Company Insolvency in Guernsey and Comparisons with Jersey and the UK

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Additional Introduction

The billing for this talk is Désastre from the Guernsey perspective. Since, as I will go on to explain, the Guernsey perspective on Désastre is that it has little to do with the law of insolvency and is rarely used in any case of significance, this could be a very short talk. What I propose to do is to outline what Désastre is, and importantly what it is not, to a Guernsey lawyer, and then briefly set the scene as to the range of processes available in Guernsey that might properly be described as falling part of its law of insolvency, with a view to enabling you to compare the legal landscape in Guernsey with that in Jersey. In Guernsey, Désastre might more properly be seen as part of the law relating to the enforcement of Judgments. As I will go on to outline, insolvency law in Guernsey can be divided between the law relating to individuals which dates back to little used legislation enacted in 1929 and that relating to Guernsey companies which is found in a succession of company laws modelled on the 1862 English Act, most recently cumulating in our 2008 Law. We have no separate legislation dealing with the insolvency as Guernsey companies, and the Guernsey Court has no jurisdiction to wind up the affairs of a foreign corporation. Our statutory insolvency law by and large is drawn from English statutory concepts, both in relation to the insolvency of individuals and corporations.

The nominal title of my talk relates to the Guernsey perspective on Désastre. For reasons I will explain, from the perspective of an insolvency lawyer, it would be legitimate not to discuss Désastre at all. So whilst Guernsey customary law refers to a person, corporate or real, being "en état de déastre", Désastre does not, under Guernsey customary law, constitute a legal state such as liquidation or administration but is merely a speedy and efficient method of dealing with the proceeds of sale of a debtor's chattels.

Accordingly Désastre is not equivalent to bankruptcy or liquidation, there is no discharge from debts nor is any person appointed to administer the affairs of the Désastre as opposed to the administration of assets in the jurisdiction which need to be applied towards a judgement debt. Further, Désastre have no impact at all on the debtor's realty.

Accordingly, in order to explain why a Guernsey insolvency lawyer would not normally wish to spend much time discussing Désastre, it is necessary to give a brief outline of the process in order to explain what it is and, more importantly what it is not.

Désastre in Guernsey typically starts with the arrest of a judgement debtor's assets. HM Sheriff is authorised by the Act of Court drawn up after judgment to seize the goods of the judgment debtor in Guernsey. This has been taken to apply to all forms of personalty i.e. goods, cash and in some circumstances intangibles. Thereafter the judgment creditor brings a summons before the court seeking the confirmation of the arrest and leave to sell any goods or apply the proceeds of any bank accounts etc to discharge the judgment debt. The judgment debtor is a party to that proceeding and this is his last opportunity to avoid the sale of his goods if he can persuade the Court that there is some good reason why the judgment debtor should not get paid.

If HM Sheriff becomes aware that there are other creditors of the judgment debtor, he will report this to the Royal Court and if it appears that the assets arrested will be insufficient to satisfy all of the judgment debtor's debts in full the Désastre procedure will begin. It used to be thought that it was necessary for there to be competing judgment debts for the process to be triggered, but in 1983 the then Bailiff Sir Charles Frossard held that it was sufficient if HM Sheriff was aware of other non-judgement debts due by the judgement debtor.

If these circumstances exist the Royal Court will order the judgment debtor and his creditors to appear before a Jurat appointed to act as a Commissioner for the purpose of establishing their claims and any preferences. An initial meeting takes place before the Commissioner at which HM Sheriff certifies the amount that he has realised and the debtor is formally declared en Désastre. The Commissioner then fixes a date for the claims against the debtor to be marshalled. It is worth pointing out here that although there is no automatic publicity of the taking of the judgment against a debtor, other than that which may find its way into the Guernsey Press, the holding of the creditors meeting is published in the Gazette.

The debtor is summoned to the meeting, although rarely attends, and the meeting itself is normally rather informal with creditors invited to set out their claims and the commissioner inviting any objections. There are no disputes in relation to claims or preferences, the Commissioner will approve a dividend to be paid to the creditors. If disputes arise as to claims or preferences they are resolved by application to the Royal Court.

There is little by way of legislation dictating how the process proceeds. The question of the necessary publications are governed by Ordinance and the priority of claims is largely governed by statute. Legal costs have been held to have priority in accordance with the decision of the then Bailiff I referred to above and, the usual sorts of preferential debts that you would expect to see applied are set out in the Preferred Debts (Guernsey) Law, 1983, i.e there are certain preferences in favour of wages, salaries, holiday, Income Tax and Social Security contributions etc.

