Grant Thornton

Changes to Guernsey's insolvency regime

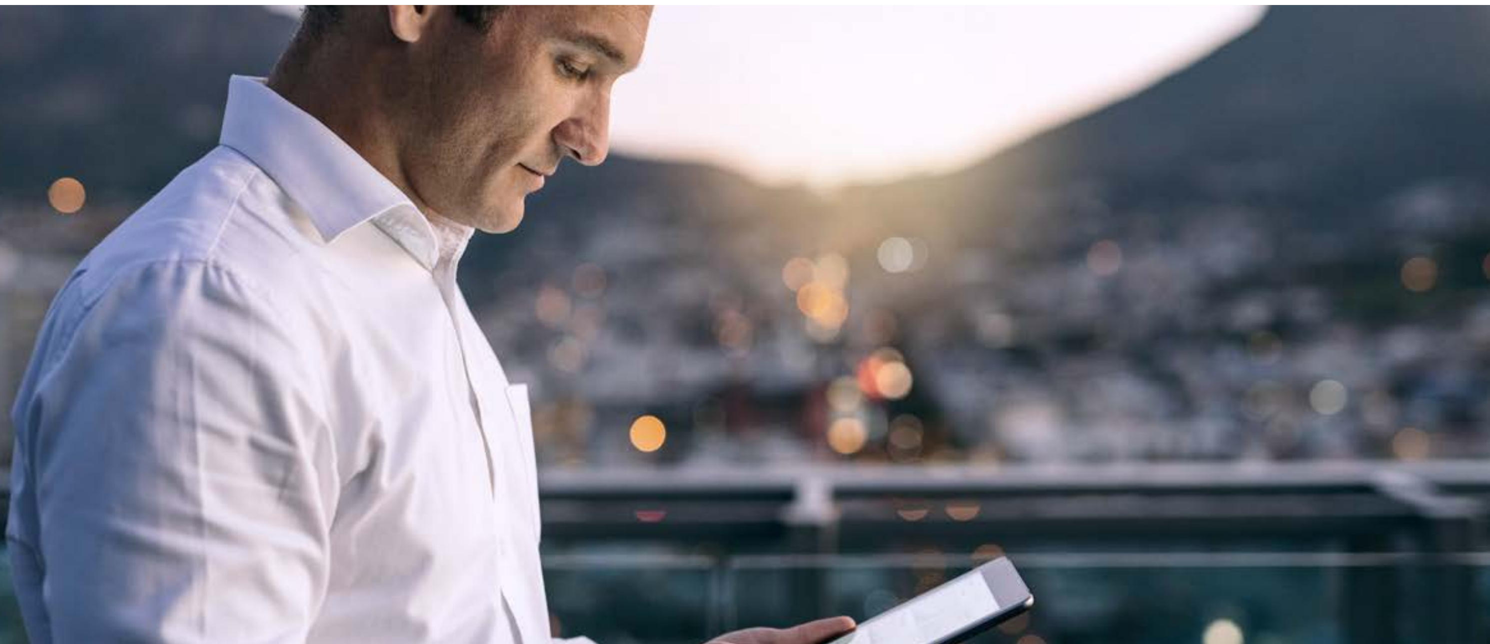
The Companies (Guernsey) Law, 2008 (Insolvency) (Amendment) Ordinance, 2020 (the "Ordinance") and the Companies (Guernsey) (Insolvency Rules) Regulations, 2022 (the "Insolvency Rules") are due to come into operation on 1 January 2023, following regulations made on 8 December 2022 by the Committee for Economic Development (the "Committee").

8 December 2022

By **Ben Rhodes** and **Andrea Harris**, Directors of Grant Thornton Channel Island's Recovery and Reorganisation department

Background to the insolvency law reform

The Ordinance and the Insolvency Rules represent the most significant and wide-ranging reform of Guernsey's corporate insolvency regime since 2008. A modern and effective corporate insolvency regime is vital for the financial services industry. A robust and predictable insolvency regime will further enhance Guernsey's reputation as a safe place to do business, which is especially important in these challenging global economic times.



