Ogier

Insolvency of Guernsey Companies

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Introduction

If a company is insolvent, it is either not able to pay its debts as they fall due, or its assets are less than its liabilities. In these circumstances a creditor and in some cases an investor will have the ability to put the company into a formal insolvency procedure and, in most cases, appoint an independent third party to take control of the assets and investigate the conduct of the company's directors, managers and other controlling functionaries. A unique aspect of Guernsey insolvency law is the ability of members to wind up their company by special resolution even when this company is insolvent.

This article has been written to take into account the legislative changes which will be enacted by the Companies (Guernsey) Law, 2008 (Insolvency) (Amendment) Ordinance, 2020 which will come into force during the course of 2020. The Ordinance is prospective, rather than retrospective, which means that it will apply to new insolvency procedures going forward rather than to ongoing procedures which were underway when the Ordinance came into force.

1. Procedures

Insolvency procedures in Guernsey in respect of companies vary depending on the legal structure of the company (i.e. whether it is a cellular or non-cellular company) and are summarised in brief below.

(A) ***Désastre:***

This is a collective court-driven procedure derived from the customary law of Guernsey which results, ultimately, and after a judgment is obtained against the debtor by the creditor in the distribution of the debtor's personal property amongst its creditors.

(B) Administration:

This court based statutory procedure (which applies to corporate structures only) provides protection from creditors and a breathing space for the company, whilst the company continues to trade and do business under the management and control of an administrator. The administrator is appointed by the Court which will only make an administration order if it is satisfied that the company is insolvent (either on the cash flow or balance sheet test) and that one of the two statutory purposes can be satisfied, namely either the survival of the company’s business as a going concern or a better realisation of assets than would be effected if the company was simply wound up.

Pursuant to the reforms put in place by the Ordinance, an administrator can make distributions to secured and preferred creditors (without needing court approval) and ordinary creditors with court approval. A company in administration can also now go straight into dissolution (without the need for an expensive interim liquidation) when there are no assets to distribute to creditors. From an investor’s point of view, if the company is insolvent but could continue to trade (and possibly become solvent) in order to maximise realisations to both creditors and investors, then administration may well be the most appropriate route to adopt.

(C) Winding up/Liquidation:

A voluntary or compulsory winding up (also known as liquidation) could take a number of forms depending on the legal structure of the company. A voluntary winding up can be prescribed by the company’s constitutional documents and the relevant legislation applicable to it. A compulsory winding up is a court-driven process that can be directly instigated by a creditor or other prescribed parties (such as a company director or member, a partner or general partner of a limited partnership, a trustee of a unit trust, or the GFSC) and may be related to the solvency of the company and/or its inability to pay debts as they fall due. A corporate structure can also be wound up on just and equitable grounds normally on the application of a shareholder. In all cases, a liquidator will be appointed to realise the assets of the company and distribute these to creditors after scrutiny from the main stakeholders (in a voluntary liquidation) or a Commissioner of the Court (in a compulsory winding up).

The company does not necessarily have to be insolvent in order for it to be wound up voluntarily by the shareholders, and accordingly, by definition, if it is solvent then there would be a return to members once the assets have been realised. Further to the recent legislative changes under the Ordinance, 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.

(D) Protected Cell Companies ("PCCs") and Incorporated Cell Companies ("ICCs"):

In respect of an ICC, winding up can be carried out in such a way as to not prejudice the affairs, business and property remaining of any of its remaining ICells, and accordingly, during the winding up, the ICells shall continue to carry on business to the extent necessary for the continuance of business of the ICC.

The liquidator of a PCC must ensure that the cellular assets are kept separate from those of the core assets, and must only apply those core assets in discharge of creditor claims in relation to the PCC and not the PCells.

In respect of PCCs, further relief may be sought through either a receivership order or a recourse agreement. A receivership order (an order in respect of a PCC directing that the business and cellular assets of or attributable to a particular cell be managed by a receiver) may be made if the Court is satisfied particular grounds are met (as set out in the Companies Law) including the cell's insolvency. The effect of a receivership order is to create a moratorium in respect of the cell, leaving the receiver to perform his functions which are similar to that of a liquidator.

A recourse agreement can be entered into by the PCC with a third party and it will provide that, pursuant to an arrangement effected by the company, its protected assets may be subject to a liability owed to that third party. The cellular assets attributable to the company may only be available to such creditors who are creditors in respect of a particular cell and such assets are protected from other creditors who are not creditors in respect of the same cell.

