



SUMMATIVE (FORMAL) ASSESSMENT: MODULE 5D

GUERNSEY

This is the **summative (formal) assessment** for **Module 5D** of this course and must be submitted by all candidates who **selected this module as one of their elective modules**.

The mark awarded for this assessment will determine your final mark for Module 5D. In order to pass this module, you need to obtain a mark of 50% or more for this assessment.

INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.
2. All assessments must be submitted electronically in **Microsoft Word format**, using a standard A4 size page and an 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way. DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.
3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).
4. You must save this document using the following format: **[studentnumber.assessment5D]**. An example would be something along the following lines: 202021IFU-314.assessment5D. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words “studentnumber” with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked.**
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6. The final submission date for this assessment is **31 July 2021**. The assessment submission portal will close at **23:00 (11 pm) GMT on 31 July 2021**. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.
7. Prior to being populated with your answers, this assessment consists of **7 pages**.

ANSWER ALL THE QUESTIONS

QUESTION 1 (multiple-choice questions) [10 marks in total]

Commented [DJ1]: Total 10/10

Questions 1.1. – 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and **mark your selection on the answer sheet by highlighting the relevant paragraph in yellow**. Select only **ONE** answer. Candidates who select more than one answer will receive no mark for that specific question.

Question 1.1

Which one of the following statements **correctly describes** the sources of Guernsey law?

- (a) Guernsey's laws mirror that of England and Wales.
- (b) Guernsey's law is all set out in statute adopted from England.
- (c) Guernsey's law is based on Norman customary law.
- (d) Guernsey substantive law is set out in statutes and the historic customary law and complimented by case law from persuasive jurisdictions.**

Commented [DJ2]: Correct

Question 1.2

Which of the following types of security can be effectively taken over Guernsey **immovable property**?

- (a) A fixed charge / mortgage.
- (b) A lien.
- (c) A hypothèque by way of bond.**
- (d) A security interest agreement.
- (e) A floating charge

Commented [DJ3]: Correct

Question 1.3

Which **two** of the following are **essential requirements** for a valid security agreement pursuant to the Security Interests Law?

- (a) Registration with the Guernsey registry.
- (b) Executed as a deed.
- (c) Identify the secured party.**
- (d) Executed before the Court.
- (e) Be in writing.**

Commented [DJ4]: Correct

Question 1.4

Which of the following parties **rank first in priority** in a Guernsey compulsory winding up:

- (a) Trade creditors.
- (b) Local tax creditors.
- (c) Money lent by a sole trader to the company.
- (d) Fees and expenses of the liquidator.
- (e) Fully paid up shareholders.

Commented [DJ5]: Correct

Question 1.5

Which one of the following procedures can be used to enforce against real property in Guernsey?

- (a) *Saisie*.
- (b) *Arret de Gages*.
- (c) *Arret de Personnes*.
- (d) *Désastre*.

Commented [DJ6]: Correct

Question 1.6

Which one of the following **is not** a standalone ground for the making of a compulsory winding up order as set out in the Companies Law?

- (a) Passing of a special resolution to wind up.
- (b) Deadlock on board of directors.
- (c) Suspension of business for a year.
- (d) Company is unable to pay its debts as they fall due.
- (e) Failure to hold a general meeting of members under specified provisions of the Companies Law.

Commented [DJ7]: Correct

Question 1.7

Which of the following **may not** be appointed as voluntary liquidator of a Guernsey company?

- (a) A director or former director.
- (b) A corporate entity.
- (c) A foreign resident individual.
- (d) A shareholder.

(e) None of the above.

Commented [DJ8]: Correct

Question 1.8

Which one of the following parties **does not** have automatic statutory standing to make an application for an administration order in respect of a Guernsey company?

(a) A shareholder.

(b) The Registrar of companies.

Commented [DJ9]: Correct

(c) A director.

(d) A creditor.

(e) None of the above.

Question 1.9

Which one of the following **is not** a ground for setting aside a judgment registered under the Reciprocal Enforcement Law?

(a) The courts of the originating country did not have jurisdiction.

(b) The enforcement of the Judgment would be contrary to public policy in Guernsey.

(c) The enforcement of the Judgment would be contrary to public policy in the home jurisdiction.

Commented [DJ10]: Correct

(d) The Judgment was obtained by fraud.

(e) The rights under the Judgment are not vested in the person by whom the application for registration was made.

