
# Enforcement of Jersey Security

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## 1. Introduction

1.1. The secured lending market is very familiar with structures involving Jersey entities, including companies, limited partnerships and unit trusts to name but a few. Jersey continues to be a popular and commercially attractive jurisdiction in which to establish asset-holding structures.

1.2. One of the reasons for Jersey's popularity as a jurisdiction for establishing such holding structures is that the Security Interests (Jersey) Law 2012 ("SIL") provides lenders with a modern, efficient and creditor friendly regime for taking and enforcing security over the Jersey situate assets of those structures (namely the shares in Jersey companies, units in Jersey unit trusts, Jersey deposit accounts, Jersey securities accounts and Jersey contract rights).

1.3. This note looks at the process of enforcing security interests created under SIL as well as some practical considerations for those planning or taking enforcement steps.

1.4. This note assumes that security interests have been validly created under SIL via a Jersey law security interest agreement between the secured party and the security provider.

## 2. Pre-enforcement steps and considerations

2.1. Prior to taking any steps to enforce security granted under 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 Jersey counsel and that any issues have been addressed;

(b) the relevant security interests remain attached and perfected;

(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; and

(d) there are no regulatory or other consents required in connection with the proposed enforcement steps.

2.3. There are also a number of steps that a secured party may take prior to commencing a formal enforcement in order to protect its position. The steps outlined below take place outside of an enforcement process and are often useful in preparing the ground for 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 security perfection:

(a) One means of perfecting a security interest over shares in a Jersey company is for the secured party to be registered in the register of members of the secured company (the "Target") as the holder of those shares. It is common for security interest agreements to restrict such perfection until the occurrence of a defined trigger event (often 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 perfection step.

(b) There are a number of 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 creditors' winding up:* Provided that the secured party is registered as the holder of a sufficient number of shares to block the passing of a special resolution, the secured party would be able to prevent the commencement of a creditors' winding up of the Target as the process is commenced by the shareholders passing a special resolution resolving to wind-up the company;

(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 or relying on its power of attorney (if there is one) 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.

## Share security - exercise of voting rights to alter the board composition 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.

(c) Altering the board composition of the Target by exercising the voting rights on the secured shares has a number of advantages for the secured party:

(i) *Consensual restructuring:* A consensual restructuring is often pursued in parallel with 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 perfection or enforcement):* If the secured party chooses to become the registered holder of the secured shares (either as a means of further perfecting 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 to potentially reduce that risk; 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.

(e) It should also be noted that any directors appointed to the board of the Target would need to comply with their own fiduciary duties as directors of the Target company.

### 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).

(b) 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 in order to mitigate the risk of asset dissipation.

(c) 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 (a list of whom is often provided to the account bank at the time when the security is taken) 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 SIL

### Who enforces the security?

3.1. Unlike in England and Wales, Jersey does not have a concept of administration or receivership and so enforcement steps under SIL are taken directly by the secured party.

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 under SIL is enforced by the secured party exercising its power of enforcement.

3.4. The power of enforcement arises upon the occurrence of an event of default under the security interest agreement. Events of default are either listed out in full in the security interest agreement, or more commonly reference is made to another agreement (such as a facility agreement) and the events of default in that agreement.[1]

3.5. In order to exercise the power of enforcement, the secured party must serve written notice of the event of default on the security provider. 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.

3.6. 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 occurred before taking any enforcement steps.

1 EMTV v Bayerische Landersbank [2003] JRC 039: decided under the previous law, but still applies to the SIL which is worded in almost identical terms. Case confirmed that events of default can be incorporated by reference.

## Power of enforcement – methods of enforcement

3.7. Once the power of enforcement has become exercisable, the secured party may use that power to, amongst other things:

(a) sell the secured collateral (either to a third party or to itself) by auction, public tender or private sale;

(b) appropriate the secured collateral;

(c) take possession or control of the secured collateral;

(d) exercise any rights of the security provider in respect of the secured collateral;

(e) instruct any person who has an obligation in relation to the secured collateral to perform that obligation for the benefit of the secured party; or

(f) apply any remedy that the security interest agreement provides for as a remedy that does not conflict with SIL.

3.8. The secured party can take one or more of the actions specified above as long as they do not conflict.

3.9. In practice, the most common forms of enforcement in Jersey are by way of sale or appropriation of the secured collateral.

## Notice of appropriation or sale

3.10. If the secured party exercises the power of enforcement to appropriate or sell the secured collateral, the secured party is required to give not less than 14 days' written notice of the appropriation or sale of the secured collateral to:

(a) the security provider (unless the security provider has waived the requirement);

(b) any person who 21 days before the appropriation or sale has registered a security interest in the secured collateral (a "Relevant Additional Secured Party") (which can be checked by conducting an on-line search of the Jersey security interests register if the name if the competing secured party is known); and

(c) any person who has an interest in the secured collateral and has, not less than 21 days before the appropriation or sale, given the secured party notice of that interest (a "Relevant Interested Person").

3.11. Any person entitled to receive notice of appropriation or sale of the secured collateral can agree in writing:

(a) to waive that right (and it is common for security providers to waive the right); or

(b) for notice to be given within a period other than 14 days.

3.12. Notice of sale of the secured collateral need not be given in certain circumstances, including where:

(a) the secured collateral is shares which are listed on a securities exchange;

(b) the secured party reasonably believes that the secured collateral will decline substantially in value if it is not disposed of within 14 days after the relevant event of default;

(c) the Jersey court orders for any other reason that notice need not be given.

