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UPDATE

# Cross-Claims and Applications for the Appointment of Liquidators

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In two relatively recent but unrelated decisions, the Eastern Caribbean Court of Appeal has provided helpful guidance in relation to how the Court ought to deal with an application for the appointment of a liquidator in circumstances where the company asserts a cross-claim in an amount exceeding the applicant's debt.

## Introduction

In *Capital WW Investment Limited (in liquidation) v Tall Trade Limited*[1] and *Arricano Real Estate Plc v Stockman Interhold SA,*[2] the Eastern Caribbean Court of Appeal considered appeals against judgments of the High Court of the British Virgin Islands on applications for the appointment of liquidators. Both applications had been resisted by the respondent companies on the basis that they had cross-claims in amounts exceeding the applicants' debts. Capital WW Investment Limited was unsuccessful in resisting the application for the appointment of liquidators, whereas Stockman Interhold SA succeeded.

## The Statutory Regime

Given that a creditor will often not be in a position to establish by admissible evidence that a debtor company's liabilities exceeds its assets, or that the company is unable to pay its debts as they fall due, it is generally desirable for a creditor to first serve a statutory demand requiring payment of its debt. Section 8(1)(a) of the Insolvency Act (the Act) provides that a company is deemed to be insolvent if it fails to comply with the requirements of a statutory demand that has not been set aside under section 157.

The requirements of a statutory demand are prescribed in section 155 of the Act. They include that the demand shall:

(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 (US$2,000.00);

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

(c) require the company 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 on it; and

(d) state that if the demand is not complied with, application may be made to the Court for the appointment of a liquidator.

Section 156(1) of the Act enables a company that has been served with a statutory demand to apply to the Court to set it aside. Section 156(2) requires that any such application be made within 14 days of the date of service of the demand on the company.

[1] Appeal Nos. BVIHCMAP2020/0025 & BVIHCMAP2020/0026, 24 January 2022.

[2] Appeal No. BVIHCMAP2021/0009, 8 February 2022.

Under section 157(1), the Court is required to set aside a statutory demand if, amongst other things:

(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; or

(b) the company 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.

Under section 162, the Court may, on the application of a creditor, appoint a liquidator of a company if it is satisfied that a company is insolvent.

## A Substantial Dispute

The threshold test that is applied by the Court in determining whether there is a substantial dispute was stated by Sir Dennis Byron, Chief Justice, as he then was in *Sparkasse Bregenz Bank AG v Associated Capital Corporation*:[3]

> '*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 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.*'

## Failure to Apply to Set Aside a Statutory Demand

A company is not precluded from being heard and from opposing an application for the appointment of a liquidator as a result of its failure to apply to set aside a statutory demand. Rather, the failure to set aside the demand is left to be weighed by the Court on the hearing of the application when the Court is exercising its discretionary powers. However, a company which has failed to challenge a statutory demand, in seeking to oppose the appointment of a liquidator, will be saddled with the burden at that stage of establishing its solvency by way of countering its state of deemed insolvency under section 8(1)(a), brought about by such failure.[4]

In addition, in both *Capital WW* and *Arricano*, the Court of Appeal applied the English authority of *Montgomery v Wanda Modes Ltd*,[5] in holding that it is not objectionable that a company asserts a cross-claim in response to attempts to commence winding up proceedings.

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[3] Civil Appeal No. 10 of 2002, 18 June 2003.

[4] *Trade and Commerce Bank v Island Point Properties SA* (Appeal No. HCVAP 2009/12, 13 August 2010).

[5] [2002] 1 BCLC 289.

## Cross-Claims

The Court of Appeal also applied the English Court of Appeal decision in *Re Bayoil SA*,[6] in holding that the Court will not wind up a company where there is a serious and genuine cross-claim save in special circumstances, provided always that the cross-claim equals or exceeds the amount of the debt the subject of the application.

