International Corporate Rescue

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

www.chasecambria.com

Annual Subscriptions:
Subscription prices 2017 (6 issues)
Print or electronic access:
EUR 730.00 / USD 890.00 / GBP 520.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

ARTICLE

Soft Touch Provisional Liquidators in the BVI: Constellation Overseas Ltd, Pointing the Way

Rosalind Nicholson, Partner, Walkers, British Virgin Islands[1]

Synopsis

In December 2018, the BVI Commercial Court appointed 'soft touch' provisional liquidators to Constellation Overseas Ltd, a BVI incorporated company, and five of its BVI incorporated subsidiaries (the 'Companies').[2] Although the practice of appointing provisional liquidators to facilitate cross-border restructuring is well established elsewhere, this was the first occasion on which the BVI Court had made such an Order.[3]

Prior to the *Constellation* decision, there had been a respectable body of practitioner opinion which held that the unique features of the BVI Insolvency Act 2003 (the 'BVI Act') excluded any jurisdiction to appoint provisional liquidators in such circumstances. Although the question as to the existence of the jurisdiction may have been answered in the *Constellation* decision, questions remain as to the limits of that jurisdiction and the circumstances in which the Court will consider it appropriate to exercise its discretion in favour of an appointment where the purpose is a restructuring. This article seeks to explore these questions and to propose answers to at least some of them.

As a starting point, we look at the factual background against which the applications in *Constellation* were made and the procedural factors material to the Court's decision in that case. Against that factual background, we then turn to the legal framework within which the Court reached its decision in *Constellation* and seek to highlight how the Court dealt with certain legal points which arose in the case and which may arise in future cases on different facts. Lastly, we tentatively suggest some general conclusions which may be drawn from the case.

Background

The Companies were members of a group of companies (the 'Group') which had its operational headquarters in Brazil and which, together, carried on the business of offshore drilling for the oil and gas industry. Importantly, at the time of the BVI applications, the Group, and each of the Companies, was already the subject of a Brazilian Judicial Reorganisation ('RJ') the object of which was to facilitate the agreement and implementation of a plan for restructuring the Group's debt. Each of the Companies continued to operate its business under the supervision of the First Business Court of Rio de Janeiro ('the Brazilian Court'). The Companies considered, and submitted to the BVI Court, that Brazil was the proper forum for its restructuring. Certain companies within the Group, including the Companies had also commenced proceedings in the US for protection under Chapter 15 of the US Bankruptcy Code seeking the recognition of the RJ as the 'foreign main proceeding' of each of the Chapter 15 Debtors. Accordingly, the Companies' approach to the BVI Court was as ancillary support to the main proceeding in Brazil, facilitated by proceedings in other jurisdictions.

The BVI Court's statutory jurisdiction to appoint a provisional liquidator arises only where an application for the appointment of a liquidator (called, for convenience in this Article, a 'petition') has been filed but not yet determined or withdrawn.[4] In *Constellation*, each of the six Companies had filed its own petition with the BVI Court seeking the appointment of liquidators on the grounds of insolvency.[5] The nature of the proceedings was therefore domestic: involving applications by BVI companies in which the BVI Court was invited to exercise a jurisdiction conferred upon it by a BVI statute within the context of pending BVI winding

Notes

1 Rosalind Nicholson and Rhonda Brown (Associate) represented Banco Bradesco S.A, the Group's largest unsecured creditor, at the hearing of the Companies' applications.

2 *Re Constellation Overseas Ltd, Lone Stare Offshore Ltd, Gold Star Equities Ltd, Olinda Star Ltd, Snover International Inc* and *Alpha Star Equities Ltd* BVIHC (COM) 2018/ 0206, 0207, 0208, 02010 and 0212 referred to together as '*Constellation*'.

3 There had been an unreported case in which the BVI Court had declined to make such an appointment – *Re Transfield ER Cape Limited* BVIHC(COM) 2010/121 (unreported) – further discussed below.

4 S.170(1) of the BVI Act.

5 Under s.162(1)(a) of the BVI Act.

up proceedings in respect of those BVI incorporated companies.

The orders sought from the BVI Court had as their purpose the facilitation of the restructuring of the Companies' debts while they continued to operate as a going concern. The Companies' applications for the appointment of the provisional liquidators were supported by creditors holding over US$1billion of the companies debts of US$1.5 billion. The support of a 50% majority of creditors was required to secure the success of the RJ. Accordingly, the Court was able to be satisfied that the restructuring enjoyed reasonable prospects of success.

