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GUIDE

The enforcement of Guernsey security

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This guide sets out the procedure for enforcing Guernsey security interests taken under the Security Interests (Guernsey) Law, 1993 (the **Law**) and some of the main legal factors that should be considered when dealing with enforcement. This guide focuses on the enforcement of Guernsey security interests over shares in a Guernsey company or units in a Guernsey unit trust, though the principles discussed are generally equally applicable to other types of Guernsey security interest.

Why would a lender enforce the Guernsey security interest?

In most structures the relevant borrowings are generally secured not only by a charge over the underlying property, but also by a security interest over shares in the Guernsey company or units in the Guernsey unit trust that owns the property.

Enforcing a Guernsey security interest may enable the bank, lender, security trustee or other equivalent party (the **secured party**) to sell the property free of Stamp Duty Land Tax and thereby utilise the tax advantages for which the structure may have been originally designed. This may enable the secured party to obtain a higher price for the asset.

How is Guernsey security enforced?

Security is enforced by means of a statutory power of sale. The Law regulates when such power becomes exercisable, its means of exercise and the order in which the proceeds of sale must be applied.

The power of sale arises when an event of default (as defined in the relevant security agreement) occurs. The power of sale becomes exercisable following service of notice of the event of default by the secured party on the entity that granted the security (the **debtor**). The notice must specify the particular event of default, but it is not necessary to give the debtor any grace period to remedy it.

A court order is not needed to exercise the power of sale, unless the security agreement requires it (which is not standard practice).

Upon exercising a power of sale, the secured party must take reasonable steps to ensure the sale is made within a reasonable time and for a price corresponding to the open market value of the shares or units at the time of sale or, where there is no open market value, the best price reasonably obtainable.

In order to assist the secured party in enforcing its power of sale, it is common for the secured party to be provided with a power of attorney under the terms of the security agreement, and also for blank share transfer forms or unit transfer forms to be provided on grant of the security which the secured party can complete on enforcement.

The proceeds of the sale must be applied in the following order:

1. in payment of the costs and expenses of the sale;
2. in discharge of any prior security interest;

3. in discharge of the security interest of the secured party who exercised the power of sale (the secured party may then apply such monies in accordance with a payment waterfall contained in an intercreditor deed or similar);
4. in payment, in due order of priority, of security interests which rank after 3. above; and, finally
5. in payment to the debtor, or (in the case of the debtor being declared *en désastre* - a form of Guernsey bankruptcy) to the Sheriff, or to another insolvency officer (if applicable).

Does the secured party need to appoint a receiver or other officer?

No, the sale is conducted by the secured party.

Does the secured party owe any duties to the debtor in relation to a power of sale?

Upon exercising a power of sale, the secured party must take reasonable steps to ensure the sale is made within a reasonable time and for a price corresponding to the open market value of the shares or units at the time of sale or, where there is no open market value, the best price reasonably obtainable. No further guidance is given in the Law.

There is no relevant Guernsey case law on the duties owed by the secured party to the debtor in relation to a power of sale. Jersey case law (which is persuasive to but not binding on the Guernsey Royal Court) suggests that if the secured party fails to sell the collateral for an open market value (where available) the debtor may have an action against the secured party in relation to the shortfall. In addition, if a power of sale in relation to a principal debtor's security is exercised in a manner that is prejudicial to a guarantor debtor (eg the secured party selling the collateral at less than market value and thereby potentially increasing the liability of the guarantor), the guarantor debtor may similarly be able to bring an action against the secured party.

Can a secured party sell the collateral to itself, a nominee or subsidiary?

Yes, the Law confers upon a secured party a power of sale or appropriation. However, it is important for the secured party (or nominee or subsidiary) to ascribe an appropriate value to the shares or units it is acquiring on enforcement, which it is able to justify, and to pay any balance left after meeting the secured obligations to the debtor or as otherwise required by the Law.

Are there any practical restrictions on the enforcement of security?

The constitutional documents should be checked to ensure there are no restrictions on enforcing the security, eg restrictions on transfer of shares or units. In addition, if the company or unit trust conducts any regulated activities there may be regulatory change of control restrictions. Consideration should also be given as to whether the enforcement of security over shares will trigger a requirement to make a mandatory offer under Rule 9 of the Takeover Code (which will arise upon the exercise of a power of sale over 30 per cent or more of the voting shares in a company to which the Takeover Code applies).

Where security has been given over the shares in a Guernsey company under the Law and that company has subsequently been put into liquidation, the shares in such company can only be transferred with the consent of the liquidator (otherwise the transfer is void).

What happens if the debtor becomes insolvent?

The effect on security of a debtor becoming insolvent or declared *en désastre* or subject to another insolvency procedure (whether in Guernsey or elsewhere) depends on the method by which security was created.

If the security was granted by means of the secured party taking possession of the share certificates or unit certificates (similar to a pledge, and the most common method of creating security over shares and units), the Law provides that the amount due to the secured party must be paid in priority to all other claims.

If the security was granted by means of the secured party taking title to the shares or units, the debtor becoming insolvent or declared *en désastre* or subject to another insolvency procedure (whether in Guernsey or elsewhere) does not affect the power of the secured party to deal with the shares or units. If, however, the property of the debtor is declared *en désastre*, the creditor claiming under the *désastre* proceedings may apply to the Guernsey Royal Court for an order vesting the shares or units in him and

directing that they be sold by the Sheriff. The proceeds of such sale must be applied in the same order as if the sale had been conducted by the secured party.

Security agreements will sometimes enable a secured party to 'convert' security by possession referred to above into security by title in order to give them potentially greater protection in a default scenario.

Is there a register of security interests in Guernsey?

No, there is no register of security interests created under the Law in Guernsey.

Contacts

For further information, please get in touch with your usual Mourant contact or, alternatively, a list of contacts can be found here.

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