

States of Guernsey

Commerce and Employment

Options for reforming Guernsey's Insolvency Regime Consultation Response

Date: 15 February 2016

Executive Summary

The objective of this consultation response document is to set out the proposals the Department is going to take forward for the reform of Guernsey's insolvency regime and their order of priority.

The consultation paper raised a wide range of issues concerning both personal and commercial insolvency as well as some cross cutting issues affecting both. 21 detailed responses were received to the consultation from industry, legal associations, individuals and individual firms. In order to assist it in deciding what to take forward, and how to prioritise the various workstreams alongside other Commerce and Employment priorities, the Department engaged an insolvency expert to assist in analysing the consultation responses and has engaged further with the insolvency law review working group and respondents to the consultation.

Following the publication of this response document, the next stage will be for detailed proposals for the two projects in the First Phase - coloured green - to be included in policy letters for consideration by the States of Deliberation.

First Phase - Proposals the Department will be taking forward

Project I: Low Value Debt Relief Order (Questions 7-8)

There was a clear consensus among respondents that there is a need for process in Guernsey similar to the UK's Low Value Debt Relief Order and the proposed Viscount's Remission Order in Jersey (the "Jersey Order"). This would be a process whereby a person of very limited means could apply to have debts (up to a certain limit) frozen and then written off after a period of time (probably 1 year). The Department's view is that introducing this new procedure, which should be relatively "stand alone" both in terms of the legislation required and the operation of the process, would greatly improve the position of those debtors of very limited means who fulfil the criteria, and will therefore take this forward as a first phase project. The view of the Citizens Advice Bureau of Guernsey is that this proposal "*addresses the heart of the problem area and where the need is greatest*". They estimate that approximately 73 of CAB clients would have been eligible in 2013. The process will offer some form of rehabilitation for debtors, rather than them facing the prospect of repeated *désastre* applications in relation to relatively small debts.

Individuals would only be able to apply subject to a qualifying period of residence in Guernsey, and applications must be made in good faith. There would be strict limits on the amount of assets and income a person may have before becoming eligible to apply for an order; those that responded agreed that the four specified requirements for the Jersey Order seemed sensible given the similar

demographics between the islands – the Department will therefore proceed on the basis that similar eligibility requirements will be adopted.

Individuals will be able to apply if:

- their debts do not exceed £25,000
- they do not own a motor vehicle worth more than £2,000
- they do not possess other assets exceeding £5,000, and
- their disposable income does not exceed £100 a month (after deduction of tax, social security contributions and normal household expenses).

An intermediary, the Guernsey Citizens Advice Bureau, has indicated a willingness to vet and forward individual applications, along with the initial assessment of their specialist money advisers.

Project II: Commercial Legislation

Respondents were asked of their experience of the insolvency provisions in relation to entities other than companies i.e. Partnerships, Limited Partnerships, Foundations and Limited Liability Partnerships. Responses were mixed, with some respondents commenting that there is no need for reform and others suggesting a more proactive stance. The Department has decided to lead with amendments to the Companies (Guernsey) Law, 2008 (the “**Companies Law**”), with amendments to the laws relating to other entities to be considered further as and when these laws are reviewed.

Respondents were also asked whether they would prefer a single insolvency law or separate personal, company and other insolvency provisions. The majority of respondents indicated a preference for separate provisions. The Department agrees and has decided that any new personal insolvency regimes will be separate from commercial insolvency provisions and that the provisions on corporate and other commercial insolvency will remain in the legislation governing each entity. This is the approach that is currently in place and the Department's view is that maintaining this will be the simplest way to effect change.

i) Insolvency Rules (Questions 19 and 20)

A clear majority of respondents were in favour of introducing insolvency rules to offer guidance on procedural matters. The Department will therefore take this forward, starting with a statutory power to make rules. Rules would “sit under” the changes to the Companies Law outlined in this paper and would cover day to day procedures with the aim of ensuring a uniform approach is taken to these matters.

Responses indicated a number of topics that the Department should consider when deciding what should be covered by insolvency rules. These will all be carefully considered as the rules are developed. Broadly, the Department's view is that provisions which concern substantive rights (such as the order of priority of claims or the treatment of unclaimed dividends or onerous assets) should be contained in the relevant piece of commercial legislation whereas procedural requirements (such as standard forms for reporting findings or suspicions of misconduct, and procedures to call a creditors meeting) could be contained in rules.

