

● A CREDITORS' GUIDE TO GUERNSEY INSOLVENCY

One of the more unfortunate things businesses have to contemplate these days is the prospect of clients not paying their bills. In many cases this can mean the creditor itself is in danger of being insolvent and can place pressure on longstanding business and personal relationships.

In this guide we hope to give our readers a refresher course on Guernsey's insolvency laws in the hope that they will be in a better equipped when one of their clients 'goes under' and that by the time they come to seek help - from Collas Crill, we hope - things have not got out of hand.

INSOLVENCY 101

Who's your debtor?

First, it is important to note that both individuals (i.e. natural persons) and companies can be made insolvent and are subject to Guernsey's insolvency laws, although some procedures differ between them. We will set out some of the key differences in this update. The first lesson to be learned though is that the procedure that applies will depend on who the debtor actually is – so it is important to know, when you supply your widgets to the widget shop on the high street, who you are actually contracting with. Is it Bill's Widgets Limited, Bill himself or something or someone else entirely? What do you know about the assets of each of them before you unload your widgets? While the many ways in which businesses can try to protect themselves from bad debts could be the topic of an entire paper, a little bit of 'due diligence' about the person or entity you are contracting with, and their financial status, can save you time and money in the long run.

Are they insolvent?

While there are various definitions of 'insolvent' used around the world (and even in different parts of Guernsey law), in

common parlance, a person or company is insolvent when they "are not able to pay their debts as and when they fall due". This is known as 'cash flow insolvent'. The other common test is where the debtor has "an excess of liabilities over assets". This is known as 'balance sheet insolvent'.

To illustrate the difference between these two tests, consider a customer who tells you that he cannot pay your account right away, but has some money coming in and will pay you in a few weeks, so you do not take action right away. However, a few months later, having become officially insolvent and having had his assets sold off, there's not enough to go around between you and all his other creditors. While the balance sheet test is what most people would consider as insolvent, the cash flow test is a good early warning of true insolvency. Additionally, many new, generally smaller businesses operate permanently (at least in the start up period) in a state of 'balance sheet' insolvency being heavily reliant on loans, rather than capital contributions, from their directors. As discussed below, Guernsey's corporate insolvency law combines these concepts.

How does the law help the creditors?

The broad object of most insolvency laws is to ensure an orderly realisation and distribution of the debtor's assets. This is to ensure, so far as is possible, that:

- the debtor's assets are removed from their control and preserved for creditors;
- there is no 'fire sale' of remaining assets and thus the most money is raised to put in the pool for distribution to creditors; and
- this pool is divided up evenly among creditors, with no one creditor gaining more than their fair share by, say, getting in early or taking advantage of a close relationship with the debtor.

While simple in concept, the rules that have been developed by Courts and legislators to regulate this process, particularly in the field of corporate insolvency, are notoriously complex. Partly, this is because there are so many disparate interests to make provision for, including secured creditors, preferential creditors such as employees, and ordinary trade creditors. The difficulty is that all of these people are 'innocent' victims in circumstances where, by definition, there is not enough money to go around. One other important feature of insolvency law is the procedure that allows certain payments made to creditors before the debtor was officially declared insolvent to be pulled back as 'preferences' in order to ensure that those creditors do not get an unfair advantage over others.

GUERNSEY INSOLVENCY

Guernsey has several different types of insolvency procedures available to creditors. Which procedure you should use will depend on a number of fixed factors, such as whether your debtor is a company or an individual, and a number of variable factors, such as the nature, quantity and location of the debtor's assets, or the commercial pressures faced by you, the creditor, to achieve a particular outcome.

Guernsey insolvency can be most usefully categorised by drawing a distinction between:

- the traditional procedures of Désastre and Saisie; and
- the more modern corporate insolvency, as provided for in The Companies (Guernsey) Law, 2008, and the (relatively) modern procedure of renunciation, concerning personal insolvency, as provided for in the Law Relating to Debtors and Renunciation, 1929.