The changes will have implications for company directors and their advisors and there will be a number of immediate considerations including:

- **What are the steps** for placing a solvent or an insolvent company into Members' Voluntary Liquidation, and how do they now differ?
- **Can a director of a company,** or another connected person, be appointed Liquidator?
- **What considerations** should a director have when making a Declaration of Solvency? What if a director is not comfortable making a Declaration of Solvency? What are the potential repercussions in making an incorrect Declaration of Solvency?
- **What obligations** does a Liquidator or an Administrator now have to communicate with creditors?
- **What additional requirements** will Liquidators and Administrators now have in relation to director misconduct, and what additional powers do Liquidators and Administrators have to pursue recourse against directors?
- **In what circumstances** might an audit be required?
- **How has** the Administration regime changed?
- **How might these changes impact** the duration and the cost of an Administration, or a Members' Voluntary Liquidation?
- **What other changes** do I need to be aware of?

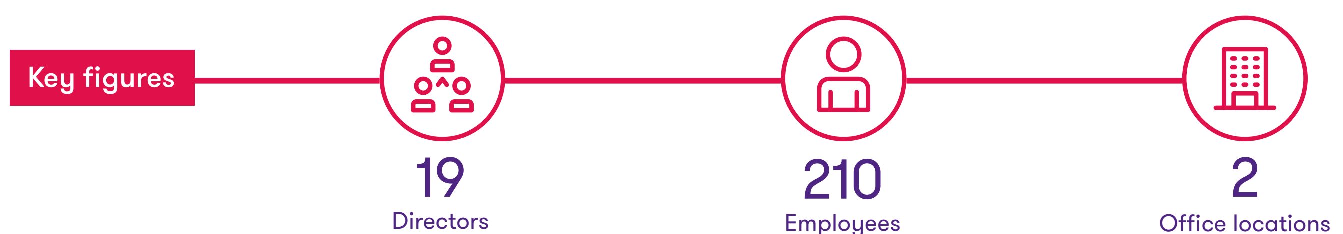
About Grant Thornton

Grant Thornton Limited is a leading Channel Island practice. With a combined staffing strength of more than 210 people, we are the Channel Islands member of Grant Thornton International, one of the world's leading international networks of independently owned and managed accounting and consulting firms.

Our team of specialists are committed to realising value for shareholders, in a way that recognises the interests of all stakeholders.

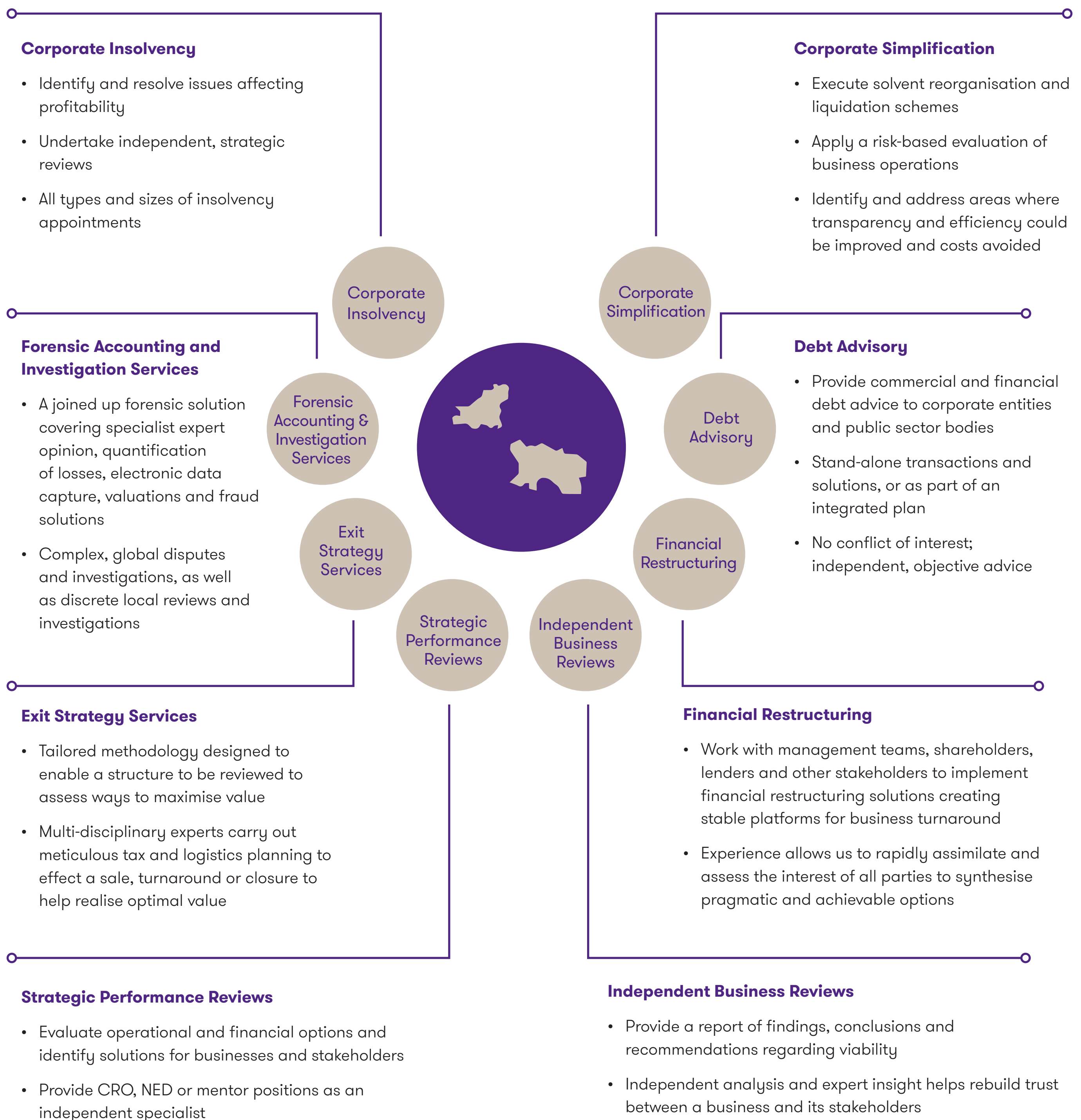
Driven by a determination to find and implement optimum solutions for clients, delivered through the prompt commitment of dedicated and experienced resources, using a tax efficient and cost effective approach:

- One dedicated team from start to finish
- Experienced specialists
- Grant Thornton International member network
- Pragmatic and solutions based approach
- Strength and depth evidenced by our track record
- Specialist fund and financial services team.



Our Recovery and Reorganisation services

We supply a wide range of services to businesses and their stakeholders. Our assignments vary from the managed wind-down of international groups, to advising distressed businesses requiring an urgent solution.



Corporate Insolvency

- Identify and resolve issues affecting profitability
- Undertake independent, strategic reviews
- All types and sizes of insolvency appointments

Corporate Simplification

- Execute solvent reorganisation and liquidation schemes
- Apply a risk-based evaluation of business operations
- Identify and address areas where transparency and efficiency could be improved and costs avoided

Forensic Accounting and Investigation Services

- A joined up forensic solution covering specialist expert opinion, quantification of losses, electronic data capture, valuations and fraud solutions
- Complex, global disputes and investigations, as well as discrete local reviews and investigations

Debt Advisory

- Provide commercial and financial debt advice to corporate entities and public sector bodies
- Stand-alone transactions and solutions, or as part of an integrated plan
- No conflict of interest; independent, objective advice

Exit Strategy Services

- Tailored methodology designed to enable a structure to be reviewed to assess ways to maximise value
- Multi-disciplinary experts carry out meticulous tax and logistics planning to effect a sale, turnaround or closure to help realise optimal value

Financial Restructuring

- Work with management teams, shareholders, lenders and other stakeholders to implement financial restructuring solutions creating stable platforms for business turnaround
- Experience allows us to rapidly assimilate and assess the interest of all parties to synthesise pragmatic and achievable options

Strategic Performance Reviews

- Evaluate operational and financial options and identify solutions for businesses and stakeholders
- Provide CRO, NED or mentor positions as an independent specialist

Independent Business Reviews

- Provide a report of findings, conclusions and recommendations regarding viability
- Independent analysis and expert insight helps rebuild trust between a business and its stakeholders

About the authors

Ben Rhodes

Director

T +44 (0)1481 753431

E ben.rhodes@gt-ci.com

Ben is a Chartered Accountant, UK Licensed Insolvency Practitioner, Fellow of INSOL International, Certified Fraud Examiner and qualified member of the Society of Trust and Estate Practitioners (STEP).

Experience

Ben began his career in Recovery & Reorganisation and Forensic Investigation Services in 2003, initially in London before moving to the Channel Islands in 2012. Ben is the only practitioner in the Channel Islands to be both a Fellow of INSOL International and a UK Licensed Insolvency Practitioner.