Once any dividend has been paid the Commissioner files a report with the Court, thereafter no further action is necessary.

Accordingly, the procedure can be seen as little more than a highly efficient method of dividing a judgment debtor's assets out amongst all of his creditors, thereby avoiding an ugly rush to judgment or worse execution.

The procedure is in practice applied as much to individuals as to companies, particularly small trading companies that have failed without leaving sufficient assets to merit a formal liquidation. The procedure works well in practice, although is largely dependent upon being administered by the leading judgment creditor or his advocates. It has generated little by way of case law in the last 30 years.

As I have already said, once the procedure terminates, it carries no further legal consequence for the judgment debtor (although there may be obvious commercial consequences as having fallen into the procedure) and if further assets are discovered, or further debts incurred, the procedure simply starts again.

<u>Declaration of Insolvency</u>

There is in fact one real legal consequence of being placed en Désastre, that is it enables a creditor to seek a declaration of insolvency. A debtor can also seek such a declaration whether en Désastre or not. This procedure dates back to legislation in 1929 which, although borrowing much from the terminology of

the customary law, is in fact closely modelled on the 1914 Bankruptcy Act. It has been very little used in Guernsey.

In brief, an application for a declaration of insolvency is adjourned to a creditors meeting before a Commissioner. Prior to the meeting, which is publicised, the debtor must prepare an inventory of his assets and he must appear at the meeting to answer questions.

The legislation contains very detailed provisions concerning the voting at the creditors meeting. Further, by way of comparison to the Désastre procedure, the legislation offers tools to the creditors committee to investigate the affairs of the debtor and there are also some anti avoidance provisions that apply in relation to transactions occurring three months before the date of the application for declaration of insolvency. Thus, once the period of investigation into the affairs of the debtor has completed, the Court will be asked to rule on the question of insolvency and, if so satisfied, the debtor is declared insolvent which carries with it a number of legal effects equivalent to bankruptcy such as the inability to engage in trade on his own account, obtain credit and so on.

The assets of the debtor are then liquidated in accordance with the Désastre principles.

However, a debtor can also seek the benefit of renunciation. This takes the form of an application to the Court against his creditors' committee and triggers a further investigation into his conduct and affairs to date. Renunciation itself can amount to a full discharge from payment of debts incurred before the application for a declaration of insolvency.

The legislation carves out certain debts from this discharge (e.g. certain Crown debts and debts arising out of fraud) and there are detailed provisions in the law that either limit the Court's ability to grant a discharge at all, or provide significant hurdles in respect thereof.

For example, no discharge can be granted at all if the debtor has been convicted of certain offences in connection with his insolvency and the legislation makes it difficult for a discharge to be granted if the realisation of the debtor's assets have produced a dividend less than 50p in the pound.

As I said, this procedure has hardly ever been used and so there is little experience to draw on as to how the Court would implement these provisions. This is surprising as the legislation is, for its time, a sophisticated code for dealing with the affairs of a debtor and contains some useful weapons such as information gathering powers and enhanced

procedures for realising the debtor's assets together with the imposition of a criminal code governing certain aspects of the procedure.

However, perception has been that the procedure is too cumbersome and costly to be useful. Perhaps in a small jurisdiction the differences in practice between the commercial effects of being en Désastre and the legal effects of a declaration of insolvency are marginal and the case simply has not arisen where enhanced regime of insolvency for an individual would have produced advantages to creditors that could not be obtained through some other process.

Corporate Insolvency

The law of corporate insolvency in Guernsey, with a few notable exceptions, takes its cue from UK insolvency statutes beginning with the Companies Act 1862 right through to the latest major iteration in the form of the Insolvency Act 1986 ("**the 86 Act**"). However, whilst the insolvency section of The Companies (Guernsey) Law 2008 (as amended) (**the "Companies Law"**), (section IV) contains provisions which are similar to those contained in the 86 Act, there are many provisions which are not replicated in the Guernsey legislation. Perhaps the best example of this is that the English Insolvency Act extends to some 444 sections and 14 appendices and is complimented by the Insolvency Rules 1986 which are the statutory instruments which accompany the act. By contrast, the Guernsey insolvency section in the Companies Law only has 72 sections and 1 appendix. It is axiomatic that many provisions are therefore missing from the Guernsey legislation and indeed there are no insolvency rules which, in the UK, have served a useful role in providing guidance on how the insolvency provisions work in practice.

