual, the reason is a well established rule in bankruptcy that where there is a situation of insolvency it is not allowed or legitimate that certain creditors are given preference over others when the state of insolvency exists, it is as we may recall replicated in the companies act whereby a liquidator is empowered to investigate

transactions particularly where there is insolvent dissolution and liquidation a liquidator is empowered to go back and investigate whether there were fraudulent transactions.

- A liquidator is empowered to investigate normally the past 18 months or 2 years to establish whether there were fraudulent transactions and the reason behind this remains the rule of public order of the par condicio creditorum, meaning that unless there is a lawful cause of preference creditors rank pro rata. The thinking behind this is the rule of par condicio creditorum, meaning that unless there is a lawful cause of preference creditors rank pro rata.

- There is an exception in 2041, to the applicability of this rule in the sense that there is a presumption that this rule will not apply if at least 15 days have not elapsed, there is a presumption, that this rule does not apply if at least 15 days have not elapsed between the registration of the privilege or hypothec and either the actual state of insolvency of the debtor or the knowledge by the creditor of the actual state of insolvency.

- There is a presumption that this rule that hypothec registered when a debtor is insolvent is ineffectual and nullable in practice is inapplicable where the time period between the registration and the actual moment of insolvency or when a debtor realises that it was insolvent, the moment of awareness by the debtor (Dr Galea would say it is more a question of fact when insolvency has happened) or the knowledge, the awareness by the creditors of the actual impending insolvency, there is a presumption that if 14 days have not elapsed this rule making the hypothec ineffectual is inapplicable.

- We are going over selectively those articles which Dr Galea thinks are relevant, we are not going so much into the formality of a hypothec, for example we’re not going to discuss and its not important the details, particulars concerning creditors, etc, ID, these are important formalities which are not our concern we are looking to be clear at the substance not the form here.

- In the case of a judicial hypothec, this can be registered even though the judgement is not final in the case of a judicial hypothec this can be registered even though a judgement is not final and subject to appeal however and this can be the subject of a litigation, a value, an amount has to be stated. Therefore it is normally the creditors decision to indicate a value, which value the debtor can challenge as being unrealistic, or excessive. It is possible to register a hypothec against the estate of a deceased person, always subject to the rule that there is no insolvency at issue.

- Now, soon during this conversation or not immediately but soon we are going to contemplate a hypothesis of a third party in possession. A third party in

possession is a person who has acquired by title an immoveable property or a designated moveable if it were to happen, which is subject to the registration of special privileges or special hypothec for which the third party is not personally liable.

- The typical case is where a party buys subject to hypothecs or privileges over the immoveable which is not cancelled. The point here for the purpose of a registration of hypothec, the question is this; let us say property passed from ‘A’ to ‘B’ subject to liabilities in favour of ‘A’. (We’re not going to enter into the question whether registration can be made against ‘B’ not at the moment but we’ll come to it) however, in this situation it is possible to register a hypothec against ‘A’ even though the property has passed into the hands of ‘B’.

- The next question is whether ‘C’ can register against ‘B’. ‘B’ has no legal relationship with ‘C’ but let us say that ‘C’ is a contractor, so he is the creditor/contractor who has a special privilege by virtue of 2010(b).

- The first point that was made that even though the property has passed from ‘B’ to ‘C’ creditor ‘C’ can still register a hypothec against ‘B’. The next question is whether ‘C’ can register against the property held by ‘B’, for example if he is a contractor, a builder, an architect on the basis of 2010(b).

- The argument in favour of this is that actually the credit is due to improvement on the property, and that therefore there is the reason to follow the property in the hands of ‘B’. The argument in this favour is that the benefit is on the property and is being enjoyed by ‘B’.

- The judgements held the contract and the line is settled and unless there is a direct relationship between the debtor and the creditor it is not possible to register a special privilege or hypothec over the immoveable. In other works because the works were not ordered by ‘B’ but were ordered by ‘A’ and the property is in the hands of ‘B’ the registration is not possible.