It stated:

> '*In an application to appoint liquidators, the burden is on the respondent company to prove: (i) that it has a cross-claim which is equal to or larger than the debt; and (ii) that its cross-claim is based on substantial grounds. It is the law that in considering whether or not there is a cross-claim which equals or exceeds the applicant's debts, the court applies the same test as that applied where the applicant's debt is disputed. In Re Bayoil SA, Nourse LJ stated as follows:*
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> > *"I emphasise that the cross-claim must be genuine and serious, or if you prefer, one of substance; that it must be one which the company has been unable to litigate; and that it must be in an amount exceeding the amount of the petitioner's debt."'*

Thus, the onus will be on the company to establish the existence of its cross-claim to the *Sparkasse Bregenz* standard.

## The Appeals

The Court of Appeal dismissed both appeals and affirmed the decisions of the Court below.

### *Capital WW Investment Limited (in liquidation) v Tall Trade Limited*

The cross-claim asserted in this case was a claim for damages against Tall Trade for unlawful means conspiracy.

Capital WW had acquired a 60 per cent stake in the holding company of an internet gambling business using the proceeds of a loan made by Tall Trade. The shareholders of the holding company had entered into a Shareholders Agreement which provided that at least 50 per cent of the net profits of the holding company would be distributed to the shareholders at least every six months. However, no distributions were made and Capital WW failed to make repayments under the loan as and when due. Relevantly, the loan agreement provided that repayment of the loan was to be effected irrespective of whether Capital WW had received dividends or not.

Capital WW complained that it had been the victim of a conspiracy in relation to the non-payment of dividends to which it was entitled, the effect of which was to starve it of funds from which it could have made loan repayments. It principally relied upon a number of telegram/text messages which it had obtained from hacking the accounts of third parties.

The Court of Appeal agreed with the Court below that the evidence did not establish any genuine or serious claim in conspiracy. It also upheld the decision of the Court below to exclude the hacked telegram messages from evidence in any event.

### *Arricano Real Estate Plc v Stockman Interhold SA*

Arricano applied to appoint liquidators to Stockman following Stockman's failure to comply with or set aside a statutory demand based upon unsatisfied costs orders made in Arricano's favour in arbitral proceedings before the London Court of International Arbitration (the LCIA).

The proceedings before the LCIA had concerned the validity of Stockman's termination of a Shareholders Agreement and Call Option Agreement in relation to the shares of a Cypriot company called Assofit Holdings Limited. Under the Shareholders Agreement, Arricano came under an obligation to transfer the benefit of five loans (the Filgate Loans) which were advanced by Filgate Credit Enterprises Limited, indirectly owned and controlled by Arricano's ultimate beneficial owner, to a subsidiary of Assofit. Whilst

[6] [1999] 1 WLR 147.

four of the Filgate loans had been transferred, one had not. The basis for Stockman's cross-claim was in relation to the remaining Filgate Loan.

Arricano relied upon a number of matters in defence of the asserted cross-claim, but the Court of Appeal held that most of those matters would need to be tested in cross-examination. That, observed the Court, would, in itself, normally indicate that there are substantial grounds of dispute. The Court of Appeal therefore agreed that there was a genuine and substantial dispute based on the cross-claim.

## Conclusion

Whilst a company will not be precluded from relying upon a cross-claim in resisting an application for the appointment of liquidators where it has previously failed to challenge a statutory demand, it will usually be preferable to first seek to set aside the statutory demand if only to avoid the deemed insolvency which will otherwise need to be addressed in evidence. There is also a risk that a company may be deprived of an award of costs in its favour if it is successful in opposing an application for the appointment of a liquidator based upon a cross-claim, which is only raised for the first time following the issue of the application for the appointment of liquidators.

Finally, it is important to bear in mind that a cross-claim will be subject to the same level of judicial scrutiny as any dispute in relation to the applicant's debt, and that the company bears the onus of establishing its cross-claim to the requisite standard. As the Court of Appeal stated in *Arricano*, '*It is clear that the court must approach the evidence with a wholly critical eye*'. The grounds of the cross-claim will therefore need to be fully and properly set out in evidence and supported by contemporaneous documents where appropriate.

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