



ADVISORY
Industry Information

Enforcement of Guernsey Security

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1. Introduction

- 1.1. The secured lending market is very familiar with structures involving Guernsey entities, including companies, limited partnerships and unit trusts to name but a few. Guernsey continues to be a popular and commercially attractive jurisdiction in which to establish investment funds, insurance and re-insurance structures as well as real estate and general asset-holding structures. These structures and entities are often involved in secured finance transactions.
- 1.2. The Security Interests (Guernsey) Law 1993 (the “SIL”) provides lenders with a familiar and efficient creditor friendly regime for taking and enforcing security over the Guernsey situs assets of those structures (namely the shares in Guernsey companies, Guernsey bank accounts and Guernsey contract rights including loan receivables).
- 1.3. This note looks at the process of enforcing security interests created under the SIL as well as some practical considerations for those planning or taking enforcement steps in Guernsey.
- 1.4. This note assumes that security interests have been validly created under the SIL via a Guernsey law security interest agreement between the secured party and the security provider. For more information on the process for taking effective security in Guernsey please refer to [our client briefing](#).

2. Pre-enforcement steps and considerations

- 2.1. Prior to taking any steps to enforce security granted under the SIL, the secured party should take legal advice to determine a robust and efficient enforcement plan.
- 2.2. The secured party should ensure that:
 - (a) the relevant security interest agreements have been fully reviewed by Guernsey counsel;
 - (b) the relevant security interests remain valid and effective;
 - (c) all security deliverables (such as original share certificates and stock transfer forms) and any CDD/KYC information required to enforce the security in an efficient manner are within its possession or control;
 - (d) there are no regulatory or other consents required in connection with the proposed enforcement steps; and
 - (e) if, as is often the case, the relevant security interest has been given in support of a foreign law loan obligation, the enforcement is consistent with the terms of the foreign law loan documentation and the enforcement process is coordinated amongst both Guernsey and foreign law counsel.
- 2.3. There are also several steps that a secured party may take prior to commencing a formal enforcement to protect its position. The steps outlined below take place outside of an enforcement process and are often useful in preparing the ground for formal enforcement or as a means of encouraging the security provider to discuss a consensual restructuring or negotiated settlement. The advantage of this approach is that after a consensual solution has been reached, these steps are easy to reverse unlike formal enforcement.



Share security - transfer of title to the secured shares as a means of further protection

- (a) One means of perfecting or further protecting a security interest over shares in a Guernsey company (the “Target”) is for the secured party to be registered in the register of members of the Target as the holder of those shares. It is common for security interest agreements to restrict the right for the secured party to do this until the occurrence of a defined trigger event (such as the occurrence of an event of default). Once that trigger event has occurred, the secured party may consider becoming the registered holder of the shares as a protective step.
- (b) There are several advantages for the secured party in becoming the registered holder of the secured shares prior to formal enforcement steps being taken including:
 - (i) Ability to block the commencement of a voluntary winding up: As the registered shareholder of the Target (assuming the secured party holds the requisite majority of the Target’s shares), the secured party would be able to prevent the commencement of a voluntary winding up of the Target as the process is (usually) commenced by way of a special resolution to wind-up the company. The secured party would also enhance its position to be heard in any creditor’s application to the Royal Court to compulsorily wind up the Target by becoming the shareholder as well as a secured creditor of the Target;
 - (ii) Ability to exercise shareholder rights directly: As the registered shareholder of the Target, the secured party could exercise the voting rights on the secured shares directly rather than requiring those rights to be exercised by the security provider under the terms of the security interest agreement or by relying on its rights as attorney to sign shareholder resolutions on behalf of the security provider; and
 - (iii) Simplifies a future enforcement via appropriation of the secured shares: Should the secured party choose to enforce the share security by appropriating the secured shares, there would be no need to transfer title to the secured shares to the secured party as it would already have been done.
- (c) The transfer of title to the secured shares only becomes effective when the secured party is registered as the holder of the shares in the register of members of the Target. The completion of the transfer is therefore dependent upon the directors of the Target updating the register of members of the Target. For more on this process and potential complicating factors please see below.

Share security - exercise of voting rights to obtain control of the board of the Target

