

## Alert

### Insolvent Trading - British Virgin Islands 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.**

A company will be insolvent under BVI law if any of the following apply:

- the company fails to comply with a statutory demand which has not been set aside;
- the company's liabilities exceed its assets;
- the company is unable to pay its debts as they fall due; or
- execution or other process issued on a judgment is returned wholly or partly unsatisfied.

Determining whether a company is unable to pay its debts as they fall due can be a grey area and so directors need to consider the issues below as soon as they become aware of prospective financial difficulties. The relevant duties apply to all directors, including shadow directors if any.

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.

A director may be held personally liable if, on the application of a liquidator, a court decides that the director knew or ought to have concluded prior to commencing formal liquidation that there was no reasonable prospect that the company would avoid going into insolvent liquidation.

There is no "bright line" test to determine when a director knew or ought to have concluded that there was no reasonable prospect that the company would avoid insolvency. Rather, the BVI Insolvency Act, 2003 provides that the facts which a director ought to know or ascertain, the conclusions which he ought to reach and the steps reasonably open to him which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both (i) the general knowledge, skill and experience that may reasonably be expected of a director (i.e., an objective test) and (ii) the general knowledge, skill and experience of that director (a subjective test).

The bottom line for directors is that, when they have serious concerns as to the solvency of a company, they will need to consider appointing an insolvency practitioner to act as liquidator in order to protect themselves from the potential personal liability which might arise if they delay taking such steps beyond the point which a court later determines was the point they should have commenced the liquidation process. No such personal liability will arise if the court is satisfied that after a director first knew, or ought to have concluded, that there was no reasonable prospect that the company would avoid going into insolvent liquidation, such director took every step reasonably open to him to minimise the loss to the company's creditors.

Once a company becomes insolvent, the directors' duties to the company are subject to an overriding duty to its creditors. The directors' duties to the company however begin to shift when the company enters the "zone of insolvency" (being an informal term

referring to when the solvency or otherwise of the company is uncertain). While the company is in the zone of insolvency, the directors should not approve new contracts where it is reasonably foreseeable that the company would not be able to make the required payments under the contracts. In the case of existing contracts, there is an obligation to not incur new liabilities under such contracts. As a result, there may be a positive obligation to tell suppliers not to deliver goods (or to tell employees at the beginning of the month that they may not get paid for that month) if there is no reasonable prospect that the company would avoid going into liquidation. While the legal analysis for new and existing contracts is identical, as a practical matter, a counterparty to a new contract may find it easier to claim that the company should never have entered into that contract.

When a court makes an order against a director for insolvent trading or fraudulent trading or finds that there has been a breach of duty by a director of an insolvent company, the most likely consequences for the director are:

- an order for the directors concerned to contribute personally to the assets of the company (the level of such contribution being at the discretion of the court); and/or
- disqualification which prohibits such director from acting as a director of a BVI company for a period of time.

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, 2003 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. Such voidable transactions are outside the scope of this article but are covered further in other Conyers publications.

## Practical Steps

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

- 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;
- 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;
- ensure that adequate and up-to-date records are being kept to be able to ascertain the company's financial position;
- hold regular meetings of directors with appropriate minutes kept which record the ongoing evaluation of decisions and, specifically, the company's financial position and prospects;
- 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;
- 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; and
- review D&O insurance and the cover provided by it.

## We are here to help

As noted above, tailored professional advice should be sought in respect of the individual circumstances of the company. Please feel free to reach out to your usual Conyers contacts with any questions regarding the insolvency of BVI companies. We will be pleased to help and would like to reassure you of our continued support.

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