Statutory demands in the BVI - Court of Appeal issues guidance on whether a dispute is "genuine and substantial"

Service area / Dispute Resolution and Litigation, Restructuring and Insolvency
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The BVI is a leading international financial centre, and BVI companies play a significant role in the flow of capital across the global economy. As global economic conditions become more challenging, lenders are increasingly reliant on formal insolvency procedures to realise value from distressed assets. As a result, the past year has seen a marked increase in the use of statutory demands against BVI companies as a precursor to an application to appoint liquidators. That trend is set to continue with the ongoing uncertainty in global markets.

It is common for debtors faced with a statutory demand to claim that a debt is disputed as a basis for an application to have the demand set aside. In those cases, the court is often faced with a dilemma as to how far it can go to test the issues raised for the purposes of concluding whether the dispute meets the "genuine and substantial" threshold.

The recent Eastern Caribbean Court of Appeal case of *Goldin Investment Intermediary Limited -v- China Citic Bank International Limited BVIHCMAP2022/0010* (decision dated 5 July 2023) ("Goldin"), on appeal from the BVI Commercial Court, has provided helpful and timely guidance on this issue. This briefing considers the key takeaways from that decision.

Executive summary

- It is a fundamental principle of the Court's winding up jurisdiction and practice that a disputed debt cannot be the subject of a statutory demand or a creditor's application to appoint liquidators. The trial of issues where a debt is substantially disputed are matters for the civil courts "*in the full plentitude of their procedures and evidential rules*". For that reason, a statutory demand must be set aside if the debt is disputed on 'genuine and substantial grounds'.
- To assess whether there exists a 'substantial dispute', the Court is not considering whether the ground put forward will succeed if the matter went to trial on the balance of probabilities. Rather, there needs to be some genuine or substantial dispute which calls for further investigation by a court or some other tribunal with requisite jurisdiction or authority. The dispute must rise above something which is 'frivolous' or 'hopeless' or 'thoroughly bad'.
- There is a single test to be applied to determine whether a debt is subject to a substantial dispute. There is no separate or additional requirement over and above this to demonstrate that the applicant does not genuinely believe the ground relied upon to dispute the debt, albeit the question of whether the debtor subjectively believes in the grounds of dispute will be relevant to the Court's overall assessment.
- Where the asserted 'genuine' dispute turns on the meaning of a contract, determination of the meaning may be appropriate if a 'patently feeble legal argument' is put forward, or the dispute is 'inherently implausible', or is 'contradicted in some material way', or 'not supported by contemporaneous documentation'. However, where the question of construction has any element of rational controversy to it, the Court must exercise restraint. Where

there are arguable alternatives as to the meaning of a term and related questions of construction, this of itself gives rise to a genuine dispute.

Background

The debt which had been claimed by statutory demand in the Goldin case was said to have arisen from an assignment agreement governed by Hong Kong law. The debtor company applied to set aside the statutory demand on the basis that the debt was disputed. In essence, the debtor argued that the assignment agreement did not create an obligation on its part to pay and discharge the outstanding debt claimed in the demand. Thus, the existence of a substantial dispute turned on the interpretation of the assignment agreement, and expert evidence was adduced before the Court as to Hong Kong law. The Court had to decide whether the debtor had raised a dispute that was 'genuine and substantial', such that the statutory demand should be set aside.

The first instance decision

At first instance, Wallbank J considered the expert evidence, interpreted the assignment agreement and decided that the meaning of the agreement was 'crystal clear', in creating a primary obligation on the debtor to discharge the claimed debt. In so doing, Wallbank J rejected the debtor's arguments that there was a 'genuine and substantial' dispute as to the interpretation of the agreement, dismissed the application to set aside the statutory demand, and gave directions for the creditor to bring an application to appoint liquidators.

The judge also went on to consider whether the debtor genuinely believed that it had a dispute to the debt claimed by the statutory demand. In this regard, the judge held that it could not have had a genuine belief, partly on the basis of evidence of negotiations prior to the signing of the agreement that demonstrated clearly that the debtor's officers understood the effect of the obligation to pay in the agreement.

Decision on the appeal

In upholding the first instance judgment, the Court of Appeal clarified (at [47] – [58] of the judgment of Farara JA, with which the other Justices of Appeal concurred) that the classic test laid out in *Sparkasse Bregenz Bank AG v Associated Capital Corporation* (BVI appeal no.10 of 2002) (18 June 2023, unreported) is "*really one test and not two separate and distinct tests or requirements*". For the dispute over the debt to be 'substantial', it had to be a 'sustainable answer' to the existence or liability for the debt. That meant being more than 'hopeless', 'frivolous' or 'thoroughly bad'. If the argument was not 'substantial' it could not be said to be a genuinely held basis to avoid repayment.

The Court of Appeal went on to hold at [79] that once the judge had found that the meaning of the assignment was 'crystal clear' (confirming the judge's finding that the debtor's arguments were 'thoroughly bad') it was strictly speaking not necessary to carry out a separate assessment of whether the debtor genuinely believed in the grounds of dispute advanced.

In relation to the expert evidence tendered by the parties, the Court of Appeal held at [72] that whilst expert evidence is a matter of fact for the judge, there was no evidence here demonstrating Hong Kong law would adopt any different an approach to the interpretation of contracts than would a BVI court. The BVI court was therefore just as equipped to interpret the assignment agreement. The matter was not one where Hong Kong law would approach interpretation differently from BVI law.

Conclusions

This is a helpful decision which will be welcomed by lenders to BVI companies, as it reiterates that obligors cannot seek to evade the consequences of non-payment by putting up thin arguments that a debt is disputed. Whilst emphasising the importance of the principle that genuinely disputed debts should not be brought before the winding up court, the Court of Appeal has endorsed the robust approach taken by the Commercial Court to the summary dismissal of assertions that do not stand up to reasonable scrutiny.

A copy of the judgment is available here.

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