GUIDE

What a creditor needs to know about liquidating an insolvent BVI company

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Introduction

One of the main reasons the BVI remains a popular place to establish an asset holding company is that its insolvency laws are creditor friendly and modelled on the English Insolvency Act 1986. Consequently, lenders around the world are comfortable lending money to BVI companies.

This guide examines the main things a creditor needs to know about liquidating an insolvent BVI company under the Insolvency Act 2003 (the **Act**) and the Insolvency Rules 2005 (the **Rules**).

A brief anatomy of a creditor initiated liquidation process is included at the end of this guide.

When is a company insolvent?

Under the Act, a company is regarded as being insolvent if:

- **cash flow insolvency**: it is unable to pay its debts as they fall due;
- **balance sheet insolvency**: the value of its liabilities exceeds its assets; or
- **technical insolvency**: it is taken to be insolvent (irrespective of its actual solvency) because:
  - it fails to comply with a valid statutory demand; or
  - execution of a judgment or other order of a BVI court against it is returned wholly or partly unsatisfied.

What is a statutory demand?

Written request for payment

A statutory demand is a formal written request for the payment of a debt given by a creditor to a debtor.

Is it essential to serve a statutory demand?

It is not essential for a creditor to serve a statutory demand before applying to appoint a liquidator because a company may be cash flow or balance sheet insolvent. In most cases, it is advisable to serve a statutory demand first because the company will be presumed to be insolvent if it does not satisfy or compound the debt within 21 days of the date of service.

If a creditor has an unsatisfied judgment against the company, it may prefer to apply to appoint a liquidator on the grounds of insolvency using the unsatisfied judgment as evidence of the company's inability to pay its debts as they fall due. However, to avoid a potential argument being raised by the judgment debtor that, notwithstanding its failure to satisfy any order or judgment for payment of a liquidated sum, it remains able to pay its debts as they fall due, it is advisable that a statutory demand for the judgment sum be issued as a preliminary step.

What must a statutory demand say?

A statutory demand must comply, and be served in accordance with, the Rules.

It must:

- be for a debt which is not less than the statutory minimum amount (currently US$2,000) and which is due and payable at the time of the demand;
- be in writing and state the nature of the debt and its amount;
- be dated and signed by, or on behalf of, the creditor;
- require the debtor to pay the debt or secure or compound it to the reasonable satisfaction of the creditor within 21 days of the date of service;
- state that, if the debtor does not comply with it, the creditor may apply to the High Court for a liquidator to be appointed; and
- state that the debtor has the right to apply to have it set aside.

Where the creditor issuing a statutory demand holds security for the debt, the statutory demand must:

- state the full amount of the debt;
- state the nature of the security interest;

- state the value which the creditor places on the security interest on the date of the statutory demand; and
- claim the full amount of the debt less the amount stated to be the value of the security interest (the balance must be at least equal to the statutory minimum amount of US$2,000).

Setting aside a statutory demand

An application to set aside a statutory demand must be made within 14 days of the date on which it was served. Where an application is made, the 21 day compliance period ceases to run from the date on which the application is filed. The High Court must set aside a statutory demand if it is satisfied that:

- there is a substantial dispute as to whether:
  - the debt is owing or due; or
  - a part of the debt (which would reduce the undisputed amount of the debt to less than the statutory minimum amount of US$2,000) is owing or due;
- the debtor has a reasonable prospect of establishing set-off, counterclaim or cross claim in an amount that would reduce the debt to less than US$2,000; or
- the creditor holds security for the debt and the unsecured portion of the debt claimed is less than US$2,000.

The court also has discretion to set aside a statutory demand if it is satisfied that there would be substantial injustice because there is a defect in it or for some other reason.

How may a company be put into liquidation?

A company may be put into liquidation by a liquidator being appointed by a resolution of the shareholders (i.e. voluntary liquidation) or an order of the High Court (i.e. compulsory liquidation).

Qualifying resolution

Where a company is insolvent, its shareholders may pass a qualifying resolution to appoint an *eligible insolvency practitioner* (See *Eligibility* below) as liquidator unless:

- a liquidator has already been appointed by the High Court; or
- an application to appoint a liquidator has been made but not yet heard.

A qualifying resolution is a resolution passed at a properly held shareholders' meeting by a majority of 75 per cent (or any higher majority specified in the company's memorandum or articles) of the votes cast by the shareholders present and voting.

