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2020 Heralds New Insolvency Law Changes for Guernsey

Insights - 15/01/2020

On 15 January 2020 the States of Guernsey passed the Companies (Guernsey) Law, 2008 (Insolvency) (Amendment) Ordinance, 2020, making Guernsey an even more desirable forum for insolvency proceedings. The new legislation is set to modernise Guernsey insolvency law, bringing the jurisdiction into line with not only the UK but other offshore jurisdictions such as the British Virgin Islands and the Cayman Islands. These changes will affect all new liquidations and administrations and will come into force when regulations to that effect are made by the Committee for Economic Development.

Having had the opportunity to advise on the new law through ARIES (the pan-Channel Islands industry body) and via the insolvency rules committee I believe that the necessary legislative tools are now in place to ensure that liquidators and administrators can quickly and efficiently gather in the assets of insolvent companies and return them to the creditors.

Some of the more important new tools are set out below:-

A members' voluntary winding up

One of the more unique aspects of Guernsey insolvency law is the ability of members to resolve (by a special resolution) to wind up their company - with creditor ratification - even when this company is insolvent. Neither the UK nor any other major offshore jurisdiction bestows such a power on the members of a company. The advantages of such a power are clear: it enables a company to be quickly and cheaply wound up without needing to involve the creditors or a professional insolvency practitioner. There are also some obvious drawbacks however: the creditors lose visibility over, and control of, the process and there is nothing to prevent a director of a company winding up that company even though that company may be heavily insolvent as a result of the acts and omissions of that director.

This potential lacuna has been remedied by the new amendments of the law which now specify that, where a company is to be placed into a members' voluntary winding up, the directors must declare the company is able to satisfy the statutory solvency test. If they are unable to make that declaration, then the company must be wound up by an independent third party (unconnected to the directors or members of the company) which will normally be a professional insolvency practitioner. This ensures that where a company is insolvent, and the creditors of that company are at risk of being prejudiced, an independent insolvency professional will be appointed to make sure that creditors are adequately protected and that the assets of the company are preserved pending distribution to the creditors.

Furthermore if a declaration of solvency is not signed by the directors, then the liquidators must call a meeting of all creditors within one month of their appointment unless in their opinion there are no assets for distribution.

The power to demand documents and interview individuals

Until these new amendments there was no statutory power or authority allowing a liquidator to demand documents from directors or employees of the company, or to interview directors or former directors. There was some common law authority outlined in Re Med Vineyards allowing a director to be interviewed but the extent of such powers were uncertain and had recently been doubted by Lieutenant Bailiff Marshall QC in Re X (a Bankrupt), Brittain v JTC (Guernsey) (2015). All these doubts have been swept aside by clear powers outlined in the amendments.

A liquidator can now demand (by court order if necessary) that all directors, former directors, employees and those who were employed by the company within the past 12 months (preceding the commencement of the liquidation) must provide all the documents that the liquidator may reasonably require to perform their duties. Furthermore the liquidator can now apply to the Guernsey Court to interview an officer or former officer of the company about matters such as the formation of the company, its business and affairs, and his or her conduct or dealings in relation to the company.

Additionally liquidators have now been granted the same powers as administrators to require a statement of affairs (summarising assets and liabilities and providing the names of creditors) from past and present officers of the company, present employees and those employed in the year preceding the commencement of the liquidation.

All of the above give liquidators considerable powers to assist the interests of creditors and shareholders and brings Guernsey substantially in line with the UK and other major commonwealth jurisdictions.

The power to disclaim

Again, this is a new power which has been copied almost word for word from similar UK legislation. The main purpose behind it is to allow a liquidator to release the company from unprofitable contracts as well as responsibility for property (including real property in Guernsey) that cannot easily be sold or is likely to incur liabilities for the liquidator. A good example might be a rusting ship moored in the harbour which is incurring storage fees and which is practically valueless.

For the disclaimer to be effective, a notice must be served by the liquidator on various government entities including Her Majesty's Receiver General, as well as any person interested in the property to be disclaimed and any person who may incur liability in respect of the disclaimed property.

There are protections in place for persons affected by any disclaimer in that they can force the liquidator to make a decision about whether to disclaim the property or contract or not, and they can also apply to the Court for relief including the vesting of the property in the interested party. The new legislation also makes it clear that any person who suffers loss as a result of the disclaimer would then rank as an unsecured creditor of the company.

Transactions at undervalue and exorbitant credit transactions

One of the more obvious gaps in recent Guernsey insolvency legislation has been the lack of a provision allowing a liquidator to claw back sums from third parties where assets or monies have been sold and/or diverted to them for no or little consideration. In recent years liquidators in Guernsey have had to rely on a customary law device known as a Pauline action (or *action paulienne*) which has its origins in Roman and Justinian law and which, in the UK, has legislative effect in section 423 of the Insolvency Act 1986 . This customary law principle, which allows a liquidator to reclaim assets which have been fraudulently transferred by a company to a third party in order to place assets beyond the reach of creditors, was confirmed in the Jersey case of *Re Esteem* JLR 53 (2002) and referred to in the Guernsey case of *Flightlease Holdings (Guernsey) Limited* (2005) by Lieutenant Bailiff Southwell as well as the Deputy Bailiff in Batty v Bourse GLR 54 [2017].