3.13. There is no requirement to provide written notice to a security provider (or anyone else) of the exercise of the power of enforcement where the enforcement steps do not involve the appropriation or sale of the secured collateral.

## Duties of the secured party – the sale/appropriation duty

3.14. If the secured party exercises the power of enforcement to appropriate or sell the secured collateral, it will owe a duty (essentially to the security provider, any Relevant Additional Secured Parties and any Relevant Interested Persons):

(a) to take all commercially reasonable steps to determine (in the case of appropriation) or obtain (in the case of sale) the fair market value of the secured collateral, as at the time of the appropriation or sale;

(b) to act in other respects in a commercially reasonable manner in relation to the appropriation or sale; and

(c) in the case of a sale, to enter into any agreement for or in relation to the sale only on commercially reasonable terms.

3.15. There is limited guidance in Jersey as to what this means in practice as to date there are only a few decisions dealing with enforcement under SIL. These cases have not provided full guidance on the relevant principles, but the following points can be distilled:

(a) a secured party will need to show the court the steps it has taken to sell or value the secured collateral;

(b) appointing a legitimate 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.

3.16. The secured party should therefore be prepared to demonstrate that it has taken commercially reasonable steps to determine or obtain the fair market value of the secured collateral when enforcing via sale or appropriation. Independent valuations of the secured collateral and (in the case of a sale) a sales/auction process are advisable and the appointment of valuation experts should be considered as soon as possible during the enforcement process. We recommend appointing an expert in advance of enforcement, to ensure that there are no delays to the process and the delivery of the statement of account within the statutory timeframe referred to below.

### Duties of the secured party – statement of account

3.17. If the secured party exercises the power of enforcement to appropriate or sell the secured collateral, it must:

(a) within 14 days after the day on which it appropriates or sells the secured collateral, give certain persons (being the security provider and any person with a registered subordinate security interest and certain other persons claiming an interest in the secured collateral) a written statement of account setting out certain financial information in relation to the appropriation or sale; and

(b) apply any resulting surplus in the order prescribed in SIL or alternatively by paying the surplus into the Royal Court in Jersey. SIL does not provide a timeframe within which the surplus (if any) must be paid, but the secured party should ensure that it is done promptly following receipt.

3.18. The Royal Court in Kidd made it clear that the purpose of the statement of account is to allow the security provider to satisfy itself that the secured party has discharged its statutory duties. If a security provider does not believe that those duties have been discharged, it may bring a claim for breach of those duties. A secured party should take legal advice at all stages of the enforcement process to mitigate the risk of such a challenge.

### Effect of sale or appropriation on subordinate security interests

3.19. If the secured party sells or appropriates the secured collateral, any subordinate security interests are automatically extinguished.

3.20. Where there is a surplus resulting from the enforcement of the senior security interest, that surplus must be applied in reduction of the obligations secured by the subordinate security interest.

## 4. Enforcement risks

### 4.1. Insolvency/bankruptcy of the security provider

SIL provides that the bankruptcy or insolvency of a security provider (or any other judicial arrangement or proceeding against a security provider consequent upon its insolvency) will not prevent the secured party from exercising its power of enforcement provided that the security interest is perfected at the time of the security provider's bankruptcy

and remains perfected at the point of enforcement, although the security may still be challenged as an antecedent transaction (such as a transaction at an undervalue or a preference) in the insolvency of the security provider.

Ordinarily, once a company is declared en désastre, its shares cannot be transferred without the approval of the Viscount. If the shares are subject to a security interest under SIL then the consent of the Viscount is not required to transfer those shares if the transfer is made in connection with the exercise of the secured party's power of enforcement under SIL.

Insolvency/bankruptcy can also be a complicating factor. For instance, it may affect the value of any underlying assets. It may also be relevant if the enforcement proceeds are insufficient to discharge the secured debt in full as the secured party would be an unsecured creditor in respect of the shortfall in an insolvency situation. Legal advice should be taken as soon as the possibility of liquidation/bankruptcy is raised to ensure that appropriate steps are taken to protect the secured party.

It is also important to understand the full security package and to ensure that appropriate security is taken throughout the structure to protect against the risk of insolvency.

### 4.2. Non-compliance by Target directors

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 perfecting the secured party's security interest in the shares as a pre-enforcement step or via appropriation or sale on enforcement, will require the directors of the Target to register the share transfer in the register of members of the Target. The share transfer will 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 its 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 to appoint new directors to the board of the Target and to remove the incumbent directors.

Once formal enforcement has taken place, the Royal Court has confirmed *In the matter of the Q Settlement [2019] JRC086* that it has the power (under Article 52 of SIL) to facilitate the realisation of the secured collateral should the directors of the Target refuse to transfer the secured collateral. In that case the Royal Court ordered the existing shareholder to execute the transfer of shares in 5 days, failing which the Viscount was directed to execute a share transfer form to transfer the collateral into the name of the secured party.

### 4.3. Challenge to Valuation

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 of the security provider. The final valuation should be carefully considered to ensure that it is as robust as possible.

### 4.4. Practical risks

#### CDD/KYC

A corporate services provider could legitimately refuse to register the transfer of shares in a Jersey company until it has been provided with any necessary CDD/KYC information on the transferee.

Similarly, a Jersey account bank could also refuse to act on the instructions of a secured party where the account banks CDD/KYC requirements on the secured party and its authorised signatories have not been satisfied.

When considering enforcement steps, the secured party should determine 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.

## Original share certificates and stock transfer forms

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.

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 secured party to sign an additional stock transfer form as attorney for the security provider just in case the original stock transfer forms are rejected by the Target.

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