



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).
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6. The final submission date for this assessment is **31 July 2022**. The assessment submission portal will close at **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. 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 **8 pages**.

ANSWER ALL THE QUESTIONS

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

Commented [DJ1]: 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 Guernsey legal system?

- (a) Guernsey is bound by decisions of the English Court of Appeal.
- (b) UK legislation is directly applicable in Guernsey.
- (c) Guernsey law is often influenced by the common law of other Commonwealth jurisdictions.
- (d) Customary law in Guernsey cannot be altered by legislation.

Commented [DJ2]: Correct

Question 1.2

Which one of the following **is not** a fiduciary duty of a director?

- (a) Exercise independent judgment.
- (b) Avoid conflicts of interest.
- (c) Act *bona fide* in the best interests of the company.
- (d) Act with skill and care.
- (e) Act for proper purposes.

Commented [DJ3]: Correct

Question 1.3

Which one of the following statements **is correct** in respect of the order of priorities in a liquidation in Guernsey?

- (a) The *pari passu* principle affects the rights of secured creditors.
- (b) Preferential debts come first in the order of priority.
- (c) There is no preferential treatment given to employees.
- (d) Debts in a certain class are given priority in relation to the time of their creation.
- (e) Rent due to a landlord has priority among preferential debts.

Commented [DJ4]: Correct

Question 1.4

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) The company has is unable to pay a dividend to members.
- (b) The company has failed to send its members a copy of its accounts or reports under specified provisions of the Companies Law.
- (c) The company has, by special resolution, resolved to be wound up.
- (d) The company suspends business for a year.
- (e) The company is unable to pay its debts as they fall due

Commented [DJ5]: Correct

Question 1.5

Which one of the following statements about Schemes of Arrangement is **incorrect**?

- (a) The process is broadly the same as that in the UK.
- (b) At the Court-convened meeting of creditors / members, a majority in number representing not less than 50 per cent in value of the members present and voting must approve the scheme before it is sanctioned by the court.
- (c) Notice of the meeting of the members of the company must be sent to each creditor or member.
- (d) A scheme may be used in conjunction with an administration.
- (e) A scheme could be used for restructuring.

Commented [DJ6]: Correct

Question 1.6

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 [DJ7]: Correct

Question 1.7

Which of the following **two statements are correct** in respect of compulsory liquidations?

Commented [DJ8]: Correct

- (a) **There is no statutory moratorium on creditors' claims.**
- (b) Once the winding-up procedure has commenced, any transfer of shares is valid for a period of 30 days without the need to seek approval from the liquidator.
- (c) **The company must not carry on any business upon the making of a compulsory winding-up order.**
- (d) The courts usually impose time frames for the length of liquidation.
- (e) A company is dissolved at the start of the liquidation.

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 member.
- (b) An incorporated cell company.
- (c) A prospective creditor.
- (d) A director.
- (e) **The Guernsey Registry.**

Commented [DJ9]: Correct

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 enforcement of the judgment would be contrary to public policy in the home jurisdiction.**
- (b) The courts of the originating country did not have jurisdiction.
- (c) The judgment debtor did not receive notice of the proceedings in sufficient time to enable him / her to defend the proceedings and he / she did not appear.
- (d) The judgment was obtained by fraud.
- (e) The enforcement of the judgment would be contrary to public policy in Guernsey.

Commented [DJ10]: Correct

Question 1.10

Which of the following statements is **incorrect** in respect of misfeasance / breach of fiduciary duty?

- (a) The test for a breach of fiduciary duty is a subjective one.
- (b) Any claim must be brought within three (3) years from the date of breach.
- (c) The court may order the director to contribute towards the company's assets.
- (d) It may arise where a director has breached their fiduciary duty towards the company.
- (e) Any creditor of the company may apply to the court for an order against the director.

Commented [DJ11]: Correct

QUESTION 2 (direct questions) [10 marks]

Commented [DJ12]: 6.5/10

Question 2.1 [maximum 5 marks]

What are the most common forms of security granted over intangible movable assets in Guernsey? Explain what is required to ensure the security documents are valid and the consequences of failure to comply with any formalities.

