

Article

Under Pressure: Key considerations and practical tips for BVI companies approaching insolvency

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Inflationary pressures and increasing interest rates are expected to continue to have a negative impact on the global economy during 2023. In this article we consider restructuring options under BVI law available to companies in or approaching financial difficulties, when a BVI company will be considered to be insolvent, the duties of directors of financially distressed or insolvent BVI companies and practical steps and considerations for directors where a BVI company may be approaching insolvency.

Restructuring Options and Creditor Arrangements

One of the key concerns arising from pressures on a business's cash flow is the inability of companies to service their debt in a timely manner and the desire to avoid distressed asset sales/enforcement of security by creditors. There are a number of practical steps which may be taken in such circumstances including:

- refinancing or extending the maturity date of existing financing; or
- equity raises or other forms of capital injections.

If the above approaches are not sufficient to alleviate the pressure on a company's cash flow, it may be necessary for the company to restructure. The BVI Business Companies Act provides two mechanisms for carrying out a wide range of corporate restructurings by way of court approval – plans and schemes of arrangement. Both mechanisms provide for compromises to be reached between a BVI company and its creditors or members (or a class of them) and are available where a company does not have sufficient member or creditor support to carry out a proposed action, or where it is otherwise desirable to “wrap” an action in a court sanctioned arrangement.

Once a plan or scheme of arrangement has been duly approved and sanctioned by the Court (which may include oversight from a court-appointed provisional liquidator) it will be binding on the company, its members and creditors and interested parties will typically have no right to dissent. Care must however be taken to ensure cross-border recognition of any schemes, particularly where foreign law security has been granted over any of the company's assets.

The BVI Insolvency Act also provides restructuring mechanisms for BVI companies which are insolvent or approaching insolvency, including:

- the appointment of a “light touch” provisional liquidator, the purpose of which is to assist the company to restructure debts or otherwise achieve a better outcome for creditors than would be achieved by liquidation; and
- creditor arrangements, which enable BVI companies to compromise liabilities with creditors without the need for court involvement but under the supervision of by a nominated insolvency practitioner. Creditor arrangements in particular are very flexible and allow for debts to be varied or cancelled, although the rights of secured or preferential creditors cannot be affected without their written consent.

Enforcement of Security and Potential Disputes

If security has been granted over the assets or shares of a BVI company a secured creditor may seek enforcement against the company following the occurrence of an event of default. In respect of charges governed by BVI law, secured creditors may have resort to the following statutory remedies: (i) the right to sell the assets; and (ii) the right to appoint a receiver (who may vote any charged

shares and receive distributions in respect of the same). In respect of security governed by foreign law the enforcement remedies available to the chargee or mortgagee will depend on the relevant foreign law and the instrument creating the mortgage or charge.

During the course of any restructuring process it is important that BVI companies proactively assess their existing security and the priorities of the same. Charges which are publicly registered in the BVI take priority over those which are not so registered and generally also have priority over those which are subsequently registered. Key dates ought to be diarized and continuously monitored in respect of what constitutes an “event of default” and the subsequent triggering of enforcement remedies. For example, in respect of BVI law governed charges, statutory enforcement remedies are not exercisable until 30 days after a default (or such shorter period as may be specified in the instrument creating the charge). Legal advice on the governing law of the security should be sought in respect of potential enforcement remedies and timings of the same.

For information regarding the process for the enforcement of security over the assets or shares of BVI companies please see Conyers’ publications [“Granting and Enforcing Security over Assets of British Virgin Islands Companies”](#) and [“Granting and Enforcing Security over Shares of British Virgin Islands Entities”](#).

Insolvency

It is very important that directors of BVI companies which may be approaching insolvency take steps to evaluate the position of the company. Among other things, a director of a BVI company can be personally liable if he or she fails to take appropriate steps to commence formal liquidation where there is no reasonable prospect of the company avoiding insolvent liquidation.

When is a BVI company insolvent?

Under BVI law solvency is judged by two key tests:

- can the company pay its debts as they fall due (the cash flow test); and
- do the company’s assets exceed its liabilities (the balance sheet test).

As a technical matter, a company will be deemed to be “insolvent” under BVI law if it does not meet the cash flow test or the balance sheet test. There are also some “fast track” ways for a creditor to prove cash flow insolvency, for example:

- the BVI company fails to comply with a formal statutory demand which has not been set aside; or
- execution or other process issued on a court judgment is returned wholly or partly unsatisfied.

