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Guernsey security enforcement and insolvency – trends and fundamentals

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Introduction

It seems like a week hasn't passed recently without some new global macro shock hitting our screens, resulting in the economic rollercoaster ride on which we find ourselves.

It is perhaps not surprising then, given that current economic climate, that as a jurisdiction we have seen an increasing number of enquiries around the enforcement of Guernsey security packages, including enquiries into the interplay between the Guernsey insolvency regime and Guernsey security enforcement, as secured lenders explore the various options available to them. The market's preference still seems to be to find consensual work-around solutions, but secured parties are certainly making preparations for alternatives.

We set out some headline points on Guernsey security enforcement, the Guernsey insolvency regime and the interaction between the two in the following sections of this Update.

Guernsey security enforcement

Security over Guernsey situate assets (shares in Guernsey companies, or Guernsey bank accounts, for example) are created under Guernsey law governed security interest agreements in accordance with the Security Interests (Guernsey) Law, 1993 (the Security Interests Law). The Security Interests Law provides for two enforcement powers available to a secured party – these are the power of sale and the power of application. These powers arise when an event of default occurs, and become exercisable by the secured party following service of a notice of that event of default on the grantor of the security.

Once the conditions for enforcement are in place, the power of sale allows a secured party to sell the assets secured under the security agreement to a third party and apply the proceeds from the sale to, amongst other things, repay the liabilities secured under the security agreement (the Secured Liabilities). In exercising a power of sale of the collateral, the secured party must then take reasonable steps to ensure the sale is made within a reasonable time and for a price corresponding to the open market value or, where there is no open market value, the best price reasonably obtainable. The Security Interests Law sets out the order in which the proceeds must be applied, with discharge of the security interest following only the payment of the costs and expenses of the sale.

The power of application is generally used where the secured assets cannot be sold in a straightforward manner to a third party (for example in the case of security over bank accounts). In this scenario, assuming all prior formalities are met, a power of application effectively involves the secured party 'selling' the secured assets to itself, to repay the Secured Liabilities. It is important in such circumstances for the secured party to ascribe an appropriate – and justifiable - value to the collateral, and to pay any balance left after meeting the Secured Liabilities to the grantor. By way of example, if a secured bank account contains £100, and the Secured Liabilities amount to £80, the secured party would on enforcement and exercise of its power of application apply £80 against the Secured Liabilities and return the balance of £20 to the account holder. The duties owed by a secured party in the exercise of a power of application, and the order in which the 'proceeds' must be applied, are the same as for the power of sale.

Guernsey's insolvency régime

Guernsey's insolvency regime comprises the traditional procedures of *désastre* (which applies to a debtor's personal, moveable Guernsey property) and *saisie* (which applies to a debtor's Guernsey real estate), and the more modern corporate procedures set out in the Companies (Guernsey) Law, 2008 (the Companies Law); primarily administration, voluntary liquidation and compulsory winding up.

Désastre and *saisie* are very rarely used in the corporate context, so we have not explored these procedures further in this note. However, do reach out if you are interested in learning more here.

Administration

A Guernsey company can be placed into administration where it is insolvent or likely to become insolvent (on a cash flow and balance sheet basis), and where it is likely that one or both of the purposes of administration may be achieved. Those purposes are:

1. the survival of the company as a going concern; or
2. a more advantageous realisation of assets than would be achieved on a winding up.

Administration is therefore intended to be a temporary process, affording a company breathing space to maximise realisation and / or save the company from a winding up.

Administration orders are made by the Guernsey courts, and once granted a moratorium applies, during which no proceedings can be started or continued against the company.

There is no set process for the conduct of an administration and no time limit on the length of the administration order. As a result legal advice is recommended to input into the content of an administration application, to ensure an appropriate administration order is made by the courts.

Liquidation

There are two routes to wind up a Guernsey company. Briefly, these consist of:

1. A voluntary liquidation:
    1.1. The members of a Guernsey company may pass a resolution for voluntary liquidation - this can be achieved even if the relevant company is insolvent.
    1.2. A liquidator is then appointed whose role is to realise the company's assets and discharge its liabilities, and distribute any remaining assets to members.
2. A compulsory liquidation:
    2.1. An application for compulsory liquidation may be made to the Guernsey court by a creditor (for example a security agent on behalf of facility lenders) if the company is 'unable to pay its debts as they fall due'.
    2.2. The court would then appoint a third party liquidator, who would take control of the company's affairs, with the directors no longer having any power to run the company. The company would cease conducting any business other than as necessary for the beneficial winding up.
    2.3. After certain formalities have been undertaken and the liquidator has realised the company's assets, a commissioner would be appointed to distribute the company's assets according to a prescribed creditor-friendly statutory formula.

Schemes of arrangement

The Companies Law also provides for restructurings of Guernsey companies by way of scheme of arrangement, substantially similar to schemes under English law. A scheme may be commenced by a creditor, but must have the relevant company's support.

Administration and liquidation are the more common procedures in Guernsey insolvency context and so we have not set out the full details of the scheme process in this note.

Guernsey security enforcement in an insolvency scenario

In the current climate, it is likely that a number of grantors will not only be in default on a specific financing arrangement (with the related security therefore being enforceable), but may also be vulnerable to

insolvency proceedings. We set out some examples of how a Guernsey insolvency proceeding may interplay with the enforcement of security below.

Administration

As noted above, when a Guernsey company is placed into administration a moratorium applies, during which no proceedings can be started or continued against the company. However, the moratorium does not affect the rights of a secured party to enforce their security interests – the secured party could therefore take enforcement steps notwithstanding that the relevant company was in administration. In addition, any assets the subject of a security interest would not form part of the pot of assets available to the administrator in exercise of its functions.

In the event that a Guernsey company is insolvent and the secured party is the only creditor (or only material creditor), this presents an interesting dynamic – a secured party could approach the administrator and give consent to the administrator to deal with the secured assets. The administrator would then deal with the assets as if they were unsecured, realising them and distributing the proceeds according to a creditor-friendly statutory formula. From a secured party perspective, this could be a more cost-effective and less involved option than enforcing against the secured assets themselves and could help limit the disruptions and challenges a secured party may face from a debtor if they sought to enforce.

Liquidation

Considering the interaction between voluntary and compulsory liquidation of a Guernsey debtor and existing Guernsey security, liquidation proceedings will generally not affect the power of a secured party to deal with the secured collateral.

Schemes of arrangement

The interaction between schemes of arrangement in relation to a Guernsey debtor and existing Guernsey security will need to be gauged on a case by case basis as each scheme has separate characteristics.

Conclusion

Given the challenging market conditions, more borrowers and lenders are exploring downside scenarios for their businesses – Mourant has expertise in-depth on Guernsey security enforcement and insolvency matters and we would be happy to assist with any queries you might have here.

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