Subscription-secured financings: enforcements vs perfection in Guernsey

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Subscription-secured financings in Guernsey: enforcement vs perfection

This article formed part of a report originally produced with Haynes and Boone LLP titled Subscription-Secured Financings: Enforcement vs Perfection (European Deals Edition). You can see links to Ogier's other chapters below and find the original report here.

Cayman

Jersey

Luxembourg

Creation of security in Guernsey

Security Agreements

Guernsey law does not recognise the concept of "perfection" of security, focusing instead on the "creation" of a security interest. Under a Guernsey law governed security agreement, a security interest over the rights of the general partner or manager of the fund to make capital calls to investors (and to receive the proceeds of such capital calls) is created where the secured party (or some person on the secured party's behalf other than the debtor or some person on the debtor's behalf) has title to the collateral pursuant to a security agreement, and where that title is acquired by assignment. A security interest will be created once (i) the secured party has title (and where that title has been acquired by assignment) and (ii) notice in writing has been served on the party from whom the debtor would be able to claim the collateral (i.e. the investors). Essentially therefore, to create security over the capital call rights, the rights are assigned to the lender and

notice of the assignment is given to the limited partners.

Notice in writing is required to create a security interest. Consequently, notice would typically be served on the relevant investors contemporaneously with the execution of the security agreement. Where notice is given at a later date, a security interest will not be created until the service of such notice on the investors. However, the timing of service of notice is a commercial issue and accordingly, transaction specific arrangements for the service of notice on investors are not untypical in Guernsey (for example, notice may be served by way of the inclusion of the notice in the next usual circular provided to investors following execution of the security agreement). Where such alternative methods of serving notice are proposed, the bank must be aware that a security interest is not created until notice is served on the relevant investors.

In respect of security granted over a bank account into which capital call proceeds are paid, a security interest will be created either:

(a) where the bank which holds that account for its customer is the secured party and where its customer and the debtor are one and the same person, by the secured party having control of that account pursuant to a security agreement; or

(b) where the account bank and the secured party are separate entities, once (i) the secured party has title (and where that title has been acquired by assignment) and (ii) notice in writing has been served on the party from whom the debtor would be able to claim the collateral (i.e. the account bank).

As detailed above, in respect of paragraph (b) above, a security interest is created only at the point at which notice is served and, accordingly, where security is granted over an account held with a third party account bank notice of assignment is typically given to the account bank contemporaneously with the execution of the security agreement.

It is market practice in Guernsey to also require the recipient of a notice served under a Guernsey security agreement to provide a signed acknowledgement of the receipt of such notice. An acknowledgment is not required as a matter of Guernsey law for the creation of a security interest but, given there is no concept of deemed receipt in Guernsey, an acknowledgment provides evidence that notice has been duly served. However, it is not untypical for the requirement for investors to provide a signed acknowledgment to be dispensed with given the practical and commercial difficulties inherent in expecting investors to provide an acknowledgement, particularly where the service of the notice can be evidenced in some other way (for example by counsel for the secured party being copied on an email circulating the notice to the relevant investors).

Many account banks have their own form of notice and acknowledgement which they are reluctant to negotiate. Therefore, similar to the English position, borrowers should liaise with their account banks as early on in the transaction as possible in order to avoid delays in the transaction.

Notices

In respect of a notice served on investors pursuant to a Guernsey law governed capital call rights security agreement, it is important that such notice specifies that the debtor has assigned to the secured party all rights, powers and interest in the rights of the debtor in and to the relevant investors' capital contributions pursuant to the security agreement. Clear and unambiguous drafting in this regard will highlight to investors that amounts to be contributed by investors pursuant to capital calls made by the secured party following enforcement of the security will be used by the secured party to service the relevant debt under the finance documents, rather than for the purposes of making investments or such other purposes as are specified in the LPA of the fund.

Further, any notice to investors must comply both with the requirements of the LPA (see the paragraph entitled "Due Diligence", below) and with the requirements of the Security Interests (Guernsey) Law, 1993 (the “SIGL”). The SIGL provides that notice may be served on any person by delivering it to him, leaving it at his proper address or by sending it by post to him at that address. Further, the Electronic Transactions (Guernsey) Law, 2000 makes provision for the service of notice by electronic means (such as email). The requirement that notice be "served", however, will require the service of the notice on the investors rather than, for example, the notice simply being uploaded to a website which investors may log onto from time to time.

Security Registration

There is no requirement as a matter of Guernsey law that any security agreement created pursuant to the SIGL be registered with the Guernsey Companies Registry or any similar body.

Enforcement

Following an event of default under the finance documents, and upon the secured party having served written notice on the debtor specifying the event of default complained of (which is a requirement of Guernsey law), the secured party will be able to exercise the capital call rights. Where the debtor and the secured party have contractually agreed, as is customary in Guernsey, that the security may be exercised without the need for an order of the Royal Court in Guernsey, then provided that the documents are enforceable in accordance with their terms there is no requirement in Guernsey for any court order, or similar approval, in order to exercise the power of sale or application.

Enforcement would be effected through the secured party and not, for example, by a receiver appointed on his behalf (Guernsey does not have the concept of receiver or administrative receiver) nor would any administrator appointed to a company have the power to realise assets subject to the security on behalf of the secured party.

The proceeds of any sale and/or application must be applied by reference to the statutory waterfall which in principle provides for the payment of the secured debt following payment of any costs, fees and any prior secured claims.

In an insolvency scenario, the SIGL provides that, where a debtor becomes insolvent (or subject to a désastre) or his property is otherwise subject to proceedings consequent upon insolvency (or declaration of désastre), the secured party may realise or otherwise deal with the collateral as if such event had not taken place (i.e. there is no stay of enforcement proceedings). Equally, the moratorium that generally exists as a result of an administration order being made in Guernsey (under the Companies (Guernsey) Law, 2008), does not affect rights of enforcement with respect to security interests created pursuant to the SIGL.

Due Diligence

In respect of any potential obstacles to the enforcement of security in Guernsey, the LPA and ideally any side letters should be reviewed carefully to ascertain as to whether there are any provisions which may affect the ability to create or enforce the security. Among other provisions, the ability to assign the rights to make capital calls and to receive the proceeds therefrom must be identified and any restrictions on the assignment or exercise of such rights should be amended or removed. The LPA should not prohibit someone other than the general partner or manager from making a capital call to investors. In addition, any contractual provisions in the LPA which allow investors to claw back some or all of capital contributions made to the general partner or manager should be considered so that the scope and extent of the rights being assigned pursuant to the security agreement is clear. Similarly, the LPA should not restrict the payment of the proceeds of capital calls directly to the secured party following enforcement of the security, i.e. by way of set-off or counterclaim. As per the position in England, it should be clear in the finance documents that any payment obligations the fund and a general partner or manager has to investors should be subordinated in favour of repayments to the secured party (in the event that such wording is not included in the LPA). Any requirements in relation to the service of notice on investors should be noted and complied with.

In the event that investors have not expressly agreed to meet a capital call request from the secured party in the fund documents, the secured party can, on enforcement, exercise the irrevocable power of attorney contained in the Guernsey security document to ‘step into the shoes’ of the general partner or manager and issue a capital call notice. Unlike the position in England, a Guernsey law governed security document which contains a power of attorney does not require to be executed as a deed.

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