



Legal Insights

Voidable Transactions in the British Virgin Islands

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Introduction

In certain circumstances, the liquidator of a British Virgin Islands (“**BVI**”) company may be able to set aside certain transactions which took place in the lead up to the company’s liquidation. It is important for those concerned with the affairs of a BVI company that they are aware of the statutory powers available to the liquidator.

For a corporate liquidation in the BVI, there are four types of voidable transactions set out in the Insolvency Act 2003 (as revised). The voidable transactions are not necessarily mutually exclusive. They are:

- (1) An unfair preference;
- (2) An undervalue transaction;
- (3) A floating charge that is voidable; and
- (4) An extortionate credit transaction.

Key definitions in relation to voidable transactions

There are various key definitions which are applicable to more than one type of voidable transaction and they are as follows:

i. **Vulnerability period**

In order for a transaction to be challenged, the transaction in question must have been entered into during the “vulnerability period”.

For the purposes of unfair preferences, undervalue transactions, and voidable floating charges, the “vulnerability period” means:

- (1) in the case of a transaction entered into with, or a preference given to, a connected person, the period commencing two (2) years prior to the onset of insolvency and ending on the appointment of the liquidator; and
- (2) in the case of a transaction entered into with, or a preference given to, any other person, the period commencing six (6) months prior to the onset of insolvency and ending on the appointment of the liquidator.

For the purposes of an extortionate credit transaction, the “vulnerability period” means the period commencing five (5) years prior to the onset of insolvency and ending on the appointment of the liquidator.

ii. Onset of insolvency

The way a liquidator is appointed is relevant. The “onset of insolvency” is defined as either:

- (1) the date on which the application for the appointment of the liquidator was filed, where a company is in liquidation and the liquidator was appointed by the Court; or
- (2) the date of the appointment of the liquidator, where a company is in liquidation and the liquidator was appointed by the members.

iii. Connected persons

The definition of “connected persons” is relevant in relation to all voidable transactions.

In relation to a company, “connected person” means any one or more of the following:

- (1) a promoter of the company;
- (2) a director or member of the company or of a related company;
- (3) a beneficiary under a trust of which the company is or has been a trustee;
- (4) a related company;
- (5) another company one of whose directors is also a director of the company;
- (6) a nominee, relative, spouse or relative of a spouse of a person referred to in paragraphs (1) to (3) above;
- (7) a person in partnership with a person referred to in paragraphs (1) to (3); and
- (8) a trustee of a trust having as a beneficiary a person who is, apart from this paragraph, a connected person.

A company is related to another company if:

- (1) it is a subsidiary or holding company of that other company;
- (2) the same person has control of both companies; and
- (3) the company and that other company are both subsidiaries of the same holding company.

In relation to an individual, “connected person” means any one or more of the following:

- (1) a relative, spouse or relative of a spouse of the individual;
- (2) a person in partnership with the individual;
- (3) a relative or spouse of a person in partnership with the individual;
- (4) a company in respect of which they are a connected person as defined above;
- (5) a trustee of a trust having as a beneficiary a person who is, apart from this paragraph, a connected person.

iv. Insolvency transaction

A transaction is an “insolvency transaction” if:

- (1) it is entered into at a time when the company is insolvent; or
- (2) it causes the company to become insolvent.

The liquidator, in challenging unfair preferences, undervalue transactions and/or floating charges must satisfy the Court that the transaction in question is an “insolvency transaction”.

Unfair preference

A transaction entered into by a company is an unfair preference given by the company to a creditor if the transaction:

- (1) is an insolvency transaction;
- (2) is entered into within the vulnerability period; and
- (3) has the effect of putting the creditor into a position which, in the event of the company's insolvent liquidation, will be better than the position they would have been in if the transaction had not been entered into.

If the transaction in question is entered into by a company with a connected person within the vulnerability period, there is a presumption that the transaction was an unfair preference and that it did not occur in the ordinary course of business. This presumption can be rebutted if the contrary can be proved.