Common forms of security

Security over real estate in Guernsey is taken as a *hypothèque* which is a legal right over the debtor's property in favour of the creditor), by either:

- *Rente hypothèque*, securing a fixed annual sum, or
- *Hypothèque conventionnel* (bond).

The *rentes hypothèque* is no longer regarded as the most common forms of security, having been overtaken by the bond which has become the dominant form of security over real estate.

The bond is a personal obligation to create a charge over the corpus of the debtor's assets by acknowledging the debt to the creditor and (if appropriate) including a covenant to repay the sum with interest.

The type of bond can be either a general charge which confers priority to the creditor over all other claimants to the immovable property belonging to the debtor at the time the bond is registered.

If the debtor does not pass a general bond, then a specific bond which confers priority to the creditor only over the immovable property specified in the bond is **passed**.

Commented [DJ13]: This answer relates to security of immoveable property and is not relevant,

Requirements and the consequences of the failure to ensure compliance therewith

The requirements establishing validity of the security documents are found in the following Laws:-

1. Security Interests (Guernsey) Law, 1993 (Security Interests Law):

In this scenario a security agreement is created over intangible movable property. In order to create the security interest, the secured party will be in possession of a certificate of title, or titles as the case may be; and, policy documents.

The assignment of collateral to title must be reduced to writing and given to the assignees.

Commented [DJ14]: 1 mark

The security agreement under this law will not pass the test of validity unless it complies with seven criteria *inter alia* it must be in writing, it must be dated, it must identify the debtor and the debtor must sign the document, it must identify the secured party, it must precisely identify the collateral provisions, it must specify the events which constitute a default on the part of the debtor, and it must contain identifiable provisions regarding the obligation, payment or performance to be secured.

Commented [DJ15]: 1 mark

If any of these requirements are not complied with, the security agreement will still remain valid, albeit that it will no longer be governed by the provisions of the Security Interests Law.

2. Law of Property (Miscellaneous Provisions) (Guernsey) Law, 1979:

In terms of this law, a set-off agreement is created along with an assignment. A proviso exists for reassignment.

Where agreements describe a mutual dealing between the parties, then debts incurred by one party may be set-off against the debts of the other party.

If a balance exists thereafter, then legal action can only be taken in respect of the balance due after that set-off. The rights to enforce legal action in the above scenario can be assigned to a third party.

Commented [DJ16]: 1 mark

In order for the agreement to pass the test of validity it must be reduced to writing and signed by the assignor. In addition, and thereafter, express notice in writing of the assignment must be served on the debtor, trustee or any other person from whom the assignor would have been able to claim the debt or enforce action.

Non-compliance with the above requirements does not render the agreement void.

Commented [DJ17]: 1 mark

Question 2.2 [maximum 5 marks]

Guernsey's insolvency regime is often described as being "creditor-friendly". Identify key features of the various insolvency procedures available to companies that support this description.

Guernsey's corporate insolvency laws, particularly liquidation procedure distinctive for their general lack of any moratorium on creditor action. This is evidenced in both a compulsory and voluntary liquidation respectively.

Commented [DJ18]: Yes but administration does afford a moratorium on unsecured claims. A key feature is the carve out for secured creditors in administration. 1 mark

All the insolvency procedures that can be utilized, from a compulsory liquidation, or a voluntary one, to an Administration, or a Scheme of Arrangement have no time frame from commencement to dissolution. This can significantly reduce the pressure upon creditors in as far as the lodgement of their claims is concerned. In addition, it ensures that interlocutory applications are comprehensively dealt with.

Commented [DJ19]: Again this is partially correct albeit a Scheme does have a natural timeframe set by the court timetabling. 1 mark

The mechanism of survival (in part or whole) of a company through the adoption of an Administration procedure further affords a creditor the potential to realize assets at a potentially higher value than that received by way of the proceeds of a liquidation.

Commented [DJ20]: Half mark

A major drawback in applying a Scheme of Arrangement also offers the possibility of a higher return for creditors, but more so, a Scheme is a more cost-effective way of dealing with a company's insolvency as compared to a liquidation.

Commented [DJ21]: I do not think a scheme is necessarily an alternative to a liquidation.

