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Complex and Commercial Fraud Including Bankruptcy and Insolvency Issues

Creditors Rights and Remedies in Guernsey, Channel Islands

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Abstract

In this article, John Greenfield, Consultant, David Jones, Partner, and Steven Balmer, Associate, of the firm Carey Olsen examine innovative mechanisms by which creditors may seek to investigate secure assets held in Guernsey structures. In the second part of the article, the authors look particularly at companies and how the traditional insolvency regimes may be employed in aid of creditors but also at how the use of share security may unlock certain doors. However, in the offshore world it is often the case that the creditor is required to do some "trust busting" because the structure to be enforced against will involve a trust holding ownership/control of a holding company which in turn will control and own underlying companies/assets. The paper starts, therefore, with a real life example of how innovative advice helped protect creditors in such a structure.

1. Receivership Orders as an aid in asset recovery against trust assets

The problem to be resolved here is that the Guernsey trust is a legal entity in its own right and the shares of any company or other asset in the trust will be owned legally by the trustee. It is first essential to understand where the creditor fits in with what can be a complex structure and in particular with what parts of that structure has the creditor a legal relationship to enable it to enforce payment of the debt. More often than not, the debtor will be the settlor and/or the principal beneficiary of the trust and not the trustee. This creates a problem for the creditor who may not have a direct relationship – contractual or otherwise – with the trustee which actually is the owner of the assets to be recovered.

In this situation, Guernsey law has a common law remedy (very similar to the statutory regime in the United Kingdom) which will come to the rescue, providing the necessary circumstances exist. Essentially, it is necessary that the trust funds were placed in the trust when the settlor had good reason to believe that he would not be able to pay all his debts as they fell due. In this situation the Court will order the assets to become available for enforcement removing the legal ownership by the trustee even though the trustee was not the actual debtor.

Case Study

In the case where the trustee is actually the debtor in its capacity as trustee of a particular settlement different issues can arise. In the fairly unusual (and factually very complex) case of *Glenalla & Others v. Investec Trust Company Limited & Others* [2018] UKPC 7 , a settlement created for a Robert Tchenguiz and his family, different but urgent remedies were needed to protect the position of a creditor (the liquidators of the claimant companies – Grant Thornton) where the validity of the debt was in dispute. In other words, the creditor was not yet at the stage of being able to take any formal legal action to recover assets for payment of the debt but was still categorised as a "contingent creditor" until able to obtain a final undisputed Court judgment. In fact, it took over seven years and a hearing before the Privy Council in London before the creditors in this case became undisputed judgment creditors for a sum in excess of £200 million including interest.

The trust assets contained an eclectic range of investments and assets from Mr Tchenguiz's personal family home to highly geared derivative investments and credit default swaps. Many were highly sophisticated investments which needed very regular and frequent management and investment decisions during that seven year period. To further complicate matters, the settlor (Mr Tchenguiz) hired and fired the trustees on a number of occasions during the seven year period and the claimant creditors were not content to let investment decisions be taken by trustees seen to be firmly in the camp of the ultimate debtor. The claimant creditor needed to be able to exercise control over the investments whether that was to include sale, lease, further acquisitions, etc. The Guernsey Court, and ultimately the Privy Council, were faced with an extremely interesting challenge in finding the right balance between the interests of the beneficiaries of the trust (should the claimant's action ultimately fail) and the interest of the creditors.

The Guernsey Court determined that the answer lay in applying a type of Receivership regime which bore certain similarities to that found in relation to companies. From late 2012 until the Privy Council hearing in 2018, Carey Olsen succeeded in obtaining and holding Court Orders whereby all but the Tchenguiz family home was transferred into the legal ownership and control of a professional receiver/insolvency practitioner nominated by the creditors (and therefore removed from the control of the trustees). This was an extremely important and innovative approach by the Guernsey Courts and gave the creditors considerable comfort that the assets upon which they were wishing to enforce once judgment had been confirmed would still have the value that they could reasonably expect.