A transaction is not an unfair preference if it is entered into in the ordinary course of business. For example, this would apply to trade creditors and financing which is entered into by the company at arm's length.

Undervalue transaction

A company enters into an undervalue transaction with a person if:

- (1) the company makes a gift to that person or otherwise enters into a transaction with that person on terms that provide for the company to receive no consideration; or
- (2) the company enters into a transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company; and
- (3) in either case set out above, the transaction concerned is an insolvency transaction and is entered into within the vulnerability period.

A transaction is not an undervalue transaction if the company enters into the transaction in good faith and for the purposes of its business and at the time of the transaction, there were reasonable grounds for believing that the transaction would benefit the company.

Where a company enters into a transaction with a connected person within the vulnerability period and the transaction falls within paragraph (1) or paragraph (2) above, unless the contrary is proved, it is presumed that the transaction was an insolvency transaction and the company did not enter into the transaction in good faith and for the purposes of its business and there were no reasonable grounds for believing that the transaction would benefit the company.

Floating charge that is voidable

A floating charge created by a company is voidable if it is created within the vulnerability period and it is an insolvency transaction.

A floating charge is not voidable to the extent that it secures:

- (1) money advanced or paid to the company, or at its direction, at the same time as, or after, the creation of the charge;
- (2) the amount of any liability of the company discharged or reduced at the same time as, or after, the creation of the charge;
- (3) the value of assets sold or supplied, or services supplied, to the company at the same time as, or after, the creation of the charge; and

- (4) the interest, if any, payable on the amount referred to in paragraph (1) to paragraph (3) above pursuant to any agreement under which the money was advanced or paid, the liability was discharged or reduced, the assets were sold or supplied or the services were supplied.

Where a company creates a floating charge in favour of a connected person within the vulnerability period, unless the contrary is proved, it is presumed that the charge was an insolvency transaction.

Extortionate credit transaction

A transaction entered into by a company within the vulnerability period for, or involving the provision of, credit to the company is an extortionate credit transaction if, having regard to the risk accepted by the person providing the credit:

- (1) the terms of the transaction are or were such as to require grossly exorbitant payments to be made (whether unconditionally or in certain contingencies) in respect of the provision of credit; or
- (2) the transaction otherwise grossly contravenes ordinary principles of fair trading.

Orders in respect of voidable transactions

Where the Court is satisfied that a transaction entered into by a company is a voidable transaction, the Court, on the application of the office holder (e.g. administrator, its liquidator, or its provisional liquidator):

- (1) may make an order setting aside the transaction (in whole or in part);
- (2) in respect of an unfair preference or an undervalue transaction, may make such order as it considers fit for restoring the position to what it would have been if the company had not entered into that transaction; and
- (3) in respect of an extortionate credit transaction, may by order provide for any one or more of the following:
 - (a) the variation of the terms of the transaction or the terms on which any security interest for the purposes of the transaction is held;
 - (b) the payment by any person who is or was a party to the transaction to the office holder of any sums paid by the company to that person by virtue of the transaction;
 - (c) the surrender by any person to the office holder of any asset held by them as security for the purposes of the transaction; and
 - (d) the taking of accounts between any persons.

Without prejudice to the generality of the Court's power to make such order as it considers fit for restoring the position to what it would have been if the company had not entered into the unfair preference or undervalue transaction, an order may, among other things, require any assets transferred as part of the transaction to be vested in the company.

It should be noted that there are limitations on orders made by the Court where it has determined that there is an unfair preference or an undervalue transaction. Such orders must not:

- (a) 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
- (b) 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 they were a creditor of the company.

Any money paid to, assets recovered, or other benefit received by the liquidator as a result of an order made in relation to a voidable transaction are deemed to be assets of the company available to pay unsecured creditors of the company.

This publication is not intended to be a substitute for specific legal advice or a legal opinion. For specific advice on BVI liquidations (insolvent or voluntary) and voidable transactions, please contact your usual Loeb Smith attorney or any of the following:

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