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

Commented [DJ22]: 10/15

Question 3.1 [maximum 7 marks]

A creditor wishes to register or enforce an English judgment in Guernsey. Explain whether this is possible and what the creditor would need to do. How would your answer differ if the officeholder sought to register or enforce a judgment from the USA?

The English Judgment

The question under consideration may be answered with reference to the Judgments (Reciprocal Enforcement) (Guernsey) Law 1957, which allows for certain foreign judgments to be registered in the Royal Court in Guernsey.

The judgments which are recognized in Guernsey emanate from most jurisdictions of Europe, including the United Kingdom, the Isle of Man, Jersey, Israel, Italy and the Netherlands. Thus, the creditor is able to obtain recognition of an English judgment in Guernsey.

Commented [DJ23]: 1 mark

Launching an application in any court of law, requires fulfilment of the criteria of establishing jurisdiction. For an enforcement application herein, the creditor is cautioned to ensure that the Guernsey court has jurisdiction *in personam* over the debtor.

In personam jurisdiction may be established in any one of the following criteria:-

- (a) The debtor submitted to the jurisdiction of the original court voluntarily.
- (b) The creditor was the Plaintiff, or had counter-claimed in the original proceedings.
- (c) The creditor agreed to the jurisdiction of the original court.
- (d) The debtor is resident in the original country or had its principal place of business there.
- (e) The creditor had its place of business in the original country and proceedings were in relation to a transaction through that office.

Commented [DJ24]: This is not quite correct. It is the original court in which judgment was afforded that must have jurisdiction although the criteria set out here are correct and seem to identify this.

Following therefrom and once jurisdiction can be established, the procedure to register the English judgment is set out in the Rules, and the application at court is made *ex parte*. The application must be supported by an affidavit together with a sealed and signed copy of the judgment.

Substantively speaking, the affidavit must contain the averments that:-

- (i) The judgment so sought to be enforced, has been obtained in a reciprocating country;
- (ii) The judgment has obtained from a superior court in the home country having jurisdiction;
- (iii) The judgment is for a sum of money payable, which monies exclude taxes, charges or other similar penalties;
- (iv) The judgment is final and conclusive;

- (v) The judgment must be unsatisfied in whole or in part and capable of execution in the country of the original court;
- (vi) The judgment must specify the amount of interest owing up to the date of registration.
- (vii) The judgment creditor is entitled to enforce the judgment and that the judgment can be enforced by execution in the country of origin.
- (viii) Lastly, the affidavit must aver that if the judgment were registered, the registration would not be, or liable to be set aside under the Reciprocal Enforcement Law.
- (ix) It may be prudent to state in the affidavit that the costs of security can be put up by the creditor in the event the court orders same.

Commented [DJ25]: Good answer - 2 marks

Once the judgment is registered, it will have the effect as if it were granted by the Royal Court in Guernsey.

It is noteworthy to point out that the judgment sought to be enforced must not involve issues of matrimony, or the administration of an estate, or the status of the natural person, and it must not be more than six years old.

Commented [DJ26]: 1 mark

The USA Judgment

The position wherein the USA wishes to enforce a judgment is different since it cannot be recognized in terms of the 1957 Law.

In this instance, the common law will apply, subject to conditions.

The Royal Court will assess whether it has competent jurisdiction to entertain the matter and will apply conflict of laws to come to a decision.

The creditor must sue on the debt and thereafter obtain summary judgment in the home country before proceeding to obtain recognition and enforcement in Guernsey.

The Royal Court has crystallized a number of requirements for the enforcement of such a judgment. The creditor should therefore take care to establish that the foreign court that issued the original judgment had jurisdiction to entertain the matter.

- (i) The defendant who forms the subject matter of the application is resident in the foreign jurisdiction.
- (ii) The defendant selected the foreign jurisdiction in which the judgment was issued as the forum for dispute with the plaintiff.
- (iii) The defendant voluntarily appeared in the court of foreign jurisdiction.
- (iv) The defendant contracted to submit to judgment jurisdiction.
- (v) The judgment was not obtained by fraud.
- (vi) Enforcement of the judgment would not be contrary to public policy, or to natural justice.

