Pooling of Assets and Liabilities of Insolvent Companies in the Channel Islands

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In his seminal work Principles of Corporate Insolvency Law, Professor Roy Goode notes '[i]f it is only infrequently that English courts will be willing to pierce the corporate veil, it is rarer still to consolidate assets and liabilities; indeed, the only case where this is likely to happen is where the assets and liabilities of the different companies within the group are so intermingled that it is impracticable to separate them'. **[1]** Such a pooling of assets and liabilities of separate companies, thus piercing the corporate veil, contrasts starkly to one of the most fundamental principles of insolvency law, namely that creditors only share in the assets of the company against which they are entitled to lodge a claim.

Professor Goode goes on to consider briefly corporate groups in the context of international insolvency looking at the procedural consolidation of insolvent corporate groups (i.e. appointing the same office holders, recognition of different sets of foreign insolvency proceedings by courts in different jurisdictions etc) and at substantive consolidation, being 'generally confined to situations in which the assets and liabilities of different companies are so intermingled that there is no sensible alternative to consolidation. **[2]** The difference between the two is that procedural consolidation involves a consolidated administration of the insolvency of the group, but will not provide for a pooling of assets, whereas substantive consolidation will.

In linked decisions delivered on 7 September and 7 October 2015 the Royal Courts of Guernsey and Jersey respectively held that where the affairs of two insolvent companies (incorporated in Jersey and Guernsey) are so intermingled that the expense of unravelling them would adversely affect distributions to creditors, it can be appropriate to treat the companies as a single entity.

Having concluded that there was no bar in the legislative framework of Guernsey which would prevent such an application and with the interests of creditors firmly to the fore, the Deputy Bailiff of Guernsey granted a proposal by the Joint Liquidators (from Grant Thornton) to consolidate the assets and liabilities of a Guernsey company with the assets and liabilities of a related, but separate company incorporated in Jersey subject to the sanction of the Jersey Court. The Jersey Court subsequently reached a similar conclusion in terms of its jurisdiction to grant a pooling order notwithstanding that the Jersey company was in a just and equitable winding up and that the proposed pooling would involve a transfer of assets and liabilities from a non-Jersey company.

This is the first time the Guernsey Court has considered and granted such an order, which has allowed a procedure which, on its face, would appear to contradict basic principles i.e. separate legal personality and that creditors can only share in the assets of the company against which they are entitled to lodge a claim. Acknowledging the inevitable rise of cross-jurisdictional corporate insolvencies, the Guernsey Court confirmed the basic purpose of a liquidation was the realisation of a company's assets for the benefit of its creditors and held that where there was a solution whereby creditors would receive more than they otherwise would, then common sense dictated that such a solution should find favour with the Court. Whilst the Jersey Court has granted a similar application previously in the context of two Jersey companies, it was the first time that an application had considered the pooling of assets and liabilities of a Jersey company with those of a foreign company. Furthermore, it is the first time that such an order has been made in the context of a just and equitable winding up.

Factual background

The Huelin-Renouf Group was a leading cross-channel cargo shipper and haulier which carried approximately 21% of all cargo between the United Kingdom and the Channel Islands and served as a lifeline of the Channel Islands for almost 80 years. At the time it encountered financial difficulties in 2013, the Group employed 92 staff across its companies in Jersey, Guernsey and a sister company called Eagleway Freight Limited in the UK ('Eagleway').

On 20 August 2013, the Royal Court of Jersey ordered the winding up of Huelin-Renouf Shipping Limited (the 'Jersey company') on just and equitable grounds **[3]** pursuant to Article 155 of the Companies (Jersey) Law 1991 ('Jersey Companies Law') the Court having held that other regimes for an insolvent winding up in Jersey were not available or beneficial to creditors. The Court's decision was one of a series of decisions in recent years in which the Court has granted a just and equitable winding up order in what has become a growing range of circumstances. The Court considered that placing the Jersey Company into creditors' winding up was not appropriate or possible in the absence of shareholder support in the guise of the requisite special resolution and given the need for speedy action to be taken in relation to assets held by the Jersey Company (which included perishables) and to avoid an 'unseemly rush after goods whose ownership might be in dispute'. **[4]** The Court also held that a declaration of désastre 5 would not be appropriate, given the likely duplication of costs of the Viscount and the expert liquidation assistance he would

likely engage. In granting the order to wind the Jersey Company up on just and equitable grounds, the Court applied, importantly for the purposes of the later application, a wide range of provisions from the Jersey Companies Law which are typically applied to creditors' winding up.

