Administration Management – The GFSC's Interventionist Powers And The Royal Court's Approach

Insights - 06/06/2016

Administration Management – The GFSC's Interventionist Powers And The Royal Court's Approach

The protection of investors is important for the reputation of any jurisdiction. In the Bailiwick of Guernsey, the Guernsey Financial Services Commission (the "Commission") and the Royal Court of Guernsey have a significant role to play in that regard.

Mathew Newman, a partner in Ogier's dispute resolution team, examines some of the powers those entities possess to assist with achieving such protection, and which were enunciated in a recent decision[1] and which is believed to be the first occasion on which such powers have been invoked.

The Protection of Investors Administration and Intervention (Bailiwick of Guernsey) Ordinance 2008 (the "2008 Ordinance") permits Commission to apply for an administration management order where it is satisfied that a relevant person has performed an act or made an omission; or will, or is likely to perform an act or make any omission that would cause undue risk to investors, and considers that the making of an order would be for the protection of investors.

As this is not an application under the Companies (Guernsey) Law 2008 (the "Companies Law"), it can only be made by the Commission.

The Commission had initiated proceedings pursuant to the 2008 Ordinance in respect of various entities, including Lancelot Management Limited ("Lancelot"), Global Mutual PCC Limited ("GMF"), the Worldwide Mutual Fund PCC Limited ("WMF"), the Universal Mutual Fund ICC Limited ("UMF") (together known as the "Mutual Funds") and the incorporated cells of UMF.

Essentially, the Commission had concerns that there appeared to be systematic failings in

corporate governance and the application of law, regulation, code and principle to the management and function of GMF and the managed funds by Lancelot and the respective boards, evidenced by failures to manage conflicts of interest. The Commission considered there were significant and systematic conflicts of interest which existed in relation to certain cells of the GMF and their underlying assets, which appeared not to have been dealt with appropriately by Lancelot. Furthermore, it was said that the failure to manage the conflicts appropriately appears to have given rise to circumstances which have negatively impacted the value of the assets of certain cells of GMF, leading to issues relating to liquidity of the cells which the remaining board members of Lancelot and GMF had failed to recognise.

Due to the serious nature of the issues and the known impact which they had had on certain cells of GMF, the Commission were of the view that there was a high risk that the behaviour causing it, also affected the Managed Funds. There was a risk that the value of the underlying assets were not accurately known and the Net Asset Value ("NAV") attributed to various cells, incorrect.

Thus, at the time proceedings were initiated, the Commission did not know how widespread within the group of funds the issues were. Principally, the problems arose from the individuals involved in the structure owning and controlling many of the entities within the structure. The Commission were concerned that the lack of sufficient independent scrutiny meant that there were potential risks to investments and investors in all entities. The Court therefore made orders putting the entities into administration management and/or liquidation so that GT could investigate matters further (the "Orders").

At that stage, the Court was not making any findings of fault or even determining that any problems had actually occurred, but was concerned with the risk to investors and whether to make orders for their protection.

Where did the Court's powers to make the Orders derive from?

The statutory framework for the administration management regime is found in the Protection of Investors Administration and Intervention ("Bailiwick of Guernsey") Ordinance 2008 ("the 2008 Ordinance"), which was made pursuant to the enabling powers in Article 28AA of the Protection of Investors (Bailiwick of Guernsey) Law 1987 (the " 1987 Law"). This empowered the States to make Ordinances authorising the Commission to take certain steps with a view to intervening in the administration of certain entities. Subsection 28AA(2)(f)of the Law provided that an Ordinance could *"modify or supplement any enactment or rule of law appertaining to the management, control and ownership of any person or entity including, for the avoidance of doubt, its assets and liabilities."*. The enabling power is thus very wide.

What is the recent judgment concerned with?

An application was made by individuals from Grant Thornton ("GT") as the joint Liquidators of Lancelot (now in liquidation) and the joint Administration Managers of the Mutual Funds the

incorporated cells of UMF.

In terms, the purpose of the application was: (1) to report to the Court on the progress of the administration of the Mutual Funds and the Cells of UMF (the "Administration Management" and on the liquidation of Lancelot (the "Liquidation"); (2) to apply for an order as to the fees and costs of the Administration Management and Liquidation; and (3) to introduce proposals and recommendations for the future of the cells of GMF, WMF and UMF (the "Application").

How did the Court approach the Application?

The Application was brought under Subsection 4(3) of the 2008 Ordinance which provides that an administration manager may apply to the court for directions in relation to the extent or performance of any function, and any matter arising in the course of the administration. The court may make an order on such terms and conditions as it thinks fit.

The Court examined a number of English authorities and held that the general principle was that it was not for the Court to interfere with commercial administrative decisions taken by an administration manager unless such decisions were taken in bad faith or were decisions that no reasonable person in their position could have taken. In other words, the Court will approach such applications in the same way they would approach an application by Trustees under the Public Trustee –v- Cooper jurisdiction. Thus, the Court's blessing is sought and this would normally be forthcoming unless it was taken in bad faith, was irrational or otherwise unreasonable.