- We said in article 2053 that a registration of the privilege of a hypothec is valid for 30 years and will lapse unless renewed within the 30 years if it is renewed later, it only ranks from the date of renewal of registration after the 30 years. If a registration of a special privilege or a special hypothec over immoveable is done within the 30 years it is extended for another 30 years ranking from date of first registration.

- The opening statement is that a special privilege and a special hypothec are valid for 30 years registered in the public registry, can they be renewed? Yes if they are renewed within the 30 years they are extended for a further period of 30 years with ranking from date of initial registration.

- If the 30 years lapse can they be renewed? Yes they can but then ranking will happen from date of renewal after 30 years not from date of original first registration.
- Now, let's go for a cluster of articles, article 2088 to 2095.
  - Article 2088.
  - **2088**. Among privileged debts priority is regulated according to the particular nature of each privilege.
  - Article 2089.
  - **2089**. Debts having a general privilege for any of the causes mentioned in paragraphs (a), (b) and (c) of article 2003 are paid in preference to those having any other privilege, excepting only the debt due to the pledgee as provided in paragraph (a) of article 2009.
  - Article 2090.
  - **2090**. Debts having a general privilege for any of the causes mentioned in paragraphs (d) and (e) of article 2003 are paid in preference to those having any other privilege, excepting the debts mentioned in paragraphs (a), (b) and (c) of the said article, the debt due to the pledgee as aforesaid, and the debt due to the hotel-keeper as provided in paragraph (b) of article 2009.
  - Article 2091.
  - **2091**. (1) Saving the provisions of the last two preceding articles, in all cases of competition of privileged debts, differing in degree, the order in which the privileges are set forth in articles 2003, 2009 and 2010 shall determine their respective priority.
  - (2) Nevertheless, the privilege of the seller, mentioned in paragraph (d) of article 2009, shall not operate to the prejudice of the privilege of the dominus or of the lessor, mentioned in paragraph (e) of the said article; the right of the seller mentioned in article 1439 shall not operate to the prejudice of the debts mentioned in paragraphs (a), (b) and (c) of article 2009; and the debt mentioned in paragraph (b) of article 2010, if it is in respect of necessary repairs for the preservation of the tenement, shall have preference over the debt due to the dominus.
  - Article 2092.

- **2092**. Hypothecary debts are paid according to the order of registration, saving the provisions of sub-article (2) of article 2033.

- Article 2093.

- **2093**. Hypothecs registered on the same day confer on the creditors an equal rank, without any distinction between registrations made at different hours of the same day

- Article 2094.

- **2094**. Privileged or hypothecary debts in the same rank, are paid ratably.

- Article 2095.

- **2095**. (1) In the same rank in which a debt is placed, there shall be placed also the interest accruing on that debt, the expenses of registration, and the expenses, if any, incurred for the judicial acknowledgment of the debt unless the latter are otherwise privileged:

- Provided that in the case of a hypothec, the above rule shall apply with reference to interest only if the fact that interest has been agreed upon is indicated in the note of registration of the hypothec in accordance with article 2042(e).

- (2) When the note of registration of a hypothec indicates that interest has been agreed to accrue on a debt, no additional note of registration shall be required when any change, variation, or amendment takes place in relation to the of rates of interest payable, the modalities for the calculation of interest including any indices, margin, or market mechanism.

- (3) Furthermore, no additional note of registration shall be required, for any change, variation or amendment of:

- (a) the repayment schedule; or

- (b) the currency in which payment of the debt is to be made.

- (4) The above shall apply irrespective of whether the change, variation or amendment takes place in virtue of a public deed or a private writing, pursuant to a term of the original agreement or as a result of a market event.

- (5) The obligations changed, varied, or amended as aforesaid shall continue to rank in the same rank in which the principal obligation is placed.

- Without going into the certain details about the general privilege etc, it is here that we find the rules which we stated initially in this discussion, that privileges rank before hypothecs in the order of ranking, that privileges between themselves rank in the order established by law, if there is more than one special privilege for the same cause, so it's 2009 (c) or (b), these rank pro rata, 2010(b) where there are contractors etc, they rank pro rata and we find a rule that hypothecs rank according to date of registration like in a mortgage. In a ship mortgage ranking is determined also by the time and this is important also when you are registering and the jurisdiction is far off. So hypothecs rank by date of registration not by hour of registration and hypothecs registered on the same day rank pro rata.