The following day, Huelin-Renouf Shipping (Guernsey) Limited (the 'Guernsey company') was wound up pursuant to Part XXIII of the Companies (Guernsey) Law, 2008 ('Guernsey Companies Law'). Alan Roberts, Jamie Toynton and Ben Rhodes of Grant Thornton were appointed joint liquidators in respect of both companies. Eagleway was placed into administration in England at the same time. **[6]**

Companies' operations intermingled

The intermingling of the affairs of the companies was already apparent when the winding up orders were made, but the extent of it was revealed once Grant Thornton commenced its investigations into the companies' operations. The liquidators concluded that the companies did not operate as distinct entities and that there was little evidence that suppliers, creditors or customers were aware of which entity they contracted with.

The Guernsey company was entirely dependent on the Jersey company for its ongoing funding and would have insufficient assets to pay a dividend to any of its creditors, including preferential creditors (which consisted mostly of employees). The liquidators concluded that if the companies were to be liquidated as separate entities, significant professional costs would be incurred in order to determine the true assets and liabilities of each company given the complex intercompany position. Guernsey creditors would receive nothing since the majority of assets were vested in the Jersey company and the likely dividend payable to Jersey creditors would be materially reduced as a result of those costs of unravelling operations.

The liquidators further concluded that if, on the other hand, the assets and liabilities of both companies were consolidated, then this would obviate the need to ascertain the true inter-company position. Accordingly, the additional professional costs would not be incurred and creditors of both companies would receive a dividend from the pooled estates. The projected outcome upon pooling was that the preferential creditors of both companies would be paid in full and unsecured creditors, as a whole, would receive an increased dividend by reason of the saving of liquidator's costs and legal expenses (for example in seeking relevant orders giving directions).

The Guernsey decision

The Guernsey Court was satisfied that the application could be brought pursuant to section 426 of the Guernsey Companies Law, and that there was no statutory bar to granting such an order. The Deputy Bailiff, following the principles set out in the *Flightlease Holdings (Guernsey) Ltd v Flightlease (Ireland) Ltd*7 decision considered the approach taken under English insolvency law, as well as under Jersey law in relation to customary law procedures such as *désastre*. The Court also considered the Royal Court of Jersey decision in *Re Corebits Services Limited (in liquidation) and*

Zoombits Limited (in liquidation) **[8]** in which the pooling of assets and liabilities of two Jersey companies was approved, and found that a similar approach could be taken in respect of two Guernsey companies. Specific consideration was given to section 419 of the Guernsey Companies Law which requires a *pari passu* distribution. To ensure compliance with this provision, the Court accepted the liquidators' undertaking to apply Guernsey law to the claims of Guernsey creditors if pooling were to be ordered. **[9]**

The Guernsey Court had significant regard to the Guernsey company's reliance on the Jersey Company for its ongoing funding with the consequence that once the Jersey company entered liquidation there was no prospect for the Guernsey company to survive. Other key considerations in reaching its decision were that the majority of assets were held by the Jersey company, both companies had been managed by a single management team based in Jersey, there was no resident Guernsey director, invoices were issued in the name of the Jersey company, and when it came to branding, both companies portrayed themselves as if a single Channel Islands entity.

Echoing the conclusions of the Vice-Chancellor in the English Court of Appeal's judgment in *Re Bank of Credit and Commerce International SA (No. 3)* **[10]** the Deputy Bailiff held as follows:

'When one remembers that the purpose of a liquidation such as the present one is to realise a company's assets for the benefit of creditors, it is plain that the proposed pooling arrangement is the only way in which the creditors of the Guernsey company are likely to receive anything ... Accordingly, if there is a way in which those creditors receive more than they otherwise would, common sense dictates that such a solution should find favour with the Court … Moreover, because of the extremely close connection between the Jersey and Guernsey companies, if there is a solution that enables them to be paid something, the injustice of declining to sanction the Joint Liquidators' proposal becomes self-evident.' **[11]**

The Guernsey Court held that it would be appropriate to facilitate the transfer given the potential benefit to the Guernsey creditors but noted that if the Jersey Court disagreed, they would suffer no prejudice because the costs of making the application would not affect a distribution of a dividend which was presently estimated to be zero.

The Jersey decision

The Jersey Court also considered the extent of its jurisdiction in the context of a just and equitable winding up and held that the broad discretion under Article 155 of the Jersey Companies Law provided the power to grant the order sought. Article 155(4) specifically provides that 'If the Court orders a company to be wound up under this article it may (a) appoint a liquidator; (b) direct the manner in which the winding up is to be conducted; (c) make such orders as it sees fit to ensure the winding up is conducted in an orderly manner.' In addition, Article 170(1) of the Jersey Companies Law, which was expressly incorporated into the Court's winding up order in August 2013 provides that 'the liquidator in a creditors' winding up may, with the sanction of the court … (b) compromise any claim by or against the company.' In view of its wide ranging discretions under the

just and equitable winding up provisions and the powers of compromise provided to the liquidators, the Court considered that there was nothing to prevent the Jersey Company being subject to a pooling order provided the Court considered it to be in the interests of the creditors.