This is a classic example of the Courts applying a flexible solution to aid the creditors up to the time of enforcement when other normal remedies would then come into play. We now turn to look at Guernsey's statutory insolvency regime as part of the recovery toolkit and the proposed changes to it.

2. The Guernsey Insolvency Regime as an aid to asset recovery - companies

The key to a successful fraud investigation and subsequent recoveries is often the speed with which control can be asserted over companies, their management, assets and records. The Guernsey insolvency regime, if utilised correctly, offers effective tools in that control-taking process.

Overview of available procedures

Guernsey's corporate insolvency regime is contained within the Companies (Guernsey) Law 2008, as amended (the **Companies Law**). The Companies Law provides for three insolvency processes, namely: administration, voluntary liquidation and compulsory liquidation. The regimes will be broadly similar to those familiar with the English insolvency regime save for a number of fundamental differences that may offer assistance in fraud investigations or with asset recoveries.

Administration

A company may be put into administration at the request of the company, the directors of the company, any member of the company, any creditor of the company (including contingent or prospective creditors), and the Guernsey Financial Services Commission. Guernsey statutory administration provisions are contained at Part XXI, ss.374 to 390 of the 2008 Law. The Royal Court has jurisdiction to make an administration order if satisfied that:

- the company concerned "*does not satisfy or is likely to become unable to satisfy the solvency test*" [see s.374(1)(a)]; and
- the "…*making of an order under this section may achieve one or more of the purposes set out in subsection (3)*" [see s.374(1)(b)].

The "*purposes*" which an administration order seeks to achieve under s.374(3)(a) and (b) are:

- the "*survival of the company and the whole or any part of its undertaking, as a going concern*", **or**
- a "*more advantageous realisation of the company's assets than would be effected on a winding up*".

The main effect of an application for an administration order would be the implementation of a court sanctioned moratorium against resolutions for the winding up of the company, and on the commencement or continuance of proceedings against the company concerned (without leave of the court) during the period between the presentation of the application and the making of the actual administration order. The granting of the administration order itself would provide the company with the continued benefit of this moratorium (save with the consent of the administrator or leave of the court). Critically, however the moratorium does *not* affect a secured creditor's right to enforce its security.

Compulsory Winding Up/Liquidation

The main grounds for the compulsorily winding up of a company are that *inter alia:*

- the company is unable to pay its debts within the meaning given in s.407 of the Companies Law or otherwise fails the 'solvency test'; or
- the court is of the opinion that it is "*just and equitable*" that the company be wound up.

An application for the compulsory winding-up of a company may be made to the Court by the company, any director, member, creditor or any other "*interested party*". There is no need for a detailed analysis of the liquidation regime for the purposes of this article given its effect will be familiar to most, *i.e.* it triggers a starting gun for a realisation of assets and payments in accordance with the statutory order of priorities. It does, however, hand control of the company to a third party liquidator who will be afforded investigatory powers (as to which see later) and certain statutory remedies with regard to antecedent transactions and delinquent conduct of directors.

Voluntary Winding Up

A Guernsey company may be voluntarily wound up by means of a special resolution of its shareholders (passed by a majority of 75%). A copy of the special resolution must be filed at the Guernsey Companies Registry within 30 days who will publish notice on its website. The process can be utilised in respect of insolvent companies albeit it is purely shareholder-driven and does not involve any Court supervision. The process is very light-touch in terms of creditor and member engagement, and is designed to serve as a simple mechanism for finalising a company's affairs.

The company must appoint a liquidator by ordinary resolution (passed by a majority of 50% plus 1) to wind up the affairs of the company and fix his remuneration. This can be done in the same special resolution resolving to wind up. The liquidator need not be a qualified insolvency practitioner nor resident in Guernsey. In fact it can be any legal person and there is currently no need for independence. Whilst there is obvious risk of abuse of the regime in those circumstances, it also offer a route into a Guernsey company for an overseas insolvency practitioner who may be appointed in another jurisdiction to an overseas parent or may be engaged by a concerned creditor holding security over the Guernsey company's shares.