2. Distribution

The distribution process in a liquidation is relatively simple in Guernsey. In respect of secured debts, if a secured party has a valid security interest in accordance with Guernsey law without title to the collateral, to the extent the collateral is sufficient, it has priority to all other claims for the amount due to the secured party. If the secured party has title to the collateral, then it may realize or otherwise deal with the collateral notwithstanding the company's insolvency. Any debts which can be set off by an insolvent corporate company will also fall outside the insolvent estate.

From the unencumbered assets, the liquidator takes his costs and expenses and pays preferred creditors (employees up to £5,000 and landlords). The balance of the company will be distributed equally amongst the unsecured creditors of the company, and if there is anything remaining then these will be distributed either pari passu or in accordance with a stakeholder agreement, amongst the members/partners.

Where a Guernsey company has assets in other jurisdictions, the insolvency and security interest laws and regulations of those jurisdictions may impact on those assets.

3. Powers and Functions of Office Holders

A liquidator has the power to commence insolvency specific actions against third parties under the Companies Law for preferences (where the company has preferred a third party creditor over other creditors), misfeasance (where a director or former director has misapplied or misappropriated company funds, or where they have acted in breach of their fiduciary duty so as to cause loss to the company) and fraudulent and wrongful trading. Whilst administrators cannot bring the above actions they can (along with liquidators), further to the new insolvency amendments, bring an action seeking to set aside a transaction at undervalue in certain prescribed circumstances including where a company has transferred an asset to a third party for less than its full value and where there were no reasonable grounds for believing that the transaction would benefit the company. Both an administrator and a liquidator can now also apply to the court to set aside an exorbitant credit transaction which has occurred in the three years prior to insolvency and where credit was provided at grossly exorbitant rates and/or otherwise contravened the ordinary principles of fair dealing.

Wrongful trading is becoming more relevant in today's climate where directors may try to continue to trade ailing companies, but with the result that creditors suffer further losses. If the directors knew or ought to have known that the company could not avoid insolvent liquidation in those circumstances, then they are liable to contribute to the insolvent estate for the losses incurred. The directors' knowledge will be based on their own skills and experience. For example in the funds industry most company officers are professionals who act in this capacity frequently, and will therefore be deemed to have a high level of knowledge and skill. Whilst wrongful trading carries only civil liability, fraudulent trading, where a company is carried on with the intent to defraud creditors or for any other fraudulent purposes, carries both criminal and civil liabilities which a liquidator can prosecute. Liquidators also have the power to apply to court to seek disqualification of directors of the company although this is usually unnecessary for the performance of the liquidators' functions.

Both the liquidator and the administrator have the power to bring actions against third parties in the name of the company. Accordingly, if a third party has breached a contract or a duty owed to the company resulting in a loss to the company, then the office holder can commence proceedings in the name of the company against that third party. On that basis, for example, an administrator appointed by the Court could procure the company to sue a director of the company, or its manager or custodian, for negligence and breach of fiduciary duty.

A liquidator now has the power to release the company from unprofitable contracts as well as responsibility for property (including real property if located outside Guernsey) that cannot be easily sold or is likely to incur liabilities for the liquidator. This section of the law is almost identical to the law on disclaimers which apply to liquidations in the UK.

Furthermore creditors can now apply to wind-up foreign companies in Guernsey where certain criteria are met and where the company has a sufficient connection to Guernsey which will normally mean that the company has assets and/or a management office within the jurisdiction.

Under section 426 of the Companies Law, liquidators and administrators also have a general power to apply to the Court for directions on the performance of their functions. 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 last 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 apply to the Court to interview an officer or former officer of the company about its business and affairs, and his or her conduct or dealings in relation to the company. Similar to Administrators a liquidator can now demand that a director provide a statement of affairs setting out the company's assets and liabilities. Both liquidators and administrators have a duty to make a report to the Guernsey Financial Services Commission where they consider that there are grounds for making a disqualification order against a present or past officer of the company.

Further regulations are likely to come into force which will prevent the suppliers of essential services such as water, gas, electricity and internet services from demanding that arrears must be paid before the supply can continue although they will be permitted to require a personal guarantee from the administrator or liquidator before they continue with the supply of services.

Conclusions

The company investor has a number of options in relation to a Guernsey investment company which has been mis-managed and/or is insolvent. The ability to pursue the parties involved in the management or formation of a company, through civil or derivative actions, has been enhanced by the insolvency regime in Guernsey that enables office holders to maximise realisations for the benefit of all creditors and investors in that company.

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