Commented [DJ27]: Again, this is a good summary 2 marks

Question 3.2 [maximum 8 marks]

Write a short essay on the benefits of using Schemes of Arrangement over other forms of corporate rescue or winding up procedures?

A Scheme of Arrangement is governed by Part VIII of the Companies Law and it is a formal compromise between a company and its creditors or members that can assist insolvent/quasi insolvent companies achieve a stated turnaround/rescue strategy.

Such compromise is a cost-effective manner of resolving balance-sheet or cashflow problems of the company which can, if not attended to, result in liquidation of the company, alternatively administration.

Commented [DJ28]: 1 mark

That it provides a court-sanctioned mechanism¹ to settle an arrangement with a class of creditors where not all of those creditors agree to the proposals can be a particularly useful tool in the context of near insolvent restructurings.

Its cramdown feature means that once sanctioned by the court, it is binding upon all creditors or class of creditors, or on the members or class of members (as the case may be) even if some of those creditors or members did not vote in favour of the **scheme**.

Commented [DJ29]: Absolutely this is a key feature. 1 mark

During this time, the company may be peacefully reorganized or restructured without the looming threat of creditor action, as legal proceedings against the company cease, except with permission of the court. This is a benefit as compared to liquidation, especially compulsory liquidations in which there is no moratorium against the claims of secured **creditors**.

Commented [DJ30]: This is not correct. Proposing a scheme will not afford any moratorium to a company unless used in conjunction with administration.

Contrary to a liquidation where all powers of the company's directors cease, and the company stops trading except in as far as trading may be beneficial to the winding-up, the Scheme of Arrangement as an agreed plan between members/creditors and the company can continue trading, which may improve the financial stability of the company.

This is a benefit which accrues to the company and its creditors and /or its members as members can ultimately benefit by the likelihood of an increased return on their investment, and creditors by a higher sum in repayment of their **debt**.

Commented [DJ31]: 1 mark

If the Scheme is agreed, the directors are absolved from personal liability for fraudulent or wrongful trading by virtue of the fact that they have taken prudent measure to avoid insolvency.

While re-organizing the company, the Scheme avoids the need for a detailed investigation of the affairs of the **company**.

Commented [DJ32]: 1 mark

In conclusion, the Scheme of arrangement is beneficial as a hybrid system which is voluntary in nature, but has some features of the liquidation system, such as the creditors' meeting.

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

Commented [DJ33]: 11/15

Pam and Jim have been asked to consider taking an appointment as insolvency officeholders over Munder & Difflin Limited (M & D), a Guernsey incorporated company specialising in selling office supplies. Michael and Dwight were the company's only members and directors.

For the last 18 months, the company has been experiencing financial difficulties as a result of the implementation of an expensive online sales platform which failed to deliver the promised increase in sales and profitability.

The platform was designed and built by Scranton Software Limited (Scranton), a company registered in England. Scranton invoiced M & D in the sum of £250,000 three (3) months ago. Scranton is owned by Ryan (Michael's son).

Following the failed launch of the website, it was obvious that M & D had cash flow issues in that it could not meet its day to day liabilities and that insolvency was inevitable. Michael and Dwight thought it would be a good idea to get cash quickly injected back into the company and took out a short term loan from a friend, Toby. The loan was primarily used to discharge the debt to Scranton.

¹ Sections 105 to 112 of the Companies Law.

The company now has no cash or liquid assets and cannot pay its major supplier that is owed £500,000. It also cannot meet this month's salaries, rent and other trade debts.

It is, however, understood that a small tweak to the sales platform could very easily return D & M to profitability if it can be protected from action by its creditors.

Jim and Pam have been approached by Michael to help navigate the crisis. Dwight has absconded to his farm in Scotland, taking with him various items of company property and valuable information.

Help Jim and Pam to advise on the following issues:

- (a) The formal insolvency proceedings available to M & D under Guernsey law and the most appropriate course to follow in the circumstances. Your answer should draw support for your conclusion from the facts set out above.
- (b) What, if any, potential claims the insolvency officeholders may wish to investigate following their appointment. For these purposes, you may assume that M & D will ultimately be placed into compulsory liquidation.
- (c) How Jim and Pam could seek assistance overseas in dealing with Dwight.

