The Company Administration Regime in Guernsey

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Introduction

The Companies (Guernsey) Law, 2008 (**"Companies Law"**) provides for companies, protected cell companies (**"PCCs"**), incorporated cell companies (**"ICCs"**) and cells of PCCs and ICCs to be placed into administration and for an administrator to be appointed to manage that entity's affairs whilst the administration order remains in force.

More recently the Companies (Guernsey) Law, 2008 (Insolvency) (Amendment) Ordinance ("**the new ordinance**") was passed on 15 January 2020. This new ordinance has made various changes to insolvency law in relation to both administrations and liquidations. The changes which affect new administrations are set out below although it is important to note that the new ordinance has not yet come into force but it is expected to do so during the course of 2020.

The concept of administration in Guernsey was first introduced for PCCs in 1997, but has expanded its scope to cover all other types of companies that can be registered in Guernsey. Administration, like the equivalent procedure in other jurisdictions, provides insolvent companies with breathing space in order to maximise realisations and asset values without increasing liabilities, which, in turn, favours creditors. However, it is important to note at the outset, that there are substantive differences from a creditor's perspective between the process in Guernsey and, for example, England.

Pursuant to section 374 of the Companies Law, a company, PCC, ICC or cell may be placed into administration by the Royal Court upon the application of certain parties. During the term of the administration order, the affairs, business and property of the company, PCC, ICC or cell are managed by an administrator who is appointed by the court for that purpose. The Royal Court will only make an administration order if various requirements are fulfilled. These are that the entity in question must fail or be likely to fail the "solvency test" as set out in section 527 of the Companies Law, and that one or both of the purposes of administration (as set out below) may be achieved by the making of the administration order. For the rest of this note, and for the sake of

brevity, the term "company" also refers to PCCs, ICCs and their cells, unless otherwise stated.

Solvency Test

The solvency test, which underpins many substantive provisions in the Companies Law, requires a company to:

- be able to pay its debts as and when they fall due (i.e the cash flow test);
- have assets greater than its liabilities (i.e. the balance sheet test); and
- pass any of the solvency tests which may be set out in the supervisory legislation (in relation to investment business, insurance, banking or fiduciary businesses that all require supervision in Guernsey, primarily by the Guernsey Financial Services Commission ("**Commission**")).

Standing and Process

An administration application may be made in respect of a company by the company itself (or in the case of an ICC or PCC by the respective ICC or PCC), its directors or its members, or a creditor as set out in Section 375 of the Companies Law. In addition, if the company is supervised, then the Commission may make the application. The Court will sit with Jurats to determine the application, and most applications are heard at Ordinary Court which takes place about twice a month on a Tuesday morning, although urgent applications will be accommodated by the Royal Court (sometimes at very short notice, depending on Judge and Jurat availability) upon a written request from an Advocate setting out the reasons for seeking to have an application heard on an urgent basis.

Purposes of Administration

The two purposes for which an administration order is made are either or both of the survival of the business of the Company and a more advantageous realisation of assets than would be effected on a winding up. In order to demonstrate that either or both of the purposes can be achieved, the Royal Court will often require evidence, in support of the application, that at least one of the purposes is achievable.

Effect of Administration Order

Once an application for an administration order is made, a moratorium prevents any "proceedings" being commenced or continued against the company by unsecured creditors and any existing application for the company's winding up will be dismissed. Furthermore, the company cannot be placed into liquidation (either by its shareholders or by the Court) except with the leave of the

Royal Court (albeit that a "fresh" winding up application may be presented to the Court in respect of the company).

The key difference between the Guernsey regime and the regime in other jurisdictions such as England is that secured creditors, including but not limited to those creditors with security granted under Guernsey law, remain entitled to enforce their security regardless of the moratorium. In addition, any creditors with rights of set off may also enforce those rights.

The moratorium continues during the course of the administration absent leave of the Royal Court or consent from the administrator.

Where a company has been placed into administration, all correspondence of the company (including e-mails and websites) must contain the name of the administrator and a statement that the affairs, business and property of the company are being managed by the administrator, unless this is obvious from the context of the correspondence or common knowledge between the parties thereto.

The Administrator's Duties and Functions

Whilst there is no legal requirement in Guernsey for an administrator to be a qualified insolvency practitioner, the practice is now that the Court will need to be satisfied that the nominated person is appropriately experienced and suitably qualified to take on this very important role. The Court also prefers at least one nominee to be resident in Guernsey. Joint appointments are permitted, and are encouraged for risk management purposes.