If the company is a regulated person, the BVI Financial Services Commission (the Commission) must be given at least five working days' prior notice (or any shorter period it may agree) of the qualifying resolution.

Appointment

The proposed liquidator must consent in writing to being appointed before the qualifying resolution is passed, otherwise the resolution is void. The company must give the proposed liquidator notice of appointment as soon as possible once the qualifying resolution has been passed.

Liquidator's powers

Where a liquidator is appointed by the shareholders under the Act:

- the liquidator's powers are limited to:
  - taking custody and control of the company's assets;
  - disposing of perishable goods or other assets that will diminish in value if they are not immediately sold;
  - doing anything necessary to protect the company's assets; and
  - exercising any other powers of a liquidator the High Court may confer; and
- the liquidator may be replaced by the creditors at the first meeting of creditors.

Court order

Who may apply?

Where a company is insolvent, an application to appoint a liquidator may be made by (among others):

- the company;
- a shareholder if the High Court has given its prior permission (which it will only give if it is satisfied that, on the face of things, there is a case that the company is insolvent); or
- a creditor who can show either that the company is insolvent (on either the cash flow or balance sheet basis) or that it is just and equitable that a liquidator be appointed.

Application

The applicant will propose an eligible insolvency practitioner to be appointed as liquidator who will be appointed if the High Court decides to appoint a liquidator.

On hearing the application, the court may appoint a liquidator or dismiss the application even if a ground on which the court could appoint a liquidator has been established. The court may not, however, refuse to appoint a liquidator simply because:

- the company's assets are subject to a security interest securing an amount that is equal to, or greater than, the value of the company's assets;
- the company has no assets; or
- where the applicant is a shareholder, the company would not have any assets available to distribute among its shareholders if the order were made.

Debt should be undisputed

Using an application to appoint a liquidator as a means of applying pressure against a defaulting creditor to pay a disputed debt may amount to an abuse of process. Accordingly, an application should only be made if the:

- debt is undisputed or incapable of being disputed; and
- application will benefit all creditors of the class to which the applicant belongs.

It is an abuse of process to make an application where a debt is being disputed on substantial grounds or to secure a collateral advantage unrelated to the debt.

When does a company's liquidation start?

A company's liquidation starts at the time the liquidator is appointed. Unlike the position in the UK and elsewhere, the start of the liquidation does not relate back to the date the application was filed.

What are the consequences of a company being put into liquidation?

Assets do not vest in liquidator

The company's assets do not automatically vest in the liquidator, however, the liquidator may apply to the High Court for an order vesting some or all of the company's assets in the liquidator.

Automatic consequences

With effect from the start of a company's liquidation:

- the liquidator has custody and control of the company's assets;
- the company's directors and officers remain in office, but cease to have any powers, functions or duties other than those required or permitted under the Act or authorised by the liquidator;
- unless the High Court orders otherwise, no person may:
    - commence or proceed with any action or proceeding against the company or relating to any of its assets; or
    - exercise or enforce, or continue to exercise or enforce, any right or remedy over or against any of the company's assets;
- unless the High Court orders otherwise, no share in the company may be transferred;

- no alteration may be made in the status, or to the rights or liabilities, of a shareholder, whether by an amendment to the company's memorandum or articles or otherwise;
- no shareholder may exercise any power under the company's memorandum or articles or otherwise, except for the purposes of the Act; and
- no amendment may be made to the company's memorandum or articles.

Any act done, or attempted to be done, in breach of these matters is void.

Restriction on execution and attachment

Unless the High Court orders otherwise, a creditor may not keep the benefit of any execution, process, distress or attachment over or against the company's assets unless the action is completed before the first to occur of the date on which the:

- company's liquidation started; and
- application to appoint the liquidator was filed in court.

Public documents

Once a company's liquidation has started, all public documents issued by or on behalf of the company or the liquidator must state:

- that the company is in liquidation; and
- the name of the liquidator.

Other consequences

Other consequences that flow from a company being placed into liquidation are that the:

- company ceases to be the beneficial owner of its assets and holds them on a statutory trust for the benefit of its creditors to be distributed in accordance with the Act; and
- liquidator may seek to:
  - challenge transactions entered into by the company (e.g. as an unfair preference, undervalue transaction or extortionate credit transaction) or to disclaim contracts as onerous property;
  - take action against the directors (e.g. for breach of duty, misfeasance or insolvent trading); or
  - take action against the shareholders (e.g. to make a call or reclaim an unlawful distribution).