(a) QUESTION A

ISSUE:

The crisp issue for determination is to establish the routes available to M & D, a company, under bankruptcy proceedings and select the most appropriate course of action to follow.

LAW:

The insolvency procedures available for a corporate rescue in Guernsey are Compulsory Liquidation, Voluntary Liquidation, an Administration, or a Scheme of Arrangement.

Liquidations

Liquidation, whether Voluntary or Compulsory is a formal insolvency process to wind-up the company. Compulsory liquidation is governed by sections 406 – 418 of Part XXIII of the Companies Law. Voluntary Liquidation is governed by sections 391 to 405 of Part XXIII of the Companies Law.

As it is understood that M & D can be rescued and returned to profitability, the options of Compulsory and Voluntary liquidation are not options that can be considered and there is therefore no further discussion **required**.

Administration

Administration is a form of corporate rescue and is governed by the provisions of sections 374 – 390 of Part XXIII of the Companies Law.

Commented [DJ34]: 1 mark

The application to be placed under Administration can be initiated by a number of different parties,² but for purposes of this question it is open to the debtors M & D to make.

The threshold for the granting of an Administration order is two-fold:-

In the first leg:

- (i) The company must be unable to satisfy the solvency tests, in that a written demand served by Her Majesty's Sergeant for an amount of GGP 750 remains unpaid for a period of 21 days, or the Court is satisfied that the company is unable to service its financial obligations to the creditor as they become due, or
- (ii) The granting of an Administration order will give the company an opportunity for survival in whole or in part as a going concern or will yield the potential for a more advantageous realization of the company's assets.

In the second leg of the test, the valuation of the company's liabilities must exceed its assets. Independent evidence of the company's recent accounts, fair valuations of company assets, bank statements, auditors' books, and any other factor known to the directors will be taken into account to found this part of the test.

Upon the sanctioning of an Administration order by the court, the company is placed into the hands of an administrator. The administrator will do all things necessary or beneficial for the management of the company's affairs and can apply to the court for powers to exercise his functions to the benefit of the company in instances where those powers are otherwise limited.

From the onset of the presentation of the application to court until an order is made, or the application is otherwise dismissed, the company is prohibited from passing any resolution to wind it up. In addition, creditors may not enforce or continue actions against the company unless with permission of the court or the administrator.

The position regarding employees during the period of Administration remains unaffected and their contracts are not automatically terminated.

The process of an Administration has no time limit.

Schemes of Arrangement

A Scheme of Arrangement ("Scheme") is governed by section 105 – 112 of the Companies Law.

A Scheme is essentially a proposal to restructure the debtor company. The proposal must be a consensual one as between the debtor company and its creditors. The proposal must detail the appropriate solutions to return the company to profitability while balancing the needs of creditors such as for example, providing longer time-frames for payment to its creditors. If the plan is backed by a moratorium, the Scheme can be used in conjunction with an Administration.

The company opting to pursue a Scheme must apply to court for an order to convene the members of the company to vote on the Scheme.

² For example the application can be made by the company, or the directors of the company, or any member of the company, or a creditor, or a liquidator, or the GFSC or a protected or incorporated protected cell company in certain defined circumstances.

Commented [DJ35]: This is not correct as this is the test for compulsory winding up on the grounds of insolvency. For administration the test is whether the company is, or is likely to become, insolvent.

A detailed notice of the meeting must be sent to each creditor and each debtor in terms of which the proposed Scheme is set out, as well as the directors' material interests in the company.

Where the notice is published it must contain the statement of the proposed scheme including the directors' interests, or where such statement may be obtained.

The Scheme may be approved at the court convened meeting of creditors and members by a 75% majority in value of those members present or voting by proxy.