The Court was also satisfied on the evidence put before it that, whilst the Companies were balance sheet solvent, in the absence of a restructuring, they had insufficient cash to meet forthcoming financial debt obligations and that default on those obligations would trigger additional defaults as a result of cross-default provisions in other financial instruments to which the Companies were party.

In addition, the evidence showed that the realisation of the Group's assets on a going concern basis was significantly better than on a breakup basis. Accordingly, the Court was satisfied that the appointment of the provisional liquidators to the Companies for the purpose proposed, namely maintaining the going concern value whilst facilitating a restructuring, was liable to maintain the value of the assets for the benefit of their creditors as a whole and, accordingly, that its discretion to make such an appointment was engaged.

As part of the RJ process, proceedings and the enforcement of claims against debtors, including the Companies, had been stayed by the Brazilian Court. Similarly, in the Chapter 15 proceedings, the Companies' objective was to obtain a stay barring the commencement or continuation of actions against them or their assets. The BVI Act provides for a moratorium on enforcement by creditors only after the point at which the Court makes an order for the company to be wound-up and there is no provision in the BVI Act to protect the company against execution by creditors between the date on which a winding up petition is filed and the date of the winding up order. This means that the appointment of provisional liquidators does not, without more, prevent creditors from executing against the company. However, the BVI Court does have power to stay or restrain Court proceedings pending before the BVI Courts or on appeal from those Courts.[6] Although the Companies were aware of only one, non-material claim, pending in the BVI, on *Constellation* the Court was invited to, and did, make an order staying such proceedings.

We now turn to the legal framework within which the Court reached its decision in *Constellation*.

Power to appoint provisional liquidators

Section 170(4) of the BVI Act confers jurisdiction on the Court to appoint provisional liquidators on 'such terms as it considers fit', if an application for the appointment of a liquidator of a company has been filed but not yet determined or withdrawn and:

'(a) the company, in respect of which the application to appoint a liquidator has been made, consents; or

(b) the Court is satisfied that the appointment of a provisional liquidator

(i) is necessary for the purpose of maintaining the value of assets owned or managed by the company, or

(ii) is in the public interest.'

Although, in *Constellation*, the Companies were themselves were the applicants for an Order appointing liquidators, the power to appoint provisional liquidators is not confined to such a case and arises equally where the applicant is a creditor or a member of the company concerned. The company's consent is, however, relevant to the application to appoint the provisional liquidators. The consent requirement is clearly satisfied where the company is the applicant (as was the case in both *Transfield*[7] and *Constellation*) or where the company confirms its consent to the Court. In such a case, English authority suggests that 'the appointment is almost a matter of course…'.[8] However, although the two conditions are expressed as alternatives, in practice, the BVI Court has required to be satisfied as to the second limb whether or not the company in fact consents in considering the exercise of its discretion.

Ordinarily, and familiarly, the BVI Court has been accustomed to appoint provisional liquidators where there are allegations of wrongdoing within a company or where steps have to be taken to preserve assets in the face of an imminent threat to their value. However, as the Applicants submitted in *Constellation*, and the Court accepted, these are not the only circumstances in which

Notes

6 S.174.

7 *Transfield ER Cape Limited* BVIHC(COM) 2010/121, see above footnote 3.

8 *Palmers Company Law* Para 15.290 as referred to in *Re Union Accident Insurance Co Ltd* [1972] All ER 1105 and para 57 of the *Constellation* judgment.

an appointment may be made: the Court has a broad and flexible power to make such an appointment.[9]

The BVI Court in *Constellation* concluded that its power to appoint provisional liquidators was one which extends to circumstances where there is a need to protect the company's assets from creditors pending a restructuring.[10] There had been some doubt whether this was the case as a matter of BVI law: Part III of the BVI Act includes provision for the appointment of administrators, similar in material respects to the administration provisions of the English Insolvency Act 1986, whereby a company can be reorganised, restructured or have its assets realised under an Administrator with the protection of a statutory moratorium. Part III has never been (and it is thought unlikely that it will be) brought into force. Prior to the *Constellation* decision, the fact that the BVI Legislature had enacted, but not brought the administration provisions into force, was taken by some to be an indicator that in enacting the provisions of the BVI Act which allow for the appointment of provisional liquidators, the legislature could not have intended that they be used as a framework for a debtor in possession restructuring.

The BVI Court did not deal with this point directly in its judgment in *Constellation*. However, it apparently accepted the Companies' submission by analogy to the judgment of Harman J in *Re Anglo American Insurance Co Ltd*,[11] as applied by Smellie CJ in the Cayman case *Re Fruit of the Loom Ltd* [2000] CILR Note 7b, to the effect that where there are *in force* no specific statutory provisions which would enable the Court to appoint an administrator in respect of the particular company, then it was open to the Court to use the broad powers conferred upon it to appoint provisional liquidators.

