HARNEYS

How to deal with insolvent BVI companies

This guide covers frequently asked questions on how to deal with insolvent British Virgin Islands companies.

What can I do if a BVI company is insolvent?

In the BVI, where a company is insolvent, a creditor may apply to the court to appoint a liquidator over the company. Insolvency law in the BVI is almost entirely codified in the Insolvency Act 2003 (***IA***) and supplemented by the Insolvency Rules 2005.

An insolvent company may seek to reorganise or restructure its capital or debts through a plan of arrangement, scheme of arrangement or creditors' arrangement. Plans and schemes of arrangement are governed by the BVI Business Companies Act 2004 (as amended) (***BCA***); the IA governs creditors' arrangements.

When is a BVI company insolvent?

Under BVI law, a company will be deemed to be insolvent if it is:

- **Cash flow insolvent**: Cash flow insolvency occurs when the company is unable to pay its debts as they fall due.
- **Balance sheet insolvent**: Balance sheet insolvency occurs when the value of the company's liabilities exceeds its assets.
- **Unpaid statutory demand**: The company is presumed insolvent if a statutory demand has not been paid or set aside.

How do I make an application to appoint liquidators over an insolvent BVI company?

An application to appoint liquidators over an insolvent company is made through an originating application supported by affidavit evidence. An application may be made by, *inter alia*, (a) the company, (b) a creditor, (c) a member, and (d) the supervisor of a creditors' arrangement in respect of the company. Liquidation is a class right under BVI law, and any application must be advertised so that class members are given notice and may support or oppose the making of an order.

Although there is no strict requirement for a creditor to issue and serve a statutory demand on an insolvent company before making an application to appoint liquidators, it is customary for a creditor to serve a statutory demand on the debtor company before issuing the application as a simple way of establishing insolvency.

What can a debtor company do if it wishes to oppose an application to appoint liquidators over it?

A debtor company which has been served with an application to appoint liquidators over it on the basis that it is insolvent can oppose the application if (a) there is a genuine and substantial dispute as to the debt on which the application is made or (b) the agreement giving rise to the debt is the subject of an arbitration agreement. The debtor company must, not later than seven days before the date fixed for the application hearing, file and serve a notice setting out the grounds on which it opposes the application.

In determining whether the debt is disputed on substantial grounds, the court will apply the well-known test in *Sparkasse Bregenz Bank AG v Associated Capital Corporation* BVIHCVAP 10/2002 (18 June 2003), which is that the "dispute must be genuine in both a subjective and objective sense. That means that the reason for not paying the debt must be honestly believed to exist and must be based on substantial or reasonable grounds. Substantial means having substance and not frivolous, which disputes the court should ignore". If the dispute is simply as to the amount of the debt and there

is evidence of insolvency, the company should be wound up. The onus is on the company to show sufficient doubt as to its liability to pay the debt to satisfy the court there is an issue to be tried.

If the agreement giving rise to the debt contained an arbitration agreement, the debtor company may request that the court stay the liquidation application and that the matter be referred to arbitration in accordance with section 18 of the Arbitration Act 2013. A debtor company must file and serve a request for referral to arbitration not later than when submitting its first statement on the substance of the dispute (that is, the same time it submits its notice setting out the grounds on which it opposes the application) to secure an automatic referral order from the court, provided that the agreement is capable of performance. In such a case, the court will refer the parties to arbitration unless it finds that the agreement is null and void, inoperative (the dispute falls outside of the scope of the arbitration agreement) or incapable of being performed.

What can a debtor company do if it accepts that the debt is due and owing but cannot pay it?

Suppose the debtor company accepts that the debt is due and owing but cannot pay the debt at that particular time. In that case, the company may consider reorganising or restructuring its capital or debts through a plan of arrangement, scheme of arrangement or creditors' arrangement. These arrangements are designed to provide a route where the company can be rescued and avoid liquidation.

To secure a moratorium to prevent creditors from bringing applications to liquidate the company while it is trying to restructure, a debtor company may also seek the appointment of so called "light touch" provisional liquidators to assist with and/or facilitate the restructuring.

What happens if the debtor company cannot oppose the liquidation application or restructure or reorganise its debts?

If the company cannot oppose the liquidation application or restructure or reorganise its debts, and the court finds it insolvent, then the court will appoint liquidators over the company. Liquidation commences on the date the order appoints liquidators over the company is made; it does not relate back to the time of presentation of the originating application to liquidate the company.

What happens when a liquidator is appointed over an insolvent BVI company?

Once a liquidator is appointed, unsecured creditors cannot start legal proceedings against the company without leave of the court, and any rights of action against the company are converted into claims in the liquidation process. When a company enters insolvent liquidation, any mutual debts between the company and a creditor intending to prove in the liquidation will be set off.

Upon the appointment of a liquidator, the liquidator's primary duty is to collect all of the company's assets and then distribute them *pari passu* to the company's creditors. The assets of a company in liquidation shall be applied in the following order of priority:

- the costs and expenses properly incurred in the liquidation
- preferential claims admitted by the liquidator
- all other claims admitted by the liquidator
- any interest payable after commencement of the liquidation

A liquidator may challenge transactions entered into in the twilight period before insolvency, where such transactions constitute either unfair preferences, undervalue transactions, voidable floating charges or extortionate credit transactions. In each case (except for extortionate credit transactions), the company must have been insolvent (excluding balance sheet insolvency) at the relevant time or the transaction must have caused it to become insolvent. The applicable vulnerability period is two years for connected persons or six months in all other cases. The statute contains relevant "safe harbours" to protect bona fide arm's length transactions in each case. A liquidator can also pursue former directors (including shadow or de facto directors) and company officers for misfeasance or insolvent trading and any person involved where the company has been engaged in fraudulent trading.

Conclusion

We hope this guide helps you understand how to deal with insolvent BVI companies. If you have any further questions, please contact Claire Goldstein or Christopher Pease.

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