- Now we are going to look at two situations which prima facie may appear to be the same and in a sense confusing and contradictory, why? Because we have sub-title V, 2059 to 2068, speaking of reduction and cancellation of registration.

- We're going to look at sub-title VIII 2084-2087 which speaks of the extinguishment of privileges and hypothecs.

- In many ways these seem to overlap because the net result is that a hypothec is cancelled. The difference between these is the following, Dr. Galea would concede that it is not entirely clear and therefore the question Dr. Galea has imposed on whether this is confusing he does not think is entirely satisfactorily answered. However the intended difference is that one is formal, the reduction and cancellation of registrations, formal from the purely formal point of view, the other is a cause for extinction which is subtitle VII on the extinguishment of privileges and hypothecs.

- So going back to subtitle V this looks at the formality, whether something is on the register book or not and as we said it's difficult to distinguish between one or the other because whether a hypothec is cancelled or extinguished in practice may be a semantic or linguistic discussion, the effect is that it's taken off.

- So, first of all we are told that article 2059, that a partial cancellation of a hypothec is called a reduction and typically as we now from notarial there is a note, a nota in the public registry whereby a hypothec is reduced in the sense that either the amount is reduced where part of the aim is claimed or where certain immoveable property is released from the hypothec but the hypothec is not totally canceled or alternatively if but this has to be ordered by court judgement, the debtor can offer sufficient immoveable property to guarantee the claim of the creditor justifying

thereby the release of some immovable property whilst retaining it in respect of others.

- The point is that a reduction except as in so far as it is reduced, releases of course what is reduced, but retains in force in effect the hypothec. A cancellation of a hypothec is where a hypothec is totally cancelled and ceases to exist.
- Now, the general principle here is that a hypothec can be reduced or cancelled in either of two ways, either through the voluntary consent of the debtor or through a court judgement, let's say a creditor wants to be difficult and doesn't want to appear on a public deed reducing or cancelling then the debtor has a right of action requesting the court to order the cancellation of the hypothec or reduction thereof.
- There is, again there are two relevant articles here Dr. Galea would like to mention, the first is 2061.
    - Article 2061
    - **2061**. If the total or partial extinguishment of a registered debt results from a judgment which has become res judicata or from any other public deed, the cancellation of the registration, or the reduction thereof as to the amount of the debt, may be effected without the consent of the creditor.
- Which is where the total or partial extinguishment of a registered debt arises either from a res judicata or another public deed, let's say there is a €100,000 claim, there is a court judgement which says that it is not due or it has been paid or there is a separate public deed which says this has been paid or part of it paid, a res judicata or a separate public deed, this is 2061. In this event, the cancellation or reduction may be effected without the consent of the creditor.
- This article not withstanding because the notary who signs the cancellation will be taking on itself significant responsibility and potentially could expose itself from a claim to a creditor, which is not easily workable.
- Finally on this part we mentioned that there is a possibility of a reduction, which is the second relevant article, 2063.
    - Article 2063.
    - **2063**. (1) The reduction, however, shall not be ordered in any of the cases referred to in the last preceding article, if the value of the immovable property to which the debtor demands that the registration should be restricted, does not exceed, by at least one- half, the amount of the registered debt together with

the interest accrued due, and that which will become due up to five years from the day of the reduction.

- (2) It shall be lawful for the court to determine the value of the aforesaid immovable property according to the rules laid down in Sub-title III of Title II of Book Third of the Code of Organization and Civil Procedure.

- The point here is we may recall, we mentioned the possibility that a debtor obtain the release of certain immoveables, if the debtor can show that the creditor is adequately secured.