The question of necessity

The burden of establishing that the appointment of provisional liquidators is necessary for the purpose of maintaining the value of assets owned or managed by the company falls on the applicant. However, the test of 'necessity' for this purpose, does not require that it is shown that the proposed restructuring will succeed. Rather, the requirement is that the restructuring has a 'real prospect' of success and that the proposed appointment will serve the purpose of maintain the value of the assets in the meantime.[12]

In *Constellation,* the Companies had the advantage of the support of a substantial majority of their creditors. In circumstances where the success of the RJ required the support of a simple majority of creditors, the Companies were therefore readily able to satisfy the Court as to the prospects of the restructuring meeting with success. However, although the Court will consider the view reached by the directors of the company itself as to the likelihood of the restructuring succeeding,[13] in the absence of evidence of majority creditor support, it is not clear what will be required in order to satisfy the Court as to the 'real prospect' of the restructuring succeeding. In particular, it is not clear whether and to what extent restructuring proposals must have been advanced before the Court will be prepared to conclude that the restructuring has sufficient prospects of success.

Ordinarily, one would expect the Company to have been in negotiations with creditors before the point had been reached where the application had been made and the assumption would be that creditor support had reached a critical mass before the company approached the Court – not least because of the absence of a statutory moratorium on presentation of a petition under BVI law (as discussed further below). That being the case, it is fair to assume the BVI Court may be reluctant to appoint provisional liquidators for the purpose of a restructuring if the company is unable to point to any creditor support, but whether minority support would suffice or whether the support of different classes of creditor might be required on another case remains to be determined.

No moratorium

The BVI Act provides for a moratorium on enforcement by creditors only after the point at which the Court makes an order for the company to be wound-up. There is no provision in the BVI Act to protect the company against execution by creditors between the date on which a petition is filed and the date of the winding up order. The only power which the Court has is to stay or restrain Court proceedings pending before the BVI Courts or on appeal from those Courts. In other words, the appointment of a provisional liquidator would not, without more, prevent creditors from executing against the company. Since the appointment of provisional liquidators is intended as a protective measure, the question therefore arises whether, in the absence of a general moratorium, the appointment could meet its objective.

Notes

9 See, for example, Rimer LJ in *Revenue & Customs Commissioners v Rochdale Drinks Distributors Ltd* [2011] EWCA Civ 1116, [2012] STC 186, [2012] 1 BCLC 748.
10 Lightman & Moss, *The Law of Administrators and Receivers of Companies* (6th ed.) Para. 2-053.
11 [1994] 1 BCLC 649
12 See paragraph 86 of the *Constellation* judgment.
13 See David Richards J in *ARM Asset Backed Securities* [2013] EWHC 3351 at para. 46.

In *Transfield*, there were various proceedings pending against the company in jurisdictions outside the BVI. The Court was not satisfied that in the absence of a blanket moratorium, provisional liquidators, if appointed, would be in any better position to secure a stay of those proceedings than the directors would be. It could not, therefore, conclude that the appointment of provisional liquidators was *necessary* for the purpose of maintaining the value of assets owned or managed by the company.

In *Constellation*, the Companies were able to point to the moratorium effected as part of the RJ process and to the moratorium within the Chapter 15 proceedings. The Companies did not rely, therefore, on the limited moratorium available to them under an Order of the BVI Court.

This is a potentially important point. Because of the particular facts of Constellation, in particular the fact that the application to the BVI Court was made against the background of an existing moratorium imposed under the RJ, the absence of an automatic moratorium in the BVI proceedings was not an issue. However, it may be that in another case, in particular one where there are pressing creditor claims outside the BVI and no pre-existing or prospective moratorium affecting those claims, the BVI Court would consider the absence of a moratorium a critical point of difference. In such a case, it is not clear whether, absent special circumstances, the BVI Court would conclude that the appointment of the provisional liquidators was 'necessary for the purpose of maintaining the value' of the company's assets or, indeed, that a restructuring had real prospects of succeeding.

Time limits under the BVI Act

A further consideration is the fact that, uniquely, the BVI Act requires that a winding up petition be determined within six months of filing.[14] Since the appointment of a 'soft touch' provisional liquidator necessarily occurs in the context of an existing winding up petition and the legislation clearly assumes that that petition will be determined within a short period of time, the concern was that this allowed little scope for an extended restructuring under the supervision of a provisional liquidator which might take years to effect an outcome. This was one of the factors which had led the BVI Court to reject an application to appoint soft touch provisional liquidators in the earlier case of *Transfield*. In *Transfield*, the Judge was concerned that he was being asked to make an open-ended appointment with the proposed restructuring scheduled to take three years, a position which he considered apparently incompatible with the scheme of the BVI Act.