Thereafter the court must sanction the Scheme (the second application to court). The court will consider whether all procedural requirements have been complied with. The court will establish if members and creditors interests are appropriately reflected, such as that they belong to different classes. The court will ensure that proper representation of creditors and members were present at the meeting and that the majority acted in good faith in the interests of their respective classes. Lastly, before giving its approval, the court will consider whether there is no blot on the Scheme and that it is one which an intelligent and honest man would approve – see *Re Montenegro Investments (in Administration)* (22 July 2013).³

APPLICATION OF THE LAW TO THE FACTS:

In an assessment of the situation facing M & D, the following becomes apparent:-

1. The company has been experiencing financial difficulties for the past 18 months.
2. The company owes a major supplier £500 000.
3. The company has no cash or liquid assets to pay its creditors, employees or rental.
4. A "small tweak" to the sales platform can return the company to viability.

The most appropriate course of action to pursue would be to place the company under Administration.

The launching of an application to be placed under Administration provides for the directors or the company to bring application. Michael, as the sole director left has *locus standi* to bring the application in his capacity as a director. It is inconceivable that the application can be brought by the company as Dwight has absconded.

Substantively speaking, adopting the test for Administration, it is evident from the above facts that the company should be able to comfortably assert its survival as a going concern, either in whole or in part. M&D can prove its insolvency through the debts it owes to creditors, employees and landlord while also demonstrating its lack of cash on hand.

Once sanctioned, the administrators Pam and Jim can take the necessary control over the business. This would then empower them to pursue actions for misfeasance against Dwight.

This solution is more workable than a Scheme of Arrangement but can be used in conjunction with a Scheme. If Pam and Jim elect to use a Scheme, this route will entail two applications to court, the preparation of the Scheme proposal, as well as the convening of a meeting to approve the Scheme. As the creditors outweigh the members – Michael is the sole director and member – there is a possibility that the Scheme may be disfavoured by the creditors who are apprehensive about the changes to the company's sale platform from which, they may not consider to be the proverbial goose that lays the golden egg. In this instance, they may well elect a compulsory liquidation.

³ <https://www.ogier.com/publications/guernsey-schemes-of-arrangement>. Accessed 16th May 2022.

Commented [DJ36]: Agreed - 1 mark

Commented [DJ37]: 1 mark

Commented [DJ38]: 1 mark

Commented [DJ39]: It is not quite correct that an administrator can pursue this action – that would only fall to a liquidator.

Commented [DJ40]: I don't think this case fits the scheme model given the lack of any group of creditors to be compromised.

(b) QUESTION B

ISSUE:

The issue revolves around a discussion on the types of legal action that can be taken against Dwight and Michael.

LAW:

There are five types of legal actions which may be considered.

Preferences

A Preference is a transaction made by the director in favour of a creditor to the exclusion of other creditors.

The payment transaction must have been made within 6 months of the company's insolvency, or within 2 years if the creditor is a "connected party" to the transaction.

Such Preference must have been made when the company was insolvent, or became insolvent thereafter as a result of the transaction.

Where the transaction improves the financial position of the creditor who has so received the Preference, it is known as a "deemed preference." A "deemed preference" may also be applied to a person who is one of the company's creditors, or stands as a surety or guarantor for any of the company's debts or liabilities.

In establishing a Preference, the claimant may factually sketch the desire of a director who may have been influenced to make such a preference, but this is a factual exercise and the inference sought to be drawn should be consistent with the overall chronology of the factual matrix presented to the court.

The company's director/s who transacts with the "connected party" within the 6 month period preceding the company's insolvency, is presumed to have transacted outside the ordinary course of business and such transaction has been made with the intention to prefer.

A director found to have preferentially traded with a creditor can be held liable and subject to any other orders that the court may see fit to impose.

Transactions at undervalue

Guernsey has no codified laws regarding the penalization of transactions at undervalue.

The claim thus made herein is that directors committed an equitable wrong by breaching their fiduciary duties in that they knew the transaction at undervalue was of such a nature so as to affect the conscience of the recipient to the extent that it would be impermissible to allow the recipient to keep such property.

The second manner of proving a transaction at undervalue is to lay the underlying doctrine of the *Actio Pauliana*, based on the intention to defraud.

Proving a claim under the *Actio Pauliana* requires that the claimant prove firstly, that the debtor was insolvent at the time the transaction was made; and, that the transaction made by both parties at that time was done so with the intention to commit fraud.

