

## Alert

### Voidable Transactions - BVI Companies

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**Many businesses are currently experiencing unprecedented pressure on their cash flow as a result of the COVID-19 pandemic and the governmental restrictions which are being implemented around the world. It is very important therefore that directors of British Virgin Islands (BVI) companies which may be approaching insolvency take steps to evaluate the position of the company with a view to avoiding personal liability. A director can be personally liable if such director fails to take appropriate steps to commence formal liquidation where there is no reasonable prospect of the company avoiding insolvent liquidation.**

Part VII of the Insolvency Act, 2003 (the "Act") sets out the circumstances under which the High Court of the BVI may make an order setting aside a transaction or disposition of property in whole or in part.<sup>1</sup> For these purposes, a company is regarded as being insolvent if:

- (i) it is unable to pay its debts as they fall due (cash flow insolvency);<sup>2</sup>
- (ii) it is taken to be insolvent because it fails to comply with a valid statutory demand; or
- (iii) execution of a judgment or other order of a BVI court against it is returned wholly or partly unsatisfied.

Under the Act transactions may be set-aside where they constitute "insolvency transactions" that are entered into during the "vulnerability period".

- An "insolvency transaction" is a transaction entered into at a time when the relevant company is insolvent or the transaction causes the relevant company to become insolvent.
- The "vulnerability period" generally commences six months prior to the onset of insolvency (normally the date of an application to appoint a liquidator)<sup>3</sup> and ends on the appointment of the liquidator. For connected persons, the period is two years prior to the onset of insolvency. For extortionate credit transactions the period is five years.

It is important to determine whether a creditor falls within the definition of a connected person. Transactions with connected persons increase the vulnerability period and shift the burden of proof in determining whether a transaction is voidable. The connected person definition is broad and includes promoters of the relevant company, directors or members of the relevant company or a related company, a related company, a company with common directors, a partner, nominee or relation of a connected person and certain trustees and beneficiaries. The definition of related companies includes subsidiaries, holding companies and those entities under common control.

The Act sets out four specific types of transactions which are voidable - preferences, undervalue transactions, certain floating charges and extortionate credit transactions:

- (i) A transaction will be a voidable preference where it is an insolvency transaction entered into within the vulnerability period and has the effect of putting a creditor into a better position on an insolvent liquidation than it would have been had the transaction not been entered into. Transactions which take place in the ordinary course of business will not constitute an unfair preference.

<sup>1</sup> For completeness, The Conveyancing and Law of Property Ordinance 1961 provides a separate basis for setting-aside a transaction: any conveyance of property made with the intention of defrauding creditors is voidable at the option of any person prejudiced by it. It is not necessary that the company was insolvent at the time the property is conveyed. This is not considered further in this note.

<sup>2</sup> The balance sheet insolvency is specifically excluded for the purposes of the voidable transactions regime, although balance sheet insolvency must to some extent be taken into account in considering cash flow insolvency.

<sup>3</sup> Where a liquidator was appointed by the members of a company, the onset of insolvency is the date of such appointment.

- (ii) An undervalue transaction is an insolvency transaction entered into within the vulnerability period which is either a gift or a transaction where the value in monetary terms of the consideration provided by the company significantly exceeds that which it received. A transaction entered into by the company in good faith, for the purposes of its business with reasonable grounds for believing that it would benefit the company will not be an undervalue transaction.
- (iii) A floating charge that is an insolvency transaction made during the vulnerability period is voidable unless it secures money or property advanced at the same time or after the creation of the charge. A floating charge made in favour of a connected person within the vulnerability period is presumed to be an insolvency transaction.
- (iv) An extortionate credit transaction is any transaction during the vulnerability period that requires grossly exorbitant payments or otherwise grossly contravenes ordinary principles of fair trading. Note that such a transaction does not have to be an “insolvency transaction”.

## Orders by the BVI Court

Upon application of a liquidator the BVI Court is granted wide powers under section 249 of the Act to set aside a transaction in whole or in part. In the case of an unfair preference or an undervalue transaction, the Court may also make such orders as it considers fit for restoring the position to what it would have been if the company had not entered into that transaction. However, such an order must not prejudice any interest in assets that was acquired in good faith and for value from a person other than the company, or prejudice any interest deriving from such an interest or require a person who received a benefit from the transaction in good faith and for value to pay a sum to the office holder, except where that person was a party to the transaction or, in respect of an unfair preference, the preference was given to that person when he was a creditor of the company.

Although voidable transactions do not directly expose directors to liability with creditors, directors should exercise caution (and obtain legal advice) before entering into transactions when a company is or may be insolvent or on the verge of insolvency, as these broaden and increase the scope of potential director liability. When directors have concerns as to the solvency of a company, they may need to consider appointing an insolvency practitioner to act as liquidator in part to protect themselves from the personal liability which might arise if they delay taking such steps.<sup>4</sup> Generally, no such personal liability will arise if the court is satisfied that after the directors first knew, or ought to have concluded, that there was no reasonable prospect that the company would avoid going into insolvent liquidation, they took every step reasonably open to them to minimise loss to the company’s creditors.

As such, for as long as directors continue to manage the business (i.e. until the appointment of a liquidator) while a company is of doubtful solvency, all transactions should be considered carefully as they may be potentially voidable as an unfair preference, undervalue transaction, voidable floating charge or extortionate credit transaction.

## We are here to help

Tailored professional advice should always be sought. Please feel free to reach out to your usual Conyers contacts with any questions regarding voidable transactions and the insolvency of BVI companies. We will be pleased to help and reassure you of our continued support.

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<sup>4</sup> The court can also make disqualification orders against directors or former directors of a company that has become insolvent and who have been guilty of fraud in relation to the company, or of any misfeasance or breach of duty as a director, which can include the entry into voidable transactions.