Notwithstanding these apparent gaps in the Guernsey legislation, the Guernsey judiciary has in the past proved willing and able to assist parties involved in insolvency proceedings to obtain useful directions in the absence of any specific legislation. In providing these directions they have normally drawn on UK statutes and the common law. In a case called *Med Vinyards Limited* the Royal Court recognised that it had a "supervisory jurisdiction" over insolvencies which, in that case, enabled it to make orders compelling a former director of an insolvent company to answer questions from liquidators on compulsion, notwithstanding the absence of any express statutory power in respect thereof, such as section 236 of the 1986 Act.

Further, although the Court recognised in case called *Flightlease* (part of the failed Swissair Group) that the Royal Court would normally follow English common law concepts in order to deal with an insolvency (in that case following English case law in order to recognise the circumstances where the rule in *Cherry v Boultbee* might apply in an insolvency) the Court also recognised that this would not be exclusively so. In *Flightlease* the Court indicated that the Royal Court would be likely to follow English concepts of set-off within an insolvency, but not necessarily in a rigid way allowing some elbow room or flexibility to modify those rules in order to avoid injustice on a particular case.

To some practitioners the absence of detailed and specific insolvency rules in Guernsey can be a challenge, although we see it as an opportunity to be creative and flexible. So, for example, in another part of the *Flightlease* liquidation, the Court was persuaded to permit the liquidator to conduct the liquidation in US dollars, a situation that may have been more difficult to achieve under the then English Rules.

This paper seeks to compare and contrast both the various insolvency procedures available in Guernsey, Jersey and the UK and the powers to attack antecedent transactions in these jurisdictions. It is not intended to be an exhaustive study of the relevant insolvency procedures but more of an overview to facilitate an understanding of the different attitudes to insolvency in the UK and the Channel Islands.

There are three routes into formal corporate insolvency in Guernsey. These are:-

1. Administration;
2. Voluntary liquidation; and
3. Court ordered liquidation.

Each of these procedures applies only to a Guernsey Company.

1. Administration

The provisions in relation to administrations were introduced into the Companies Law in Guernsey in 2006. Administration is a product of the "rescue culture" and imposes a moratorium on a company to enable it to formulate proposals to help ensure its survival as a going concern or realise its assets more beneficially than would be the case in a liquidation. The difficulty with liquidation is that it is the beginning of the end of the life of the company and as such it is much more difficult to preserve any part of the business as any trading is

carried out for the beneficial winding up of the company. Administrations, on the other hand, allow a company to keep trading normally so that proposals can be made to creditors to try and save the company as a going concern.

The administration procedure was introduced in the UK in 1986 and was not very popular in the first seventeen years of its existence. The main problem was the perceived expense in making an application to Court. Banks generally tended to appoint administrative receivers further to loan agreements which did not require an application to be made to Court. Another reason for the limited enthusiasm for administrations was the use of a section 2.2 report which was an independent report on the company's affairs. Whilst these reports were not mandatory they were nearly always produced and were very detailed and consequently caused great expense and delay.

It is interesting to note which parts of the new administration procedures were cherry picked by Guernsey when they introduced administrations in 2008. Perhaps the most obvious omission is the lack of an out of Court procedure which has made the UK administrations so popular. As such the only method by which a member, creditor or director of a company can place a company into administration is to apply to the Court.

Section 376 1(b) of the Companies Law provides for the imposition of a moratorium on the commencement or continuance of proceedings against the company in administration. Interestingly there is a carve out section for secured creditors who can go ahead and enforce their rights regardless of the administration order. This is in contrast to UK legislation where, under Schedule B1 paragraph 43 (1), no step can be made to enforce any security where a company is in administration and this would include a secured creditor enforcing a charge over any property.

However, the moratorium in Guernsey is noteworthy as, unlike in the UK, there are no automatic moratoriums for a company in compulsory liquidation in Guernsey although in practice a liquidator will apply to the Court, under section 426, to seek an order from the court staying any proceedings brought against a company in liquidation. However, clearly the automatic moratorium which is available in administrations will be preferable to a company in negotiation with its creditors rather than being obliged to make an application to Court if a company is in liquidation.