Proving these requirements will demonstrate to the court that the recipient of the transaction had (inside) knowledge that the directors thus committed an equitable wrong, and that the recipient may be thus regarded as a constructive trustee of the company's assets.

A finding that the directors breached their fiduciary duties will lead the Court to grant an order making restitution.

The time period for bringing this action is limited to a period of six years from the date of insolvency.

Misfeasance or a breach of fiduciary duties

Misfeasance is a codified action that can be claimed under section 422 of the Companies Law during a winding-up.

A claimant who wishes to pursue this action is limited to bringing his claim within 6 years from the date of breach.

The threshold of proving misfeasance is to prove either the appropriation of monies or misappropriation of company assets by a director, the director's personal liability for company debts or liabilities, or, where the director has otherwise been found guilty of misfeasance or a breach of a fiduciary duty.

Crossing the threshold involves the complex task of factually proving a subjective intention to commit misfeasance on the part of the director – see *Carlyle Capital Corporation Limited (in liquidation) and others v Conway and others*. This involves a consideration of the director's skill-set (the "subjective test") against the objective standard of the reasonable care and skill-set that a director should possess.

Where any of the above grounds can be proved, the court will order restitution or restoration of the monies or property. The court can in the alternative, or additionally order that the director contribute sums towards the company assets including interest on that amount from the date of breach.

Wrongful trading

A claim for wrongful trading is founded on the knowledge or an objective finding of reasonable knowledge on the part of the directors that whilst trading, the directors knew or objectively knew that there was no reasonable prospect of the company avoiding liquidation.

The claimant in this instance will apply for a declaration that the directors are liable to contribute to the assets of the company.

A director can overcome the claim by raising a defence that he took every reasonable step to minimize loss to creditors and that the action taken was taken at the appropriate time.

Fraudulent trading

Fraudulent trading is governed by section 423 of the Companies Law and is wide in ambit. A claimant is given sufficient berth to prove either the intention of the director to defraud creditors, or that a transaction was made for a fraudulent purpose. Every party privy to such a transaction shall be guilty of an offence.

In the case of a director who is found guilty, such director may also be subjected to criminal sanctions.

The test to prove fraudulent trading is the proof of actual dishonesty. This is a factual exercise and can be demonstrated for example by a company which carries on business in the knowledge that there is no reasonable prospect of a return to viability.

The claimant in this forum will apply to the court for an order that the director contribute to the company assets.

APPLICATION OF THE LAW TO THE FACTS:

Preferences: A claim for a Preference to be avoided in respect of the £250 000 paid to Scranton can be pursued against Michael with reference to the following:-

- The director of Scranton is Michael's son Ryan, commencing the inference of a "connected party" and setting the basis for a finding that by biological relations alone, Michael may have been influenced to prefer Ryan;
- The payment to Scranton has been made within the relevant 2 year period, bolstering the inference to desire Ryan as a preferred creditor over all other creditors such as the landlord, other trade debts and the employees of M&D;
- The payment made to Scranton was done so at a time when the company was already insolvent. This is proved by the fact that a loan granted by Toby was used to discharge the debt owed to Scranton.

Commented [DJ41]: Correct but note the action need not be limited to being against Michael. The recipient of the of the payment is also at risk given the breath of orders the Court could make. 2 marks

Transactions at undervalue: There appear to be no transactions made at undervalue in this set of facts, therefore no courses of action to pursue.

Commented [DJ42]: 1 mark

Misfeasance/Breach of fiduciary duties: The pursuit of a misfeasance action can be levelled against Dwight who has misappropriated property and information relating to the company. The principle of theft be it director or lay-man remains the same: the punishment of the taking of property that belongs to a lawful owner with the intent to exercise ownership over the item as the lawful owner would. Applying the decision of *Carlyle* herein, this misappropriation cannot, under any stretch of the imagination be said to be in the interests of the company. |

Commented [DJ43]: 1 mark

An action of misfeasance can also be levelled against Michael, in the alternative to a claim for the avoidance of a Preference made to Scranton. This can be done by proving that subsequent to the payment, the absence of cash and liquid assets, as well as the inability to pay the major supplier, rent, trade debts and the salaries amounted to a failure on the part of Michael to exercise independent judgment, and/or to act in the best interests of the company.