Once a BVI company is proved to be “insolvent” on one or more of the bases above then (among others) a creditor could in theory apply to the BVI Court to put the company into liquidation. The BVI Court has the discretion as to whether or not to accede to that application.

Negative Net Assets

The standard way for a creditor to put a BVI company into insolvency is to prove that it is unable to pay its debts as they fall due, normally by issuing a statutory demand for a debt. Where however the company is simply balance sheet insolvent but is able to pay its debts as they fall due, it is much more difficult for a creditor to put the company into liquidation. In such a case, the Court should determine:

*“...whether it has been established that, looking at the company’s assets and making proper allowance for its prospective and contingent liabilities, **it cannot reasonably be expected to be able to meet those liabilities**. If so, it will be deemed insolvent although it is currently able to pay its debts as they fall due. The more distant the liabilities, the harder this will be to establish.”¹* [emphasis added]

In practical terms, this means that provided the company has sufficient cash to pay its immediate debts, and has a clear and viable plan to meet its longer term liabilities, an action to liquidate the company on the basis of balance sheet insolvency is unlikely to succeed.

A negative net assets position is therefore manageable provided that the BVI company can pay its debts as they fall due and there is a clear business plan to repay its other debts. This is particularly the case in a situation where the large creditors are also shareholders and there is comfort that they will agree to extensions until a liquidity event occurs. However, whilst potentially manageable, a negative net assets situation will mean that:

- the decisions of the directors will come under increased scrutiny (this will be the case particularly in respect of decisions of the board in relation to the approval of capital expenditure items and the entry into new contracts which impose financial obligations on the company);

¹ See the UK Supreme Court decision of *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3 BL plc and ors* [2013] UKSC 28: applied in the BVI in *Donna Union Foundation v Koshigi Limited* BVIHC (Com) 231 of 2018

- the company will not (as discussed below) be able to pay any dividends or make other distributions (including share-buy backs and redemptions); and
- there is a risk that the company will eventually become cash flow insolvent.

Directors Duties

In the case of a solvent BVI business company, the fiduciary duties of the directors to the company require the directors to have regard to the collective interests of the members of the company. Where a BVI company is insolvent however (i.e. cash flow or balance sheet insolvent), on the brink of insolvency, or where an insolvent liquidation is probable, there will be a shift in the interests directors of the company must have regard to and the directors' fiduciary duties will require them to take into consideration the interests of the creditors of the company (as a general body). This has been confirmed by the recent UK Supreme Court decision in BTI 2014 LLC v Sequana SA and others² (which, whilst a UK decision, is very likely to be followed by the BVI Courts) which also confirmed, among other things, that:

- the creditor duty only arises when the directors know, or ought to know, that the company is insolvent (i.e. cash flow or balance sheet insolvent), bordering on insolvency or that an insolvent liquidation is probable: it is not sufficient that there is simply a real risk that the company may in the future become insolvent;
- the duty is not merely a duty to take account of the interests of creditors to the extent only of securing the success of the company for the benefit of its members (which is the extent of the duty to consider creditors' interests when the company is solvent): instead, there is a sliding scale, such that once the duty is engaged, the more parlous the state of the company, the more the interests of the creditors will predominate and the greater the weight that should be given to their interests as against those of the shareholders; and
- a breach of the creditor duty cannot be authorised or ratified by the shareholders of the company.

For further information regarding the Sequana case and the creditor duty please see Conyers' publication "[BVI Directors' Duties And Insolvency: The Impact of the Sequana Case](#)".

Entering Insolvency

The fundamental question directors should consider, both when financial difficulties first become apparent and on an ongoing basis until the financial difficulties are resolved, is whether there are reasonable prospects that the company will avoid insolvent liquidation. If the answer is that there are no such reasonable prospects, the directors should take appropriate steps to appoint an insolvency practitioner to act as liquidator of the company as soon as reasonably practicable.

Although the directors' primary consideration will be whether the company should continue to trade at all or whether an insolvency practitioner should be appointed to act as liquidator, there are also a variety of grounds provided for under the BVI Insolvency Act upon which transactions made by a company which subsequently becomes formally insolvent can be set aside. For so long as the directors continue to manage the business (i.e. until the appointment of a liquidator) while it is of doubtful solvency all transactions entered into by the company should be considered carefully in relation to whether the transaction may be potentially voidable as an unfair preference, undervalue transaction, voidable floating charge or extortionate credit transaction.

