

BILLS COMMITTEE ON LAND TITLES BILL

Restrictions against Subsequent Charges

Purpose

This paper addresses Members' concern about restrictions against subsequent charges without the consent of a prior legal chargee.

Background

2. At the Bills Committee on 14 October 2003, Members noted a 'restriction' appearing in the sample register under the English system in Annex 2 of the paper on "Format of Title Registers" (LC paper No. CB(1)38/03-04(04)). It reads :-

"(2 April 1996) RESTRICTION: Except under an order of the registrar no disposition by the proprietor(s) of the land is to be registered without the consent of the proprietor(s) of the Charge ..."

Members asked the Administration to look into the effect of such restrictions under the land title registration system and whether any policy change was involved.

Present Position

3. At present, section 44(5) of the Conveyancing and Property Ordinance (CPO) (Cap. 219) provides that, subject to any agreement between the mortgagor and the mortgagee, where land is mortgaged by way of legal charge the mortgagor *may* execute a second or subsequent charge against the land.

4. In practice, a covenant to prohibit the creation of a second or subsequent charge ('covenant not to charge') is not an uncommon requirement of banks and other lending institutions. A breach of a 'covenant not to charge' may result in the chargee (the lender) demanding repayment of the whole debt and enforcing the security immediately. The need for a 'covenant not to charge', and its exact contents, will depend on the bargaining position of the parties and the nature of business of the borrower.

5. At present, although a 'covenant not to charge' cannot be registered on its own, its existence is usually evident when the instrument relating to the charge itself is registered. While any person may register an instrument relating to a second charge even if this would be in breach of a 'covenant not to charge', he does so in full knowledge of the implications, including the priority of the further advance or re-advance under the first legal charge after the registration of the second legal charge, and that a default would enable the prior chargee to take immediate action against the chargor.

6. Usually a solicitor preparing a second charge will advise both the subsequent lender and the chargor to adhere to the contractual terms of the legal charge and obtain the consent of the prior chargee. Only in rare cases would a subsequent lender be prepared to lend against the prohibition under a prior charge or mortgage. The second lender would have to waive the usual duties of the handling solicitor to inspect original title deeds, and be advised of the risk of triggering a default under the prior legal charge. The chargor (the borrower) would have to be subject to a similar risk in doing so.

Position Under the Land Titles Bill

7. The position under section 44(5) of the CPO (para. 3 above) will not be changed by the Bill. A chargor (as owner of property) is free to create second or subsequent charges unless proscribed by the terms of the legal charge.

8. Under Clause 35(1)(a) of the Bill, a legal charge of registered land shall be effected by its registration *as an incumbrance*. The Bill does not require the specific or separate registration of any covenant contained in the legal charge when the legal charge is being registered. Therefore only upon the specific or separate application by the chargee for registration of a 'restriction' under Clause 77 of the Bill will the particulars of a 'covenant not to charge', 'covenant not to let', etc. be noted as a 'restriction' on the Title Register.

9. Before a 'restriction' is entered, nobody is prevented from registering a second or subsequent charge even if this would be in breach of a 'covenant not to charge' in a prior charge. If a restriction has been entered, it prohibits *the registration* of any dealings of the land, charge or

lease which is inconsistent with the restriction except with the consent of the Registrar or by an order of the Court (please see Clause 78).

10. The wording of a 'restriction' will vary according to the content of the relevant covenant. For a restriction deriving from a 'covenant not to charge', it may read like this: "*No second or subsequent charge created by the owner is to be registered without the consent of the owner of Legal Charge dated 00.00.0000 in favour of ABC Bank Ltd.*", i.e., very much along the lines of the 'restriction' noted in the sample of the English register referred to in paragraph 2 above.

11. In short, insofar as a restriction gives effect to the parties' contractual intention of a 'covenant not to charge', it does not alter the existing legal position. No new policy is involved. As at present, the parties to the charge are free to negotiate the terms on which the charge is given.

12. On the operational level, the Bill may change the existing practice, whereby a chargor and the second chargee may proceed to register a second charge in disregard of the 'covenant not to charge'. The first chargee may exercise the option of registering the 'restriction' instead of relying on the chargor and the prospective second chargee to observe the contract. Obviously the first chargee has to decide whether to so register having regard to his own circumstances and the prevailing practice of the lending market.

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