

## British Virgin Islands briefing: Insolvency Act and cross-border issues

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The Insolvency (Amendment and Consequential Provisions) Act 2004 was passed in July. The amendments were a necessary precondition to the Insolvency Act 2003 Act, which came into force on August 16 2004.

As expected, the provisions adapted from the UNCITRAL model law on cross-border insolvency will not come into force, nor will the provisions relating to administration (a rehabilitation procedure based on the English 1986 Act). Less expectedly, and contrary to indications previously given, the intention is that provisions relating to voidable transactions will not apply to any transaction that took place before 16 August.

It is in the cross-border context (in the sense of BVI companies with assets, liabilities and management outside the BVI) that the legislation will have the most impact and be most seriously tested. A BVI company can be the subject of all the insolvency regimes provided for in the legislation, that is, liquidation, administration, administrative receivership, and creditors' arrangements, and they do not need to have any connection with the BVI other than by virtue of their incorporation.

The absence of any moratorium in a creditors' arrangement will restrict its use. The administration procedure has not come into force. When it does, it will apply only to certain types of company and will be emasculated by the use of floating charges.

### Trust of assets

When a BVI company goes into liquidation in the BVI, its assets become impressed with a trust for the benefit of those entitled to them under the legislation as enunciated in *Re Oriental Inland Steam Company* (1874) LR 9 Ch App 557. A liquidator's principal duties, as set out in section 185(1) of the legislation, are to realize the assets of the company and distribute them in accordance with the legislation, which in effect creates this statutory trust.

This principle is fundamental to the cross-border analysis because, even if the assets are outside the BVI, BVI law maintains that they fall within the scope of the liquidator's powers. In practice, difficult conflict of laws questions arise if the company disposes of assets after it goes into liquidation. The liquidator may have to resort to the courts of the place where those assets are situated to recover them, becoming subject to the conflict-of-laws rules applied by those foreign courts.

### Authority of liquidator to act abroad

As a matter of BVI law, the liquidator becomes the appropriate person to deal with the company's assets in place of the directors, but the recognition of his authority abroad is practically a matter for the foreign courts. The English courts, in common with the courts in many other common-law jurisdictions, will generally recognize a liquidator of a foreign company appointed by the court of the place of incorporation. The liquidator will be recognized as having the authority to administer the assets of the company worldwide. (The liquidator could also seek the assistance of the English courts under s 426 of the UK Insolvency Act 1986.)

### Submitting claims, set-off and netting of market contracts

The provisions of the BVI legislation govern the submission of claims to the liquidator and they apply regardless of where the debt was incurred or what law governs it. The liquidator's power to reject claims is also governed by BVI law. However, whether a debt exists in the first place is a matter for the proper law of the debt; liquidation does not affect questions of whether the debt has been discharged or extinguished, it only affects the enforcement of those debts. If the debts owed to a creditor are discharged under its proper law after the company goes into liquidation, but before payment of dividend, the liquidator can reject the claim because the debt ceases to be a provable claim.

The provisions for *pari passu* distribution and set-off are mandatory and must be applied by a liquidator in respect of any creditor who submits a claim in the liquidation.

However, netting market contracts is effectively taken outside the scope of insolvency set-off and *pari passu* distribution under sections 434 and 435 of the Act, and these provisions are also mandatory in the absence of fraud or misrepresentation so the liquidator or the courts have no discretion to disapply them, irrespective of where such contracts were entered into.

### Position of secured creditors

The legislation expressly provides that liquidation does not affect the rights of secured creditors to enforce their security (Section 175(2)). The proper law of the instrument that creates the security would govern the

right of enforcement and the legislation does not add to those rights or detract from them. Certain foreign jurisdictions may impose limitations on the rights of secured creditors to enforce their security in insolvency and, if the assets over which the security is granted are situated there, questions can arise as to whether the secured creditor is subject to such limitations. A BVI court would probably regard this as a matter for the *lex situs* but with the following considerations: (a) the company cannot object to the enforcement on any grounds of BVI law if the enforcement is in accordance with the agreement by which the security was granted and that agreement is valid; (b) if the company can be kept out of any insolvency process in that foreign jurisdiction, it is questionable whether the limitations could apply in the first place.

#### **Receivership abroad**

As well as being in liquidation in the BVI, the company may be in receivership abroad, for example, if a secured creditor has appointed a receiver in respect of the assets outside the BVI. The assets that are subject to such security (and over which a receiver has been appointed) will be outside the statutory trust of the company's assets discussed above, and the costs and expenses applicable to the receivership will in general be payable out of the assets in the receivership.