Désastre and Saisie

The key distinction between a Désastre and a Saisie is that a Désastre is concerned with a debtor's personal property, or moveable goods, rather than the debtor's real estate, which is the subject of a Saisie.

Before commencing either set of proceedings it is necessary to first obtain judgment from the Court against the debtor in the amount of the debt. While it is not necessary to do so in order to participate in a Désastre or Saisie that has been commenced by someone else, you need to do this in order to commence your own proceedings. In many cases where the debtor is insolvent and there is no real dispute in the amount of the debt, this initial judgment might be obtained by 'default', meaning the debtor has not come to Court to defend the claim.

After judgment for the debt has been obtained, the arresting creditor (as the person who commences these types of proceedings is known) must decide whether or not to go via the Désastre or Saisie paths (or both). This decision is critical, as will become apparent when we compare the process and effect of each option (saisie).

Désastre

If a Désastre is chosen, the arresting creditor first applies to the Court for an order that the judgment be executed against the debtor's personal property and then delivers a copy of the order to HM Sheriff.

HM Sheriff will then make investigations of the debtor's assets and arrest those assets up to the value of the arresting creditor's debt. After securing the permission of the Court, HM Sheriff sells the assets by public auction.

While this may be the end of the matter with the proceeds ordered to be paid to the arresting creditor, usually further claims will be notified to HM Sheriff during the investigation and auction period which will, in most cases, result in more claims than can be satisfied from the proceeds of sale. If this is the case, the core process of Désastre begins.

The Désastre process involves the appointment of a Jurat (called a 'Commissioner' in this role) to convene a meeting of creditors, the details of which are published in the Official Gazette, at which the Commissioner will 'marshal' claims against the debtor. The meeting is presided over by the Commissioner, but in practice is conducted by the arresting creditor's Advocate. At the meeting, attending creditors are invited to make their claims against the debtor and establish an entitlement to any priorities over other creditors. The debtor is also summoned to appear, but rarely attends in practice. At the conclusion of the meeting the Commissioner will prepare a report declaring dividends for each creditor, taking account of the various amounts and priorities of each creditor's proven claims.

The order of priority in Désastre is as follows:

- the fees and costs of the Désastre itself, such as HM Sheriff's costs, take highest priority;
- the costs (but not the claims) of the arresting creditor in pursuing the Désastre are accorded second highest priority;
- next come secured creditors with a registered security interest under the The Security Interest (Guernsey) Law, 1993. Other secured creditors who are in possession of the secured goods may simply sell the goods to discharge their security, which do not form part of the debtor's estate in Désastre. However 'secured' creditors who are not in possession, and who do not have a registered interest, are considered unsecured.
- The final category of priority claims is in respect of preferred debts which includes debts owed to landlords in relation to rent, claims of employees for unpaid wages and certain benefits, debts owed to the States in respect of taxes and social security payments withheld by an employer.

Set off of mutual claims (where the creditor also owes some money to the debtor but less than the debtor owes the creditor) is also available in Désastre. This in effect gives the creditor a preference (which they are allowed to keep) for the amount set off. Otherwise, all other creditors will rank equally as unsecured.

Notably, Désastre does not extinguish creditors' claims against the debtor to the extent that those claims remain unpaid. There is therefore nothing to stop a creditor claiming in a subsequent Désastre should further personal property be discovered, or initiating a Saisie in respect of the debtor's real estate, for any unpaid amounts. However creditors should be aware that any future claim may be prescribed (or out of time), if they wait too long.

Saisie

Saisie entails a process of realisation and distribution of the debtor's real estate which is conceptually similar, but in some crucial respects very different. After obtaining judgment against the debtor, an arresting creditor electing Saisie will:

- Obtain a preliminary vesting order, or PVO, over the debtor's real estate. The effect of the PVO is not to give title over the debtor's real estate to the arresting creditor, but to give them certain rights in relation to the property including the power to evict people living on the property, or collect rent from tenants. This order can be sought either as part of the initial judgment for the debt or at some later time;
- Next, obtain an interim vesting order (IVO), which takes the debtor's property away from him and transfers it to the arresting creditor, who holds the property (and any rents or profits derived from it) on trust for all potential claimants against that property.

