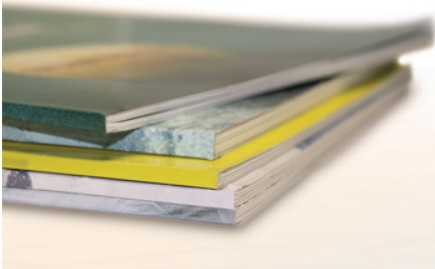


Enforcing Security Interest Agreements in Guernsey

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In the current economic climate, the possibility of defaults under credit and loan facilities is increasingly a concern for lenders. Where a lender wishes to enforce security taken under a Guernsey security interest agreement, be it over shares in Guernsey companies, bank accounts in Guernsey or contractual rights under Guernsey law governed contracts, there are a number of legal issues to consider.

Is the Security Valid?

The first legal issue to consider is whether the security interest agreement itself is valid. Guernsey law does not recognise a floating charge over Guernsey assets. Accordingly, security interest agreements over Guernsey sited assets must comply with certain formalities set out in the **Securities Interest (Guernsey) Law 1993**, (the “Security Interests Law”).

The Security Interests Law requires that a Guernsey security interest agreement must:

- be in writing;
- be dated;
- identify, and be signed by, the debtor;
- identify the secured party;
- contain provisions sufficient to enable the precise identification of the collateral at any time;
- specify the events of default; and

- contain provisions regarding the obligation payment or performance to be secured sufficiently to enable it to be identified.

The Security Interests Law also lays down particular methods to be used when taking security over the different types of collateral. For example, in respect of security over bank accounts when the secured party and the account holding bank are one and the same. The security over that bank account is created where the bank takes control of the relevant bank account. Where the account is held by a third party bank, security is taken by assignment of title to the account to the secured party and notice of the assignment is given to that third party.

Similarly, security may be taken over shares and other securities either by possession of certificates of title or by assignment of title with appropriate notice being given to the company issuing the shares or securities.

Whether or not the control, possessory or title method has been used to create the security, there will be implications for the enforcement of the security.

Moving from Possessory to Title Security?

Many banks prefer to take security by possession of share certificates, only transferring the shares into their own name if an event of default occurs. This is worth considering as a preliminary step, because if

the borrower goes into liquidation or becomes bankrupt (désastre), the collateral will not automatically fall into the hands of a liquidator or the Sheriff (who administers désastre) if security has been taken by title. As long as the secured party has a valid security interest its position would be protected on a désastre or liquidation in any event, however; there are likely to be delays in realisation.

Banks often hold pre-signed stock transfer forms and the security interest agreement will usually include a power of attorney to facilitate putting shares into the bank's or purchaser's name. The articles of association will also be amended to remove any impediments to the transfer of shares. Where regulatory consent to the transfer of shares is required, consent may be obtained prior to the execution of the security interest agreement, but if not, it will need to be obtained before the shares are transferred to the bank.

Notice of Event of Default

A power of sale or application of the collateral arises when an event of default (as the parties have set out in the security interest agreement) occurs. However, a power of sale or application is not exercisable unless the secured party has served on the debtor a notice specifying the particular event of default. There is no requirement in the Security Interests Law for the bank to allow the debtor time to remedy an event of default, although the terms of the security interest agreement may contain such a provision. There is no requirement to obtain a court order before exercising

the power of sale unless the terms of the security interest agreement require it.

Power of Sale – Timing and Valuation Issues

The Security Interests Law provides that the secured party must take all reasonable steps to exercise the power of sale within a reasonable time and for a price corresponding to the value on the open market at the time of sale of the collateral being sold, or where there is no open market value the best price reasonably obtainable.

Sale Proceeds

The Security Interests Law sets out the order in which the sale proceeds must be applied. After the payment of costs and expenses of the sale and the discharge of any prior security interests, the bank may discharge the secured obligations and any subsequent security interests before accounting for the balance to the debtor or, if the debtor is insolvent or has been subjected to any other judicial arrangement in relation to insolvency, to the Sheriff, insolvency practitioner or other proper person.

Conclusion

In the current climate, it is inevitable that more borrowers will default on their loan obligations. Lenders will however, be able to protect themselves if they take the correct steps to enforce their security and recover the proceeds effectively.

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