The administrator's functions are to collect in and realise assets for the benefit of creditors. He has broad management powers, akin to the powers afforded to directors of the company in the company's constitutional documents. A list of the administrator's management powers is set out in schedule 1 to the Companies Law. The directors remain in office, but must not do anything (or omit to do anything) that interferes with the operation of the administrator's functions.

The administrator takes into his custody and control all of the property to which the company is entitled upon his appointment and manages its affairs and business of the same in accordance with any directions from the Royal Court. The administrator can commence or continue proceedings brought in the name of the company but he is unable, under Guernsey law, to bring actions in his own name (which is in contrast with the powers of a liquidator to bring statutory-based actions for preference, wrongful trading and misfeasance).

However, an administrator can now further to the new ordinance challenge any transaction entered into at an undervalue within 6 months of the onset of insolvency or 2 years where the transaction was with a connected party. A challenge will not be successful where the company can show that the transaction was entered into in good faith, for the purpose of carrying on the

business of the company and there were reasonable grounds for believing that the transaction would benefit the company. Under the new Ordinance an administrator can also challenge transactions (within 3 years of the onset of insolvency) which involve grossly exorbitant terms in relation to the provision of credit or grossly offends the principles of fair dealing. The Guernsey Court has the power to set aside these transactions and to amend the terms of the provision of credit.

The administrator may do all things necessary for the management of the affairs, business and property of the company. He is deemed to be an agent of the company when exercising this power, but does not incur any personal liability except where he acts in a fraudulent, reckless or grossly negligent manner or acts in bad faith.

An important power, amongst others, that may be exercised by an administrator is that he is entitled to remove and appoint directors of the company and to call meetings of members and creditors of the company. He also has the right to approach the Royal Court for the discharge or variation of the administration order where circumstances permit such actions.

Furthermore, the administrator of an ICC must not carry on the administration in such a manner as to prejudice the underlying businesses of its incorporated cells during the administration, and on that basis that administrator must carry on the business of the ICC if necessary to ensure that its cells' businesses also continue. There are no such statutory protections for the cells of PCCs, but there are provisions governing the inter-relationship of the insolvency processes of a PCC with its cells.

Once the administrator has realised the company's assets under the new ordinance, he is able to make distributions to secured creditors and preferential creditors. He may also make distributions which, in his view, are likely to assist the achievement of any purpose for which the administration order was made. An administrator can additionally make distributions to unsecured creditors if the court's permission is obtained. It is now possible for a company to proceed immediately from administration to dissolution. In cases where there are no assets to distribute to creditors, Guernsey companies are able to avoid the need of an interim liquidation which may prove costly. This may prove practical and economical, for example, where the company's estate is exhausted in making distributions to secured and preferential creditors and where it is clear that no distributions could be made to unsecured creditors.

Under the new ordinance Administrations will also involve greater creditor participation. Within 10 weeks of the date of the administration order (unless the Court orders otherwise) Guernsey administrators are now required to send a notice to all creditors inviting them to a meeting and explaining the aims and likely process of the administration.

Remuneration and swearing in of the administrator

Once the administrator is appointed, he will be sworn into office by the Royal Court, to act not only as an administrator in relation to the company, but also as an officer of the Royal Court. As stated above, joint appointments are permitted and the Court may order that the office holders may act jointly or alone.

The remuneration of the administrator and the related expenses incurred in the administration are payable from the company's assets in priority to all other claims, and his remuneration will be fixed (or at least the basis of his remuneration determined) by the Royal Court when the application is made. As such, it is recommended that any proposed administrator offer up evidence of, for example, his hourly charge out rate when the application is made.

Maintenance of Essential Services and Utilities

The new ordinance also brings Guernsey into line with the UK by allowing the Insolvency Committee to make rules preventing providers of essential services, such as electricity and water, from making it a condition of continued supply that the company in administration pay all previous invoices up front. However, providers can ask that the administrator personally guarantee the payment of future invoices following commencement of the administration. This gives some protection to payments due to services providers whilst disallowing threats to withhold essential services.

