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Directors of BVI companies: to whom do you owe duties

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Introduction

Notwithstanding the development and rollout of Covid-19 vaccines, the global pandemic and the associated economic crisis will continue to have a significant impact on businesses of all sizes in most sectors for the foreseeable future. It is clear that a number of companies' revenues will decline further. Not only will such companies be concerned about their ability to retain employees, there may be continued doubt in their ability to sustain their supply chains. Other companies will be forced to abandon, or at least delay, planned growth projects. Inevitably, a proportion of companies will be concerned as to their ability to continue to service existing loans.

In these circumstances, a director's duty-check is required. The general position under BVI law is that a director owes duties solely to the company as a whole. This means that the directors must consider the interests of the current and future shareholders of the company. However, where a company is insolvent, or even of doubtful solvency, the directors have a duty to consider the interests of the company's creditors.

Duties of a Director

The duties of a director of a BVI company arise under the common law, the BVI Business Companies Act 2004 (as amended) (the "**BCA**") and the company's memorandum and articles of association ("**M&A**").

Common Law

At common law, directors owe the company two types of duties: fiduciary duties and the duty to exercise care, diligence and skill.

A director of a BVI company owes the following fiduciary duties to that company:

a. to act honestly, in good faith and in what he or she believes to be in the best interests of the company
b. to exercise his or her powers for a proper purpose
c. to avoid conflicts of interest; and
d. not to fetter his or her discretion; and
e. not to misuse company property

The duty to exercise care, diligence and skill and care requires a director to exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances taking into account the nature of the company, the nature of the decision, his or her position and the nature of the responsibilities undertaken by the director.

The BCA

Sections 120 to 125 of the BCA give statutory footing to the fiduciary and common law duties owed by the director of BVI company to that company. Sub-sections 120 (2)-(4) also permit, in certain circumstances and only if the necessary amendments are made to the M&A, directors to act in the best interests of a parent company or appointing shareholder instead of the company.

The M&A

Directors a of a BVI company have a duty under both the common law and the BCA to act in accordance with the company's M&A.

When do the duties of a BVI company's director switch from being owed to the company to being owed to the creditors of the company, and why?

Why the switch occurs is easier to answer than when the switch occurs. When a company is solvent, the economic stakeholders whose interests are at risk are the shareholders. It is their equity which requires protection. However, when the company is insolvent, or even of doubtful solvency, it is the company's creditors whose interests are at risk, and not the shareholders of the company (whose equity is of negligible value, if not worthless)

The precise point at which the duties of a BVI company's director switch from being owed to the company (or to the parent company or appointing shareholder) to being owed to the creditors of the company is difficult to identify, and the courts have struggled to prescribe a definitive legal test.

A company will be considered insolvent under BVI law if:

a. the company fails to comply with a statutory demand which has not been set aside; or

b. execution of a judgment or other order of the BVI court against the company is returned wholly or partly unsatisfied; or
c. the company is unable to pay its debts as they fall due; or
d. the value of the company's liabilities exceeds its assets

Various judicial expressions appear in the authorities to describe the possible point at which the switch of duty occurs, including "*the company is or is likely to become insolvent*", "*a real, as opposed to a remote, risk to creditors*", "*doubtfully solvent*" "*on the verge of insolvency*", "*in a dangerous financial position*" and "*in a parlous financial state*".

In *BTI 2014 LLC v Sequana SA and others* [2019] EWCA Civ 112, the Court of Appeal of England & Wales found that the duty may be triggered when a company's circumstances fall short of actual, established insolvency. It went on to find that the duty switches when the directors know or should know that the company is or is likely to become insolvent. Further, in this context, "likely" means "probable".

Although the distillation of the test by the Court of Appeal is welcome, it remains difficult to determine the precise point following which directors need to take into account the interests of their company's creditors. As ever, disputes will be judged on a case by case basis. Nonetheless, directors of BVI companies would be well advised to continue to monitor and assess their company's financial position on a regular basis.

If the directors consider that their company is or is likely to become insolvent, or are doubtful whether such a position has arisen, they should seek professional legal advice as a matter of urgency.

It is worth noting that the Court of Appeal's judgment will not be the last word on this area of the law. The Supreme Court is due to hear the appeal in May 2021. Watch this space.

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