Ben is an Executive Member of ARIES, and also sits on the ARIES Legal & Regulatory Committee and the Guernsey Insolvency Rules Committee.

Ben is a lecturer for the INSOL International Foundation Certificate in International Insolvency Law.

Andrea Harris

Director

T +44 (0)1481 754594

E andrea.harris@gt-ci.com

Andrea is a Chartered Accountant, a Fellow of INSOL International and a Certified Fraud Examiner.

Experience

Andrea began her career in Recovery & Reorganisation and Forensic Investigation Services in 2004. She has a wealth of experience which has been gained globally with work domiciled in Australia, Bermuda, Bahamas, the British Virgin Islands, Cayman Islands and the Channel Islands, and she has taken appointments as Liquidator, Administrator, Administration Manager and Director over various entities.

Andrea has also worked on a number of forensic accounting assignments, including fraud investigations, cash tracing, and money laundering investigations.

Andrea is a member of the ARIES Legal and Regulatory Committee and is a member of the Guernsey Insolvency Rules Committee.

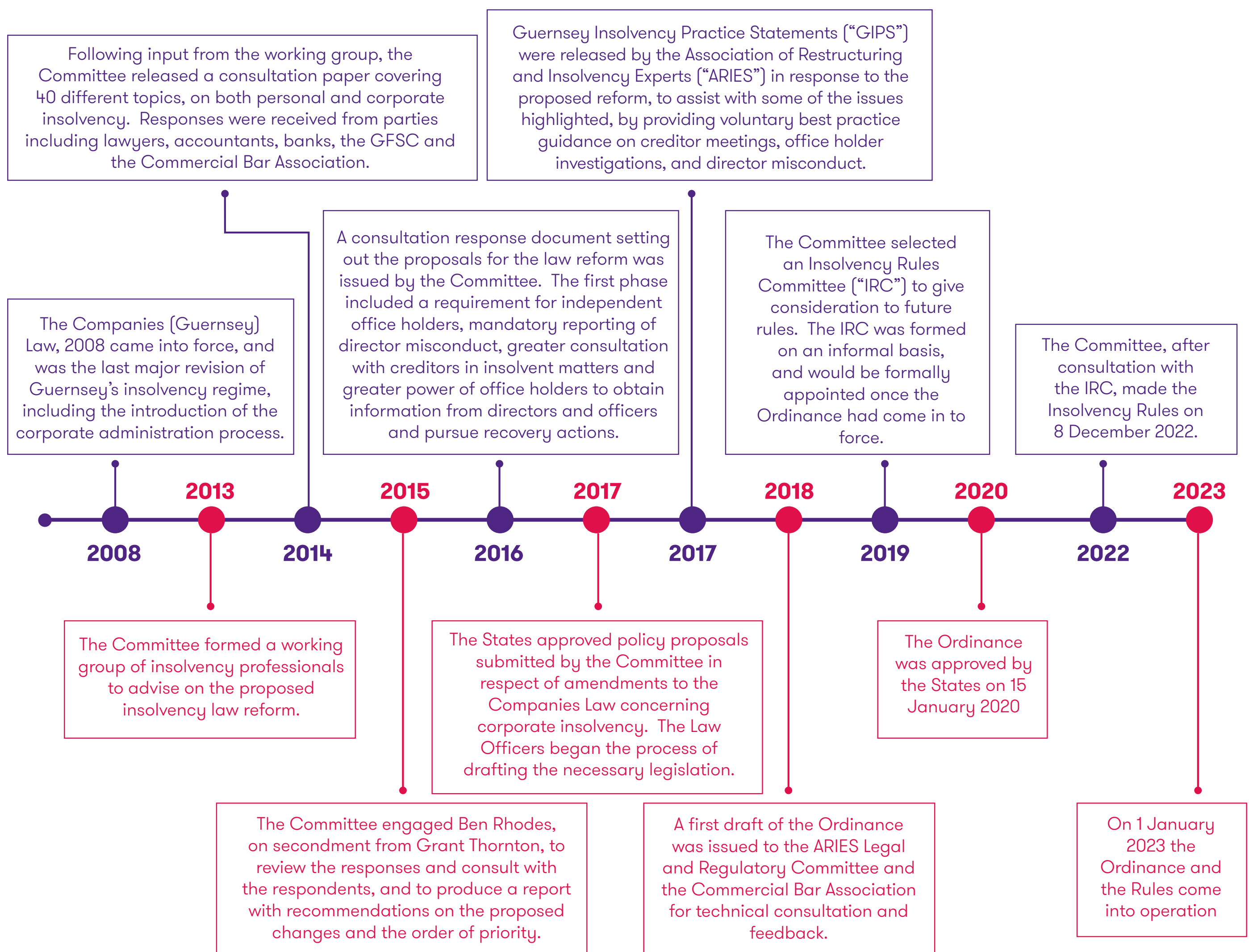
Background to the Ordinance and the Insolvency Rules