- Now, for this to happen there are two conditions and these are indicated at article 2063. The first is that the remaining hypothecated property has to have a value of 1½ of the amount due, now an unanswered question here is what is the value, is it the value in an open market or a value in the forced sale, there is no inkling but good practice is that it is value in a forced sale, a sale by auction which can go either way. There is a difference in having you property you have the time to sell, say no, to when it happens in half an hour, whatever goes and that's it. Dr Galea would suggest its forced sale value and the other is that the remaining property (which will be retained subject to the hypothecs) has to cover five years interest.

- Now let's go to subtitle 7. 2084-2087.

  - Article 2984.

  - **2084**. Privileges and hypothecs are extinguished -

  - (a) by the extinguishment of the principal obligation;

  - (b) by the creditor's renunciation of the privilege or hypothec;

  - (c) by the fulfilment of the formalities prescribed in Title II of Part II of Book Second of the Code of Organization and Civil Procedure;

  - (d) by prescription.

  - Article 2085.

  - **2085**. Prescription takes place in favour of the debtor, in respect of property of which he is in possession, by the lapse of the time established for the prescription of the debt to which the privilege or hypothec refers.

  - Article 2086.

- **2086**. As to property which is in the possession of a third party, prescription takes place in favour of such third party by the lapse of ten years from the day on which he acquired such property, even though the creditor may not have known that such property had passed into the hands of a third party.

- Article 2087.

- **2087**. The registration caused to be made by the creditor shall not interrupt the running of prescription in favour of the debtor or of the third party in possession.

- This is more the substantive question, the substantive issue because the thinking always is that a privilege and a hypothec has to have a legitimate cause for existence, an obligation, a cause to agree, to be guaranteed, that is the basic principle we spoke about in day one. Therefore if the principal obligation is extinguished and this is 2084(a), if the principal obligation is extinguished then there is a reason to demand the hypothec is extinguished because the principal obligation which it guarantees is extinguished. Hypothec is a subsidiary ancillary guarantee, it is ancillary and follows a principal obligation, no principal obligation no guarantee, no hypothec. So if the principal obligation ceases to exist/is extinguished, then a ground exists for the hypothec to be extinguished. A hypothec is also extinguished in substance, comes to an end if the renunciation by the creditor to the privilege of the hypothec is allowed, this is 2084(b) and it acknowledges the possibility. 2084(c) refers to something which the Code of Civil Procedure calls the issue of the edicts, what is this, this was conceived two centuries ago in the Codes du Rohan and the Codes du Manoel (De Vilhena), in the past it was possibles for creditors who had a privilege or a hypothec who couldn't be found therefore a situation could have been addressed where a debt has been paid an obligation extinguished but the creditor cannot be found and therefore there was a procedure which we won't go into detail where the court orders once, twice any person who has an interest to appear is given publicity it's posted in the media etc and if no one comes forward and a good case is made then the courts can order an issue of the edicts, meaning in italian cleaning the property, it's a way to clean the property, to purge the property to eliminate privileges and hypothecs, this happens once every generation, the last time it happened was some 20 years ago people thought it has been disused but a bank tried it and managed, it doesn't happen every day.

- Prescription is a case, 2084(d), of course this here refers to extinctive prescription,. This is the familiar discussion that we're left guessing is it acquisitive or is it extinctive prescription, here it is extinctive prescription.

- 2085 is a bit tricky to understand and contemplates the hypothesis where a debtor is in possession of a property belonging to someone else but over this property this someone else who is a creditor has a registered privilege or hypothec.

- ‘A’ is the creditor, ‘B’ is the debtor, personal debtor, ‘B’ owes ‘A’ but ‘B’ possesses property over which the creditor who is the owner of the credit has registered a hypothec. Maybe let’s develop a bit better, ‘B’ is in possession ‘B’ is a personal debtor of ‘A’ ‘B’ is in possession of property belonging to ‘A’ over which ‘A’ has registered in favour of themselves (sometimes it doesn’t happen every day) for property which is in the hands of the debtor but the debtor is a personal debtor of ‘A’ who is the creditor. So this is different from the situation of a third party in possession, why? Because as we said a third party in possession is not the personal debtor of the creditor but in the article we’re looking at here where there is a debtor who personally owes the creditor and for some reason the creditor has registered a privilege or hypothec over the property and this property is possessed by the debtor. It’s a bit unclear, but it’s there and we have to deal with it.