Duties of office holders to report delinquent company officers

Under the new ordinance administrators are now under an obligation to report to the Registrar of Companies and the Guernsey Financial Services Commission (as regards supervised companies) where they consider that there are grounds for making a disqualification order against a present or past officer of the company. The report must be submitted within six months of the administrator vacating office. Office holders are also required to assist the Registrar and Commission by providing information which they may require.

Information and documents to be submitted by and to administrator

Once an administration order has been made by the Royal Court, the administrator is obliged to give immediate written notice of the order to the company and to give, within 28 days from the date of the order, written notice to all the company's creditors, the Registrar, and in the case of a supervised company, the Commission.

The administrator may also require the following persons to submit a statement of affairs to him within 21 days of being required to do so:

- Current and former officers of the company;

- Parties who have taken part in the formation of the company within 1 year before the administration order was made (the "**preceding year**");
- Current and former employees of the company, who are or were employed within the preceding year.

The statement of affairs must be verified by affidavit of the person submitting it and show, inter alia:

- particulars of the company's assets, debts and liabilities;
- the names and addresses of the company's creditors; and
- the security held by any of the creditors and an indication when the security was given.

Unlike in England, the administrator does not have a specific power to require directors, employees or third parties to provide information or documentation in relation to the company's business and affairs. The administrator does, however, have a general power to apply to the Royal Court for directions in relation to the performance of his functions or regarding any matter arising during the administration, and it is likely that the Royal Court will attempt to assist the administrator, as a Court-appointed officer, in resolving any enquiries of third parties that he may have if those enquiries assist the administrator in performing his functions, in the same way that the Royal Court has been willing to assist liquidators seeking similar relief in the past. The directors do have a statutory duty to comply with the administrator in relation to the management of the affairs of the company.

Protection of interests of creditors and members

Once a company has been placed in administration and creditors notified, the creditor may send notification of its claim to the administrator.

At any time when an administration order is in force, a creditor or member of the company, and in the case of a supervised company, the Commission, is entitled to apply to the Royal Court if they feel they are being unfairly prejudiced by the manner in which the administrator is managing the property, affairs and business of the company. If such an application is successful, the Royal Court may regulate the future management of the company by the administrator, restrict the actions of the administrator or, in the harshest circumstances, discharge the administration order.

Recent judgments

Ogier Legal is at the forefront of most of the recent significant administration applications made in Guernsey. Two recent matters in which Ogier Legal were involved and where noteworthy judgments were made by the Royal Court are:

Re Montenegro Investments Limited (In Administration) 2013-14 GLR 345

This is the first scheme of arrangement to be sanctioned by the Royal Court in relation to the restructuring of an insolvent business operated by a Guernsey company Montenegro Investments Limited (In Administration) ("**MIL**").

In summary, MIL was insolvent on a balance sheet and cash flow basis and was not able to continue to operate as the holding company of overseas vehicles which held numerous real estate sites in the Balkan state of Montenegro. The purpose of the administration order was for the survival of the company or the whole or part of its undertaking as a going concern. In order to achieve the statutory purpose, the joint administrators sought to restructure the company's business with support of its existing, and some new, investors and its investment manager. The most effective way in which to achieve the restructuring was through a scheme of arrangement pursuant to part VIII of the Companies Law.

Shortly after their appointment, the scheme proposed by the joint administrators was that MIL's existing business would be transferred to a new company, incorporated in the British Virgin Islands, and that existing shareholders would be offered the opportunity to invest in the new company in proportion to their shareholdings in MIL. New investors would also be invited to join. The principal condition of the scheme was that the creditors of MIL would be paid in full. This was to be achieved by the new company raising sufficient cash to acquire the assets of MIL and to provide a fund for the future trading of the new company. Two further aspects of the scheme were that the administrators sought approval from the Court to distribute funds to creditors and proposed that, under section 111 of the Companies Law, MIL simply be dissolved after conclusion of the scheme rather than proceed, as would normally be the case, into liquidation and then be wound up.

Like in other jurisdictions, a scheme of arrangement in Guernsey has three stages. The first stage is where the Court, upon application, convenes a meeting of the relevant stakeholders required to approve the scheme. The second stage is the meeting itself, where the scheme is approved (or not) by those stakeholders, and the third stage is where the Court sanctions the decision of the stakeholders.

At the scheme sanction hearing, the Royal Court concluded that in the circumstances where MIL's creditors had been paid in full (with no more creditors expected, advertisements having been placed several times calling for all creditors to make themselves known), where MIL no longer had a business and where there would be considerable costs saving if MIL was dissolved following the end of the administration, the joint administrators should be sanctioned to distribute funds to creditors and that MIL should be dissolved once the relevant distributions took place.