Guernsey's corporate insolvency regime has remained largely unchanged since the introduction of the Companies (Guernsey) Law, 2008 ("the Law"). Whilst workable in its existing form and, thanks to a flexible and pragmatic Court, is used successfully on many cases, the insolvency regime nevertheless suffers deficiencies in several areas.

These deficiencies lead to uncertainty, unpredictability, and the risk of potential abuse and include:

- Lack of independence for Liquidators of insolvent companies
- Minimal requirement to consult with creditors in insolvent Liquidations, primarily insolvent Members' Voluntary Liquidations
- No positive obligation on Liquidators and Administrators to report director misconduct to the Registry and the GFSC where applicable
- Insufficient powers for Liquidators or Administrators to obtain information from directors and officers and pursue recovery action for stakeholders

History of the insolvency law reform



Insolvency Rules

In 2019, the Committee appointed the following individuals as the Insolvency Rules Committee ("IRC"):

- Andrea Harris, Director, Grant Thornton Limited;
- Ben Rhodes, Director, Grant Thornton Limited;
- Advocate Alex Horsbrugh-Porter, Partner, Ogier (Guernsey) LLP;
- Advocate David Jones, Partner, Carey Olsen (Guernsey) LLP; and,
- Jurat Jonathan Hooley.

Insolvency Rules have been created to support the changes brought about by the Ordinance. The initial Insolvency Rules produced by the IRC cover:

- Meetings of creditors and shareholders;
- Duty to report delinquent officers;
- Declaration of Solvency; and,
- Disclaiming assets.

The Committee is able to introduce additional Insolvency Rules and the IRC is drafting further Insolvency Rules covering important areas such as proof of debt procedure.

Changes per the Ordinance

What are the steps for placing a solvent or an insolvent company into Members' Voluntary Liquidation, and how do they now differ?

The historical position: Voluntary Liquidation is a Liquidation commenced by shareholder resolution. It is widely used in Guernsey, and is attractive as it is procedurally straightforward, it can be commenced quickly, and it is a relatively low-cost solution to wind up a company. Under the current law, a Voluntary Liquidation can apply to companies that are both solvent and insolvent.

Potential problems: The lack of distinction between solvent and insolvent Members' Voluntary Liquidations is problematic, as the process is shareholder driven in either scenario. There is minimal requirement to consult with creditor views, regardless of whether the company is insolvent and therefore the creditors have the primary financial interest in the outcome of the Liquidation. This also presents the risk of potential abuse.

The new position: The Ordinance distinguishes between solvent and insolvent Voluntary Liquidations, by the introduction of a Declaration of Solvency (Section 391A of the Ordinance). If a director (representing the board of directors) is prepared to sign a Declaration of Solvency, then the Voluntary Liquidation can be streamlined, and will effectively continue as under the current regime. The Declaration of Solvency must be filed with the Registrar within 30 days of it being made. A template Declaration of Solvency is contained in the Insolvency Rules and refers to the solvency test at Section 527 of the Law (Rule 301 of the Insolvency Rules). This will therefore be familiar to Guernsey directors, as the same considerations will be given when making distributions.

If a Declaration of Solvency is not signed by the directors, then certain additional steps will need to be taken. Subject to certain exceptions, which are discussed below, an independent Liquidator must be appointed; the Liquidator will be required to hold a meeting of creditors and present a report to creditors; and the Liquidator will be required to consider the conduct of the directors and to report any adverse finding to the Registrar, and to the Regulator if it is a regulated business.

Rationale: The rationale for this fundamental change is to ensure that the Liquidation process is robust in relation to insolvent Liquidations; that proper consideration is given to creditors and their financial interests; and, that proper consideration has been given to the conduct of the directors in light of the insolvency. This is consistent with other jurisdictions including England and Wales, and Jersey.