- Once the IVO is obtained, the arresting creditor calls for claims against the debtor's property. The register of claims is maintained by the Greffe. When the claims registration period has expired, a Commissioner is appointed to prepare a draft report detailing the claims of creditors and their respective priorities. He will then 'marshal' the claimants to prove their debts before him or her at an appointed time.
- Finally, the Royal Court is asked by the Commissioner to make a final vesting order. This hearing is typically dramatic, as the Court asks each creditor in turn, starting with those having the lowest priority claims, whether they wish to either:
 - i take the real property of the debtor, on condition that they repay **all** higher priority creditors in **full**; or
 - ii renounce their claim against the debtor.

Critically, once the creditor takes this first step down the Saisie path (as arresting creditor obtaining the PVO, or as a participating creditor, registering his claim with the Greffe), his claim becomes tied to the real property of the debtor. Unlike Désastre, the debt is extinguished and no future claims against the debtor (including a Désastre) can be made in respect of the debt. Accordingly, before doing so it is crucial to know:

- that the debtor has sufficient real property to satisfy, or provide a commercially acceptable return to the creditor,
- what other creditors might be out there, and what their claims or entitlements are in relation to the debtor's property compared to your own.

Finally, it should be noted that neither Saisie nor Désastre have any punitive consequences for, or adverse professional impact upon, the debtor. Although no doubt there will be a financial impact of the loss of his assets and invariably some reputational damage. In this regard, Saisie and Désastre can be contrasted

with company insolvencies, which can lead to sanctions on the directors of the company, and renunciation, which is similar in effect to UK personal insolvency laws.

COMPANIES LAW INSOLVENCY

Parts XXI - XXIV of The Companies (Guernsey) Law, 2008 constitute Guernsey's modern corporate insolvency law. In many respects, the Guernsey provisions are similar to the corporate insolvency regime in the UK. The Companies Law has two different forms of corporate insolvency procedures:

- administration; and
- compulsory liquidation.

Administration

Administration is a relatively modern introduction to insolvency law generally, and a brand new concept to Guernsey insolvency which was introduced pursuant to the 2008 revision of The Companies Law. The **purpose of administration** is to create a temporary 'safe haven' for the company and its directors in order to enable:

- the Company to trade out of its difficulties and survive as a going concern; or
- the Court to achieve a better result than might otherwise be achieved in a liquidation of the company.

The interests of present and future creditors are protected during this period by the appointment of an administrator (who will almost always be a qualified and very experienced accountant) who takes control of the company's affairs. The administrator has wide powers to operate the company's businesses, request information from relevant people in relation to the affairs of the business, and deal with the Company's debtors and creditors, including making any compromise or arrangement with respect to debts and claims.

In order to give the company and the administrator the 'breathing room' to do his job, there is a moratorium on most claims against the company during this period. This means that Court proceedings cannot

be commenced or continued against the Company without the leave of the Court (or the consent of the administrator) to do so, except for claims of registered secured creditors.

The Royal Court can order a company into administration (usually on the application of the Company or its directors but a number of other people, including creditors, can apply) where the Court is satisfied that:

- the company doesn't pass the **solvency test**, which in this case is a three limbed test (failing one means you fail the test) to determine whether the company:
 - i is able to pay its debts as and when they fall due (cash flow test);
 - ii has more assets than liabilities (balance sheet test); and
 - iii in the case of a company which is supervised by the GFSC, complies with all its regulatory financial adequacy requirements; and
- one of the **purposes of administration** is likely to be achieved.