- (a) Security interest agreements are often drafted to allow the secured party to exercise (or instruct the security provider to exercise) the voting rights on the secured shares after the occurrence of a defined trigger event (often the occurrence of an event of default).
- (b) Voting rights could (depending on the constitutional documents of the Target) be used by the secured party to pass a shareholder resolution to appoint additional directors to the Target and/or remove some or all of the incumbent directors of the Target, thereby gaining control of the board of the Target.
- (c) Gaining control of the board of directors of the Target by exercising the voting rights on the secured shares has several advantages for the secured party:
 - (i) Consensual restructuring: A consensual restructuring is often pursued in parallel to the preparation for a formal enforcement. If the Target is required to take part in the consensual restructuring and the secured party has a concern that the incumbent directors of the Target may be unwilling to engage, then replacing the incumbent directors of the Target may reduce the execution risk at the Target level;
 - (ii) Transfer of title to the secured shares (as a means of protection or enforcement): If the secured party chooses to become the registered holder of the secured shares (either as a means of further protecting the security or as a means of enforcement), the directors of the Target will be required to enter the secured party/third party purchaser as the holder of the secured shares in the register of members of the Target (and the transfer of the secured shares will only be effective once the register of members has been updated). If there is a concern that the incumbent directors of the Target may not comply with the request to update the register of members, the secured party may consider replacing the incumbent directors; and
 - (iii) Access to subsidiary companies: If the secured party appoints directors to the board of the Target, it may be able to exert control over the subsidiaries of the Target by requesting (via its rights to exercise the voting rights on the



secured shares) that the Target passes shareholder resolutions at the level of its subsidiaries. This could again be useful in making board changes at subsidiary level.

- (d) The change of directors would be effective immediately following the passing of the shareholder resolution referred to above. Any new directors will need to complete the formalities for becoming such with the Guernsey Companies Registry and any corporate services provider to the Target. Subsequent notice of any changes to the directors of the Target would need to be given the Guernsey Companies Registry in accordance with the requirements of the Companies (Guernsey) Law, 2008 (the "Guernsey Companies Law").

Account security – restricting the ability of the security provider to operate any secured accounts

- (a) Often security providers are permitted to operate secured bank accounts until the occurrence of a trigger event set out in the security interest agreement (often the occurrence of an event of default).
 - (i) Upon the occurrence of such a trigger event, it is advisable for the secured party to serve notice on the relevant account bank to prevent the security provider from operating the secured account to mitigate the risk of asset dissipation.
 - (j) The secured party will need to ensure that the account bank has completed its CDD/KYC procedures on the secured party and its authorised signatories as it is unlikely that the account bank will accept any instructions from those persons until such checks have been completed.

3. Key aspects of enforcement under The SIL

Who enforces the security?

- 3.1. Unlike in England and Wales, Guernsey does not have a concept of receivership (other than in relation to cells of a protected cell company), so enforcement steps under the SIL are taken directly by the secured party. For the purposes of protection and liability limitation, and in particular where the secured party is to appropriate the shares in the Target itself, it is common for the secured party to use a nominee or professional security trustee to carry out the enforcement procedure on its behalf.
- 3.2. The secured party will therefore be very closely involved and can exercise a great degree of control over the enforcement process.

Power of enforcement – the trigger

- 3.3. A security interest is enforced by the secured party exercising its power of enforcement in accordance with the SIL and the terms of the security interest agreement. The power of enforcement arises upon the secured party giving the security provider written notice of the occurrence of an event of default as specified under the security interest agreement. Generally, the events of default are defined by reference to those in another agreement (such as a facility agreement). There is no statutory timeframe or prescribed form for the notice. The requirement for a notice of event of default cannot be waived by the security provider.
- 3.4. The notice of event of default can be served as soon as an event of default has occurred, and it is advisable for a secured party to take legal advice to determine whether or not events of default have in fact occurred before taking any enforcement steps.

Power of enforcement – methods of enforcement

- 3.5. Once the power of enforcement has become exercisable, the secured party has the right under the SIL to exercise its power of sale or application under the SIL. While the SIL does not specifically refer to a power of appropriation, there is generally seen to be no prohibition to a secured party effecting a sale in its own favour and applying the proceeds of a realisation of the Target's underlying assets in satisfaction of the secured obligations, provided that the usual duties to obtain the best open market value or reasonable price obtainable for the underlying assets and to observe the procedure for applying the proceeds of any sale or application set out in the SIL are adhered to. While the matter has not been tested in the Guernsey Courts, it is standard practice for a secured party to provide in the security interest agreement for this type of appropriation and application of the proceeds where the secured shares are in a private company with no liquid market for those shares.

Power of enforcement – duties of the secured party

- 3.6. If the secured party exercises the power of sale or application in respect of the secured collateral, it must:
 - (a) take all reasonable steps to ensure that the sale or application is made:



- (i) within a reasonable time; and
 - (ii) for a price corresponding to the value on the open market at the time of the sale of the collateral being sold or, where there is no open market value, the best price reasonably obtainable; and
- (b) act in a commercially reasonable manner.
- 3.7. While there is no Guernsey case law on the steps and principles to be followed by a secured party when enforcing its power of sale or application, the following points would, in our view, be useful in order to protect the process followed by the secured party from being challenged:
- (a) a secured party should record the steps that it has taken to sell or value the secured collateral;
 - (b) appointing an independent agent/valuer will be a significant component in establishing that all commercially reasonable steps have been taken;
 - (c) evidence of value will need to be objectively justified. In the context of a sale, any evidence of offers received will be helpful in establishing that the sale was at a fair market value; and
 - (d) valuations can be challenged and so the valuer's methodology should be scrutinised and if appropriate challenged by the secured party to ensure that it is robust. Secured parties may want to take a cautious approach to valuation, particularly where a range is expressed or a particular valuation method is taken.