However, the new law has incorporated a section modelled on section 238 of the UK Insolvency Act 1986,which provides the Guernsey Court with the jurisdiction to make various orders against third parties where property has been transferred to them for no consideration, or for consideration which is considerably less than that provided by the third party.

There are three important criteria that must be met before the Court can take action:-

- The transaction must have occurred (looking backwards) within six months (or two years where the third party is connected to the company) of the company entering insolvency;

- The company must be insolvent at the time of the transaction or as a result of it; and
- The Court will not take action if the transaction at undervalue was entered into in good faith for the purposes of carrying on the business of the company and where there were reasonable grounds for believing the transaction would be of benefit to the company.

The Guernsey Court can make various orders including that property be returned to the company but cannot take action against a third party who had acted in good faith, paid full value and who had no knowledge of the circumstances giving rise to the action, except where these third parties were party to the transaction themselves.

It is worth noting that Pauline actions will still be useful to liquidators or administrators where the transactions lie outside the six month or 2 year period outlined above.

In relation to extortionate credit transactions, the provisions will apply to those transactions which occur within 3 years of the insolvency and which involve grossly exorbitant terms in relation to the provision of credit and/or grossly offends the principles of fair dealing. The Guernsey Court has the power to set aside the transactions and/or amend the terms of the provision of credit. As with transactions at undervalue these provisions are closely based on the UK Insolvency Act 1986 in this case section 244. There has been very little case law in the UK on the meaning of *"grossly exorbitant"* and "*grossly contravened ordinary principles of fair dealing*" although the leading academic texts suggest that the Courts will only impugn a credit transaction where it is grossly unfair and the transaction is one which no reasonable company, in normal circumstances, would agree to.

Further administrator powers- distributions to creditors, early dissolution and creditor meetings

One of the more useful changes to the law in relation to administrations has been the express power to make distributions to secured and preferred creditors without needing court approval. Previously there was some doubt as to whether an administrator could make a distribution to a secured creditor, despite the fact that the Guernsey Companies Law specifies that an administration order will have no effect on the rights of secured creditors. This ambiguity has now been cleared up and distributions can even be made to unsecured creditors with Court approval.

The new law also now allows a company in administration, where there are no assets to distribute to creditors, to go straight into dissolution without the need for an expensive interim liquidation. An administrator could presumably now distribute all the assets to the secured and preferred creditors and, if there are no assets left over for unsecured creditors, apply immediately to go into dissolution. This could avoid a considerable amount of costs.

A further protection for creditors has been introduced with the requirement for the administrators to send a notice to all creditors inviting them to a meeting and explaining the aims and likely process of the administration. This meeting has to be held within 10 weeks of the date of the administration order, unless the Court orders otherwise.

Winding up non-Guernsey companies

The power now exists (similar to section 221 of the UK Insolvency Act) to wind up non-Guernsey companies. According to the legislation, a foreign company can be wound up where:

- it has ceased to carry on business or is carrying on business only for the purpose of winding up its affairs;
- it is unable to pay its debts under section 407 of the Guernsey companies law;
- or the Court is of the opinion that it is just and equitable that the company should be wound up.

The case law in the UK (which is of persuasive authority in Guernsey) suggests that only foreign companies that have a "sufficient connection" to Guernsey will be wound up here, and due to the nature of the financial business in Guernsey, it is difficult to conceive of many circumstances in which that will not occur. Clearly, what a "sufficient connection" is will need to be defined and tested, and will undoubtedly depend on the facts of each case.

Supplies of gas, water, electricity and IT

This amendment again brings Guernsey into line with the UK in relation to the maintenance of essential services, and allows the Insolvency Committee to make rules preventing the provider of essential services, such as electricity and water, making it a condition of continued supply that the company in liquidation pay all previous invoices up front. However, these providers can ask that the liquidator or administrator personally guarantees payment of all future invoices post the commencement of the liquidation.

This strikes the balance of protecting these service providers in relation to future payments but stops them from threatening to withhold services unless all previous invoices are paid.

Duty to report delinquent officers of the company

A duty has now been imposed on both liquidators and administrators to make a 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. This report must be submitted within six months of the administrator or liquidator vacating office.

Conclusion

The new changes are to be welcomed and have shown that Guernsey is a modern progressive jurisdiction which is prepared to arm insolvency office holders with the necessary tools and powers to tackle, draw in and preserve the assets of an insolvent company for the benefit of creditors. Former directors can no longer refuse to provide documents or answer questions and third parties that hold diverted company assets can now be forced to return those assets. Administrations are also likely to be cheaper as administrators can now distribute assets to secured and preferential creditors and then place the company straight into dissolution if there no further assets to distribute and liquidators can now rid themselves of unwanted contracts and property. All of the above will likely save money and preserve assets for creditors, and is a welcome and substantive change which finally brings Guernsey into line with many other Commonwealth jurisdictions.

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