THE STATES OF DELIBERATION
of the
ISLAND OF GUERNSEY

COMMITTEE *for* ECONOMIC DEVELOPMENT

INSOLVENCY REVIEW - AMENDMENTS TO THE COMPANIES LAW

The States are asked to decide:-

Whether, after consideration of the Policy Letter entitled 'Insolvency Review – Amendments to the Companies Law dated 9th February, 2017, they are of the opinion:-

1. To approve the proposals set out in section 3 of the Policy Letter to amend the Companies (Guernsey) Law, 2008 as follows:
    a. to introduce creditors' committee procedures and rules as set out in paragraph 3.1.1,
    b. to allow administrators to make distributions to creditors as set out in paragraph 3.1.2,
    c. to allow the Royal Court to permit dissolution of the company in the circumstances set out in paragraph 3.1.3,
    d. to introduce objectives of winding up as set out in paragraph 3.2.1,
    e. to require an independent liquidator in a voluntary winding up where the company is insolvent as set out in paragraph 3.2.2,
    f. to strengthen creditor protection in an insolvent voluntary winding up by introducing the requirements set out in paragraph 3.2.3,
    g. to allow inquorate final general meetings in a voluntary winding up as set out in paragraph 3.2.4,
    h. to provide for rules for the establishment of claims in a winding up as set out in paragraph 3.2.5,
    i. to exempt companies in liquidation from the requirement to prepare audited accounts as set out in paragraph 3.2.6,
    j. to allow a liquidator to disclaim onerous assets and unprofitable contracts in the circumstances set out in paragraph 3.2.7,
    k. to authorise the establishment of a statutory scheme for unclaimed dividends and direct the preparation of a further policy letter as set out in paragraph 3.2.8,
    l. to introduce a statutory power for the Royal Court to wind up insolvent foreign companies as set out in paragraph 3.2.9,
    m. to introduce a statutory power for the Committee for Economic Development to make insolvency rules as set out in paragraph 3.3.1,

n. to require administrators and liquidators to report findings, or suspicions, of misconduct on the part of directors or officers of a company as set out in paragraph 3.3.2,
o. to introduce statutory provisions with regard to transactions at an undervalue and extortionate credit transactions as set out in paragraph 3.3.3,
p. to introduce statutory powers for liquidators to require statements of affairs and to apply to court for orders requiring the production of such statements and other documents and the attendance of directors and former directors for the purpose of examination, as set out in paragraph 3.3.4, and
q. to make ancillary amendments as identified in paragraph 3.3.5 regarding consistency in time periods, utilities and essential services, typographical matters, corrections, clarifications, consequential and minor amendments.

2. To direct the preparation of such legislation as may be necessary to give effect to the above decisions.

The above Propositions have been submitted to Her Majesty's Procureur for advice on any legal or constitutional implications in accordance with Rule 4(1) of the Rules of Procedure of the States of Deliberation and their Committees.

THE STATES OF DELIBERATION
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INSOLVENCY REVIEW - AMENDMENTS TO THE COMPANIES LAW

The Presiding Officer
States of Guernsey
Royal Court House
St Peter Port

9th February, 2017

Dear Sir

1 Executive Summary

1.1 This report recommends the enactment by the States of Guernsey of amendments to the Companies (Guernsey) Law, 2008 (the "Companies Law") to reform corporate insolvency provisions. The aim of the reform is to enhance Guernsey's current corporate insolvency law, to ensure that it continues to be modern and effective and to ensure predictable and equitable outcomes when a business fails. In doing so the reform supports and enhances the financial services industry and the wider economy.

2 Background

2.1 Effective, equitable and clear insolvency laws are an essential ingredient of a modern economy. Exit strategies for business are an increasingly important factor when choosing where to establish a venture; and the certainty offered by a clear and effective insolvency regime can give a jurisdiction a competitive advantage. Up to date and effective insolvency laws can also improve the quality and flow of credit to an economy, since they enable creditors to understand at the outset how a liquidation or administration will progress. In turn, this can lead to a greater willingness on the part of credit providers to lend in a jurisdiction; so allowing businesses improved access to finance to facilitate growth.