Effect on contracts

Any contracts entered into by the company before the start of its liquidation will not generally be affected by its liquidation, except as noted below.

- Termination of contract: the terms of the contract may automatically terminate, or give another party the right to terminate, the contract.
- Application for rescission: a person who is entitled to the benefit, or subject to the burden, of a contract made with the company, may apply to the High Court for an order rescinding the contract. The court may rescind the contract on any terms regarding payment by or to the person of damages for the non-performance of the contract or otherwise as it considers just. If the person is entitled to payment of damages under the order, the person may claim the damages as a debt in the company's liquidation.
- Liquidator challenges: as noted under *Other consequences* above, the liquidator may seek to challenge transactions entered into by the company or disclaim contracts as onerous property.

It is noteworthy that, unlike the position in the UK and in other common law jurisdictions, BVI law contains no provision equivalent to section 127 of the Insolvency Act 1986 (UK) that would require a company against whom a winding-up petition has been filed to make applications to validate payments or transactions.

How do creditors claim in a company's liquidation?

Making a claim

An unsecured creditor may make a claim against a company in liquidation by submitting to the liquidator a written claim signed by, or on behalf of, the unsecured creditor.

The liquidator may require an unsecured creditor to:

- provide further details of its claim;
- verify its claim by affidavit; or
- provide documentary or other evidence to substantiate its claim.

It is an offence to submit a claim knowing that it is false or misleading in any material matter or it omits a material fact or matter.

Currency

A claim that is based on a liability that is not denominated in US dollars, must be converted to US dollars at the start of the liquidation using the closing mid-point rate published in the Financial Times (US edition).

Contingent debts

Where a claim is subject to a contingency or its amount is uncertain, the liquidator must:

- agree an estimate of the value of the claim at the start of the liquidation; or
- ask the High Court to decide the amount of the claim (the court may decide the amount or a method to calculate it).

Interest

A claim may include interest accruing up to, but not accruing after, the start of a company's liquidation.

However, if a surplus remains after the payment of all claims in the company's liquidation, it is to be applied in paying interest accrued on claims after the start of the liquidation. All interest ranks equally at the rate that is the higher of the court rate (which is currently five per cent) and the contractual rate.

Admitting or rejecting claims

As soon as reasonably practicable after receiving a claim, the liquidator must either admit or reject the claim in whole or part.

If the liquidator rejects a claim (in whole or part), the liquidator must provide the creditor (as soon as practicable) with a written notice giving reasons for rejecting it.

What is a creditors' committee?

Establishing the committee

The creditors may pass a resolution to establish a creditors' committee and appoint its members at any time after the appointment of the liquidator, but typically at the first meeting of creditors. The creditors' committee must consist of not less than three, and not more than five, members.

Only an individual who:

- is a creditor (or its designated representative) whose claim has not been rejected; and
- has consented in writing to being appointed,

is eligible to be appointed as a member of the creditors' committee.

Functions

The functions of the creditors' committee are to:

- consult with the liquidator about matters relating to the liquidation;
- receive and consider reports of the liquidator;
- assist the liquidator to carry out the liquidator's duties; and

- carry out any other functions given to it under the Act or the Rules.

Powers

The creditors' committee may call a creditors' meeting and require the liquidator to appear before it, and to provide it with information and reports regarding the liquidation.

Any application to the court for the approval of the liquidator's remuneration is served on the creditors' committee. The creditors' committee may also (with cause) apply to the court for the removal of the liquidator.

What is the order of distribution of the company's assets?

Pari passu principle

Like many other common law based jurisdictions, the *pari passu* principle applies under the Act. It is one of the most fundamental principles of insolvency law.

Under this principle, all unsecured creditors of an insolvent company should share equally and rateably in the assets of the company (that are not subject to a valid security interest) remaining after payment of any preferential claims and the liquidation expenses.

Excluded assets

The company's assets exclude any asset:

- held by the company that does not belong to it (e.g. an asset held on trust or subject to retention of title terms); and
- of the company that is subject to a valid security interest which secures an existing payment obligation.

