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A brief guide to statutory demands and applications to set aside statutory demands in the BVI

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This article provide an overview of statutory demands and applications to set them aside.

1. The importance of the statutory demand in BVI insolvency law and practice

The importance of the statutory demand in BVI insolvency law and practice is derived from section 2 of the Insolvency Act, 2003 (the **"Act"**) where "insolvent" in relation to a company or a foreign company, has the meaning specified in section 8(1).

Under section 8(1)(a) of the Act, a company or a foreign company is insolvent if it fails to comply with the requirements of a statutory demand that has not been set aside under section 157.

Hence, once a statutory demand is served on a company, and that company either fails to satisfy the demand or have it set aside, the Act deems that company to be insolvent, with the result that the creditor would be entitled to apply to the High Court to have liquidators appointed over that company.

2. Statutory requirements for a statutory demand

Section 155 of the Act sets out the requirements for a statutory demand as follows:-

A demand under subsection (1) must:

(a) be in respect of a debt that is due and payable at the time of the demand and that is not less than the prescribed minimum (Insolvency rule 149(1) sets the prescribed minimum at US$2,000);

(b) be in writing and must specify the nature of the debt and its amount;

(c) be dated and must be signed by the creditor or by a person authorized to make demand on the creditor's behalf;

(d) require the person to pay the debt or to secure or compound for the debt to the reasonable satisfaction of the creditor within 21 days of the date of service of the demand, or such longer period as may be prescribed;

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(e) state that if the demand is not complied with, an application may be made to the Court for the appointment of a liquidator or a bankruptcy trustee, as the case may be;

(f) set out the rights of the person to make an application to set the demand aside under section 156 of the Act; and

(g) comply with and be served in accordance with the Insolvency Rules (the statutory demand would ordinarily be served at the company's registered office).

(h) If the creditor making the demand under subsection (1) is a secured creditor in respect of the debt, the full amount of the debt must be specified in the demand, but

(i) the demand must specify the nature of the security interest, and the value which the creditor places on it at the date of the demand; and

(ii) the amount claimed must be the full amount of the debt less the amount specified as the value of the security interest; and

(iii) must equal or exceed the prescribed minimum.

A key point to note about a statutory demand is that its service or even subsequent winding up proceedings based on an unsatisfied statutory demand does not constitute enforcement proceedings. So that, for example, a creditor under a foreign arbitral award need not apply to the BVI Court for an order recognizing and granting permission to enforce the award before it can form the basis of a statutory demand. (See on this the Court of Appeal and Privy Council decisions in ***Vendort Traders Inc v Evrostroy Grupp LLC*** BVIHCVAP2012/0041; [2016] UKPC 15.

3. Applications to set aside a statutory demand

Applications to set aside statutory demands are dealt with at sections 156 and 157 of the Act and Insolvency rule 152.

Under section 156 of the Act, where a person has been served with a statutory demand, he may apply to the Court to set it aside within 14 days of the date of service of the demand. Under section 156(3), the Court has no jurisdiction to extend the time for making or serving an application to set aside a statutory demand. A person applying to set aside a statutory demand must give the creditor seven days' notice of the hearing.

Under Insolvency rule 152, an application to set aside a statutory demand must be supported by an affidavit that specifies the date when the demand was served and the grounds on which the debtor claims that the demand should be set aside. In addition, a copy of the demand must be exhibited to the affidavit in support.

Section 157 of the Act sets out the grounds for setting aside a statutory demand which are as follows:-

The Court must be satisfied that

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(a) there is a substantial dispute as to whether

(i) the debt, or

(ii) a part of the debt sufficient to reduce the undisputed debt to less than the prescribed minimum, is owing or due;

(b) the person on whom the statutory demand was served has a reasonable prospect of establishing a set-off, counterclaim or cross claim in an amount equal to or greater than the amount specified in the demand less the prescribed minimum; or

(c) the creditor holds a security interest in respect of the debt claimed and the value of the security interest is equal to or greater than the amount specified in the demand, less the prescribed minimum.