2.2 The proposed amendments are to the Companies Law, which when it was introduced in 2008 represented a fundamental reform of Guernsey's previous company law. Following a post-implementation review, the Companies Law has been amended on a number of occasions to ensure that it continues to be modern and effective and to support Guernsey's international offering.

Following an extensive consultation process, this report recommends further amendments to the Companies Law focused on the insolvency provisions of the Law.

2.3 Because there are so many more companies in Guernsey compared with other types of entities such as Limited Partnerships, the vast majority of insolvent situations take place in the corporate sphere. The Committee therefore proposes to lead with amendments to the Companies Law, with amendments to the laws relating to other commercial legal entities and arrangements (i.e. Partnerships, Limited Partnerships, Foundations and Limited Liability Partnerships) to be considered as and when these laws are reviewed. The proposed changes to the Companies Law are detailed in section 3 below.

3 Proposed Amendments

3.1 Administration – amendments to Part XXI

Administration is a rescue process. An order may be granted by the Court where a company is, or is about to become, insolvent, and the Administrator is appointed to manage the affairs, business and property of the company. The aims of the process are to rescue the company as a going concern, or if this is not possible, to obtain a more advantageous realisation of the company's assets than would be effected on a winding up.

3.1.1 Creditors' Committee Procedures in Administration – Unlike most jurisdictions, including England and Wales, 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). The proposal is that administrators should be obliged to call at least one initial meeting of the company's creditors within a set number of days after appointment. They should also be required to send notice of their appointment to creditors with an explanation of the process and its aims. Following the initial notice and meeting, the proposal is that any further rules with regard to creditors' committee procedures should be flexible so that the process can be tailored to the size and complexity of the administration and the number of creditors.

3.1.2 Powers of Administrators – 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 all types of creditor. The administrator can pay secured creditors and pay the expenses of the administration, but there is some debate as to an administrator's ability to pay other creditors (for instance arrears to employees of the company) if it is still trading during administration. The proposal is to amend the Companies Law to

specifically allow administrators to make distributions to creditors where these are in accordance with the objects of the administration.

3.1.3 Exit from Administration – Administration can only be brought to an end by the Court. In cases where it is necessary for the company to be wound up after Administration the Court has to bring the Administration to an end and make a winding up order. The proposal is that the Court should have the power to permit dissolution of the company at the same time as discharging an administration order. This would represent a procedural simplification and cost saving in cases where the Court agrees that making a winding up order would be an unnecessary extra step.

3.2 Winding up – amendments to Part XXII, XXIII and XXIV

Winding up, or liquidation as it is often known, is "the end of the road" for a company; it involves the winding up of the company's affairs and the gathering in of the assets of the company for distribution to creditors (and shareholders in the event of there being a surplus). In Guernsey there are two forms; (i) voluntary winding up which is initiated by the members of the company passing a resolution (or in other limited circumstances such as the expiry of the period, if any, of the company's duration) and which does not usually involve the Court and (ii) compulsory winding up in which the winding up is led and supervised by the Court. There is no legislative distinction in Guernsey Law between a solvent or insolvent winding up, as is found in some other jurisdictions including England and Wales; both voluntary and compulsory winding up can be either solvent or insolvent.

3.2.1 Objectives of winding up – Many jurisdictions set out the general objectives of insolvency procedures in their legislation. The Companies Law addresses the objectives of administration in section 374 to the Law, but is silent as to the objectives of liquidations. The Committee is of the view that objectives would provide useful statutory guidance to office holders as to their duties and how these should be fulfilled and proposes the introduction of high level objectives of winding up in Guernsey. These will be to safeguard and collect in assets, realise them and distribute the proceeds to the companies' creditors in order of priority, after liquidation costs, and the payment of any surplus assets to the entitled recipients. It is also proposed to introduce a provision that these duties should be carried on in a reasonable and efficient manner.