It is noteworthy that Guernsey did not replicate the apparent mistakes of the early English legislation by burdening applications for administration with the need for an expensive report. In practice, applications for administration in Guernsey are accompanied by evidence of the target company's insolvency, or near insolvency, and evidence of the likelihood of achieving one or more of the statutory purposes. Such evidence tends to be in standard form, such applications are no more vexing than routine applications to place companies into liquidation. Further, the legislation does not prescribe at all how the administrators should conduct themselves during the period of administration, nor contain any provisions requiring sanction. The legislation contains a code dealing with the birth and death of the administration, but does not tell the administrators how they should or should not run the affairs of the estate in between.

2. Voluntary Liquidation

Again, not surprisingly voluntary liquidations in Guernsey are closely based on UK legislation. There are, however, some notable variations to the UK provisions. Under the 86 Act there two types of voluntary liquidation: members and creditors. In a members' winding up the Company must be solvent and indeed the directors must make a statutory declaration confirming the solvency of the company within a prescribed period of time. These types of liquidation are commonly used to restructure a company (under section 110 of the 86 Act) where the liquidator sells off the assets of the company to another related company in which the members of the former company hold shares or securities. In a creditors' voluntary liquidation the company is insolvent and both the members of the company and its creditors decide that it should be wound up. In these circumstances, the creditors will often appoint the liquidator who will consult with the liquidation committee. The major advantage to this type of liquidation is that it avoids the costs and expenses of making applications to Court. If there are no suspicious circumstances surrounding the failure of the company and consequently no need, for example, to examine the directors at Court or order them to produce documents then, a creditors' voluntary liquidation will be more appropriate than a Court ordered one.

In Guernsey the legislation governing voluntary liquidations makes no distinction between creditors and members' liquidations, the sections on voluntary liquidations are contained within Part XXII of the Companies Law from sections 391 to 405. There is no requirement that the company is solvent before a voluntary winding up is commenced in

Guernsey. However, if a creditor is not content with the voluntary winding up, he or she can always apply under either section 402 or 405 of the Companies Law for an order that voluntary liquidation be converted into a Court ordered one.

A voluntary liquidation is commenced by way of an ordinary resolution by the members (if provision is made for the voluntary winding up in the articles of association) or otherwise by a special resolution passed by the members of the company. It appears that the Guernsey legislation is loosely based on the sections on voluntary liquidations at Part IV of the UK Companies Act 1862. The main disadvantage appears to be that creditors have little oversight over a voluntary liquidation even where the assets of the company are less than its liabilities. However, as explained above, the creditors can apply for relief from the Court, and if necessary, can convert their liquidation into a Court ordered one.

This apparent lacuna in respect of creditors caused an issue in one case I was involved in where the liquidators of an insolvent company in voluntary liquidation sought assistance in the US Court. The application was resisted on the basis of the apparent lack of standing of creditors in the process in Guernsey. This is not the case as creditors can always seek directions from the Court, seek to remove the liquidator or convert the liquidation into a compulsory one. In practice liquidators fully involve creditors as you would expect and issues have not in practice arisen.

The position in Jersey appears to be quite different. The legislation at Part 21 of the Companies (Jersey) Law 1991 ("**the Jersey Companies Law**") is closely based on the UK legislation and provision is made for both a members and creditors voluntary winding up. In terms of a members' voluntary liquidation, similar to section 95 of the UK Act, the directors must make a statement of solvency in relation to the company (Article 146 (2) – (3) of the Jersey Company Law). This type of liquidation can only be used if the company is solvent, normally the company has been wound down as it is no longer conducting any business or a reconstruction is being effected. Jersey also has, under article 157 of the Jersey Companies Law, a creditors winding up procedure which is similar to the UK one (section 98). The liquidator (normally appointed by the creditors), obtains wide powers to deal with the company's property, albeit in some circumstances (such as paying a creditor in full) sanction must be obtained from either the Court or the liquidation committee before these powers are exercised. In Guernsey, there are no provisions for the constitution of a liquidation committee nor are there any

other detailed provisions regarding the scope of the liquidator's powers. It merely states at section 397 (1) (a) that the liquidators shall "*realise the company's assets and discharge the company's liabilities and having done so distribute any surplus amongst the members according to their entitlements".* Whilst no provision is made for the liquidator to apply to the Court to seek approval for any particular course of action prudence dictates that should the liquidator have any concerns about whether he should undertake any particular course of action he/she should make full disclosure to the Court and seek sanction.