Question 1.10

It is advisable for a creditor to take **which one** of the following steps before commencing a *saisie* action?

(a) Obtain a prohibitory injunction to prevent the debtor from disposing of the realty.

(b) Register an interest in the realty at the *Greffe*.

(c) Advertise in the local Gazette an intention to commence *saisie* proceedings against the debtor.

(d) Exhaust the debtor's personalty (personal property) and register a claim in *Livre des Hypotheques* in the interim.

Commented [DJ11]: Correct

(e) Enter into a security interest agreement with the debtor to ensure that the creditor's interest in the realty is protected.

QUESTION 2 (direct questions) [10 marks]

Commented [DJ12]: Total 10/10

Question 2.1 [maximum 5 marks]

What are the most common forms of security granted over immovable and movable property in Guernsey? Explain the formalities (if any) that the security documents, the secured creditor or the debtor must comply with.

Immovable Property

The most common form of security formed over immovable property is a hypothec which is an encumbrance which attaches to a freehold property or a contract lease which come in the form of a hypothecque judiclaire or a hypothecque conventionnelle.

Rentes Foncieres/ Rente Hypotheque

Rentes Hypotheque, a payable annual sum, has become almost redundant, and the bond has become the dominant type of **security**.

Commented [DJ13]: Half mark

Hypotheque conventionnelle (HC)

A Hypotheque conventionnelle only typically occurs in two circumstances:

- when a property is sold and part of the purchase price is not paid to the seller but remains outstanding as an encumbrance on the property, representing the debt owed to the seller by the purchaser;
- when the terms of borrowing in a real property transaction, with provision for security, are otherwise sworn to before the Court. The terms of borrowing are therefore available for public inspection at the Registry, which can make a hypothecque conventionnelle unattractive for commercial or complex **lending**.

Commented [DJ14]: Half mark

A HC is essentially a bond over the property and can be a general charge or a specific charge.

A HC requires:

- it must be in writing and must be consented by the debtor before the Royal Court of Guernsey as a contract court before being registered at the registry of the Royal Court.
- Following ratification by the contract **court**:
 - o The bond is assess for document duty of 0.5% of the secured amount, the fees of the contract court and registration fees;
 - o The document duty and fees are paid;
 - o The bond is registered in the Greffe and available for public inspection to anyone wishing to conduct a search against the debtor.

Commented [DJ15]: Half mark

If the above is not complied with then the contracts court is **invalid**.

Commented [DJ16]: Half mark

Movable Property – Intangible

There are two types of security over tangible movable property: a security interest (under Securities Law) which can be secured over any property but a lease, or a security under the Law of Property (Miscellaneous Provisions) (Guernsey) Law 1979 by way of a set-off **agreement**.

Commented [DJ17]: Half mark

The pre-requisites of a security agreement are set out in the Security Law. Such an agreement must:

- be in writing;
- be dated;
- identify and be signed by the debtor, i.e. the party giving the security;
- identify the secured party;
- contain provisions regarding the collateral sufficient to enable its precise identification at any time;
- specify the events which are to constitute events of default; and
- contain provisions regarding the obligation payment or performance of which is to be secured, sufficient to enable it to be identified.

Commented [DJ18]: Half mark

For an assignment under Law of Property (Miscellaneous Provisions) (Guernsey) Law the assignor must:

- execute it in writing; and
- express notice in writing of the assignment must be served on the debtor, trustee or other person from whom the assignor would have been able to claim the debt or chose in action.

If the above requirements for the security or assignment are not complied with then that does not necessarily render those contract void, however, take the security outside of the scope of the Securities Interests Law.

Commented [DJ19]: Half mark – please note however that it is not correct here to apply the comment to both a security interest and an assignment. An assignment may well be invalid if it does not comply with the formalities.

Movable Property – Tangible

Security over tangible movable property in Guernsey can generally only be taken by way of actual possession of the property in question under a pledge. Separate regimes apply to the taking of security over Guernsey registered aircraft assets (taken by way of charge) and over Guernsey registered ships (taken by way of mortgage).

Commented [DJ20]: Half mark

The most common forms of security are:

- Lien (the right to retain another's property if an obligation is not discharged);
- Pledge (a bailment or deposit of personal property);
- Landlord's right to priority (for unpaid rent which is secured);
- Reservation of title; or
- Mortgage.