3.2.2 Requirement for independence in an insolvent voluntary winding up – At present, there is no statutory restriction on who can be appointed as a liquidator of a Guernsey company, although where the Court makes the appointment there will of course be scrutiny of the suitability of appointees. However, in a voluntary winding up, a company can appoint a liquidator itself by ordinary resolution. This may be a director or

shareholder who will then be empowered to wind up a company in which they have an interest and distribute its assets. This is typically seen as a commercially attractive option due to advantages of speed and cost. Where a company is solvent the Committee believes it to be appropriate to retain this possibility. However, where a company is insolvent this increases the potential risk of creditors being disadvantaged due to conflicts of interest. The Committee proposes that the Companies Law be amended to introduce a requirement that a liquidator appointed by an insolvent company in a voluntary winding up must be independent, subject to the Court, on application, having a power to approve the appointment of a liquidator who does not meet the requirement of independence.

3.2.3 Voluntary winding up and creditor protection – The Committee proposes increasing protection for creditors in respect of voluntary liquidations where the company is insolvent. Where the company is solvent, the creditors should be paid in full, so arguably require less protection and the Committee believes that the current level of creditor protection is sufficient. However, where the voluntary winding up is of an insolvent company, there will by definition be insufficient funds to repay all creditors, who therefore require greater protection and a greater level of engagement in the process. The Committee believes that, where the company being voluntarily wound up is insolvent, notice of a liquidator's appointment should be required to be sent to creditors with the aim of explaining the process, a liquidator should be required to call at least one initial meeting of creditors, and that there should be an ongoing statutory obligation to report to creditors and shareholders.

3.2.4 Allowing inquorate final meetings – In a voluntary winding up it is necessary to hold a final general meeting of the company's members to present the accounts. In practice, in cases where the affairs of a company have been satisfactorily wound up there may be insufficient members present to form the necessary quorum under section 213 of the Companies Law. The Committee believes it is appropriate for the Companies Law to provide that the final meeting is not invalidated by reason alone of being inquorate.

3.2.5 Establishing claims – The Committee believes that a power should be inserted into the Companies Law providing for rules to be prescribed by the Committee relating to the establishment of claims in a winding up. This will address the process by which a liquidator can determine the validity of a claim (a "proof of debt" procedure), and will provide clear guidance as to advertisement, how claims should be submitted and the factors a liquidator should consider when determining the validity of a

claim. Once the correct procedure has been followed, the liquidator will have the statutory power to accept or reject claims. Currently, there is no formal procedure for proving debts and, for instance, liquidators are unable to impose a cut off date on late claims without first making an application to the Court for directions. There should also be a route by which a creditor can challenge a liquidator's decision in Court.

3.2.6 Audited Accounts in a Liquidation – The Committee believes that the Companies Law should be amended to exempt companies that are in liquidation from the requirement to prepare audited accounts. The requirement to have accounts audited is an unnecessary expense in circumstances where a liquidator has been appointed; liquidators act in a fiduciary capacity in relation to the company and will report to the Court (or members in a voluntary liquidation) on the company's financial position.

3.2.7 Disclaimer of Onerous Assets – In some jurisdictions, liquidators have the power to disclaim onerous property and unprofitable contracts to enable the liquidator to complete the liquidation without being restrained by the continuing obligations of the company, or by the company owning property which is effectively valueless to creditors. The Committee proposes that liquidators should have such a power in Guernsey, subject to a requirement that notice is served on all relevant parties, including Her Majesty's Receiver General where property or rights could become bona vacantia as a result of the exercise of the disclaimer. The Committee also believes that there must be a right for interested parties to apply to the Court to challenge a liquidator's decision to exercise his power.

3.2.8 Unclaimed dividends – The Committee is advised that liquidators are sometimes unable to make distributions and/or pay dividends to members, despite their best endeavours, where they are not able to identify up to date contact or payment details. In many jurisdictions, a statutory scheme exists for such amounts to be paid across to the State, from whom it can be reclaimed within a specified period of time. For example the Insolvency Service performs this function in the UK. The Committee has carefully considered a number of options for how to treat such unclaimed distributions in Guernsey, and on balance recommends the establishment of a statutory scheme for such amounts to be held by the States where a liquidator has taken all reasonable steps to make a distribution to a member. Such a scheme would enable legitimate claims to be made by former members of the company within a specified period of time. Consideration will need to be given as to which States body will administer the scheme and what will happen to any funds which are not claimed within the specified period, and this will be brought back to the States in due course.

