

- What exactly is administration?
- How will it affect creditors' rights?
- How can lenders protect their rights?

Potential Changes to Creditors' Rights in the BVI – Administration Orders

The British Virgin Islands (BVI) is once again considering proposals to bring into force provisions which permit the making of administration orders in relation to BVI companies. Any person with a credit exposure to a BVI company needs to be aware of the proposals and what this might mean in relation to their rights against the company.

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Q1. What exactly is administration?

A1. The administration process is an alternative to liquidation for financially distressed companies. Whereas liquidation is intended to break up the company and sell off all of its assets, administration is intended to try to preserve the company as a going concern.

Q2. How does it work?

A2. An application is made to the BVI court for an administration order. If the order is granted then an administrator (who must be a licensed insolvency practitioner) is appointed to administer the company's assets. But the crucial point is this – once the order is made, there is a moratorium on the exercise of creditors' rights. None of the company's creditors – including its secured creditors – may enforce their rights against the company whilst the order is in effect.

Q3. So administration orders are good for companies, but bad for creditors?

A3. Not necessarily. Although administration orders can be used as a way to obtain relief from creditors, creditors themselves can also put companies into administration to obtain a more effective return. The experience in the UK (whose laws the BVI provisions are modelled on) is that many administrations are actually commenced by secured creditors who see the process as a viable alternative to receivership.

Q4. Will the courts always make such orders on application?

A4. Not always. In order to obtain an administration order the company (or creditor) must be able to satisfy the court that (a) the company is or is likely to become insolvent, and (b) one of the objectives of the legislation will be achieved by making the order. Those objectives are (briefly) (i) rehabilitation of the company, (ii) survival of all or part of the company's undertaking, (iii) better return for the company's creditors, (iv) approval of a creditors' arrangement under Part III of the legislation, or (v) to facilitate cross-border cooperation with a foreign insolvency official under Part XIX of the Insolvency Act 2003.

Q5. What about the priority of claims against the company? Is the priority of a security interest protected?

A5. Administration does not affect the priority of claims. The underlying rights themselves are unaffected. But it creates a moratorium on the enforcement of those rights. Although a secured creditor will still enjoy a priority claim to the collateral, it loses control over the timing of any enforcement action, and the administrator will have power to administer the collateral whilst the order is in effect.

Q6. If security is created over assets where the value fluctuates, surely losing the ability to control the timing of enforcement and sale is potentially a serious issue?

A6. Yes, clearly the negative effects of administration for secured creditors are exaggerated with respect to security over certain asset classes. Where security is over highly illiquid or highly immobile assets, the concern is much smaller. But volatile assets or highly portable assets can create concerns. For example, in aircraft financing it is crucial to be able to enforce security over the aircraft at short notice lest it fly to another jurisdiction where it cannot be arrested. That concern does not apply to a block of flats in West London.

Q7. Can a company be stopped from obtaining an administration order?

A7. Yes, there is a hard way and an easy way. The hard way involves instructing lawyers in the BVI to turn up to court and argue against the grant of the order. The easy way involves taking a lightweight floating charge from the company at the outset. An administration order cannot be made without the consent of a floating chargeholder, so taking a lightweight floating charge gives the creditor a right to veto the making of an administration order. We recommend the easy way.

Q8. Does the lightweight floating charge need to be BVI law governed, or would a foreign law floating charge work?

A8. It depends. The specific criteria require that the chargeholder must be able to appoint an administrative receiver. So whilst that would certainly include a BVI law floating charge as well as floating charges from a number of other common law jurisdictions which permit the appointment of administrative receivers, it would not normally include (for example) an English law floating charge.

Q9. So will BVI law be the same as English law in relation to administration orders?

A9. Very similar, but not exactly the same. For example, under English law it is only necessary to show that an administration order is "likely to" achieve one of the statutory purposes, whereas in the BVI the requirement is to show that it "will". In the BVI an administration order can be made if it facilitates the rehabilitation of the corporate group, whereas under the UK legislation the order must relate to that specific company.

Q10. Why is the regime being brought into force? I had understood the BVI regime utilising provisional liquidation and schemes of arrangement could achieve the same thing?

A10. Whilst it is still possible to restructure a company using the traditional provisional liquidation route, most of the difficulties were created by the inability to wrap in the smaller secured creditors. The new regime will provide an alternative which enables a more effective process to be run (at least where a floating chargeholder does not object).

Q11. When are the provisions likely to be brought into force?

A11. At this stage we still don't know exactly how the proposals will proceed. The relevant provisions have all been enacted, so theoretically they could be brought into force at any time by proclamation. But our best guess is sometime in Q3 or Q4 2015 a firm decision will be made.

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