Commented [DJ21]: Half mark

For a pledge to constitute valid security, giving the lender priority in relation to the pledged assets, the following two conditions must be satisfied:

- The lender must have possession of the subject matter of the pledge (physical possession of the pledged property).
- The pledged goods must have been given to the pledgee on terms that the pledgee should have possession of such goods as security for the debt in **question**.

Commented [DJ22]: Half mark

For a charge over Guernsey registered assets, the charge must be in writing and must be registered in the charges register maintained by the Registrar, It is also possible to register a notice of intention to make an application to register a charge over Guernsey registered **assets**.

Commented [DJ23]: I am uncertain as to why the phrase charge is used here. A charge is not a concept familiar to Guernsey law and there is no such register of charges in Guernsey save for specifically in relation to aircraft.

For a mortgage over a Guernsey registered asset, the mortgage must be in the form prescribed by the registrar and must be registered in accordance with applicable laws.

Question 2.2 [maximum 5 marks]

Michael was recently appointed liquidator of Dodge Co Limited, a Guernsey incorporated company. There are two directors of the company, Roger and Novak. The books and records of the company show that Novak paid £5,000 to purchase a car from the company two months prior to the company entering into liquidation. However, the fixed asset register had listed the car as having a value of £20,000.

Identify the issue with this transaction and explain the possible causes of action against the company or directors, as well as the possible remedies for recovery of the difference in value between the value and sale price of the asset.

We can determine that the director is a connected party, and has received the equivalent of a £15,000 payment from the company, and has therefore been given preference.

Novak would have had significant influence over the transactions, and as such, there is clear desire to give preference and give himself a favorable outcome prior to Dodge Co Limited entering liquidation. If preference has been given, the Court has power to restore the position of the Company by making the Novak personally liable for settling the deficit of **funds**.

Commented [DJ24]: One mark – note the Court's power here extends to making any order it thinks fit to restore the position and not just making Novak liable.

The above question does not state whether the company is insolvent nor whether the transaction lead to the Company being insolvent. As such, any payments made to a "connected party" within 2 years immediately preceding the application for compulsory winding up, or a resolution for voluntary winding up is vulnerable to be set **aside**.

Commented [DJ25]: One mark

There is no specific law in Guernsey relating to transactions undervalue (Novak has purchased the car under value) however, the liquidator could claim that the directors have committed an equitable wrong – Novak accepted the vehicle presumably with oversight of the assets schedule and if the company is insolvent, it would be inappropriate for them to consciously keep the **asset**.

Commented [DJ26]: One mark

The liquidator could also instigate a customary law Pauline action if it can be proved that Novak was attempting to defraud creditors where Dodge Co Limited was insolvent at the time of disposing of the car, or became insolvent due to it. Doing this successfully (the liquidator would need to bring the claim within 6 years) would mean the transfer of assets is set aside and the assets become available to satisfy any creditor **claim**.

Commented [DJ27]: One mark

Finally, if the liquidator can prove that Novak has misapplied the company asset by selling the care at significantly undervalue, the liquidator can apply for misfeasance or breach of fiduciary duty as Novak consciously sold the car to himself at undervalue, and therefore

made the wrong decision and there is no clear evidence that Novak did it for any benefit but his own. The liquidator can do this 6 years after the transaction took place.

Commented [DJ28]: One mark

QUESTION 3 (essay-type questions) [15 marks in total]

Commented [DJ29]: Total 13/15

Question 3.1 [maximum 7 marks]

Guernsey has not adopted the UNCITRAL Model Law on Cross-Border Insolvency. Explain what methods are available to foreign insolvency officeholders seeking recognition in Guernsey and the limitations of those options.

Introduction

Guernsey is neither a signatory to the UNTIRAL Model Law on Cross-Border Insolvency, nor a member of the European Union but the Guernsey Royal Court has been known to assist foreign liquidators if deemed necessary. Such assistance is recognised under the UK Insolvency Act 1986, or under Common Law.