3.2.9 Winding up of foreign companies – There are a significant number of foreign companies which carry on business in Guernsey and/or which have assets under control here. Some jurisdictions allow for foreign companies to be wound up in certain circumstances, for instance the UK, Hong Kong, Singapore, the BVI, Australia and the Bahamas. Statute and/or case law govern the exercise of the power and typically require a sufficient connection with the jurisdiction, such as a place of business or assets within the jurisdiction. The Committee proposes that the Royal Court should have a statutory power to compulsorily wind up an insolvent foreign company; and that the statutory provisions should reflect the position in English Law. This will have the advantage of allowing the Royal Court to take account of English jurisprudence, which would be of persuasive authority in Guernsey.

3.3 General

3.3.1 Insolvency Rules – In many other jurisdictions such as England and Wales, the Cayman Islands and the BVI, statutory insolvency rules are in place to govern procedural matters (such as standard forms and procedures) to ensure that a predictable, efficient and uniform approach is taken to such matters. The advantages of this are that there can be certainty for those interested in insolvency proceedings and also that the rules can be updated swiftly to keep pace with developments without the need to amend the substantive primary legislation. The Committee believes that a statutory power should be given to the Committee to make Insolvency Rules advised by a standing rules committee, including industry practitioners.

3.3.2 Reporting of findings, or suspicions, of misconduct – The Committee believes 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 assist the authorities in identifying delinquent directors and officers and protecting Guernsey's reputation. Liquidators in a compulsory liquidation are required to report to the Court at the conclusion on such matters, but there is currently no other mandatory reporting requirements by which suspected misconduct is required to be reported to the authorities. The Committee proposes that reports should be made to the Registrar of Companies in respect of non-GFSC licensed entities, and to both the Registrar of Companies and the GFSC in respect of licensees or former licensees.

3.3.3 Transactions at an undervalue and set aside of extortionate credit transactions – The Committee proposes that liquidators and administrators should be permitted to "claw back" transactions at an

undervalue via an application to Court. This will allow the Court to order that certain funds be refunded to the company such as gifts to unrelated parties, or commercial transactions where the consideration was significantly less than market value where these transactions took place during the run up to insolvency.

The Committee also proposes that liquidators and administrators should be able to apply to Court to ask that extortionate credit transactions be set aside. These are credit transactions which the company enters into in the run up to insolvency, for instance where the company takes out a loan at an extortionate rate of interest, which allows that loan creditor a greater recovery than they would be entitled to had the loan been on reasonable market terms.

These changes will bring Guernsey's regime broadly into line with that in the UK and Jersey.

3.3.4 Statement of Affairs and Examination powers – The Committee proposes that liquidators should have the statutory power to require the production of a statement of affairs from the company's directors and officers about the company's financial position. This would enable liquidators to gain a rapid understanding of the company's assets, liabilities, debts, creditors and any security held by creditors. Administrators already have the power under section 387 of the Companies Law to require a statement of affairs, but liquidators do not.

In addition, the Committee believes that the liquidator should have an explicit power to apply to Court to request an order for 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. They should also have an explicit power to apply to Court to require the attendance of directors and former directors for the purpose of examination.

Where someone has failed to produce a statement of affairs it is proposed that there should be a power for the liquidator (or administrator under the current provisions regarding statement of affairs in administrations) to apply to Court for an order compelling its production.

3.3.5 Ancillary Amendments – In addition to the matters set out above, the Committee has identified the following ancillary amendments that are required:

- Consistency in time periods – statutory time periods to be reviewed and amended as appropriate to ensure they are consistent and logical, and
- In some jurisdictions, provisions exist that require utilities and other essential service providers to continue to provide services during administration and winding up. It is proposed at this time that a regulation making power should be inserted into the Law, to allow the flexibility to introduce such provisions should this be considered appropriate in future.