The Department will also, working with representatives from the Royal Court as necessary, consider how best statutory rules should be drafted and kept updated. It is the Department's view that a standing rules committee, including some industry practitioners, would be the best way to effect this. The Department agrees with those respondents that commented that the ability to amend the rules swiftly is important.

Finally, the Department is aware that ARIES Legal and Regulatory Committee is in the process of producing four Statements of Insolvency Practice for Guernsey ("**SIPS**") which will set out a "best practice" approach to be followed by Guernsey practitioners on a voluntary basis only. This is separate to the Department's review of insolvency law and is designed to sit within the existing legal framework. Where some of the topics covered by the SIPS overlap with intended rules we will consult with interested parties (and give due regard to the content of any SIPS) before making such rules.

ii) Requirement for independence in office holders (Question 25)

At the present time, there is no limitation on who can be appointed a liquidator or administrator of a Guernsey company, although for Court appointments there is already Judge or Jurat scrutiny of the suitability of appointees. When asked if the registration and/or licensing of insolvency practitioners was necessary, opinion was divided with the majority consensus being that a register is not desirable. The Department agrees and, on balance, is unconvinced at the present time that the benefit of a register would compensate for the loss to companies of the ability to use in house liquidators in some cases and for the increased administrative and costs burdens of registration and/or licensing.

In response to this question, many respondents raised the issue that there is no requirement for an insolvency practitioner to be independent and that therefore directors or shareholders can wind up their own structures. This increases the risk of creditors being disadvantaged due to conflicts of interest, particularly in insolvent liquidations. The Department will recommend that the Companies Law be amended to introduce a requirement that liquidators be independent in an insolvent winding up. The aim is to avoid conflicts of interest where interested parties are winding up their own insolvent structures. For the avoidance of doubt, there will continue to be no restriction on who may wind up a solvent company in a voluntary winding up.

iii) Objectives to Insolvency procedures(Questions 26 and 27)

Many jurisdictions set out the general objectives of insolvency procedures in their legislation. The Companies Law covers this to some extent for administrations in section 374 and Schedule 1 to the Law, but is silent as to liquidations. When asked if they thought objectives and statutory duty provisions to be of value, respondents agreed unanimously, commenting that they provide important statutory guidance to office holders as to their duties and how these should be fulfilled.

The Department is minded to include in the Companies Law high level principles/objectives to liquidation as suggested in the consultation paper, these, broadly, are to safeguard and collect in the assets, realise them and distribute the proceeds to the companies' creditors in order of priority, after liquidation costs, paying any surplus assets to the entitled recipients. There should also be a provision that these duties should be carried on in a reasonable and efficient manner.

iv) Should office holders be required to report findings or suspicions of misconduct to the relevant authorities? (Question 32)

It is the Department's view that it is appropriate to place a statutory duty on administrators and liquidators to report to the relevant authorities if they find, or suspect, misconduct on the part of the directors or officers of a company. The aim of this is to enhance Guernsey's reputation and may lead to more actions against directors and officers for disqualification. All respondents agreed. Liquidators in a compulsory liquidation are already required to report to the Court at conclusion.

As to whom the report should be submitted to, the Department believes it is appropriate for the Registrar of Companies to receive such reports relating to non-GFSC licensed entities, and for the GFSC to receive those relating to licensees or former licensees.

v) Creditors' Committee Procedures in Administration (Questions 34- 36)

Unlike most jurisdictions including the UK, administrators in Guernsey are currently under no obligation to call a meeting of creditors when conducting an administration (though in practice they generally do, or make informal contact with key creditors). A majority of respondents agreed with the proposal that administrators should be obliged to call a meeting of the company's creditors within a set period of time after appointment. There was also support for creditors being given notice of the appointment together with an explanation of the process, and for a number of additional proposals to strengthen a creditor's position. The Department is minded to proceed with amendments to the Companies Law on this issue, with provisions to include:

- notice of the administrator's appointment to be sent to creditors with the aim of explaining the process, and
- administrators obliged to call at least one initial meeting of creditors within a given time frame.

Following the initial notice and meeting, and in line with responses, the Department will aim to make any legislation and rules on this flexible, so that the process can be tailored to the size and complexity of the administration and to the number of creditors.

vi) Powers of Administrators and exit from Administration (Questions 37-40)

An administrator has a reasonably comprehensive range of powers set out in Schedule 1 to the Companies Law. However, they are unable to make distributions of the companies' assets to creditors. The administrator can pay secured creditors and pay the expenses of the administration, but they cannot pay other creditors (for instance arrears to employees of the company) if it is still trading during administration. The Department agrees with the majority of respondents that the Companies Law should be amended to allow administrators to make distributions to all creditors where these are in accordance with the objects of the administration, these being to rescue the company as a going concern or achieve a better result than liquidation.