As a consequence of the sanction hearing and ancillary orders granted, MIL's business was duly transferred to the new company in consideration for payment of a sum equal to the amount due to MIL's creditors (including accrued interests) and the amount payable in respect of the costs of the

administration and the scheme of arrangement. Creditors were paid in full and MIL was dissolved shortly thereafter. The new company in the BVI is now operating MIL's former business, with significant cost savings, and substantially more investor support to see it through today's turbulent economic climate.

Re Esquire Realty Holdings Limited, Royal Court, Judgment 19/2014

This case involved recognition by the Royal Court for the first time that a pre-packaged sale of a company's assets immediately following that company being placed in administration would satisfy the statutory purpose of a more advantageous realisation of the company's assets than would be effected in a winding up.

The application was made by Lloyds Bank PLC as Security Agent on behalf of certain principal creditors of Esquire Realty Holdings Limited ("**Esquire**") and was supported by Esquire. The application was part of a much larger arrangement designed to preserve the operations of a large group of companies, engaged in providing specialist adult and children's care homes throughout the UK.

In this case the Royal Court reiterated the special concerns and issues which may arise with a pre-pack administration order which concerns and issues were considered by the Joint Insolvency Committee in England and Wales in a Statement of Insolvency Practice ("**SIP 16**"):

1. It is particularly important that the administrators should have regard to the interests of the full body of creditors, especially those who are not represented in the application to court; and
2. The professionals advising on the arrangements must be mindful of their duties owed to the company and its creditors, not just to the directors and/or principal creditors who may stand to gain from the proposed arrangements.

In deciding to grant an administration order in this case and to approve the appointment of joint administrators, the Royal Court found that they had carefully considered the position of all creditors including those who would not benefit from the proposed arrangements, and thereby the special concerns and issues that referred to above had been adequately addressed.

The Royal Court concluded that although it did not expressly approve the detailed arrangements making up the "pre-pack sale" that would follow with the making of an order, by implication, it may appear to be doing so. It also helpfully noted that while there was no statutory requirement for a SIP16 Report to be produced in pre-packaged administration applications in Guernsey, the Report was of great assistance to it in this matter and it recommended that in any similar applications, such a report be produced unless there are overwhelming reasons not to do so.

The Royal Court also mentioned that when exercising its discretion under the Companies Law, it may take account of the interests of the other stakeholders of Esquire. In this instance, the "other

stakeholders" included the employees of Esquire and also those for whom care is provided for and the families of those individuals.

In two more recent administration applications that Ogier Legal were involved in it was possible to obtain administration orders where the applications were held in camera. Although unusual the particular circumstances of those applications justified the in camera orders.

Conclusion

Administration, unlike liquidation under the Companies Law, is not a terminal process. It is a process that provides a company with "breathing space" and stability in trying financial times although, as noted above, secured creditors may continue to enforce their rights regardless of the administration order, as may those creditors who can set off their claims against claims brought by the company. However, the administration order empowers a company to initiate mechanisms to realise assets, ultimately to be distributed to creditors, without facing debt recovery proceedings and other enforcement measures from those same creditors. Administration will also often facilitate the sale of the company's business as a going concern as goodwill is preserved. It is also often more advantageous to effect a sale of assets through an administration because events of default in funding arrangements (leading to potential enforcement of security) may not be triggered. As a result, the company may survive the procedure, or at least ultimately provide a better return to creditors than might have resulted if the company had simply been wound up.

The flexibility of administration allows Guernsey-specific entities, such as PCCs, ICCs and their cells, to enter the procedure and to benefit from its many advantages. Since the introduction of the Companies Law, a large number of Guernsey registered non PCC/ICC companies and/or their creditors have taken advantage of the regime. Furthermore the new ordinance will afford greater powers to administrators to both collect in assets and more easily distribute them to creditors.

Finally, the recent judgments of the Royal Court referred to above demonstrate the flexibility of Guernsey legislation and the Guernsey court in dealing with complex restructuring and insolvency matters. The Court is not afraid of reaching its own conclusions, without the restraints that prescriptive legislation can bring to bear on it, in order to grant just, pragmatic and effective solutions to restructuring problems.

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