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Cross-border recognition of equitable liens?

JULY 2019

Collas Crill LLP recently represented Joint Liquidators who applied to the Royal Court for directions in respect of a class of claims made in the liquidation of a company. It was the first time that the Royal Court considered whether English equitable security interests would be recognised under Guernsey law in the context of the liquidation of a company. The Court found that the English equitable lien would not be recognised as a security in Guernsey and the creditors may rank as an unsecured creditor when the liquidators adjudicated on their claims. This is a reminder that lenders and other creditors should be giving consideration to what security they have and how it may be enforceable in another jurisdiction.

Background

Conqueror Holdings Limited (**the Company**) was formed in 2014 as a special purpose vehicle to acquire land with attached planning permission to construct a 50 room hotel in Greenwich ("**the Development**").

The Development was funded by a mixture of secured loan notes and the sale of long leases to individual rooms to private investors (**the Room Buyers**). Whilst the Room Buyers had paid a deposit and made progress payments, no leases would be created until practical completion had been achieved.

In late 2016 it became apparent that the Company would not be able to complete the Development and in February 2017 the Company was placed into Administration. At this point the construction had not reached Practical Completion.

The Administrators then proceeded to sell the Development and discharge the loan notes, and in March 2018 the Company was placed into liquidation.

In adjudicating Room Buyers' claims, the Joint Liquidators were required to consider the construction of the English law standard form contract, pursuant to which they invested. However, there were two issues.

First, the termination clause was drafted poorly. Amongst a number of glaring problems with syntax, was a potential construction to the effect that if the Company terminated as a result of its *own* insolvency, Room Buyers' funds were forfeited, leaving them without even a claim as unsecured creditors. The Bailiff accepted the English legal advice that the courts of England and Wales would interpret the clause in favour of the Room Buyers and not allow the deposit to be forfeited because of the Company's insolvency.

Second, there was a more fundamental question of what priority should be accorded to Room Buyers, assuming they were creditors at all. This issue arose out of the English first instance decision in *Eason v Wong [2017] EWHC 209 (Ch)*, which was handed down around the time the Administrators were completing on the sale of the Development. This decision was to the effect that persons in the position of the Room Buyers may

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acquire an equitable lien, a form of security interest, based on the theory that the funds paid were for the acquisition of property, notwithstanding that no property interest had been created.

In consideration of the Joint Liquidators' application for directions, the Royal Court, inter alia, addressed the following issues:

- Did the Room Buyers have any ownership rights in respect of the proceeds of sale or any beneficial rights in the proceeds of sale?
- If not, does Guernsey law recognise the Room Buyers as having an equitable lien over the proceeds of sale?
- Do the Room Buyers have any priority over other unsecured creditors in the distribution of the proceeds of sale?

In resolving these questions, the Court was assisted by a representative respondent acting on behalf of the Room Buyers, together with English and Guernsey law opinions produced by Counsel for the Joint Liquidators and the Room Buyers.

Did the Room Buyers have any ownership rights in respect of the proceeds of sale or any beneficial rights in the proceeds of sale?

English Counsel agreed, and the Bailiff accepted, that an English law equitable lien did not create a beneficial interest in the proceeds of sale of the Development. The Bailiff was also satisfied that the position did not change when the net proceeds were deposited in a bank account in Guernsey. In particular, the Bailiff considered that no Guernsey trust came into existence.

Does Guernsey law recognise the Room Buyers as having an equitable lien over the proceeds of sale?

The Bailiff concluded that Guernsey law would not recognise any equitable lien of the proceeds of sale. He was not aware of any instance under the customary law where the Guernsey Court has imposed or recognised an equitable charge. As there had been statutory intervention with the enactment of legislation, the *Security Interests (Guernsey) Law 1993*, it was difficult to see any scope for further development of the customary law in this area. In reaching this conclusion, the Bailiff considered an opinion from Advocate Ian Kirk, and an authoritative article by Advocate Nigel Carey, *Security Interests in Personalty under Guernsey Law*.

Do the Room Buyers have any priority over other unsecured creditors in the distribution of the proceeds of sale?

The Bailiff found that he was required to look no further than the statutory waterfall, set out at section 419 of the Companies Law, to answer this question. Relevantly, that section provides that priority is derived from the relevant sections of the *Preferred Debts (Guernsey) Law 1983* which in turn refers to the *Security Interests (Guernsey) Law 1993*.

In this case, as the equitable liens arose by operation of English common law, there were no written security agreements, therefore, no security interest within the meaning of the Security Interest Law had been created.

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The Court found that Guernsey law does not offer any remedy which would give the creditors a secured interest or priority over other unsecured creditors in the distribution of the Company's assets.

Conclusion

The case is interesting because it is the first time that the Royal Court has considered whether an equitable lien giving security in another jurisdiction would be enforceable in the liquidation of a company in Guernsey. Lenders and investors should be mindful of how any security interests they have the benefit of might be enforced against assets in another jurisdiction.

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