Administration can only be brought to an end by the Court; following this in most cases the company will enter liquidation in order that distributions can be made and the company wound up. Some respondents were of the view that the move to liquidation (or a move straight to dissolution) should

be able to take place out of court as a costs saving measure. However, the Department's view is that the end of administration should continue to be a Court process, but that the Companies Law should be amended to allow the court to permit dissolution of the company at this point. This would save costs in cases where the court agrees liquidation to be an unnecessary extra step.

vii) Voluntary Winding Up (Questions 41-43)

Respondents gave generally positive feedback on their experience of the voluntary winding up regime finding the process straightforward and flexible, however, there was unanimous support for inserting greater protection for creditor interests into the legislative provisions in respect of insolvent voluntary liquidations. In a solvent liquidation, the creditors will be paid in full, so arguably require less protection. However, where the voluntary winding up is of an insolvent company, there will, by definition, be insufficient funds to repay all creditors who should therefore be engaged in the process.

The Department will recommend the following changes to the Companies Law with the aim of strengthening creditor protection in an insolvent voluntary winding up:

- introducing a requirement that a liquidator be independent in an insolvent winding up (covered at (ii) above)
- requiring notice of a liquidator's appointment to be sent to creditors with the aim of explaining the process,
- obliging a liquidator to call at least one initial meeting of creditors within a given time frame, and
- creating a statutory obligation to report to creditors and shareholders.

viii) Establishing and ranking claims (Questions 46 and 47)

Respondents agreed unanimously that a legislative framework to both establish and rank claims in a liquidation should be introduced.

Establishing claims - The Department considers that a process by which a liquidator can determine the validity of a claim (a "proof of debt" procedure) should be set out in rules or other secondary legislation. This will grant a liquidator the power to accept or reject a claim, and will aim to provide clear guidance as to how claims should be submitted by creditors and the factors a liquidator should consider when determining the validity of a claim. Respondents also indicated that there should be a route by which a creditor can challenge a liquidator's decision. The Department will give careful further consideration to respondents' other suggestions in answer to this question, in particular, as to whether – once a proof of debt procedure is in place – to dispense with the requirement for a Commissioner's Hearing.

Ranking of claims – the Department received some helpful comments on the ranking of claims in liquidation and will give these due consideration when formulating the policy letter. Many respondents commented that it would be helpful for the order of priority of claims in a liquidation to be explicitly set out in legislation, even if this does not substantially reform the current order of priorities.

Issues surrounding the priority of claims in the specific event of the insolvency of a bank are out of the scope of this consultation and are being considered separately by the Department.

ix) Statement of Affairs and Examination Powers (Questions 48-51)

Respondents were unanimously supportive of this proposal. The Department is of the view that both liquidators in a compulsory liquidation, and administrators, should have the power to require:

- the production of a statement of affairs
- the production of documents and information from directors, officers, employees, shareholders, accountants, bookkeepers bankers and any other person involved in the promotion of the company or with knowledge of its affairs, and
- that directors and former directors attend (either on the liquidator or, following an application by the liquidator, at court) and be examined.

The Department will therefore take this forward.

Respondents made a number of other helpful comments based on their experience as to how the Companies Law could be improved in this area. In particular, the importance of being able to enforce the legislative provisions by seeking a court order if necessary was emphasised. The Department will consider carefully how best new provisions on examination powers (and the current provisions regarding statements of affairs in administrations) should be enforced.

x) Audited Accounts in a Liquidation (Questions 52 and 53)

The Department will recommend that the Law be amended to exempt companies that are in liquidation from the requirement to prepare audited accounts.

xi) Preferences and Antecedent Transactions, Disclaimer of Onerous Assets and Unclaimed Dividends (Questions 54 and 55)

Transactions at an undervalue – respondents unanimously agreed that liquidators and administrators should be permitted to pursue, i.e. “claw back” transactions at an undervalue via an application to Court. The Department will therefore take this forward and intends to model a provision on section 238 of the UK’s Insolvency Act 1986.

Set aside of extortionate credit transactions - respondents unanimously agreed that liquidators and administrators should be permitted to set aside extortionate credit transactions via an application to Court. The Department will therefore take this forward and intends to model a provision on section 244 of the UK’s Insolvency Act 1986.