Order of application

The liquidator is required to apply the proceeds of realising the company's assets in paying the claims in the liquidation in the following order of priority:

- the costs and expenses properly incurred in the liquidation in the order of the prescribed priority set out in the Rules;
- the claims of any preferential creditors (which rank equally and rateably among themselves);
- all other claims admitted by the liquidator (which rank equally and rateably among themselves);
- any claims for interest allowed in connection with the liquidation (which rank equally and rateably among themselves); and
- any surplus remaining to the shareholders in accordance with their rights and interests in the company.

How are secured creditors affected by a company's liquidation?

General position

The restrictions on taking actions against a company in liquidation or its assets described under *What are the consequences of a company being put into liquidation* above do not prevent a secured creditor from taking possession of, realising or otherwise dealing with, assets of the company over which the secured creditor has a valid security interest.

Liquidator challenge

If the liquidator considers that there is an irregularity in connection with a creditor's security, the liquidator may seek to challenge it (See *Other consequences* above).

Claiming in the liquidation

A secured creditor may (but is not required to):

- value the secured assets and claim in the company's liquidation as an unsecured creditor for the balance of its debt that exceeds the value of the secured assets; or
- surrender its security to the liquidator for the benefit of all creditors and claim in the liquidation as an unsecured creditor for the whole of its debt.

Where a secured creditor sells the secured assets and the net sale proceeds are insufficient to satisfy the secured liability, if the secured creditor:

- previously valued the secured assets and claimed in the company's liquidation for the balance, the amount of the net sale proceeds is substituted for the value previously given; or
- did not do so, the secured creditor may claim in the liquidation as an unsecured creditor for the balance of the security liability.

If a secured creditor values the secured assets and claims in the company's liquidation for the balance of its debt as an unsecured creditor, the liquidator may redeem the secured creditor's security at the value placed on the secured assets by the secured creditor.

If a secured creditor claims in the company's liquidation without disclosing that it holds security over the secured assets, the secured creditor's security is surrendered for the benefit of all unsecured creditors unless the High Court considers that the omission was inadvertent or resulted from an honest mistake.

Who are preferential creditors?

Preferential creditors

The Act and Rules create a class of unsecured creditors (called preferential creditors) whose claims are preferred over, and rank ahead of, other unsecured creditors other than the liquidator in respect of the costs and expenses of the liquidation which rank ahead of all unsecured creditors.

The preferential creditors are creditors with the following claims:

- past or present employees for amounts due to them up to US$10,000 each;
- the BVI Social Security Board for employee contributions deducted from employees and for employer contributions for the six months before the start of the company's liquidation;
- amounts due for employee pension contributions or medical insurance for the 12 months before the start of the company's liquidation up to US$5,000 each;
- the BVI government for amounts due to it for any tax, duty, licence fee or permit up to US$50,000; and
- the Commission for any fee or penalty up to US$20,000.

As a practical matter, in most cases, the claims of preferential creditors should not be significant because most companies carry on business outside the BVI and, therefore, don't have any BVI employees.

Priority

If the assets of the company available for distribution to its unsecured creditors are insufficient to pay in full the liquidator's costs and expenses and the claims of the preferred creditors, the claims of the liquidator and the preferred creditors will rank ahead of the claims of any holders of a floating charge.

The claims of preferential creditors rank equally among themselves.

What are the claims of current and past shareholders?

The current and past shareholders of an insolvent company are unable to claim in the company's liquidation for any sums due to them in their capacity as shareholders. These amounts would normally be unpaid dividends or unpaid share redemption payments.

However, these amounts will be taken into account for the purposes of the final adjustment between current and (if relevant) past shareholders.

It has been held that unpaid share redemption payments due to past shareholders who have redeemed their shares rank ahead of amounts payable to current shareholders.

Do shareholders have to contribute towards the company's debts?

Current shareholders

Under the BVI Business Companies Act 2004:

- a shareholder of a limited company has no liability (in the capacity of shareholder) for the liabilities of the company; and

- the liability of a shareholder (in that capacity) to the company is limited to any:
  - amount unpaid on any share held by the shareholder;
  - liability expressly mentioned in the company's memorandum or articles; and
  - liability to repay a distribution paid when the company did not satisfy the statutory solvency tests.

Under the Act, where a limited company enters insolvent liquidation, the liability of a shareholder to contribute to the assets of the company is limited to any:

- amount unpaid on any share held by the shareholder (including any liability for calls); and
- liability expressly mentioned in the company's memorandum or articles.