- When is this special privilege or special hypothec subject to extinctive prescription?

- The form leads us to substance, and the debtor acquires the right to be released from the action for payment and consequently the cancellation of the privilege and the hypothec, for the same period as the debt in substance is time barred. In other words if the debt is five years 2156(f) of the civil code, or it’s thirty years, or one year or eighteen months or two years then that is the period whereby the debtor can claim extinction of the principal debt and of the hypothec of the property of which he is in possession.

- Finally, the action, the actio ipotecaria, it is the action by the creditor against the third party in possession known as the actio ipotecaria is time barred by the period of ten years, this is 2086.

- The discussion now is the actio ipotecaria, there’s a good thesis by John Gambin on the subject, basically, it is the right of a creditor in the case that a special privilege or a special hypothec in the hands of a third party in possession, we were saying it is the action of the creditor against a third party in possession of an immoveable property over which the creditor has in its favour a special privilege or a special hypothec the same applies in the case of designated moveables if this went to force.

- Now we said and we’ll repeat it that the actio ipotecaria is a situation where the third party in possession is not, owes no personal liability no personal debt personally to the creditor.

- The third party in possession is not personally liable, and therefore the third party in possession is not personally liable and therefore the creditor cannot go against the assets of the third party in possession but the third party in possession is responsible not personally, but through holding the immoveable for the registered debts.

- This therefore underlines the strength of the droit de suite in the case of a special privilege or special hypothec over an immoveable, why? Because this special privilege or special hypothec follows the immoveable into whosever hands the immoveable passes and remains subject to the actio ipotecaria. As we have seen before the break, the time limit/period for the exercise of the actio ipotecaria against the third party in possession is a peremptory period of ten years from the moment the immoveable was/came into the hands of the third party in possession irrespective of the knowledge of the creditor when the third party in possession acquired the immoveable.

- A good read on this for those who can follow French, Marcel Planiol, Georges Ripert, even though the last edition was in the 50's the law hasn't changed it is a very clear and not too long an exposition. The merit of the French writing is that it is concise, not never ending. (The title is "Droit Civil Francais")

- What is the effect, is either or, either the creditor is entitled to bring the judicial sale of the immoveable property and to be paid from the proceeds according to ranking, that is step one or number two, the third party in possession releases itself of all obligations, arising from being in possession of a burdened immoveable by surrounding the property to the court.

- So let's go to step one, you will see that most of this is procedure, so it commences by the creditor serving what is known as a hypothecary Protest (a Protest is a formal document in court) against the debtor and the third party in possession and intimating on the third party in possession that failing payment and intimating to the third party in possession that failing payment, it will exercise the actio ipotecaria.

- Not earlier than thirty days from the service, not the filing, the service, it has to be received of this judicial Protest, the creditor is entitled to file proceedings against the third party in possession and judicially it has been recognised as good practice whilst the action is filed against the third party in possession, the personal debtor is also named and included in the proceedings as an interested party, the demand of the actions is for the court to order the sale of the immoveable property by judicial action, and the demand in the proceedings is for the court to order the judicial sale of the immoveable property.

- When this is res judicata then the second stage being the judicial sale as we know it subbasta, commences leading to the sale of the property and then ranking of creditors. So this is the strength of it.

- Now what are the defences available to the third party in possession?

- The first is the surrender of the immoveable thereby the third party in possession can no longer be the respondent in the actio ipotecaria because it is no longer a third party in possession.

- Next question is how far can the third party in possession raise pleas relative to the debt? And we have two articles which may be a bit confusing because they seem to be in contradiction of each other for example article 2073 mentions that the third party in possession may raise the plea of discussion if there is in possession of the debtor sureties or other persons liable for the debt personally, (this is important) sufficient to pay the claim.