For further information regarding insolvent trading and voidable transactions please see Conyers' publications "[Insolvent Trading - British Virgin Islands Companies](#)" and "[Voidable Transactions – BVI Companies](#)".

Solvency Requirements for Distributions

A BVI company may not lawfully make or pay a distribution (including dividends, share-buy backs and redemptions) unless the directors are satisfied that immediately after the distribution, the company will satisfy the relevant solvency test. For companies incorporated under the BVI Business Companies Act the relevant solvency test is that:

- the value of the company's assets exceed its liabilities; and
- the company is able to pay its debts as they fall due.

The directors of a BVI company are required to confirm their opinion that the company will satisfy the solvency test in the resolution approving any proposed distribution.

As a result, a BVI company with a negative net assets position will not be able to lawfully make any distributions to its shareholders.

The failure by a BVI company to satisfy the solvency test immediately following a distribution could result in the relevant distribution being clawed back and/or the relevant director(s) incurring personal liability in relation to that (unlawful) distribution.

² [2022] UKSC 25 On appeal from: [2019] EWCA Civ 112

Practical Steps

The practical steps which a BVI company in financial distress should take will depend on the individual set of circumstances. As such, obtaining tailored professional advice at an early stage is important. Directors of BVI companies should however be alive to any warning signs of impending financial difficulty and, as soon as they are aware that there may be concerns about the company's solvency or prospects for continued solvency, the directors should take the following steps:

Seek legal and financial advice

- seek legal advice as soon as possible, as well as other appropriate professional advice aimed at reviewing whether insolvent liquidation is inevitable or whether there are potential ways of resolving or mitigating the financial difficulties;
- review D&O insurance and the cover provided by it;
- remain apprised of the company's financial situation at all times, including, if appropriate, by obtaining reports from the CFO, accountants or other financial experts, particularly in relation to companies with complex cash flow or balance sheet issues; and
- keep the company's position under constant review for so long as the financial difficulties continue and seek further professional advice as to the implications of any change in the company's position;

Consider interests of creditors

- be aware of who the company's creditors are, the nature and extent of those liabilities and ensure there is a clear plan to discharge the company's debts as they fall due;
- to the extent repayment of creditors depends on achievement of a business plan or financial projections, continuously re-assess the business plan and projections to ensure they remain valid and substantiate plans to repay creditors; and
- to the extent existing indebtedness will need to be refinanced with new debt or equity regularly assess the viability of refinancing plans and ensure the necessary processes for refinancing are started and progressed on a timely basis. This is particularly important in an environment where interest rates are rising;

Ensure proper record keeping

- ensure that adequate and up-to-date records are being kept to be able to ascertain the company's financial position;
- ensure that directors' decision making is properly and accurately recorded, including the reasons why they are taking decisions. This includes holding regular meetings of directors with appropriate minutes kept which record the ongoing evaluation of decisions and, specifically, the company's financial position and prospects. When the company is insolvent or nearly so, the company's records should explain what considerations and weight directors gave to the creditors' interests (as opposed to the interests of others) and the reason why they believe that the relevant decision is in the interests of the creditors as a whole; and
- ensure that the solvency test is considered and documented in the approving resolutions prior to making any distribution to any of the shareholders of the company including dividends, share-buy backs and redemptions;

Entering insolvency

- if a director concludes (or thinks there is a sufficient risk such that the directors ought to conclude) that there is no reasonable prospect of the company avoiding insolvent liquidation, seek legal advice and take such steps as are necessary to appoint an insolvency practitioner to act as liquidator, as well as taking all steps reasonably available to minimise losses to creditors in the meantime; and
- exercise caution about entering into any transaction which could be considered to be a voidable transaction were the company to enter formal insolvency within the applicable vulnerability period.

We are here to help

Tailored professional advice should be sought in respect of individual circumstances. Please feel free to reach out to your usual Conyers contacts with any questions regarding BVI companies, refinancing/restructuring, insolvency or enforcement proceedings against BVI companies. We will be pleased to help and would like to reassure you of our continued support.

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