Whether such a receiver is also an administrative receiver under BVI law will depend upon whether the appointment satisfies the legislation requirement (Section 142(1)), that is, that the receiver was appointed by the holder of a floating charge over the whole or substantially the whole of the business and assets of the company, and is a licensed insolvency practitioner under the legislation (an individual resident in the BVI holding a prescribed licence from the BVI Financial Services Commission). If these conditions are not satisfied, he will not have the status of an administrative receiver under BVI law (even though he will be a receiver under BVI law, and even though he may be an administrative receiver under the law of some other jurisdiction, for example, the UK). Nothing *per se* prevents a receiver appointed under an English law governed floating charge being an administrative receiver under the BVI legislation. However concerns over the impact of the English Enterprise Act and (that if the purpose of having an administrative receiver were to prevent, in the future, the appointment of a BVI administrator) the technical point of having to adduce English expert evidence as to the nature of the charge at a hearing for an administration order suggests that BVI law governed floating charges will become the norm. Where the remainder of the security package is governed by a law that does not have the administrative receiver concept it will be essential.

#### **Effect of concurrent foreign and BVI liquidations**

If a BVI company has been wound up by a foreign court, it can nevertheless be placed in liquidation in the BVI by either of the two routes available, that is, the appointment of a liquidator by the court or by the members.

In such situations, the liquidation of the company in its place of incorporation (that is, the BVI) will generally be regarded as the primary liquidation and, in common-law countries at least, all others will be treated as ancillary liquidation where the liquidator's powers are confined to collecting and distributing the assets in that jurisdiction.

#### **Other insolvency proceedings**

If a BVI company is in liquidation abroad, it is not prevented from entering into other insolvency regimes available under the legislation, that is, administration, administrative receivership or creditors' arrangement. But these regimes by themselves will not negate the foreign liquidation of the company.

#### **Assistance to a foreign representative under Part XIX**

Part XIX of the Insolvency Act brings in a new regime for judicial assistance in insolvency proceedings. It allows the foreign representatives of certain types of insolvency proceedings, that is, collective judicial or administrative proceedings in which the property and affairs of the debtor are subject to control or supervision by a foreign court (for example, liquidations) that take place in designated territories to apply to the BVI courts for assistance. (Section 466(1) – definition of foreign proceedings: it is arguable that administrative receivership is not within the ambit of this definition because it is not a collective proceeding nor is the administrative receiver truly under the control or supervision of the court.) The representatives who can apply for such orders are persons authorized to administer the reorganization or liquidation of the company's property or affairs or who are authorized to act as representatives of the foreign insolvency proceedings. The provisions are modelled on section 426 of the UK Insolvency Act 1986, but with significant differences.

The BVI courts, when faced with such an application, will do what will best ensure the economic and expeditious administration of the foreign principles to the extent that is consistent with certain guiding BVI principles, that is, the just treatment of all persons claiming in the foreign proceedings; the protection of persons in the BVI who have claims against the company against prejudice and inconvenience when the claims are processed in the foreign proceedings; the prevention of preferential or fraudulent disposition of property; the need for distributions to claimants in the foreign proceedings to be substantially in accordance with the order of distributions in a BVI insolvency; and comity.

The orders that the BVI courts can make in aid of the foreign proceedings are extremely wide and include: restraining proceedings; orders requiring a person to deliver up the property of the company to the foreign representative; orders to facilitate the co-ordination of insolvency proceedings in the BVI with the foreign insolvency proceedings; and authorizing the foreign representative to examine any person who could be

examined in BVI insolvency proceedings.

However, secured creditors are protected in that the legislation specifically provides that these orders will not affect the rights of secured creditors to take possession of and realize the property over which they have security.

It seems that the provisions are wide enough for the BVI courts to render not merely procedural assistance but also to apply substantive principles of BVI insolvency law. The BVI court has discretion whether to apply the law of the BVI or the law that applies to the foreign proceedings. However, set-off and preferential creditors are protected from this provision in that court orders that affect the right of any creditor to benefit from the set-off provisions in Section 150 of the legislation, or result in a preferential creditor receiving less than they would under a BVI insolvency, cannot be made without the consent of such person.

Apart from the statutory provisions, a liquidator appointed under a foreign liquidation may apply to the BVI courts for relief on behalf of the company in liquidation and the BVI courts will recognize his title.

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