Can a director of a company, or another connected person, be appointed Liquidator?

The historical position: Any person can be appointed as Liquidator of a company, regardless of whether they are connected to the company, and regardless of whether the company is solvent or insolvent.

Potential problems: This presents the risk of potential abuse. In an extreme example, a director might have breached their fiduciary and other duties and have been directly responsible for the insolvency of a company because of their actions. The company can be placed into Voluntary Liquidation by the shareholder (who may also be the director), with the same director (or a connected party) appointed as Liquidator. The Liquidation can be concluded without proper investigation of the cause of the insolvency and the director's actions, and without consultation with creditors, and the company can then be dissolved. In this scenario, a creditor seeking recourse might have to apply to court at their own cost to restore the company and to appoint a Liquidator to investigate what has occurred, and to pursue recourse against the director.

The new position: If a Declaration of Solvency is not signed by the directors, then an independent Liquidator must be appointed, unless the Court approves otherwise. If a director signs a Declaration of Solvency and they (or a connected party) are appointed Liquidator, but it subsequently transpires that the company is in fact insolvent, then they will be required to convene a meeting of creditors to ratify their appointment, or to appoint an alternative independent Liquidator, or alternatively the Liquidator may apply to Court to have their appointment sanctioned, with notice given to creditors.

Rationale: The rationale for this change is to ensure the opportunity for independent Liquidators to be appointed over insolvent companies, as they are better placed to investigate the cause of the insolvency and director conduct, and to take appropriate action as required.

Changes per the Ordinance

What considerations should a director have when making a Declaration of Solvency? What if a director is not comfortable making a Declaration of Solvency? What are the potential repercussions in making an incorrect Declaration of Solvency?

What considerations should a director have when making a Declaration of Solvency? A director (representing the board of directors) will need to consider the solvency of the company as defined in Section 527 of the Law, specifically: can the company meet its debts as they fall due, and are the assets greater than the liabilities. This is the same consideration that directors will give when making distributions under the Law. Directors will need to consider the balance sheet of the company in a Liquidation scenario, as opposed to a going concern scenario. They will need to consider the realisable value of assets and the quantity of liabilities including contingent and other liabilities (such as warranty claims) which might not be reflected on the balance sheet.

What if a director is not comfortable making a Declaration of Solvency? There will be situations where directors believe the company to be solvent, but they are not comfortable to sign a Declaration of Solvency, for example where there is uncertainty over the potential liabilities of the company, or if the director has been in office for only a limited period and does not know the full history of the company. In this scenario, the Voluntary Liquidation can still go ahead with the appointment of an independent Liquidator. The Liquidator will need to hold a meeting of creditors and report to creditors (assuming there are known creditors) and will be required to consider the conduct of the directors and report any misconduct (which is unlikely if the company is indeed solvent).

What are the potential repercussions in making an incorrect Declaration of Solvency? There is no specific sanction under the law against directors making an incorrect Declaration of Solvency. In this scenario, the Ordinance requires a Liquidator, who is a director or connected party, to convene a meeting of creditors to ratify their appointment, or to appoint an alternative independent Liquidator. Such meeting is to be convened within 28 days immediately following the date in which it became apparent that the company does not satisfy the solvent test (Rule 1.2), or alternatively the Liquidator may apply to Court to have their appointment sanctioned, with notice given to creditors. If an alternative independent Liquidator is appointed, then they will be required to consider the conduct of the directors and to report any misconduct to the Registrar, and to the Regulator if it is a regulated business. The making of an incorrect Declaration of Solvency might be something that is reported in this scenario.

What obligations does a Liquidator or an Administrator now have to communicate with creditors?

The historical position: Under the current law there is no legal requirement for a Liquidator of a Voluntary Liquidation to report to creditors, even if the company is insolvent and creditors therefore have the primary financial interest in the Liquidation. Likewise, there is no requirement under the law for an Administrator to communicate with creditors, other than providing notice of appointment.

Potential problems: Creditors have the primary financial interest in insolvent matters, such as Administration or Liquidation of an insolvent company, and accordingly their views should be taken into account. Professional Liquidators and Administrators would most likely communicate with creditors in an insolvency scenario, as a matter of best-practice, but this has not previously been a legal requirement. The lack of required communication with creditors presents the risk of abuse, as highlighted above.