Disclaimer of Onerous Property – Respondents were in favour of the introduction of the power for a liquidator to formally disclaim onerous property and unprofitable contracts. This would enable the liquidator to complete the liquidation without being restrained by the continuing obligations of the company under unprofitable contracts, or by the company owning property which is effectively valueless to creditors. In principle the Department is minded to take this forward, subject to

appropriate safeguards including introducing a provision whereby any relevant party who has suffered loss can apply to court to challenge the liquidator's decision.

Unclaimed dividends – Respondents were in favour of introducing a procedure within the Companies Law to deal with unclaimed dividends when a company is in liquidation. These are dividends which the company has declared but have not been paid due to the relevant shareholder being untraceable. The Department recognises this is an issue that needs consideration and in principle, is minded to take this forward - subject to identifying an appropriate and cost effective administrative process. This may include returning the dividend to the company after an appropriate period of notice, or another mechanism.

xii) Other Areas of Potential Reform (Question 59)

- Expanding the winding up provisions that apply to protected cell and incorporated cell companies – there was a mixed response with some support for insolvency provisions tailored specifically to cellular companies, but other respondents querying the necessity (as current PCC/ICC and general insolvency provisions cover this) and the priority of this workstream. The Department will therefore consider any proposals that should apply specifically, or be modified to take account of, cellular companies that arise when taking forward the commercial legislation project above.
- Consistency in time periods –all those that responded to this question were in favour of statutory time periods being consistent (e.g. for notice for creditors meetings in administration and voluntary liquidation) and logical. Where the Department is introducing new time periods as a result of this consultation under the commercial legislation project (including via insolvency rules) every effort will be made to ensure they are consistent. Time periods under the existing law will also be reviewed.
- Allowing inquorate final meetings in voluntary winding up – in a voluntary winding up it is necessary to hold a final general meeting of the company's members to present the accounts, however, in many cases there are insufficient members present to form the necessary quorum under section 213 of the Companies Law (or as specified in the company's articles). There was unanimous support for allowing inquorate final meetings, and given that the liquidator will have sent notice of the meeting to every member, the Department will recommend a provision stating that the final meeting is not invalidated by reason alone of being inquorate.
- Royal Court and jurisdiction to wind up foreign companies - 11 out of 13 respondents to this question supported the proposal that the Royal Court should have jurisdiction to wind up foreign companies. The Department will take this forward by consulting more widely within the finance sector given that this proposal could have implications beyond insolvency.

- Transfer of uncertificated securities – there was a range of views on this issue and the Department will give further consideration to whether any legislative change is appropriate when developing the policy letter.

Respondents were also asked if there were any other areas of the corporate insolvency regime that they consider would benefit from reform. There were 10 further suggested areas, and many of these were suggested by a single respondent. The Department is grateful for all of these suggestions and will consider them carefully when formulating policy proposals for the States.

Second Phase – Projects the Department would like to take forward/consider further in the future

PROJECT: Bankruptcy and the Loi ayant rapport aux débiteurs et à la renonciation(Questions 3-6)

The majority of respondents had no experience of the 1929 procedure. Those that did commented that it was out of date, little used or understood, and had uncertain outcomes. There was support for repealing and replacing the 1929 Law.

There was general consensus that a new bankruptcy regime should be introduced and that it should be simple, readily accessible to a lay person and offer debtor rehabilitation. There was some support for introducing a simplified version of the English bankruptcy process, as this regime was familiar to most. The Department intends to progress this as part of a second phase after completion of phase one, noting that further careful consideration needs to be given to:

- i. the necessity of creating a new office or office holder;
- ii. the option of adapting an existing office, to administer the estate, and
- iii. options for funding any such office (see below).

PROJECT: Individual Voluntary Arrangements (Question 9)

A majority of respondents were supportive of the introduction of a simple statutory scheme based on the UK concept of an IVA procedure. The Department intends to consider this further after completion of phase one.

PROJECT: Official Receiver (Questions 21-24)

When asked about their experience of dealing with offices in other jurisdictions which perform the functions of an “official receiver”, most respondents had experience of the official receivers in the UK, where the primary benefit was as a liquidator of last resort in compulsory liquidations and bankruptcies. Other comments included that official receivers fulfil an important role in pursuing directors disqualification actions. Some respondents had experience of similar offices in Australia and Jersey. In other jurisdictions there is no such office, for example the BVI where some of the functions are undertaken by the BVI regulator.

A clear majority of respondents thought an office exercising official receiver functions would be a positive addition to Guernsey's insolvency regime, however likely problems regarding funding were acknowledged.