Commented [DJ30]: Half mark

UK Insolvency Act

The Royal Court of Guernsey may offer assistance to Courts of England, Wales, Scotland, Northern Ireland, the Isle of Man or Jersey under section 426 of the UK Insolvency Act 1986 which was extended to Guernsey in the Insolvency 1986 (Guernsey) Order, 1986. This also means that officeholders in Guernsey can request assistance in jurisdictions that have elected Guernsey as a specified country for requests. Recognition in a foreign Court requires a strict procedure to be followed under section 426:

Commented [DJ31]: Half mark

Commented [DJ32R31]:

- 1) The Guernsey appointed liquidator must submit a "Representation" to the Royal Court "Royal Court" of Guernsey;
- 2) The Royal Court then writes to the Court in the Jurisdiction the Guernsey liquidator is looking to obtain recognition, known as a "Request" (this must be prepared under section 426);
- 3) The Request will then be issued by order of the foreign court;
- 4) The Royal Court then submits an application seeking assistance of the foreign court for the order as sought in the Request ("Application").

Commented [DJ33]: Half mark

There are several other things to know when seeking representation by the Royal Court such as the requests should be made to the High Court of Justice in England and Wales, or certain county courts; the court that the application is being made in must be in the jurisdiction that the insolvency matters relate. Such a Request is authority for the foreign court to apply either Guernsey insolvency law, or its own insolvency law.

In addition to the above procedure which the Royal Court must follow in making an application to a foreign court, the foreign court is limited to accepting Requests only when they have considered the following:

- 1) Its own jurisdiction and powers;
- 2) Its own insolvency law;

3) The insolvency law applicable by the requesting court to comparable matters falling within its jurisdiction.

Commented [DJ34]: Half mark

The general consensus is that the foreign court, if it can within the applicable laws be applied, should grant assistance, but if it is deemed not possible, then the request may be withheld. In addition, section 426(5) of the Insolvency Act gives the Royal Court the ability to apply the insolvency law of either Guernsey or the foreign jurisdiction in relation to similar matters falling within its jurisdiction.

Commented [DJ35]: Half mark

Common Law

There is a principle of common law where the foreign court has power to grant assistance in foreign insolvency proceedings. This type of recognition has recently been developed by recent decisions, and the below is derived particularly in the decision that of the Privy Council in *Singularis* (where an appeal was dismissed against the Court of Appeal in Bermuda when they refused to order an auditor to release information it held on a company which had been wound up in the Cayman Islands (*Singularis Holdings Limited v PriceWaterhouseCoopers (2024)*)).

Commented [DJ36]: Half mark

Firstly, it is important to note that there is a need for there to be an equivalent power in the home jurisdiction under common law. The common law power doesn't allow a foreign liquidator to have any additional power than the provisions of the law under which they were appointed, however, the court could make an order against the individuals or companies in its own jurisdiction in favour of the foreign liquidator but this is dependent on the foreign liquidator having similar rights under the domestic court which appointed them.

Commented [DJ37]: One mark

This essentially means that the powers of the domestic court applied to the liquidator are exercised through their existing powers and those powers can be extended and/or developed through the traditional judicial law-making techniques. These powers are limited in that the application of legislation means the judiciary cannot be extended beyond the scope to cases where it does not apply and as a consequence, the powers do not extend to make the foreign insolvency as if it was a domestic insolvency, and statutory powers may not apply instantaneously.

Secondly, the order must be submitted with consistence with the substantive law and public policy of the assisting state but the Guernsey court broadly co-operates in insolvency proceedings providing that there is a sufficient connection between a liquidator's jurisdiction and the jurisdiction in which the application for recognition is made.

Commented [DJ38]: One mark

The Royal Court has complete discretion under the common law, however, if there is sufficient connection, the court will typically grant relief sought, however, normally the Guernsey Court cannot grant relief unless it has a common law power to do so.

Recent Cases to Consider

A recent case to consider when seeking guidance as to the factors that will be considered when interpreting the Rules to determine whether or not a particular procedural order sought by a party falls within the Court's jurisdiction is *EFG Bank (Channel Islands) Limited v BC Capital Group Limited & Ors* as passed by the Royal Court in July 2014 (liquidation proceedings commencing 2013). The proceedings were issued by EFG Private Bank (Channel Islands) (EFG) in respect of assets held in accounts in Guernsey on behalf of a number of hedge funds which were incorporated in the BVI which were in liquidation with two BVI liquidators appointed.

Two civil complaints had been made in the US by the U.S. Securities and Exchange Commission (the "SEC") and the U.S. Commodity Futures Trading Commission (the "CFTC") against Nikolai Battoo and related entities of his as a consequence of alleged fraudulent schemes which he enacted to cover losses suffered as a result of the Madoff Ponzi scheme. He induced investors to invest further funds into the portfolios in order to fund redemption payments to existing investors. These funds had allegedly been invested in Guernsey.