The new position: For Voluntary Liquidations, if a Declaration of Solvency has not been signed then the Liquidator will be required to hold at least one meeting of creditors to take place within one month of the Liquidator's appointment, on at least seven days' notice (but where reasonably practicable at least 14 days' notice). The notice of the meeting must include an explanation of the likely process of the Voluntary Liquidation.

For Administrations, the Administrator will be required, within 28 days of the Administration Order, to provide creditors with an explanation of the purpose and likely process of the Administration and to convene a meeting of creditors (alongside the notice of their appointment) to be held within

Changes per the Ordinance

10 weeks of the Administration Order (S.386A), on at least 14 days' notice (Rule1.4). The Ordinance specifically gives the Committee the power to make regulations in respect of these meetings, and it is anticipated that an Insolvency Rule will be drafted in this regard, to provide guidance. The Insolvency Rules provide an exception where the Liquidator or Administrator considers that there are no assets available for distribution to creditors, in which case the Administrator must notify creditors of this within 28 days immediately following the day of their appointment (Rule 1.1).

Notices of creditor meetings must contain various information including the date, time and location of the meeting, details of the general nature of the business to be dealt with, information in respect of any vote to be taken, and the terms upon which the office holder is being remuneration (Rule 1.5). Meetings may be held in Guernsey or elsewhere, having regard to the convenience of creditors, and remote attendance is allowed (Rule 1.6).

Rationale: The purpose of this change is to ensure a dialogue with creditors, where creditors have a financial interest in the outcome of the Liquidation. This is consistent with other jurisdictions including England and Wales, and Jersey.

What additional requirements will Liquidators and Administrators now have in relation to director misconduct, and what additional powers do Liquidators and Administrators have to pursue recourse against directors?

The historical position: Under the current law, Liquidators and Administrators have the ability to apply to Court for the disqualification of a director, however there is no positive obligation for them to do so. In Compulsory Liquidation however, Liquidators have to report to Court at conclusion if any matters have come to their attention regarding preference payments, misappropriation of monies, misfeasance, fraudulent or wrongful trading, or any matters that would be ground for disqualification (S.424, S.422, S.433, S.434 and S.428 of the Law respectively).

The new position: Under the Ordinance (Sections 387A and 421E), Administrators and Liquidators will have a duty to report to the Registry, and the GFSC in respect of regulated companies, if it is considered that there may be grounds for a disqualification order. The Insolvency Rules covers the format of reports, including a standard form (Rule 2.1).

Additionally, Liquidators will now have the power under the Ordinance to require a statement of affairs to be submitted by various parties, including directors/former directors (Section 419A). This is the same power as is already available for Administrators.

Liquidators will also be able to require production of documents and information from parties including directors/former directors, following an application to Court (Section 419B). Liquidators will also be able to apply to Court for a private examination of any person who has been an officer of the company (Section 419C).

The Ordinance also expands the powers available to Liquidators and Administrators to pursue recourse in relation to transactions at undervalue (being transactions with a person at an undervalue such as a gift of assets, prior to the Liquidation or Administration (Section 426D). The Ordinance also allows a Liquidator or Administrator to pursue recourse in relation to extortionate credit transactions (being transactions with grossly exorbitant terms) prior to Liquidation or Administration (Section 426E).

Rationale: It is widely accepted that Administrators and Liquidators of insolvent companies should have a positive obligation to report findings or suspicions of misconduct to the relevant authorities so that appropriate action can be taken. This is consistent with other jurisdictions with modern insolvency laws. Whilst there will undoubtedly be additional cost in conducting investigations and submitting reports, and these costs might not be recoverable from the insolvency estate, it is hoped that the standardizing of reports should help reduce costs.

The widening of Liquidators and Administrators powers to obtain information and pursue recovery actions is a significant positive step.

Changes per the Ordinance

In what circumstances might an audit be required?

The Ordinance (Section 256A) specifies that companies in Liquidation will be exempt from the requirement to have accounts for a financial year audited, specifically each financial year of the winding up; the financial year in which the Liquidator is appointed; and, the company's final financial year. This will reduce cost, and the wish to avoid the audit fee can often be a deciding factor for the timing of a Liquidation. This does not however have any effect in relation to other obligations that a company might have to produce an audit, for example in relation to regulatory requirements.

How has the Administration regime changed?