Incoming Changes to the Guernsey Insolvency Regime

In January 2020, the States of Guernsey approved the Companies (Guernsey) Law, 2008 (Insolvency) (Amendment) Ordinance, 2020 ('the Ordinance'). The Ordinance was designed to further enhance Guernsey's reputation as a robust jurisdiction for restructuring and insolvency. Among the many key changes being introduced is the introduction of new powers for liquidators who will be able to compel the production of documents from directors and officers and to appoint an Inspector of the Court to examine directors and company officers. The proposed changes presented a significant "beefing up" of the statutory investigatory powers available to insolvency office holders in Guernsey bringing them broadly in line with those available under the section 235 and 236 of the English Insolvency Act 1986. This ability to compel the production of information and documentation will prove a vital tool in any investigation of wrongdoing and subsequent recovery action.

A further important change will be the introduction of a formal statutory remedy by which office holders will now be able to pursue recovery of transactions at an undervalue and extortionate credit transactions - a power notable by its absence in the current regime.

Another important change is the ability to wind up a non-Guernsey company. Under the existing regime, there is no ability for the Royal Court to wind up a non-Guernsey registered company. In light of Guernsey's modern status as an international finance centre providing administration and asset management services to many foreign companies, this was a lacuna in the law which has now been filled. This change brings Guernsey in line with other major jurisdictions and will allow the Royal Court to apply the Guernsey regime to foreign companies where they have a sufficient connection to the jurisdiction. It provides comfort to those doing business with entities operating or with assets in Guernsey but not registered here, that they will have access to the jurisdiction's insolvency regime if necessary.

Finally, we examine an often overlooked tool in terms of securing control in the form of enforcing share security.

Using Share Security to Take Control

Security over shares in a Guernsey company must be created by a security interest agreement that complies with the Securities Interests (Guernsey) Law, 1993 (the 'Securities Law'). Typically, the security will involve possession of the share certificates and an assignment of the voting rights. In the event of a default in the lending sufficient to crystallise enforcement remedies, the Securities Law only specifies a power of sale or application as the only available method of enforcement. There is no concept of receivership in Guernsey in this context. As such, the security holder will have the right to take possession of the shares in discharge of a debt or with a view to a sale of them Guernsey's statute is express in not requiring Court approval for the exercise of the statutory powers of sale or application.

In a normal enforcement scenario in default of a debt, the security holder may look to sell shares to pay down debt or may consider applying the shares by housing them in some other vehicle to enable it to realise value whilst preserving the group structure. However, where there are concerns about the activities of management and potential fraud, share security may also offer a quick and effective route to denude delinquent directors of control but also to secure information for investigative purposes. Ultimately, the liquidator may also be afforded statutory causes of action to recover assets otherwise unavailable to a shareholder.

One way in would, of course, be for a security holder to take possession of shares and "perfect" its security by demanding that it be placed onto the shareholder register pursuant to its possessory rights. In that way, the security holder would become the shareholder of record and would be able to exercise all voting rights attaching to the shares accordingly. However, taking this step may present its own challenges in terms of ensuring compliance by the company or its corporate administrator and in terms of the security holder having the appetite for taking ownership of shares. For example, it is unlikely that a retail bank will acquiesce to becoming the owner of shares in an offshore structure.

Whilst there are ways around the ownership conundrum, about which we could write a separate paper, there is another potential option. The security documents themselves will provide a host of powers for the lender to assist it in the enforcement of the security. Those powers will often include the right to direct the borrower to vote the shares in a particular way and an acknowledgment from the company itself that it will comply with that direction. The documents may also give a power of attorney to the security holder to exercise its rights without recourse to the company.