This does not affect any liability of the shareholder to:

- pay or repay money to the company under the Act or the BVI Business Companies Act 2004; or
- the company under any contract or any tort or other actionable wrong committed by the shareholder.

Past shareholders

Unless the High Court is satisfied that the current shareholders are able to discharge their liabilities to the company, any person who ceased to be a shareholder during the period of one year before the start of the company's liquidation, is liable to contribute to the assets of the company to the same extent as a current shareholder.

A past shareholder is not, however, liable to contribute to the assets of the company in respect of any liability of the company that arose after the past shareholder ceased to be a shareholder.

Who may be appointed as liquidator?

Status

A liquidator is both an agent of the company and an officer of the court.

Once the liquidator has been appointed, the liquidator effectively takes over the powers of the directors and controls the company's actions.

Offence

Except as noted below, it is an offence for a person to act as an insolvency practitioner without a valid licence issued by the Commission.

Eligibility

To be eligible to be appointed as liquidator, an individual must:

- be a licensed insolvency practitioner;
- have consented in writing to act as liquidator in the prescribed form;
- not be disqualified from acting as liquidator under the Act; and
- not have been an auditor or a director of the company at any time in the preceding three years.

To obtain a licence to act as an insolvency practitioner, a person must:

- make an application in the prescribed form; and
- be an individual who:
  - lives in the BVI; and
  - is considered by the Commission to be a fit and proper person and qualified to act as an insolvency practitioner.

Overseas insolvency practitioners

An overseas insolvency practitioner does not need to obtain a licence under the Act to act as the liquidator of a company if the overseas insolvency practitioner acts a joint liquidator with a licensed insolvency practitioner. To be eligible to be appointed as joint liquidator, an overseas insolvency practitioner must:

- have sufficient qualifications and experience to carry out the appointment;

- have consented in writing to act as liquidator in the prescribed form;
- not be disqualified from acting as liquidator under the Act; and
- have given prior notice of the proposed appointment to the Commission.

What are the liquidator's duties?

Core duties

The core duties of a liquidator under the Act are to:

- take possession of, protect and realise, the company's assets;
- distribute the company's assets (or the proceeds of their realisation) in accordance with the Act; and
- (if there are surplus assets remaining) distribute them, or the proceeds of their realisation, in accordance with the Act.

Duty to report wrongdoing

If a liquidator believes that the:

- company has carried on unlicensed financial services business, the liquidator must report the matter to the Commission as soon as practicable; and
- conduct of a director or former director makes the person unfit to be involved in the management of a company, the liquidator must, as soon as practicable, prepare and send a written report to the official receiver, who may apply for an order disqualifying the person from acting as a director of a company.

Common law duties

Skill and care

A liquidator owes a common law duty to act with skill and care in the performance of the liquidator's duties. The standard of care required of a liquidator is that of a reasonably skilled and careful insolvency practitioner. A liquidator is required to act with a high standard of care because the liquidator is entitled to take legal advice and to submit any matter concerning the liquidation to the High Court for guidance.

The actions of a liquidator will not be open to challenge if the liquidator exercises the liquidator's powers in good faith after taking proper advice, however, this is not the case if the instructions to the adviser were flawed.

Fiduciary duties

A liquidator occupies a fiduciary position but is not a trustee. Consequently, a liquidator owes fiduciary duties, including:

- to act in good faith;
- not to make a secret profit from dealings with the company's property;
- to avoid conflicts of interest;
- to act impartially; and
- to exercise powers for proper purposes.

To whom are duties owed?

The liquidator's duties are owed to the insolvent company itself and may also be owed directly to its unsecured creditors as a class who, in any event, are the ultimate beneficiaries of its assets.

In the absence of a special relationship, a liquidator does not owe any common law duty of care to individual creditors.

What is the liquidator's role?

In practical terms, the liquidator's role is to:

- ascertain the assets and debts of the company;
- preserve the company's property and seek to maximise the assets available to unsecured creditors;

- make claims on the company's current and past shareholders for amounts payable by them to the company (if relevant);
- assess the creditor claims and accept, reject or compromise them;
- collect, realise and distribute the company's assets to its unsecured creditors and (if any surplus remains) shareholders;
- potentially bring proceedings against the company's directors or professional advisers; and
- potentially challenge transactions and reclaim the company's property or to avoid liabilities on the grounds of (among other things):
    - an undervalue transaction;
    - an unfair preference;
    - a voidable floating charge;
    - disclaiming onerous property;
    - an extortionate credit transaction; or
    - a transaction to defraud creditors.