The historical position: Administration is a rescue process available in Guernsey. The objective of Administration is to either enable the survival of the company or any part of its undertaking as a going concern, or a more advantageous realisation of the company's assets than in a winding up. Under the current law, Administrators are not able to make distributions to non-secured creditors. To dissolve a company following Administration, it must first be converted into Compulsory Liquidation and a Commissioner's Hearing must be held to enable a distribution to creditors, following which the Liquidator can apply for dissolution. Furthermore, Administrators have limited powers with which to pursue recovery action against directors and connected parties.

Potential problems: The inability to pay distributions in Administration is a frustration for creditors, who must wait for their distributions. The requirement to transfer to Compulsory Liquidation in order to pay distributions and dissolve the company leads to additional delay and increased cost.

The new position: The Ordinance allows an Administrator to apply to Court to distribute assets to unsecured creditors in certain circumstances; and to dissolve the company following discharge of the Administration Order if there are no further assets to realise or distribute, without having to convert the Administration to a Liquidation. As noted above, Administrators will also be required to hold an initial meeting of creditors after appointment (subject to certain exceptions) and to communicate with creditors. Furthermore, Administrators will have increased powers to obtain information and pursue recovery action, in line with the powers that they would have as Liquidator.

Rationale: The purpose of these changes is to streamline the Administration process and reduce unnecessary cost, and to also ensure better communication with creditors.

How might these changes impact the duration and the cost of an Administration, or a Members' Voluntary Liquidation?

Administration: the Administration process is now significantly streamlined, where it is possible to conclude the Administration, distribute to creditors and move to dissolution without the requirement for a Compulsory Liquidation. Accordingly this should lead to a reduction in cost. There will be an additional requirement for Administrators to investigate

Changes per the Ordinance

the conduct of directors and to report misconduct if appropriate, and there will be a cost involved in this process, without necessarily any increase in realisations to cover this additional cost.

Liquidation: Liquidators will be required to report to creditors and have meetings with creditors, which they had not previously been required to do under the Law. However, most professional Liquidators of insolvent companies will likely already correspond with creditors in a similar fashion and therefore there might not be an additional cost. As with Administration, there will be an additional requirement for Liquidators of insolvent companies to investigate the conduct of directors and to report misconduct if appropriate, and there will be a cost involved in this process, without necessarily any increase in realisations to cover this additional cost.

What other changes do I need to be aware of?

Inquorate final meetings: The Ordinance (Sections 400(2A) and 400(3)) inserts provisions into the Law relating to inquorate final meetings of shareholders. The Liquidator is required to notify the Registrar that the meeting was duly called and that no quorum was present.

Winding up of non-Guernsey companies: The Ordinance (Section 418A) allows Compulsory Liquidation to be available for companies that are not registered in Guernsey. Guernsey is a Specialist Finance Centre with companies administered here or holding assets here that may not be registered in Guernsey. The purpose of these changes is to allow for such companies to be wound up locally if required.

Disclaiming onerous property: Many jurisdictions permit a Liquidator to disclaim assets where those assets are onerous to locate and administer or effectively valueless. For example the costs of recovering and realising an asset may exceed the amount recovered from that process. The result being that locating and realising that asset leaves creditors worse off than they would have been had the asset been simply disclaimed. The Ordinance (Sections 421A to 421E) inserts provisions giving Liquidators a power to disclaim onerous property. The Insolvency Rule (Rule 4.2 onwards) covers the notice of disclaimer; non-effective notice of disclaimer to interested persons for information; disclaimer presumed valid and effective, and existing rights unaffected by disclaimer.

Conclusion

A modern and effective corporate insolvency regime is important for the financial services industry and the broader business community. The proposed changes to Guernsey's insolvency regime will make it more robust and will enhance Guernsey's reputation as a safe place to do business.

grantthorntonci.com

© 2022 Grant Thornton Limited. All rights reserved.

Grant Thornton Limited is a Channel Islands practice with offices in Guernsey and Jersey with combined staffing strength of over 120 professional people. We provide audit and assurance; accounting; corporate recovery; liquidation; payroll; and taxation services. We are the Channel Islands member of Grant Thornton International, one of the world's leading international organisations of independently owned and managed accounting and consulting firms. Grant Thornton International is not a worldwide partnership. Services are delivered independently by the member firms and as a member firm within Grant Thornton International we have access to member and correspondent firms in over 135 countries, offering client's specialist local knowledge supported by international expertise and methodologies.