A receiver was appointed over the assets of Nikolai Battoo and his related entities, and liquidators have been appointed over a number of defendant entities. The liquidators in the BVI, the Bahamas and the US Receiver have all been formally recognised in the Royal Court of Guernsey and are contesting title to the assets of Nikolai Battoo.

Further, the extent of assistance that can be provided to a foreign officeholder as a matter of common law was considered by Lord Hoffman in *Cambridge Gas (Cambridge Gas Transport Corporation v The Official Committee of Unsecured Creditors (of Navigator Holdings Plc and others))*. Hoffman adopted the principles of "modified universalism". The principle of modified universalism essentially provides that, within the constraints of public policy, courts should co-operate across jurisdictions.

The Privy Council was faced with a letter of request sent by the Federal Bankruptcy Court for the Southern District of New York (the 'New York Bankruptcy Court') to the High Court of Justice of the Isle of Man. The letter of request sought assistance in giving effect to a plan of reorganisation put forward by the creditors of a business pursuant to Chapter 11 of the United States Bankruptcy Code which had been approved by the New York Bankruptcy Court. The plan of reorganisation had the effect of vesting shares in an Isle of Man company which were held by Cambridge Gas Transport Corporation ('Cambridge Gas'), a Cayman Islands company, in the creditors of the business. It was accepted by the Privy Council that the New York Bankruptcy Court had no personal jurisdiction over Cambridge Gas; the central issue in dispute was whether the order of the New York Bankruptcy Court approving the plan was a judgment in rem or a judgment in personam, the answer to which would determine whether the order could be enforced against the shares held by Cambridge Gas in the Isle of Man company. The Privy Council held that the order of the New York Bankruptcy Court was neither a judgment in rem nor a judgment in personam.

There are other cases such as *Brittain* and *Douglass* that provide decisions made by the Royal Court, giving guidance to the outcomes and applications of such recognition requests.

Conclusion

In the light of the decisions and explanations above, foreign officeholders may, in certain circumstances, be able to obtain certain orders in the pursuance of foreign insolvency proceedings in reliance on the common law, but this is by no means a *carte blanche* (a full discretionary power). In particular, foreign officeholders will need to pay particular attention to any local customary law proceedings on foot and may have difficulty obtaining orders that could be considered beyond the ordinary course.

Question 3.2 [maximum 8 marks]

Write a short essay on the method of enforcing creditor's rights against real estate owned by individuals in Guernsey.

Introduction

Real Estate is regarded as immovable property; property that cannot be moved from one place to another and which follows or is associated with the land. Parcels of land are by their nature

Commented [DJ39]: One mark – good to see consideration of the cases here and a nice conclusion. I would have liked to see the analysis of the recognition points in the Batoo case brought more to the fore (i.e. the circumstances where the Royal Court might consider recognising a foreign receiver) but generally a good answer.

immovable, and as are all those things attached included houses, trees, shrubs and other products of the land.

Hypothèque

Hypothèque is a legal right over the debtor's property in favour of the creditor by either *Rente Hypothèque* (a fixed annual sum) or *Hypothèque conventionnel* (a bond).

In modern age, the Rente Hypothèque method is rarely used, and rarely heard of, the Hypothèque Conventionnel (translates to mortgage) has become to dominant form of security over real estate. The bond creates an obligation with a charge over the debtor's assets (or real estate) by acknowledging the debt to the creditor including a covenant to repay with the sum with interest. The bonds come in either to form of a general charge or a specific charge:

- General charge → confers priority to the creditor over all other claimants to the immovable property belonging to the creditors over all other claimants to the immovable property belonging to the debtor at the time the bond is registers; or
- Specific charge → confers priority to the creditors only over the immovable property specified in the bond.

Any successor of the immovable property is, by virtue, on notice of the creditor's claim and becomes guarantor to the creditor of the bond. They will need to make good the value of the good or surrender the property. This is often enforced under the Saisie **process**.

Commented [DJ40]: One mark – helpful to set out here the basis of the bonds being enforced.

Saisie

The *saisie* process is rooted in ancient customary law and has developed over several hundred years. A *saisie* is the procedure used for the distribution of realty of an insolvent individual between more than one creditor who would otherwise be in **competition**.