The Court therefore blessed various "exit strategies" proposed by GT.

There was then an examination of how GT's fees were to be paid. When the Court appointed GT, it was ordered that their fees be payable from the assets of the funds and the underlying cells in such proportions as were available to meet them and as GT deemed appropriate (the "Fees Order"). The Application thus sought directions as to how to give effect to the Fees Order, as there were objections from certain investors and from Lumiere Fund Services Limited ("Lumiere"), the fund administrator of the Mutual Funds.

The Court held that no one had applied to set aside or vary the Fees Order, despite the fact that under Section 11 of the 2008 Ordinance permits an investor, creditor or the Commission to apply to the Court for various relief, including the discharge or variation of orders made. As no such application had been made, GT were entitled to rely on the Fees Order and seek the Court's blessing as to how to give effect to it.

The allocation proposed by GT was first of all to allocate specific costs to the specific cells in respect of which those costs have been incurred where fund-specific costs could be identified. GT had incurred further substantial costs that were general or common in nature and could not be allocated to a specific fund or cell. In respect of those expenses, GT proposed to allocate them equally to all the funds concerned.

The second limb to the exercise was that GT had identified four funds in respect of which there existed a shortfall, the great bulk of which related to general or common costs, rather than cell specific costs. GT proposed to re-allocate the shortfall to the other funds where there existed sufficient assets on a per fund basis.

The final exercise GT performed was to look at future costs, much of which had now been paid, which represented their estimate of costs required to liquidate or exit each fund, some central core costs, future legal fees and some specific service provider fees. The proposal was to allocate them on a similar basis: fund specific costs to the relevant fund; costs of a central nature across all funds; and a provision for recovery from the funds that could afford to pay a share of costs which the funds with a shortfall could not.

The proposals by GT were challenged. Firstly, it was submitted that rather than allocating the common costs on a per fund basis, they should be allocated in proportion to NAV's. GT had considered this option and rejected it because of the uncertainty and unreliability of the NAV's in relation to certain funds. The Court held GT's approach was a good example of a commercial administrative decision for GT to take, and not one with which the Court would interfere unless it was not rationally based or if taken in bad faith.

As regards the proposed allocation to the funds with sufficient assets of a share of the shortfall of costs relating to funds that did not have sufficient, it was submitted by Lumiere that the innocent should not be subsidising the guilty who are unable to pay. To do so would be to defeat the purpose of the Protected Cell Company ("PCC") legislation, which was to protect the integrity of individual cells and their assets so that any one cell does not have to pay liabilities incurred by any other cell.

However, such concerns were not shared by the Commission. The purpose of Section 28AA of the 1987 Law and 2008 Ordinance was to give the Court the power to override legislation in exceptional circumstances, of which this was one. The Court agreed – what was exceptional was the fact there were a whole group of companies with numerous conflicts of interest and a risk to investors identified by the Commission. The Fees Order was the only practical pragmatic order that could have been made at the time and the only basis upon which GT or any other person would have accepted the role they were being asked to undertake.

The Court further recognised there were well recognised instances of pooling of costs in the liquidation of group or related companies and such instances in administrations and liquidations pursuant to the Companies Law were directly analogous.

Conclusion

Where administration managers have been appointed pursuant to the 2008 Ordinance, any application for a "blessing" of steps taken by them will be approached on a Public Trustee –v- Cooper basis and the Court will not interfere with any administrative decisions unless they were

taken in bad faith or were unreasonable in a Wednesbury sense.

The Court has the power to override legislation in exceptional circumstances, where there are risks to investors, though there are mechanisms for investors, creditors and others to challenge orders made by the Court. In short, such orders need to be challenged by application under Section 11 of the 2008 Ordinance, as opposed to waiting until an application for directions as to how to implement the order is made.

This case was one of **exceptional circumstances** such that it is not anticipated that many, if any, other future decisions will order one cell to meet the liabilities of another.

---

[1] In the matter of Global Mutual Fund PCC Ltd (In Administration) Universal Mutual Fund ICC Ltd, Worldwide Mutual Fund PCC Ltd, Lancelot Management Ltd, Trinity Global Fund/Mr. A.J. Roberts and Mr. J.R. Toynton and Guernsey Financial Services Commission

About Ogier

Ogier is a professional services firm with the knowledge and expertise to handle the most demanding and complex transactions and provide expert, efficient and cost-effective services to all our clients. We regularly win awards for the quality of our client service, our work and our people.

Disclaimer

Meet the Author

Mathew Newman

Partner

Guernsey

E: mathew.newman@ogier.com

T: +44 1481 752253

Key Contacts

Simon Davies

Partner

Guernsey

E: simon.davies@ogier.com

T: +44 1481 737175

Related Services

Dispute Resolution