- So this would tend to suggest that the third party in succession can say listen the debtors or persons bound with the debtor have sufficient assets to pay, you don't have to sell the property for which you are not personally liable. However the effect of this seems to be and Dr. Galea doesn't think that there is a clear answer, the benefit of discussion is 2073. The next article 2074 tends to take away the effect of 2073 by stating that the benefit of discussion may not be set up against a creditor (this is article 2074) having a privilege or a hypothec over the immoveable. This doesn't make sense, there is a problem to read 2073 and 2047 Dr. Galea suspects that when this was touched there was an oversight as it didn't make sense, probably therefore Dr. Galea believes that the correct conclusion is that the third party in possession cannot plead the benefit of discussion it has either to pay or to surrender.

- The question arises as to the condition of the immovable during the period in which the immoveable property was in the hands of the third party in possession.

- There area couple of relevant articles, the first is 2075, where the hypothesis is where the actual value of improvements exceeds the value of immoveable in other words the third party in possession put money into the property exceeding the value of the property the third party in possession has the option to pay the value of the immoveable without improvements or surrender. The hypothesis is where the third party in possession has put money in the immovable property exceeding the value of the property, if it was worth €500 he puts €700. It exceeds the value of the property, in this event the third party in possession is being given the benefit to either pay the value of the property the €500 without improvements or surrender.

- Now, the third party in possession responsible towards hypothecary creditors if during the period within which the property was in its hands the third party in possession is responsible towards the hypothecary creditors if during the period he let it go into deterioration thereby diminishing the realisable value of the property to the prejudice of the creditors.

- If he let the property deteriorate and the value went down and the creditors could get less, then he could be liable towards the creditors. Let us remember the special privilege let us go back to article 2010 the special privileges over the immoveables, we said that there is first the architect, the builder, the party who has worked and put improvements then there is the lender who has financed improvement through a public deed and then there's the third party in possession, this is article 2010(b) on special privileges over immoveables and therefore the third party in possession over the immovable which is subject to be sold or is returned to court for improvements.

- The third party in possession has spent money and carried out improvements, this gives rise to a special privilege over the immoveable in favour of the third party in possession for money spent on the immoveable and let us say the immovable is sold through court auction, let us imagine that it is surrendered and eventually sold the third party in possession has this special privilege to be entitled to be paid and to rank.

- What happens when the property is surrendered?

- In this event if there are any easements, real rights, which existed but were extinguished prior to the transfer to the third party in possession by virtue of the act of surrender, these easements, these servitudes, these real rights revive.

- Let us say that prior to acquisition by the third party in possession there were easements and real rights on the property, these were extinguished when the third party acquired, the third party surrenders, on surrender these real rights and easements revive.

- The creditors of the third party in possession whose debt has been registered after surrender still retain a right of action against the new owners or the people who have bought the property provided these debts have been registered. Needless to say there is a right of regress against the third party who has either paid the debt to be released, or has been for any reason evicted from the property against the principal debtor of course for the price paid by the dispossessed third party in possession. So this is about the actio ipotecaria.

- We will anticipate something that has to do with civil procedure, but this question arises when you go and buy from court in subbasta it is always a risky and

hazardous sale, that is a given, you have to advise clients that it is a risk, due diligence searches etc regulatory permits have to be carried out anyway, because there was in the past a wide spread idea that if you buy from court your sale should be fine, okay.

- This is wrong because acquisition through court order does not extinguish unpaid registered special privileges or special hypothecs over the immoveables. In other words lets say you're happy you go to court you win the bid you've got the money and you say I own the immoveable, you are the owner. But if there are unpaid registered creditors, they could get the sale again of the property you have acquired in subbasta. In other words, where there are registered privileges or hypothecs which are unpaid not withstanding that the property was sold in court auction this can sell the property again, this is known as actio sperimentalis, it has to do with experimenting, selling the property again and again. This actio sperimentalis is always a risky affair such that it was always felt necessary (this is a risky procedure) to provide for the abbreviation of the times because otherwise it could remain subject to the original ten years, the second or third actio sperimentalis could still be exercised for a period of ten years by acquisition by the new bidder. This is under judicial sale by auction in the code of procedure.