Commented [DJ44]: 1 mark

Wrongful trading: The claim for wrongful trading can be pursued on its own or in the alternative to any of the above claims, against both directors. This is on the simple fact of obtaining a loan to pay-off another loan, the proverbial "robbing Peter to pay Paul" approach in which Toby's loan to M&D was utilized to pay off Scranton. This was done at a time at which the company was already undergoing difficulties for a period of 18 months and could not, after the failed launch of the website, afford to pay day to day liabilities, thus meeting the cash-flow test for insolvency. At that stage, the directors ought to have concluded that there was no prospect of the company avoiding liquidation. |

Commented [DJ45]: 1 mark

Fraudulent trading: Applying the test under section 432 of the Companies Law it is unlikely that Pam and Dwight will be met with any level of success in this claim. It will be difficult to prove that the payment to Scranton was done out of fraud, as opposed to it being regarded as a Preference (the lower standard) or that it was made for a fraudulent purpose.

Commented [DJ46]: 1 mark

Thus in conclusion, the liquidators should pursue a claim against both directors for the avoidance of the Preference made to Scranton, and in the alternative an action for misfeasance.

An action for wrongful trading can be taken against both directors either in the main, or as an alternative to the avoidance of a Preference or as a second alternative to an action for Misfeasance.

A separate action can be brought against Dwight for misfeasance based on the misappropriation of company property.

(c) QUESTION C

Despite the fact that Guernsey is not a signatory to the UNCITRAL Model Law on Cross-Border Insolvency, the Royal Court has a history of providing assistance to requesting countries in appropriate , and section 426 of the UK Insolvency Act has been extended to Guernsey. In this way, a reciprocal arrangement of mutual assistance exists as between the courts of the UK, including Scotland, and vice-versa for Guernsey office holders.

Pam and Jim therefore have two options in requesting recognition and assistance from a foreign country. They may utilize section 426 of the UK Insolvency Act, 1986 or apply via common law principles. The decision as to which process to utilize may also hinge on procedural conveniences.⁴

Commented [DJ47]: 1 mark

Pam and Jim will need to make an application to the Royal Court to seek a request from the Royal Court to recognize their statutory powers of examination ("Request"). The Royal Court will then issue a letter of request seeking assistance from Scotland under section 426 of the UK Insolvency Act. This request is issued by order of the foreign court which must be the court having jurisdiction in insolvency matters.

An application is then made to the English Court for an order as per the Request. In providing assistance, the English Court will decide whether to apply its own laws or the laws of Guernsey.

Commented [DJ48]: The answers is a little confused as between England & Scotland. Also, there is no consideration given as to the lack of examination powers in England and the importance, therefore, of possibly being able to use the Scottish law powers.

The assistance will be granted subject to the fulfilment of certain criteria. Assistance will be granted where the receiving country shares the same jurisdiction and powers as the requesting country, where the matter will be dealt with in accordance with its own insolvency laws and where the laws of both the requesting and requested country are applicable to comparable matters falling within its jurisdiction.

If Pam and Jim ignore the invitation under section 426 of the UK Insolvency Act to utilize its mechanisms, for reasons such as procedural inconvenience, they may elect to proceed under the common law. In this juncture they will be applying the case of *Singularis* to their application and must fulfil the criteria set out by *Singularis* in the consideration of an application for recognition and assistance.

Commented [DJ49]:

Singularis found that a liquidator cannot do something by which they cannot do under the laws by which they were appointed; and, that the order sought by the requesting country's liquidators must be consistent with the substantive law and public policy of the existing State.

It is advisable for the insolvency office-holders to proceed in terms of section 426 of the UK Insolvency Act as opposed to seeking recognition under common-law principles, so as to avoid further requests for which Scotland, as the requested Jurisdiction, may have no equivalent powers to grant.

Commented [DJ50]: 1 mark

⁴ *In the matter of X (a bankrupt)* Royal Court Judgment 36/2015.

*** End of Assessment ***

Commented [DJ51]: Total mark awarded 37.5/50

Generally a good paper demonstrating a good understanding of the underlying material and with some good application to the facts at times.