The Royal Court applied its earlier decision in *Re Corebits and Zoombits* **[12]** holding that, although in that case the companies were both Jersey companies, the principles applied equally to a situation where one of the companies was incorporated in another jurisdiction. The Court also referred to the fact that there were examples in the context of the Jersey law on *désastre* where, in the interests of creditors, compromises involving the consolidation of assets with other entities had been sanctioned. For example, the Royal Court cited *In the matter of the désastre of Royco Investment Company Limited* **[13]** in which similar reasoning had been followed and the Court had held that creditors' interests were to be borne primarily in mind and that, on the facts of that case, it made no sense to spend funds pursuing investigations which had limited prospects of success, particularly 'where the affairs of the debtor company are inextricably intermingled with other entities, the affairs of which are being administered in another jurisdiction.' **[14]** In that case the Court concluded that a proposed compromise which would result in a scheme of distribution to a general body of creditors (including those in Jersey) was the fairest outcome to the creditors and investors of *Royco* alike.

The Court noted the liquidators' evidence that the affairs of the companies were inextricably intermingled and accepted that the estimated dividend positions (in a pooled or non-pooled scenario) were reasonable. The Court accordingly concluded that the transfer and consolidation of the assets and liabilities of the Guernsey and Jersey companies would be for the benefit of creditors of both companies. The Court also accepted the liquidators' undertaking that creditors of the respective companies would be treated in accordance with the law of their respective jurisdiction, albeit noting that pursuant to the winding up order in respect of the Jersey company, the statutory provisions concerning the rights of creditors (notably preferred creditors) had been expressly incorporated.

Comment

The key message is that the circumstances in which pooling orders might be made appear to remain relatively unchanged since the English Court established the principle in *BCCI*.15 It will certainly be necessary to demonstrate a degree of intermingling that renders an unravelling exercise wholly unworkable and a waste of precious resources in an insolvent estate. On the facts of Huelin-Renouf, it was particularly important to both the Guernsey and Jersey Courts to understand the somewhat counter-intuitive conclusion that the transfer of the assets and liabilities of the Guernsey Company (which effectively had no assets) to the liquidated estate of the Jersey Company would lead to a greater dividend payable to the creditors of the Jersey Company. It demonstrates that, even on a scale that is dwarfed when compared to the jurisdictions involved in the *BCCI* case, a houghtful and creative approach to a group liquidation which engages the assistance of the Court can achieve the right end result.

These linked decisions are noteworthy not only because they represent a welcome development in cross Channel Islands co-operation and insolvency/restructuring law, but also because there is little reported authority in this area (no doubt due to its apparent disregard of a fundamental principle of corporate insolvency law). Until the introduction of the Guernsey Companies Law the Court was mainly reliant on the customary law derived from *coutume de Normandie* (the customs of medieval Normandy) which still survives today. In extending the guidelines of the *Flightlease* decision (which were held to be of general application to companies operating outside the financial services sector), the Guernsey Court confirmed that gaps in the statutory regime could be filled by looking to English insolvency law and for guidance on customary law procedure, it was appropriate to look to Jersey. What is clear is that Guernsey's statutory regime, which is intentionally less prescriptive than those of Jersey or England, has once again enabled the Court to take a more pragmatic and flexible approach to insolvency situations as they arise.

Likewise, the Jersey Court has again demonstrated that, in appropriate circumstances, it will grant orders in the exercise of the discretion conferred upon it by statute, for the benefit of interested parties, being the creditors in the case of an insolvent company. In recent years there has been a widening of the circumstances in which the Royal Court has been prepared to order the winding up of Jersey companies on just and equitable grounds, including insolvent companies where a creditors winding up or *désastre* are not available. In granting such orders the Royal Court will typically incorporate provisions of the Jersey Companies Law that apply in a creditors winding up; this provided the legal framework for the sanction of the cross-border pooling in this case. The development of the use of just and equitable winding up in insolvent situations in Jersey to an extent that is greater than in other jurisdictions has undoubtedly led to a situation where this kind of order could be entertained. However, in the more traditional circumstances when just and equitable winding up orders are made (such as deadlock in quasi partnership scenario or where there is a loss of substratum but where solvency from a creditor position is often not in issue) the need to address the interests of creditors in respect of their likely recoveries does not arise.

Insolvency law and its practice in the Courts of both Guernsey and Jersey continues to develop and the jurisprudence and bank of authorities is increasing steadily. The approach taken to the unfortunate collapse of the Huelin-Renouf business is the latest in what is becoming a growing line of cases where the Court has shown that, provided it is comfortable that it has sufficient jurisdiction, it will do what it can to protect the interests of creditors.

Notes

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