The Department does not believe that establishing an office of official receiver or adapting an existing office is essential for the implementation of phase one so has decided to revisit the issue alongside the second phase projects identified in this section.

PROJECT: Register of fixed and floating charges (Questions 56-58)

The majority of respondents were supportive of the introduction of a register of fixed and floating charges, primarily as it provides greater certainty and is therefore likely to provide greater access to financing for businesses. The Department agrees and continues to hold the view that introducing a register of charges would be likely to increase the availability of credit for Guernsey businesses and provide greater certainty for lenders when making lending decisions. However, most respondents agreed that it was outside the scope of this consultation. The Department agrees and will consider conducting a separate workstream on the introduction of a register of charges in the future.

Projects the Department has decided not to take forward as part of this review

Désastre (Question 1)

The Department stated in the Discussion Paper that it did not believe that it was necessary to make any changes to désastre at the present time. Having considered the consultation responses this view has not changed post consultation and the Department will not be recommending any change to the way désastre proceedings operate. Respondents commented in the main that that this was a little used process. The Department's view is that it is essentially an enforcement process and remains a relatively cheap and efficient method of realising and distributing assets among creditors after a judgment.

Saisie (Question 2)

The Department's view that substantial reform of Saisie is not necessary has not changed post consultation. Respondents commented that it was little used and that any review would require a wider consultation, to include consideration of security interests legislation. However, in the few instances the process has been used in recent years, it has operated to realise a debtors real property in satisfaction of debts. Again, it is essentially an enforcement process with origins in customary law, and the Department does not intend to put forward any changes to it as a result of this reform.

Company Voluntary Arrangements (Question 28 and 29)

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When asked if the introduction of a simple Company Voluntary Arrangement (“CVA”) regime would be beneficial, most respondents – while recognising it might be a useful tool - queried the demand for such a process. Among the insolvency practitioners who responded, few could think of any circumstances where a CVA process would have been useful in practice. The Department has therefore decided not to take this proposal forward.

Out of court appointment of Administrators (Questions 30-31)

Under the Companies Law, only the Royal Court can appoint an administrator. When asked if out of court appointment of administrators should be permitted, there was a mixed response with some respondents in favour of allowing the directors of a company to do this as it would avoid certain costs and be faster. However, a further group of respondents were supportive only if there were also safeguards in place to avoid abuse, and a final group strongly opposed this proposal.

The Department has decided to retain the current principle that an administrator can only be appointed by the court. The Department considers that court scrutiny of appointments should continue in view of:

- the fact that administrators powers are to be increased so that they can make distributions (see Project II, paragraph (vi) above)
- there is to be no register of insolvency practitioners (see Project II, paragraph (ii) above)
- there are complex issues surrounding who should be able to block an out of court administrator's appointment, particularly given the absence of a register of fixed and floating charges, and absent a review of the security interests law.

Set aside of a statutory demand (Questions 44 and 45)

The Department asked respondents for their view as to whether a “set aside” provision should be inserted into the Companies Law, i.e. a process within the statutory demand provisions which would provide that the Court can resolve a dispute as to whether the sum is actually due or not. Responses were mixed; although a majority were in favour on balance a number of persuasive reservations were also expressed. On review, the Department does not believe that the absence of a statutory procedure is causing any significant difficulty as in practice the Court could address this matter on any winding up application, and it will therefore not be taken forward.

Avoidance of charges placed within a certain time period (Questions 54 and 55)

Although respondents were in favour of office holders being able to apply to Court to avoid certain charges being placed on the company's assets within a specified time period prior to insolvency, the Department has decided not to take this forward at this time. This is for the reason given by many respondents; that charges given to existing creditors should only be avoidable if they are also preferences under the Companies Law, which the Companies Law already legislates for. In addition, the equivalent UK provision (section 245 of the Insolvency Act 1986) is limited to avoidance of floating charges which are not currently recognised in Guernsey. In the absence of a register of fixed and floating charges (see answer to Q56-58 above) and in light of the fact that charges granted in

favour of existing creditors and which are preferences are adequately legislated for, the Department has decided not to take this forward.

Appointment of Receiver as a pre-insolvency measure to protect assets (Question 59)

Respondents met with reservation the idea that a receiver could be appointed to assess assets at risk of dissipation before insolvency procedures have commenced. Although there was some limited support for the idea, other comments included that it would require the overhaul of the entire system and could not easily be “bolted on”, that it would be an unnecessary complication and that the mechanism of saisie provides for this when required. The Department will therefore not be progressing this proposal.