While the basis for the Court's determination as to whether to set aside a statutory demand is set out at section 157 of the Act, the test that is applied in making this determination is known as the ***Sparkasse Bregenz*** test, based on the Eastern Caribbean Court of Appeal decision in ***Sparkasse Bregenz Bank AG v In The Matter of Associated Capital Corporation*** BVI Civil Appeal No.10 of 2002.

The test is set out at paragraph 3 of the judgment as follows:

The Court will order a winding up for failure to pay a due and undisputed debt over the statutory limit, without other evidence of insolvency. If the debt is disputed, the reason given must be substantial and it is not enough for a thoroughly bad reason to be put forward honestly. But if the dispute is simply as to the amount of the debt and there is evidence of insolvency the company could be wound up.

To fall within the principle, the dispute must be genuine in both a subjective and objective sense. That means that the reason for not paying the debt must be honestly believed to exist and must be based on substantial or reasonable grounds. Substantial means having substance and not frivolous, which disputes the Court should ignore. There must be so much doubt and question about the liability to pay the debt that the Court sees that there is a question to be decided. The onus is on the company to bring forward a ***prima facie case*** *which satisfies the Court that there is something which ought to be tried either before the Court itself or in an action or by some other proceeding.*

A creditor who has served a statutory notice on the company is not entitled to a winding up order if the company bona fide disputes the debt and there is no evidence of the insolvency of the company. If the existence of the debt on which the winding up petition is founded is disputed on grounds showing a substantial defence requiring investigation, the petitioner would not have established that he was a creditor and thus would not be entitled to present the petition, accordingly the presentation of such a petition would be an abuse of the process of the Court.

The process of the Companies Court could not be used in cases where there were issues of disputed fact. Such questions must be resolved in actions. A debt disputed on genuine and substantial grounds could not support a

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winding up petition. Invoking the process of the Court in relation to a debt which was known to be disputed on genuine and substantial grounds was an abuse of the process of the Court.

Also helpful is the quote below from para. 1 of the Privy Council decision in ***Vendort Traders:-***

The grounds on which a statutory demand may be set aside by the court are identified in section 157 of the Act. One of them is that there is a "substantial dispute as to whether ... the debt ... is owing or due". The test for whether there is a "substantial dispute" is not in doubt. It is the same as the test for summary judgment, namely whether the debtor can raise a triable issue on the point.

Based on these decisions, it seems to us that the threshold required in order to successfully apply to set aside a statutory demand, or to avoid a winding-up order being made on the basis of an unsatisfied statutory demand is not a particularly high one. We would therefore suggest that this is a consideration that creditors ought to bear in mind when contemplating whether to issue a statutory demand.

We would also note that while ***Sparkasse*** was dealing with a dispute as to the existence of the underlying debt, it has been held that the ***Sparkasse*** formulation applies equally to a cross-claim (see the judgment of Jack J. in ***Everbright Sun Hung Kai Company Limited v Walton Enterprises Limited*** Claim No. BVIHC (COM) 2020/0022).

4. Other grounds for setting aside a statutory demand

Other grounds for setting aside a statutory demand are set out in section 157(2) of the Act which provides that:

The Court may set aside a statutory demand if it is satisfied that substantial injustice would otherwise be caused

(a) because of a defect in the demand, including a failure to comply with section 155(3); or

(b) for some other reason.

5. Final useful points to note with statutory demands

A few final useful points may be made concerning statutory demands and hearings to set them aside, which may be found at section 157(3) to 157(6) of the Act:

- Where the Court is satisfied that the security interest of a secured creditor has been under-valued in the statutory demand, the Court may require the creditor to amend the demand accordingly, but without prejudice to his right to make an application for the appointment of a liquidator or for a bankruptcy order, as the case may be.
- If, on hearing an application to set aside a statutory demand, the Court is satisfied that there are no grounds for setting aside the statutory demand, it may extend the time for compliance with the statutory demand.

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- If the Court dismisses an application to set aside a statutory demand, it must make an order authorizing the creditor to make an application for the appointment of a liquidator or for a bankruptcy order, as the case may be.
- Having considered the evidence before it on a hearing under this section, the Court may either summarily determine the application or adjourn it giving such directions as it considers fit.

If you have any question on this please contact a member of our Dispute Resolution team.

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