



British Virgin Islands: Insolvency laws tested

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Insolvency legislation and other laws affecting creditor's rights are a bit like safety features on a car – whilst everyone acknowledges the need for them, the hope is not to see them put into practice.

The British Virgin Islands enacted a new set of insolvency laws in 2003, and tightened and updated its laws relating to certain aspects of secured creditor's rights in 2004. Thereafter, the world's economies roared through several years of astonishingly strong economic growth (it would be nice to think otherwise, but the two are probably unrelated). Legal architecture designed to facilitate secured lending seemed almost redundant as the world was awash with liquidity and credit.

But then, like all good things, it all came to a fairly dramatic end. While the economists debate whether or not this is, or will be, a depression, down at ground level the banks and their lawyers are finding out just how well the credit friendly regime that the British Virgin Islands sought to implement is working in the face of rising volumes of distressed debt.

As might have been predicted, some things worked well and some things less so. As might also have been predicted, there were some things that nobody was able to predict. For example, back in 2003, despite the example of BCCI in the relatively recent past, nobody gave serious thought to the possibility that we might have solvent borrowers but insolvent banks.

Netting: One of the things that has largely worked as advertised so far has been the jurisdiction's ISDA Model Netting law. Designed to ensure that parties' rights to net out in relation to derivatives transactions were given primacy, these have proved so far to be effective in minimising the risk of exposure in the event of counterparty insolvency.

Foreclosure: One of the perplexing features of the depth of the recession is that asset prices have fallen so far that secured creditors are reluctant to enforce because enforcement would crystallise losses on their balance sheets. Some clients have turned to the new, old-fashioned way – foreclosure. Although thought of as a historical relic, some secured lenders have proposed taking title over the underlying security assets in return for releasing the debt through a foreclosure action; they can then sit on the asset until prices improve without having to either book the loss or keep a defaulting loan on their books.

Transaction avoidance: An area that has not had much judicial exposure yet relates to "voidable transactions" occurring in the twilight period prior to insolvency. This may be because, like a good football referee, not hearing much about it may show that the legislation is working well – companies are not seeking to re-engineer their assets inappropriately. Or it may reflect the fact that liquidators lack the resources to pursue applications.

Insolvent trading: Like voidable transactions, there has been a dearth of applications against directors for wrongful trading prior to insolvency. The reason for this may be more closely related to liquidators' resources. It may also reflect a new generation of directors documenting far more carefully decisions whether or not a company can continue trading.

Receivership: Receivership remains the most popular remedy of secured creditors in the British Virgin Islands. Modernisation of this area of the law has clearly done no harm; administrative receiverships remain rare, but it is difficult to tell whether the new restrictions that were brought in have affected this.

Legal practice will always evolve to meet new challenges. Thus far, the British Virgin Islands legislators can be reasonably pleased that the majority of their legislative changes have functioned effectively and efficiently in a distressed economic environment, even if not always in the manner that they expected.