Commented [DJ41]: One mark – good summary.

Regardless of whether the debtor transfers a realty for less value than that owed to the creditor, the creditor has no further rights against the debtor's personalty (through *désastre*). In contrast, *désastre* proceedings do not extinguish recourse to any realty belonging to the debtor. It is therefore advisable for the debtor first to exhaust the debtor's personalty before considering *saisie*, and register a claim in *Livre des Hypothèques* in the interim. This is because the creditor's right to be paid transfers from the debtor to the **realty**.

Commented [DJ42]: One mark

The procedure has recently been revised by the *Saisie* Procedure (Simplification) (Bailiwick) Order 1952 and is designed to be deliberately long in order to allow the debtor maximum opportunity to pay off debts and potentially keep the property. It is spread in to three stages:

- 1) Preliminary Vesting Order;
- 2) Interim Vesting Order; and
- 3) Final Vesting Order

Preliminary Vesting Order → In order to start *saisie* proceedings the creditor needs to obtain a judgment debt and obtain a Preliminary Vesting Order ("PVO").

The debtor will apply for a commissioners meeting upon which the debtor will be given a commissioners report which details:

- Whether the Debtor attended;
- Whether the Debtor examined the accounts and agreed them or made representations;
- A declaration of the sums that the Commissioner considers are payable to the Principal **Creditor**.

Commented [DJ43]: One mark

Interim Vesting Order → At this stage of the saisie procedure the Creditor will request the Debtor repay the debt owed to him or to renounce his ownership of and to vacate the realty. If the IVO is granted the Debtor will lose his ownership of the property, which will pass to the Creditor as trustee for all of the Debtor's creditors

After the IVO is granted the Creditor may request that the Greffe opens the Register in order that the Debtor's creditors may come forward to register their **claim**.

Commented [DJ44]: One mark

The Creditor must publish on twice notifying other creditors that the Register is open. The Register will remain open for 28 working days from the date of the second notice. All claims will then be marshalled by the principle creditor, and placed before the commissioner.

Final Vesting Order → Creditors are called in reverse order before the Court. If they opt to take the realty then they must pay off higher ranking creditors within 15 days - the creditor that elected to take the realty is then the sole owner of the property and can dispose of it, or not, as they please. They do not have to inform the Debtor of any 'equity' realised after retirement of debt and costs. This can result in a significant windfall for the Creditor who obtains the **FVO**.

Commented [DJ45]: One mark

Licitation

Licitation can be applied in the *Saisie* procedure where a real estate is owned jointly. In this scenario, the creditor would apply to be a co-owner of the **property**.

Commented [DJ46]: One mark – well done for picking up this point which is often overlooked.

Livre de Hypotheques

Another tool available to a claimant in Guernsey proceedings is the registration of an interlocutory act in those proceedings in the Livre des Hypothèques (applied for instead of or as well as the PVO), with the leave of the Royal Court of Guernsey (the Royal Court). This is a customary law procedure dating back to at least the 19th Century, the effect of which is to create a charge over the respondent's interest in any Guernsey property, with priority over any subsequent charges. This is typically only undertaken when a Pauline action is taken.

Commented [DJ47]: Whilst not strictly a method of enforcing a bond, this is a good explanation of the use of the Livre de Hypothèques.

QUESTION 4 (fact-based application-type question) [15 marks in total]

Commented [DJ48]: Total 9/15

In July 2016, Andy and Bob incorporated a company (Athletico Ltd) that specialised in selling novelty football T-shirts. Andy and Bob were the company's only members and directors. For the past 18 months, the company has been experiencing financial difficulties. In September 2018, the company's overdraft with Beardsley Bank plc had reached its limit of £250,000. In return for increasing the overdraft limit to £300,000, Beardsley Bank plc demanded security for the additional borrowing and took a bond over the company's property (valued at £100,000). In December 2018, Athletico Ltd borrowed £100,000 from a friend, Barry Homeowner, who also took a bond over the same property.

The business continued to struggle and in February 2019 Andy and Bob were informed by the company's auditor that insolvent liquidation was inevitable, although Andy and Bob disagreed

and held out hope that the company's financial prospects would improve. Andy and Bob decided to try and trade their way out of their financial difficulties by having a sale. Unfortunately, the sale failed to increase business and in May 2019 Athletico Ltd was wound up compulsorily. By this time, the company's overdraft with Beardsley Bank amounted to £290,000.