What are the liquidator's powers?

General powers

The liquidator has all powers necessary to carry out the functions and duties of liquidator under the Act and the powers conferred on him under the Act. These powers include the power to:

- pay any class of creditors in full;
- make any compromise or arrangement with creditors or persons claiming to have any claim against the company, whether present or future, certain or contingent, ascertained or not;
- commence, continue, discontinue or defend any action or other legal proceedings in the name of, and on behalf of, the company;
- carry on the business of the company to the extent necessary to carry out its liquidation;
- sell or otherwise dispose of the company's property;
- do all acts and execute any document in the company's name;
- borrow money on a secured or unsecured basis;
- call creditor meetings; and
- appoint any solicitor, accountant or other professionally qualified person or agent.

In certain circumstances, the High Court may provide that certain powers may only be exercised with the sanction of the High Court.

The liquidator is to use the liquidator's own discretion in carrying out the duties of liquidator.

The liquidator may apply to the High Court for directions in relation to any matter concerning the liquidation.

Investigative powers

The liquidator may give (among others) any director, former director, employee, shareholder or former shareholder a written notice requiring the person to:

- provide any information concerning the company, including its business, dealings, accounts, assets, liabilities or affairs as the liquidator reasonably requires;
- be examined under oath or by affirmation on any matter mentioned above; or
- meet with the liquidator at any reasonable time and place specified in the notice.

In addition, the liquidator may apply to the High Court for an order that any person mentioned above, or any other person the liquidator considers is capable of giving information about the company, be examined in court.

A liquidator may also apply to the High Court for an order requiring any person in possession or control of any asset or document to which the company appears to be entitled to pay, deliver, convey, surrender or transfer the asset or document to the liquidator.

What is a provisional liquidator?

A provisional liquidator is a liquidator appointed to preserve a company's assets where there is a real concern that, between the filing of the application to appoint a liquidator and the making of an order to appoint a liquidator, the company's affairs will not be properly conducted or its assets will be dissipated.

Furthermore, following a recent landmark decision[1], 'soft-touch' provisional liquidators may be appointed in circumstances where there is no wrongdoing on the part of the company's management, and instead, the aim is to maintain the value of assets owned or managed by the company, and aid in the possible restructuring of the same.

Who may apply for appointment?

An application to appoint a provisional liquidator may be made by (among others) a person who has made an application to appoint a liquidator, a creditor, the company or a shareholder.

When will a provisional liquidator be appointed?

The usual basis on which a provisional liquidator is appointed is that there is a risk of jeopardy to the company's assets before a liquidator is appointed. In this context, jeopardy includes the risk that the company's assets will be dissipated or the company's books and records will be lost or destroyed.

The High Court may appoint a provisional liquidator on any terms it thinks fit, including requiring the applicant to deposit at court or otherwise provide security in an amount the court considers reasonable to cover the remuneration of the provisional liquidator.

The court may appoint a provisional liquidator if the:

- company consents to the appointment; or
- court is satisfied that appointing a provisional liquidator is:
  - necessary to maintain the value of the company's assets; or
  - in the public interest.

To succeed in appointing a provisional liquidator, the applicant will need to show that:

- there is an application before the court for a liquidator to be appointed;
- there is a good and arguable case that a ground to appoint a liquidator exists;
- there is a good and arguable case that the applicant has the standing to make the application; and
- the court should exercise its discretion to maintain the existing state of affairs regarding the company's assets.

Powers

A provisional liquidator has the rights and powers of a liquidator to the extent necessary to maintain the value of the company's assets or to carry out the duties for which the provisional liquidator is appointed.

The order appointing the provisional liquidator will normally set out the provisional liquidator's powers as well as any limitations placed on them.

When does the appointment end?

The appointment of a provisional liquidator ends on the appointment of a liquidator.

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[1] Constellation Overseas Limited et al BVIHC (Com) 2018/0206, 0207, 0208, 0210 and 0212; See also our update on this decision.

May a liquidator's actions be challenged?

A person who objects to an act, default or decision of a liquidator may apply to the High Court for an order addressing the person's objection. The court may confirm, reverse or modify the act, default or decision of the liquidator[2].

In addition, a liquidator may bring an action against a former liquidator for misfeasance.

Who may apply to remove a liquidator?