Power of enforcement – application of the proceeds

- 3.8. The secured party must deal with the resulting proceeds of a sale in accordance with the waterfall provision under the SIL as follows:
- (a) first, in payment of the costs and expenses of the sale;
 - (b) second, in discharge of any prior security interest;
 - (c) third, in discharge of all monies properly due in respect of the obligations secured by the security interest agreement itself;
 - (d) fourth, in payment, in order of priority, of secured parties whose security interests were created after the security interest agreement; and
 - (e) fifth, as to the balance (if any) in payment to the security provider or the borrower.

4. Enforcement risks

Insolvency/bankruptcy of the security provider

- 4.1. The SIL provides that:
- (a) where the secured party does not have title to the collateral, but has a security interest created by means of possession of certificates of title, and the security provider becomes insolvent, then to the extent that the collateral is sufficient, the amount due to the secured party in respect of its security interest shall be paid in priority to all other claims; and
 - (b) where the secured party has title to the collateral, and the security provider becomes insolvent, this shall not affect the power of a secured party to realise or otherwise deal with the collateral in the same manner as it would have been entitled to realise or deal with it if the security provider or its property had not been the subject of such insolvency.
- 4.2. As a result of the above it is standard practice when preparing a Guernsey security interest agreement in respect of shares to ensure that security interests are taken both by possession and by assignment of legal title.
- 4.3. Under the Guernsey Companies Law, any transfer of a company's shares made after the commencement of a winding up, other than a transfer made to or with the sanction of the liquidator, is void. For this reason, a secured party may wish to exercise its right to register itself as the holder of the shares following the occurrence of an event of default, but before formally exercising its power of enforcement, as described above.
- 4.4. Further, under the Guernsey Companies Law, where a company is subject to an administration order, rights in relation to security interests under the SIL and rights of enforcement thereof are unaffected by the administration order.



Non-compliance by Target directors

- 4.5. As noted above, a number of the pre-enforcement and enforcement steps in connection with share security require the cooperation of the board of directors of the Target. The transfer of the shares in the Target, whether as a means of further protecting the secured party's security interest in the shares as a pre-enforcement step or via or sale or application on enforcement, will require the directors of the Target to register the relevant share transfer in the register of members of the Target. Normally, under the terms of the security interest agreement, the secured party will have required the Target to amend its Articles of Incorporation to remove any discretion for the board to refuse such a transfer on enforcement. However, the share transfer will still only be effective when the new shareholder is registered in the register of members of the Target. Non-compliance by the board of directors of the Target may therefore cause delay as the secured party would likely need to make a court application to compel the Target to update the register of members. The risk of non-compliance by the directors of the Target may be reduced by the secured party exercising its voting rights on the secured shares in order to appoint new directors to the board of the Target and to remove the incumbent directors.

Challenge to valuation

- 4.6. As noted above, it is open to any interested party to challenge a valuation or sale price, including a security provider, and any other creditors or guarantors of the security provider. The final valuation should be carefully considered to ensure that it is as robust as possible.

5. Practical risks

CDD/KYC

- 5.1. The Guernsey corporate services provider to the Target could legitimately refuse to register the transfer of shares in the Target until it has been provided with any necessary CDD/KYC information on the transferee. Similarly, a Guernsey account bank could also refuse to act on the instructions of a secured party where the account bank's CDD/KYC requirements on the secured party and its authorised signatories have not been satisfied. When considering enforcement steps, the secured party should consider as early as possible what CDD/KYC information may be required and should ensure that full CDD/KYC information is available at the time that enforcement steps are taken to avoid delays. There may be other practical issues to resolve at this point in time, such as agreeing new terms of engagement with the existing corporate services provider (who may be owed fees by the Target or its former shareholders or require payment for the additional attendances required in connection with the enforcement process) or finding a replacement corporate services provider. In summary, we would caution that in practice reaching the point where the share transfer has been registered and the secured party controls the Target and its board may take longer than anticipated.

Original share certificates and stock transfer forms

- 5.2. Where enforcement involves the transfer of secured shares, the secured party will need to deliver the original share certificates relating to the secured shares to the registered office of the Target together with a fully executed stock transfer form in respect of those shares.
- 5.3. Stock transfer forms are often signed by the security provider (and left undated) at the time that the security is granted. If the stock transfer form was signed by a director of the security provider who is no longer in office at the time that the form is dated, the form may not be recognised by the Target. Security interest agreements often include powers of attorney that allow the secured party to sign documents on behalf of the security provider. Where the terms of the security allow the secured party to sign documents on behalf of the security provider as attorney, it is advisable for the security party to sign an additional stock transfer form as attorney for the security provider.



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