Debbie and Rahid have been appointed as joint liquidators and have discovered several facts:

- in March 2019, Andy and Bob caused the company to repay an unsecured loan of £5,000, which Bob had made to the company some months before;
- in addition to the money owed to Beardsley Bank and Barry Homeowner, the company owes £10,000 to the Guernsey Revenue Service for unpaid tax, £30,000 to employees in wages, and £100,000 to unsecured creditors.

Debbie and Rahid estimate that the total remaining assets of Athletico Limited amount to £440,000. Debbie and Rahid's expenses in acting as liquidators amount to £3,000. Advise Debbie and Rahid, addressing the following:

- (a) the role of the joint liquidators;
- (b) how to pool the assets;
- (c) potential claims against the directors; and
- (d) how to manage distributions to creditors.

Role of the Joint Liquidators

Liquidators, or Joint Liquidators are required to swear an oath of office on appointment as, unless they are appointed voluntarily by shareholders, they are considered officers of the Royal Court.

The Joint Liquidators primary duty is to collect and realise the company's assets and to distribute dividends according to a statutory order of priority. All powers of the company's directors cease upon the Joint Liquidator's appointment except insofar that the Joint Liquidators deem their assistance beneficial for the company. Any director that exercises powers is guilty of an **offence**.

Commented [DJ49]: One mark

A liquidator must also send a copy of the compulsory winding-up order to the Registrar of Companies within seven days after being appointed. The Registrar of Companies publicises the fact that the company has been placed into liquidation. It is also good practice for the liquidator to contact all known creditors.

The Joint Liquidator may investigate the timeline leading up to the insolvent liquidator and whether the directors may be guilty of fraudulent or wrongful trading upon which the liquidators can seek to recover funds personally from the **directors**.

Commented [DJ50]: One mark

Once the assets have been realised, the Joint Liquidators must apply for the appointment of a court commissioner to examine his accounts and distribute the funds derived from the company's assets. The commissioner will then arrange to examine the financial statements and creditor claims, and fix a date for distribution of the company's **assets**.

Commented [DJ51]: One mark

Pooling of assets

Pooling of assets normally happens over a group of companies but is rare because it is not consistent with the principle that a creditor can only enforce their debt against the assets of a liable entity.

The above said, in accordance with the *Pari Passu* principle, all creditors participate in the common pools of assets in proportion to the size of their admitted claims. These assets will need to be realised prior to **distribution**.

Commented [DJ52]: One mark

Claims Against the Directors

The directors allowed the company to continue to trade despite it being insolvent for some time, and were warned in February 2019, and had significant financial difficulties in 2018 and could therefore be guilty of wrongful trading, or even fraudulent trading.

Arguably, the directors put the company in a worse off position because they moved £5,000 to the director to pay off an unsecured loan, and have secured a bonds over properties worth £200,000 when the property is only worth £100,000. Because they were warned by the auditors, and moved money to pay themselves, it is clear that they ought to have known there was little chance of **recovery**.

Commented [DJ53]: Half mark – the answer did not pick up that the overdraft position of the company worsened by £40k in the period after insolvency became doubtful even if the auditor did not say insolvency was inevitable until February. Of course, directors may be excused from liability for wrongful trading if they take every step with a view to minimizing the potential loss to creditors.

As such, a liquidator may apply under the preference principle, to set aside a transaction by a company if it was made when the company was insolvent, or the company becomes insolvent as a result of the transaction. Because a director is considered a connected party, such transactions can be set aside if they happened within a 2 year period preceding the application for compulsory or voluntary winding **up**.

Commented [DJ54]: One mark

Below is a table of figures to determine the position of the company at the time of the transfer to Bob in March 2019, and this transaction was 2 months prior to the compulsory winding up, so would fall within scope providing the two conditions could be met:

	Mar-19	May-19
Overdraft	285,000.00	290,000.00
Barry Homeowner	100,000.00	100,000.00
Director Loan	5,000.00	-
GRS	10,000.00	10,000.00
Wages	30,000.00	30,000.00
Unsecured Creditors	100,000.00	100,000.00
Joint Liquidator Fee	-	3,000.00
Liabilities	530,000.00	533,000.00
Assets per question	440,000.00	440,000.00
Net Liability Position	- 90,000.00	- 93,000.00

Whilst the director paying off his loan doesn't necessarily have a huge impact on the liquidity of the company, it means that the overdraft has increased on a third party, and worsened the cash position of the company. Provided there were no large assets sold (there is no indication that there were) then it is clear to see in March 2019, the company is balance

sheet insolvent. The only reason they have been able to maintain solvency is due to the cash flow available by way of an **overdraft**.