In addition to the substantive amendments identified above, it is proposed that typographical matters, corrections, clarifications, consequential and minor amendments, which the Committee does not believe will substantively alter the provisions of the Companies Law, will be addressed in the amendments.

4 Consultation

4.1 In 2013 a working group of insolvency practitioners was established to advise the Commerce and Employment Department on the options for reform of Guernsey's commercial and personal insolvency regimes. A detailed public discussion paper was issued by the Commerce and Employment Department at the end of 2014 which asked questions on a wide range of issues and options for reform. The consultation was well received with 21 detailed and substantive responses submitted. Following the secondment to the Department of a specialist Insolvency Practitioner, who produced an independent analysis of the responses, policy proposals were developed and a public consultation response document was released in February 2016. This set out the changes which the Commerce and Employment Department intended to take forward and which the Committee has developed and adopted in this report.

4.2 The Law Officers have been consulted regarding these proposals.

5 Financial Implications

5.1 The new scheme for unpaid dividends to be held by the States will have some financial implications, but these are unlikely to be onerous and are likely to be able to be met within existing resources. There will be legislative drafting and officer time needed to prepare the legislation which will also be met within existing resources.

6 Propositions

The States are asked to decide whether they are of the opinion:-

1. To approve the proposals set out in section 3 of this policy letter to amend the Companies (Guernsey) Law, 2008, as follows:
    a. to introduce creditors' committee procedures and rules as set out in paragraph 3.1.1,
    b. to allow administrators to make distributions to creditors as set out in paragraph 3.1.2,
    c. to allow the Royal Court to permit dissolution of the company in the circumstances set out in paragraph 3.1.3,
    d. to introduce objectives of winding up as set out in paragraph 3.2.1,
    e. to require an independent liquidator in a voluntary winding up where the company is insolvent as set out in paragraph 3.2.2,
    f. to strengthen creditor protection in an insolvent voluntary winding up by introducing the requirements set out in paragraph 3.2.3,
    g. to allow inquorate final general meetings in a voluntary winding up as set out in paragraph 3.2.4,
    h. to provide for rules for the establishment of claims in a winding up as set out in paragraph 3.2.5,
    i. to exempt companies in liquidation from the requirement to prepare audited accounts as set out in paragraph 3.2.6,
    j. to allow a liquidator to disclaim onerous assets and unprofitable contracts in the circumstances set out in paragraph 3.2.7,
    k. to authorise the establishment of a statutory scheme for unclaimed dividends and direct the preparation of a further policy letter as set out in paragraph 3.2.8,
    l. to introduce a statutory power for the Royal Court to wind up insolvent foreign companies as set out in paragraph 3.2.9,
    m. to introduce a statutory power for the Committee for Economic Development to make insolvency rules as set out in paragraph 3.3.1,
    n. to require administrators and liquidators to report findings, or suspicions, of misconduct on the part of directors or officers of a company as set out in paragraph 3.3.2,
    o. to introduce statutory provisions with regard to transactions at an undervalue and extortionate credit transactions as set out in paragraph 3.3.3,
    p. to introduce statutory powers for liquidators to require statements of affairs and to apply to court for orders requiring the production of such statements and other documents and the attendance of directors and former directors for the purpose of examination, as set out in paragraph 3.3.4, and
    q. to make ancillary amendments as identified in paragraph 3.3.5 regarding consistency in time periods, utilities and essential services, typographical matters, corrections, clarifications, consequential and minor amendments.

2. To direct the preparation of such legislation as may be necessary to give effect to the above decisions.

7 Committee Support for Propositions

7.1 In accordance with Rule 4(4) of the Rules of Procedure of the States of Deliberation and their Committees, it is confirmed that the propositions above have the unanimous support of the Committee.

Yours faithfully

P T R Ferbrache
President

J Kuttelwascher
Vice-President

A C Dudley-Owen
J S Merrett
J I Mooney