In *Constellation*, the specific concern with respect to the abbreviated timescale which the BVI Act contemplates was dealt with by reference to case law in other jurisdictions[15] which recognises the reality that companies which enter provisional liquidation for the purposes of a restructuring will often ultimately not go in to liquidation at all: indeed, the objective is that they should not need to go in to liquidation. That being the case, it cannot be said that it is a condition precedent for the appointment of provisional liquidators for the purposes of a restructuring that the company concerned will ultimately be wound up. The Judge in *Constellation* accepted this proposition. He also observed, as is the case, that there is no limitation on the number of times that the Court may extend the initial six month period provided that at the time of the application, the Court is satisfied that special circumstances exist for it to grant such an extension.

It must follow from this line of argument that it is not necessary to show that restructuring plans are so advanced or of such a nature that they can be implemented within a very short timescale. Having said that, for the reasons already given, a mere inchoate hope that a restructuring might occur, as distinct from a proposal, even in outline, which has achieved sufficient form to allow negotiations with creditors to commence, may very well not impress a Court invited to appoint provisional liquidators although that too remains to be seen.

Part XVIII, common law and comity

The last point which it is useful to make with regard to the *Constellation* decision concerns the way in which the Court dealt with the question of Part XVIII of the BVI Act. Part XVIII, which like Part III has never been brought into force, provides a statutory scheme allowing the BVI Court to provide assistance and cooperation in cases of cross-border insolvency, including recognition of foreign main proceedings. If brought into force, Part XVIII would incorporate into BVI law the provisions of the UNCITRAL Model Law on Cross-border insolvency. In *Re C* (BVIHC (COM) 0080 of 2013) the BVI Court itself (Bannister J) had held that the common law power to assist representatives from territories which were not designated under Part XIX of the BVI Act had been impliedly excluded by the BVI

Notes

14 The Court may extend this period for one or more periods not exceeding three months each in special circumstances.

15 Notably, *Discover Reinsurance Company v PEG Reinsurance Company Ltd.* [2006] Bda L.R. 88 where Kawaley CJ observed that 'In the restructuring context at least, this Court clearly possesses the jurisdiction to appoint provisional liquidators over companies which are not Inevitably liable to be wound-up'.

Act as inconsistent with the statutory scheme in Parts XVIII and XIX[16] of the Act.

The issue which presented itself to the Court in *Constellation* was whether, against the statutory background coupled with its own decision in *Re C*, there could subsist jurisdiction either under the BVI Act itself or at common law to appoint provisional liquidators in support of foreign main proceedings. Indeed, the first question which the Court raised in *Constellation*[17] was whether, in effect, the application before it was an attempt to obtain by the back door relief which was not available to it by virtue of the fact that Part XVIII is not in force.

In any event, the BVI Court was persuaded that Part XVIII was not in point. Part XVIII is predicated on the recognition by the BVI Court of a foreign insolvency proceeding. By contrast, the jurisdiction invoked in *Constellation* was entirely domestic in nature: the BVI Court was invited to exercise a jurisdiction conferred upon it by existing provisions of a BVI statute, within the context of a pending BVI winding up proceedings in respect of BVI incorporated companies.

For the same reason, the BVI Court was satisfied that *Re C* could be distinguished: in that case, the foreign representatives were seeking to invoke the BVI Court's powers as conferred by Part XIX of the BVI Act and, by way of addition, its common law powers in respect of a foreign insolvency proceeding. Accordingly, *Re C* was not authority for the proposition that the BVI Act had excluded by implication the common law power to assist a foreign court which, under principles of comity, are of general application.

To this consideration was added the fact in May 2017, the BVI Court had adopted the *Guidelines for Communication and Cooperation between Courts in Cross-Border Insolvency Matters,* as formulated by the Judicial Insolvency Network.[18] Those guidelines specify that:

> 'The overarching objective of these Guidelines is to improve in the interests of all stakeholders the efficiency and effectiveness of cross-border proceedings relating to insolvency or adjustment of debt opened in more than one jurisdiction ("Parallel Proceedings") by enhancing coordination and cooperation amongst courts under whose supervision such proceedings are being conducted'.