It is clear to see that preference has been given to the director, which grants the court wide-ranging powers to make any order it thinks fit to restore the position of the company to where it would have been absent of the preference, making the directors personally liable for it.

Another thing to consider is transactions undervalue; there isn't quite enough information in the text about to ascertain how much the sale reduced the value of the stock. Moving the stock and selling it at significantly undervalue to a supplier they knew, and hence, potentially moving it elsewhere so it couldn't be touched. In such a case the Pauline Action might be applied, but significantly more information regarding this value would need to be considered (i.e. were they selling it to a supplier for cheap, who could then sell it on for a higher price and they take the profit **personally?**).

The directors are likely to be considered for wrongful trading because they knew, some time before it when in to liquidation, that there was no reasonable prospect of the company avoiding going into insolvent liquidation (as they were warned by the auditors and there were obvious signs). The joint liquidators could apply to court for a declaration that the director shall be liable to contribute to the company's assets, but it will but up to the director to defend and demonstrate he acted to minimise the loss of the **company**.

In either case, Bob should return the £5,000 taken in preference, and the liquidators could seek the make the directors cover the **shortfall**.

Distributions to Creditors

There will be an order of priority in the liquidation that the Joint Liquidators must follow:

- 1) firstly, their fees of £3,000 and any connected fees in relation to the wind down of the company such as relevant costs, charges and expenses incurred (legal fees, court fees for example) can be settled;
- 2) Next, preferential debts must be paid – this includes the £10,000 income tax and salaries of £30,000;
- 3) .Ordinary debtors, or trade creditors of £100,000.

The above does not mention the loan with a bond over a property. These are known as secured creditors. Barry Homeowner and the bank are entitled to be repaid from the realisation of the property. The claim by the bank or Barry Homeowner will be considered in priority of the earliest charge registered, which means only the bank will receive proceeds from the sale. The remaining amounts outstanding will fall under 'unsecured creditors' as **follows**:

Item	Classification	Amount
Assets per question		440,000.00
Joint Liquidator Fee	Wind down costs	- 3,000.00
Bank Overdraft - Secured	Secured debt	-100,000.00
Wages	Preferential Creditor	- 30,000.00

Commented [DJ55]: Half mark – the factual analysis here is good and helpful. However, the answer does not make explicit that Guernsey's solvency test is a two part one requiring both balance sheet and cash flow solvency.

Commented [DJ56]: One mark

Commented [DJ57]: See above comment which is dealt with here but credit is already given in the mark above for picking up the wrongful trading point.

Commented [DJ58]: Half mark

Commented [DJ59]: One mark – the answer re preferential creditors may have made reference to the limits on employee claims.

Commented [DJ60]: See below – the secured assets may actually provide a distribution to both secured creditors but only for part of their debts. It is right to say the bank (as first in time) would receive priority. The unsecured balances would then be added as unsecured claims.

Commented [DJ61]: The question suggests that the bank's security was taken only in relation to its additional lending and so only £50k would have been secured.

GRS	Preferential Creditor	- 10,000.00		
Assets available to unsecured creditors		297,000.00		
		Amount Outstanding	Amount Due	Percentage recovered
Remaining overdraft (directors fee refunded)		-185,000.00	-142,714.29	77%
Barry Homeowner		-100,000.00	- 77,142.86	77%
Trade Creditors		-100,000.00	- 77,142.86	77%

As the above demonstrates, unsecured creditors will only receive 77% of their amounts owed, whereas secured and preferential creditors receive 100%.

Because the bank secured the property in September 2018, and Barry Homeowner secured it in December 2018, the bank receive the security proceeds.

As mentioned above, the directors may have to cover any shortfall (the additional 33% not recovered).

*** End of Assessment ***

ⁱ <https://www.careyolsen.com/briefings/fraud-asset-tracing-recovery-20212022-%E2%80%93-guernsey-commercial-dispute-resolution-cdr>

Commented [DJ62]: Half mark – a good effort at setting out the order with the major principles all picked up.

Commented [DJ63]: Total mark 42/50