As a result, the holder of the security may be able to exercise the voting rights which in turn may permit it (dependent on the percentage shareholding it controls) to:

- replace a board or appoint a director; or
- commence a voluntary liquidation process and appoint a liquidator to take control of the company.

As set out above, this is particularly useful in Guernsey where the voluntary winding up process can be used without a declaration of solvency, i.e. for an insolvent company in terms of giving control and access to records. The remedy is also instant in that the appointment will commence the moment the resolution is passed and as such circumvents the time involved in the Court process. The option always remains to convert a voluntary liquidation to a compulsory at a later date by application to the Court.

This method has been successfully used for Guernsey entities that own UK real estate where there is a default in the lending that has led to the appointment of a LPA receiver a UK real estate asset but gaining control of the holding company is important for information gathering or to prevent the incumbent directors from undermining the receivership.

There are, of course, issues to be considered in advance of using the security powers not least, the statutory requirements that may go along with a change of shareholder. For example, The Beneficial Ownership of Legal Persons (Guernsey) Law 2017 requires the resident agent of a company to take reasonable steps to ascertain the identity of the beneficial owners of a company and keep records of them. Security holders have to be prepared to provide CDD information this CDD information if they are to be entered onto the share register. However, utilising share security is an often overlooked tool in the box that can be very effective.

Summary

Guernsey has pursued a policy over many years now to be user friendly to creditors seeking to recover the debt owed to them by entities subject to Guernsey Court jurisdiction, whether companies or trusts. The creditor has an array of weapons in his armoury and should not be afraid to use them.

About the Authors

John Greenfield is a consultant at Carey Olsen in Guernsey, where he was previously senior partner. John undertakes the complete range of major litigation and advocacy work including asset tracing, multi-jurisdictional disputes and commercial and trust litigation. John has been counsel in many of the major litigation cases before the Royal Court of Guernsey and the Guernsey Court of Appeal and is one of the few Guernsey advocates to have appeared as counsel in the Privy Council. John was a founder member of the Guernsey Royal Court Working Party which completely reviewed the island's Civil Procedure in 2008 and is a member of the UK Fraud Advisory Panel. He is a founder (and only Guernsey member) of Fraudnet and is a member of the Association of Contentious Trust and Probate Specialists (ACTAPs) and is a Notary Public. He features in the Legal 500 UK, 'Hall of Fame' for Dispute Resolution.

David Jones is a partner at Carey Olsen and a Guernsey advocate, providing specialised advice in relation to business restructuring and insolvency in contentious, non-contentious and multi-jurisdictional matters. He has been involved in many of the largest insolvencies involving Guernsey entities, ranging from investment funds to global retailers. He is able to assist lenders in respect of the taking and enforcement of all forms of security. David regularly advises the boards of distressed entities and has extensive experience acting for office holders. He is a member of the Insolvency Lawyers Association and R3 and sits on the young members Committee of INSOL International. David lectures on INSOL's Foundation Certificate in International Insolvency and is part of the working group tasked with updating and revising Guernsey's insolvency laws. He has also been appointed as a member of Guernsey's first ever Insolvency Rules Committee (IRC). He is ranked in the Legal 500 UK, 2020 edition for Dispute Resolution as a 'Next Generation Partner'.

Steven Balmer is an associate at Carey Olsen in Guernsey, who specialises in commercial litigation and insolvency matters as well as employment law. He works on a range of high-value commercial cases, contentious multi-jurisdictional litigations and insolvencies for both domestic and international clients including the Tchenguiz Discretionary Trust litigation and the liquidation of Joannou and Paraskevaides (Overseas) Limited. Steven trained with a national firm in Scotland and prior to that, spent two years working at the Judicial Institute of Scotland. He is a member of INSOL, the Guernsey International Legal Association (GILA), the Association of Restructuring and Insolvency Experts (AIRES) and the Asset Recovery Next Gen Association.

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