This reflects and acknowledges the broader common law principle, which is part of BVI law, which requires that courts should do all in their own power under their own law to provide assistance to a foreign court (without importing other laws to enable them to do so).[19] It is apparent[20] that the fact that the Court was thereby affording comity or cross-border co-operation to a restructuring attempt in another jurisdiction played a role in supporting the exercise of the Court's discretion in *Constellation*. However, it is equally clear from the judgment that such considerations were not determinative of the Court's decision. Accordingly, and, subject to the question of the moratorium as discussed above, the BVI Court clearly has jurisdiction in principle to make an appointment in an appropriate case whether or not there are existing foreign insolvency proceedings on foot.

Conclusion

Constellation is the first case of its type in the BVI and it remains to be seen how precisely the Court will be prepared to exercise its jurisdiction in subsequent cases. However, with the door ajar, we suggest that some principles of general application can be drawn from the decision which may be developed as time goes on. Our suggestions are the following:

a) Although in *Constellation* the petitions were those of the Companies themselves, this is not a condition to the appointment of 'soft touch' provisional liquidators nor is it a requirement that it should be the company itself which applies for the appointment of the provisional liquidators. The Company's consent will, however, improve the prospects of an order being made and, although not strictly required, given the purpose for which the provisional liquidators are proposed to be a restructuring of the company's liabilities, it would be an exceptional case were the company itself not to consent. Indeed, in the absence of consent, there must be a question whether the Court could be satisfied that there was a 'real prospect' of the restructuring succeeding.[21]

b) In principle, there is no reason in principle why 'soft touch' provisional liquidators may not be appointed on an application by the company within the context of a creditors' petition. Nor is it necessary that the petitioning creditor must support the application. However, if that creditor opposes, or is not supportive of the proposed restructuring, and the company is unable to point to significant

Notes

16 Part XIX of the BVI Act provides for the making of Orders in aid of foreign proceedings. The Part XIX powers are confined to proceedings in specific designated jurisdictions which do not include Brazil.
17 See paragraphs 6-9 of the judgment.
18 Practice Direction No 2 of 2017.
19 As made clear in *Rubin v Eurofinance* [2013] AC 236 and *Singularis Holdings v PriceWaterhouseCoopers* [2015] AC 1675.
20 See paragraph 89 of the *Constellation* judgment.
21 Cf. *Re Savoy Hotel Ltd* [1981] Ch 351, [1981] 3 All ER 646, [1981] 3 WLR 441, 125 Sol Jo 585.

third-party creditor support, then, again, there must be a question whether the Court can conclude that the appointment of provisional liquidators is necessary or the restructuring is liable to succeed.

c) Where the applicant is able to point to substantial creditor support, particularly where that creditor support represents a majority of relevant creditors, then the BVI Court is likely – though not, of course, bound – to accede to an application to appoint provisional liquidators to facilitate a restructuring. It may not be necessary to demonstrate that the supporting creditors represent a majority, however, and it is always open to the Court to appoint provisional liquidators for a limited period to allow the applicant to canvas additional support. Whether the support of different classes of creditor might be required on another case remains to be seen.

d) The Court must be satisfied that the appointment of provisional liquidators to the Companies for the purpose proposed, namely maintaining the going concern value whilst facilitating a restructuring, is liable to maintain the value of the assets for the benefit of their creditors as a whole. Evidence that the realisation of the company's assets on a going concern basis is significantly better than on a breakup basis will go some way to establishing that. However, the absence of a general moratorium under BVI law needs also to be taken into account. In the absence of a general moratorium, it is not clear that in a case where there are pressing creditor claims outside the BVI and no pre-existing or prospective moratorium which would stay those claims the BVI Court would conclude that the appointment of the provisional liquidators would be capable of the maintaining the value of the company's assets or, indeed, that a restructuring has real prospects of succeeding.

e) It is not necessary for an applicant to show that restructuring plans are so advanced or of such a nature that they can be implemented within a very short timescale. However, it is likely that something more than a mere hope that a restructuring might occur will be required, not least because the BVI Court is likely to need be satisfied that there is at least some creditor support in order to conclude that a restructuring has some prospect of being successful.

We look forward to seeing whether and how these general principles are applied as the jurisprudence in the BVI develops.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

Alongside its regular features – Editorial, US Corner, Economists' Outlook and Case Review Section – each issue of *International Corporate Rescue* brings superbly authoritative articles on the most pertinent international business issues written by the leading experts in the field.

International Corporate Rescue has been relied on by practitioners and lawyers throughout the world and is designed to help:

- Better understanding of the practical implications of insolvency and business failure – and the risk of operating in certain markets.
- Keeping the reader up to date with relevant developments in international business and trade, legislation, regulation and litigation.
- Identify and assess potential problems and avoid costly mistakes.

For more information about *International Corporate Rescue*, please visit www.chasecambria.com