An application to remove a liquidator may be made by (among others) the creditors' committee (if any), a creditor or a shareholder.

The High Court may remove a liquidator, on an application made by an eligible applicant or its own motion, if the:

- liquidator:
  - is not eligible to act as an insolvency practitioner in relation to the company;
  - breaches any duty or obligation imposed on the liquidator by the Act, the Rules or any other applicable law; or
  - fails to comply with any direction or order of the court made in relation to the company; or
- court is satisfied that:
  - the liquidator's conduct of the liquidation is below the standard that may be expected of a reasonably competent liquidator;
  - the liquidator has an interest that conflicts with the liquidator's role as liquidator; or
  - for some other reason the liquidator should be removed as liquidator.

Does set-off apply on insolvency?

The Act states that where, before the start of a company's insolvent liquidation, there have been mutual credits, mutual debts or other mutual dealings between the company and a creditor claiming, or intending to claim, in the company's insolvency:

- an account is to be taken of what is due from each party to the other in respect of those mutual credits, mutual debts or other mutual dealings, as at the start of the company's liquidation;
- the sum due from one party is to be set-off against the sum due from the other party; and
- only the balance (if any) may be claimed in the company's liquidation or is payable to the company (as applicable).

The insolvency set-off provisions do not apply to a claim where a creditor has actual notice that the company was insolvent at the time it:

- gave credit to, or received credit from, the company; or
- acquired a claim against the company or any part of, or interest in, the claim.

Insolvency set-off under the Act only applies where the creditor is claiming, or intending to claim, in the company's liquidation. In other common law jurisdictions, insolvency set-off is automatic and mandatory.

For the purpose of these provisions, insolvency means cash flow insolvency or technical insolvency only (the balance sheet insolvency test does not apply).

Does closeout netting apply on insolvency?

The Act states that, despite anything in the Act, the Rules or any rule of law relating to insolvency, the provisions relating to:

- netting of obligations;
- setting-off money provided by way of security;
- enforcing a guarantee; and

[2] See our update on 'Challenging a Liquidator's Decision'

- enforcing a collateral arrangement and setting-off the proceeds of enforcement,

in a netting agreement or a guarantee relating to it are enforceable against each party to the netting agreement and (where applicable) any guarantor or security giver.

For this purpose, the Act defines:

- a **collateral arrangement** as any margin, collateral or security arrangement or other credit enhancement relating to a netting agreement or financial contract;
- **netting** as:
  - terminating financial contracts;
  - determining the termination values of those contracts; and
  - setting-off those termination values,

  to arrive at a net amount due (if any) by one party to the other where each determination and set-off is carried out in accordance with the terms of a netting agreement between those parties;
- a **netting agreement** as an agreement between two parties, relating to present or future financial contracts between them, the provisions of which include terminating those contracts in existence, determining the termination values of those contracts and setting-off those termination values to arrive at a net amount due; and
- a **party** as a person who is a party to a netting agreement.

In addition, the Rules define a **financial contract** as a contract (including any terms and conditions incorporated into it) under which payment or delivery obligations that have a market or an exchange price are due to be performed at a certain time or within a certain period of time.

The Rules set out a non-exclusive list of contracts that constitute a financial contract, including various categories of swap agreement, various categories of derivatives (including equity and credit derivatives), currency and interest rate futures or options, repurchase agreements, agreements to buy, sell, borrow or lend securities and title transfer collateral arrangements.

The insolvency set-off provisions of the Act are expressly subject to the netting provisions. Therefore, if the:

- netting provisions and the insolvency set-off provisions would apply; and
- insolvency set-off provisions would produce a different result to the netting provisions,

the netting provisions would prevail.

The netting provisions state that they will not:

- stop the Act, any other legislation or rule of law applying where it would invalidate any netting, set-off, enforcement or realisation; or
- allow any netting, set-off, enforcement or realisation where any provision of a netting agreement would make netting, set-off, enforcement or realisation void,

due to fraud, misrepresentation or any similar ground.

A brief anatomy of a creditor initiated liquidation process

The creditor initiated liquidation process is typically as follows:

- The creditor serves a statutory demand requiring the debtor to pay or compound the debt owed to the creditor within 21 days.
- The debtor fails to pay or compound the amount set out in the statutory demand, and does not file and succeed in an application to set aside the statutory demand.
- The creditor files at the High Court an:
  - application to appoint a liquidator stating the grounds on which the appointment is sought and normally stating the name of the proposed liquidator; and
  - affidavit in support attaching a notice of eligibility and consent to act signed by the liquidator named in the application.
- A sealed copy of the application and the affidavit in support is served on the company within 14 days of the application being filed.