The ability to achieve one or other of these purposes is central to the administration process. The Court will only grant an administration order for a specified period of time, and while this time may be extended, the Court will only do so where one or both of the prescribed purposes might still be achieved. The administrator must come back to Court to bring the administration to an end if neither is possible.

The key advantage of the administration process is its flexibility. There are no formal rules or requirements for reporting, and the general procedures for handling claims and distributing assets that apply in liquidation do not necessarily have to be followed. This enables Court, the administrator, and creditors themselves, to design and conduct each administration in a way that ensures the best chance of a positive outcome for creditors as a whole in the circumstances of each company. In other jurisdictions the administration process has been the vehicle

for some very inventive solutions to the problem of not having enough money to go around.

For example, it may be in some creditors' interests to see the company continue trading (such as where the insolvent company is an important retail distribution channel for a product). In this case affected creditors might elect to compromise their claim for a lesser amount in return for a percentage of future profits. In other cases, the Company might be engaged in a major court case. Under the control of an independent person, it may be more likely for the case to be settled commercially, generating or freeing up assets to allow the company to continue trading. Alternatively, the present management of the company may simply be incompetent. With a professional manager, and the breathing space of the moratorium, the company may be simply able to trade out of its problems.

Liquidation

A company can enter liquidation voluntarily or, as is more usual within the insolvency context, compulsorily pursuant to an order of the Court. The Court may order a company into liquidation when it is 'unable to pay its debts'. A company is considered unable to do so when either:

- A creditor has served a written demand for payment of a sum exceeding £750 and the company does not pay for 21 days; or
- It is proved to the satisfaction of the Court that the company fails to satisfy the **solvency test**.

The difference between these two options is in the level of proof that is needed to satisfy the Court that the company is insolvent. Under the first option, all the creditor needs to do is prove that a qualifying debt is owed and that the statutory notices have been duly served on the company. There is no need, as there is under the second limb, of conducting any further enquiry into the financial affairs of the company. Accordingly, in most instances, creditors will apply for winding up via the written demand route.

However there are a number of other grounds upon which the Royal Court may order that a company go into liquidation, other than insolvency. Generally these grounds relate to various failures of the company to properly function as a company, includes things like failing to have any members, suspending its business for a year, or failing to hold meetings required under The Companies Law. Notably, the Court can also order a company into liquidation where it is 'just and equitable' to do so and where (only on the application of the GFSC) winding up the company would be in the best interest of the public or to uphold the reputation of the Bailiwick. These 'other' grounds may be relied on, where available, in addition to insolvency.

The compulsory liquidation process is similar to administration in that an independent person, the liquidator, takes control of the company's affairs and has all the necessary powers to do so. Liquidation is a more clearly defined process though, that is not designed to save the company, but to investigate and wind up its affairs in an orderly manner. Accordingly:

- any payments to creditors within a certain period of the start of the winding up can be 'clawed back' as preference payments, in certain circumstances;
- the liquidator can take action against the directors as a result of breach of duty or other misfeasance to recover funds or property of the company;
- the liquidator is required to present a report to the Court once the assets of the company have been realised. A Commissioner (again, a Jurat) will then be appointed to examine his accounts and make any appropriate distributions to creditors;
- the assets of the company are distributed equally amongst the company's creditors, subject to certain priority claims being recognised. These priorities are generally similar to those recognised in a Desastré (as discussed above at paragraph 15).

- when the assets of the company are distributed the company is then dissolved.

In addition to being liable to an action to return property of the company, liquidation has other serious consequences for directors of the company. For example, the director of an insolvent company in liquidation may:

- be liable for wrongful trading where the company traded at a time the director was aware that the company was balance sheet insolvent; or
- risk having a disqualification order made against him preventing him from being a director, or otherwise being involved in the management or affairs of a company.