3. Court Ordered Liquidations

Compulsory liquidations in Guernsey are governed by Part XXIII of the Companies Law and specifically sections 406 to 418. Once again they are closely modelled on UK legislation, albeit the relevant sections of the UK 86 Act and accompanying statutory instruments are much more extensive then those incorporated in the Guernsey law. The criteria under which an application can be made to the Court, in Guernsey, on compulsory winding up is almost identical to section 122 (1) of the 86 Act. In Guernsey these criteria are set out at section 406 of the Companies Law, the most important criteria being:- that the company is unable to pay its debts in accordance with the section 407, or that the Court is of the opinion that it just and equitable and the company should be wound up.

The meaning of "unable to pay debts", in section 407, includes the UK test i.e. if a statutory demand has been sent (section 407 (a) and (b)), or if it is proved, to the satisfaction of the Court, that a company fails to satisfy the "solvency test". The solvency test is defined at section 527 of the Companies Law and is based on section 123 of the UK Act. In essence it states the company is insolvent if it is unable to pay its debts as they become due or the value of the company's assets is "*less than the value of its liabilities*".

One point worth noting, that sets Guernsey liquidations apart from the UK and indeed Jersey insolvency procedures, is that there is no automatic statutory moratorium on proceedings that have been or are about to be brought against the company in liquidation as there is under section 130 (2) of the 86 Act. In Guernsey the liquidator must apply to the Court and seek for it to exercise its inherent jurisdiction to prevent any proceedings against the company either continuing or being commenced. In Jersey it would appear that under the Désastre Law, article 10 prevents actions, remedies or executions being brought against the debtor without the

consent of the Viscount (the Jersey equivalent of a liquidator).

The powers of the liquidator in a Court ordered winding up in Guernsey are set out at section 413 (4) of the Companies Law. The main provisions set out at section 413 (4) are to bring or defend actions in the name of and on behalf of the companies carry on the business of a company to the extent expedient for the beneficial winding up of the company, to make calls of capital, to sign all receipts other documents in the name of and on behalf of the company, and to do any other act relating to the winding up, and for these purposes to use the company seal where necessary, and to do any other act authorised by the Court. The wording appears to afford fairly broad powers to the liquidators to undertake any act *"relating to the winding up".* However, as mentioned in the section dealing with the voluntary winding up if the liquidator has any doubts about, for example, commencing or defending proceedings he/she should seek sanction from the Court. There are no provisions in our legislation requiring sanction from the Court or from the creditors.

<u>Challenging Transactions</u>

Guernsey's Company Law contains statutory provisions in relation to preferences broadly similar to the UK Insolvency Act. These provisions of course only apply to companies and, in relation to individuals, there are the more limited provisions I have referred to in the 1929 Act only if a Declaration of Insolvency is obtained. I understand that in Jersey there are preference provisions in both the Désastre Law and the Jersey Company Law that are also closely modelled on the UK position. One particular point to note in relation to Guernsey administrators is that they do not have the power to seek to set aside a preference, unlike the statutory position in England.

In England there are also detailed statutory provisions governing transactions at an undervalue in Section 238 of the 1986 Act. There also appears to a similar provision in Article 17 of the Désastre Law in Jersey. Surprisingly, there are no specific statutory provisions in Guernsey in the Companies Law, although there are some specific provisions that apply in relation to the granting of certain security interests, although their application is much more limited. There are also some relevant anti-avoidance provisions governing individuals in the 1929 Law, but only if a Declaration of Insolvency is granted.

There are of course certain customary law remedies available to a liquidator, specifically the Pauline Action. In Guernsey,

LB Southwell accepted this remedy to be available in Guernsey law (following the Jersey case of *Esteem*) in another case involving the liquidation of *Flightlease*.

Further, in any case involving breaches of fiduciary duty, a liquidator is likely to take advantage of some common law principles to set aside transactions based upon the principles enunciated in cases such as *Rolled Steel v British Steel [1986] Ch 246.*

Wrongful and Fraudulent Trading

Legislation has been enacted in Guernsey that is almost identical to the provisions for a wrongful trading in the 1986 Act. There are similar but not identical provisions in Jersey Law, although it seems that the objective element in the test is different as to the extent of the company's chances of avoiding winding up. Both islands have similar legislation in relation to fraudulent trading.