- Unless the High Court orders otherwise, the application is advertised in the BVI Gazette and any newspaper(s) the creditor considers appropriate not less than seven days:
  - after service of the application on the company; and
  - before the hearing date.
- On hearing the application, the High Court makes an order to appoint the liquidator.
- Upon making the order, the High Court will:
  - give notice of appointment to the liquidator; and
  - send a sealed copy of the order to the liquidator as soon as possible.
- Within 14 days of being appointed, the liquidator will:
  - advertise notice of appointment in the BVI Gazette, a newspaper published and circulating in the BVI and any newspaper(s) the liquidator considers appropriate;
  - file a notice of appointment with the BVI registrar of corporate affairs;
  - give notice of appointment to the company; and
  - if the company is or has been a regulated person, serve notice of appointment on the Commission.
- Unless the liquidator determines that it will not be necessary to:
  - require the shareholders to contribute to the assets of the company; or
  - adjust the rights of the shareholders,

  as soon as practicable after being appointed, the liquidator will settle a list of shareholders and notify each person on the list that the liquidator has done so.
- Within 21 days of being appointed, the liquidator will call the first creditors' meeting by:
  - sending to every known creditor not less than seven days before the date of the meeting a:
    - notice of meeting; and
    - claim form; and
  - advertising the meeting in the BVI Gazette and any newspaper(s) the liquidator considers appropriate.

  Before the first creditors' meeting, a creditor may ask the liquidator for a list of creditors and any other information regarding the liquidation the creditor may reasonably request and the liquidator is reasonably able to provide.
- At the first creditors' meeting, the creditors may:
  - resolve to apply to the High Court to appoint a different liquidator; and
  - appoint a creditors' committee.
- Each unsecured creditor wishing to claim in the liquidation will submit a claim to the liquidator.
- As soon as reasonably practical after receiving a claim from a creditor that complies with the Act and Rules, the liquidator will admit or reject the claim in whole or part. If the liquidator rejects a claim (in whole or part), the liquidator will, as soon as practicable, send the creditor a rejection notice specifying the reasons for the rejection.
- Within 60 days of the start of the liquidation (unless the High Court allows more time), the liquidator will prepare and send to each creditor a preliminary report covering the following matters:
  - (if the company has share capital) the amount of the issued and paid up share capital;
  - the company's assets and liabilities;
  - if the company has failed, the cause of the failure; and
  - whether the liquidator considers it is desirable that further enquires be carried out in relation to any:
    - matter relating to the promotion, formation or insolvency of, or the conduct of the business and affairs of, the company; or
    - possible claims for malpractice, insolvent trading or fraudulent trading.

- The liquidator may require any person who is, or was in the two years preceding the appointment of the liquidator, any promoter, director, secretary or employee of the company to prepare a statement of affairs which must be verified by an affidavit and set out (among other things) the:
  - company's assets and liabilities;
  - names and addresses of the company's creditors; and
  - security interests created by the company and the dates on which they were created.

  A person required to prepare a statement of affairs may, instead, give an affidavit of concurrence stating that the person concurs with a statement of affairs prepared and verified by another person. The liquidator will file in court each statement of affairs and affidavit of concurrence.
- Before the liquidator pays a dividend, the liquidator will send a written notice to each creditor stating a date by which the creditor must submit a claim.
- The liquidator will pay a dividend in accordance with the statutory order of priority and send to each creditor participating in the dividend a statement providing information that will allow the creditor to understand how the amount of the dividend was calculated.
- Once the liquidator has completed the liquidation, the liquidator will:
  - prepare and send to each creditor whose claim was admitted and each shareholder a:
    - final report and a statement of realisations and distributions; and
    - summary of the grounds on which a creditor or shareholder may object to the company being struck off the register of companies; and
  - file with the registrar of corporate affairs the final report and a statement of realisations and distributions.
- The company is dissolved and the registrar of corporate affairs strikes off the company's name from the register of companies.

Contacts

To find out more, please get in touch with your usual Mourant contact, or alternatively, a full list of contacts specialising in BVI Restructuring and Insolvency Law can be found here.

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