RENUNCIATION

Finally, it is important to remember that Guernsey still has Renunciation available, this jurisdiction's near equivalent to personal bankruptcy in the UK. While this process is little used, it may be summarised as follows:

- The action can be commenced by the debtor themselves, or where they are already in Desastré, by a creditor;
- A Jurat is appointed Commissioner, and a committee of creditors is formed;
- A meeting of creditors is convened at which the debtor must answer questions from creditors;
- The debtor must undertake not to leave the Island without leave of the Court;
- Preference payments within three months prior to the date of insolvency can be recovered;
- The Court can grant renunciation, or forgiveness of debts, immediately and unconditionally, or at some future time and/or subject to conditions.
- Prior to having been granted renunciation, the debtor is unable to engage in any trade or business on his own account, or obtain credit.

SO, I'M CONCERNED ABOUT ONE OF MY CLIENTS, WHAT SHOULD I DO?

First, speak to an Advocate as soon as you think this might be more than just a customer being difficult. As mentioned above, certain things that happen in the very early stages of the insolvency process can have a permanent effect on your rights and expectations of recovery. When you speak to your Advocate he or she will probably have some questions, which you should be prepared for before your meeting, for example:

Who is the true debtor?

As we said at the very beginning, it is important to know who it is that owes you money in order to determine what options are available. The best source of this information is a written contract showing the names of each party (it is just as important to know who the true creditor is!). If you don't have a written contract, other documents like invoices, receipts, bank records or letters will be useful. If your debtor is an individual, in practice your options will be either Désastre or Saisie. If it is a company, you have a range of options available.

Do you know what assets are available?

Do you have security over those assets? If there is significant real estate involved, it may be that Saisie is an option, particularly if it is likely that you will be the highest ranking creditor. This process is relatively quick and inexpensive, unlike the corporate insolvency process that can be expensive and take some time to result in a dividend being paid. On the other hand, where there is any amount of valuable personal assets, Désastre might be the best initial option, and you always have the ability to look to the property in due course.

Where are the assets located?

Désastre and Saisie only are effective in relation the property located on Guernsey (and Alderney), however under The Companies Law, the Royal Court can make a formal request to some other Courts within the British Isles to assist them in the administration or winding up of a company, in order to access assets in those other jurisdictions.

Where the debtor's assets are located outside the UK, the ability of Guernsey insolvency procedures to access those assets will depend on the jurisdiction where the assets are based. There are general international legal principles which suggest that Courts should respect and assist Courts of other countries. These principles have been relied on to assist in an insolvency context, although their application in any given case is far from certain and will depend on the views previously taken by the Court of the foreign jurisdiction. In addition, a number of countries have enacted a UN promoted 'model law' which gives express recognition to foreign insolvency proceedings. Where the assets are located in one of these jurisdictions it is much more likely that Guernsey insolvency proceedings will be able to access those assets

Do you have any concerns about the conduct of the person/company?

If the debtor is a company and you suspect that the directors have been engaged in fraud or misconduct such as hiding assets or making preference payments to associates at the expense of creditors, it may be that an administrator or liquidator can investigate or take proceedings in order to recover funds for distribution to creditors. Renunciation may provide a similar avenue of recovery if the debtor is an individual.

Do you know why the debtor can't pay?

If there is a specific reason why a corporate debtor cannot pay, it may be that the appointment of administrator will enable the company to trade out of its difficulties and mean that the creditors do not lose what may otherwise be a valuable customer or supplier.

Does the corporate debtor still have something valuable to offer creditors?

Similarly, if the debtor owns something more valuable to you or another creditor than what it could otherwise be sold on the market for, such as a brand name, a licence, or the expertise of its employees, it may be possible to use the flexibility of the administration procedure to realise the value of that asset.

Is the debtor hopelessly insolvent?

While the creditor who institutes any of the above insolvency procedures has priority for the costs of bringing the action, if there are no assets available to satisfy even these costs (and the costs of any official appointed to administer the insolvency), the creditor will be further out of pocket. At the end of the day, you do not want to be throwing good money after bad.

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