Legal Insight: Avoiding BVI law and Cayman Islands law pitfalls in banking & finance and corporate transactions

There are certain notorious pitfalls to avoid in the context of British Virgin Islands ("**BVI**") and Cayman Islands banking & finance and corporate transactions. In this article, we examine five such pitfalls. While there are no "one size fits all" solutions to these issues, we set out some practical considerations, solutions and risk mitigation tools (as appropriate) with respect to them.

1. Backdating documents

What is it?

Backdating a document refers to the practice of executing a document and dating it with an earlier date than the actual date of execution. The purpose of this practice is usually to try to gain an advantage by giving rise to legal rights before the actual date of execution.

Is it lawful?

Backdating may facilitate, among other things, fraud (or conspiracy to commit fraud), forgery, a misrepresentation, false accounting or a false statement by a company director and therefore is not encouraged as a matter of legal practice in either the BVI or the Cayman Islands.

The above being said, there are a few instances in which it may be permissible to backdate documents as a matter of BVI and Cayman Islands law. For example, the original version of a document may have been lost or damaged. In that instance, it is acceptable to re-execute an identical version of the missing or damaged document in order to replace it. Additionally, if the relevant parties reached an oral agreement on a certain date and documented it in writing at a later date, it would usually be acceptable to include the date of the oral agreement in the written agreement so long as the terms are identical. In both of these cases, though, backdating can only operate where the relevant agreement is executed as a "simple contract" and not as a deed. This is because signing is an integral part of the process of creating rights by way of deed.

Are there any practical workarounds?

If the parties to an agreement governed by BVI law or Cayman Islands law would like an agreement to take effect from a date earlier than the date upon which it was or will be signed and entered into, the parties should expressly state that the agreement is intended to be effective from a date earlier than the date on which the parties entered or will enter into it. Stating that the agreement will be effective from an earlier "effective date" will, however, only be effective as between or among the parties to the agreement. It will not affect those parties' obligations under the terms of the agreement with regard to third parties who are not privy to the agreement. The obligations to third parties will almost invariably be based on the date that the agreement is fully executed subject to any applicable special circumstances. Any legal opinions delivered by offshore counsel will typically include a qualification to this effect.

2. Asset disposals by a BVI company

What is the general rule?

Subject to the exemptions noted below, the BVI Business Companies Act, 2004 (the "**BCA**") provides that any sale, transfer, lease, exchange or other disposition of more than 50 per cent in value of the assets of a BVI company should be made in the following manner:

i. **firstly**, the sale, transfer, lease, exchange or other disposition should be approved by that company's board of directors;

ii. **secondly**, following the board approval referenced above, the board of directors should submit details of the disposition to the company's shareholders for the purposes of authorization by way of a shareholders' resolution; and

iii. **thirdly**:

   a. if the resolution of the company's shareholders will be passed at a meeting, notice of that meeting, accompanied by an outline of the relevant disposition, should be given to each shareholder; and

   b. if the resolution of the company's shareholders will be passed in writing, an outline of the disposition should be given to each shareholder.

Therefore, unless an exemption applies, shareholder approval is required with respect to a significant asset disposal by a BVI company. There is no analogous provision of law in the Cayman Islands pursuant to which shareholder approval is required in the context of a disposal.

Although the point is not necessarily settled in case law, the term "assets" is most commonly taken to mean "*gross assets valued on an unconsolidated basis*".

What are the exemptions?

Shareholder approval is not required pursuant to the statutory mechanism set out above if the relevant BVI company's disposition is:

i. permitted pursuant to a provision of its memorandum of association or its articles of association (collectively, the "**M&A**") which dis-applies section 175 of the BCA;

ii. a mortgage, charge or other encumbrance, or the enforcement thereof;

iii. in the usual or regular course of the business carried on by it; and/or

iv. intended to comprise a transfer of its assets into trust for the purposes of protecting the assets of the company for the benefit of the company, its creditors and its members and, at the discretion of the directors, for any person having a direct or indirect interest in the company.

It should be noted that there is no specific exemption with respect to a transaction that is completed for fair value and/or is on arm's length terms.

For the purposes of establishing whether a transaction is in the "usual or regular course of the business" of a BVI company, it is important to have regard to that company's ordinary business activities. For example, a company which is in the business of buying and selling property will not need shareholder approval to dispose of such property. However, whether a company which owns one property and seeks to dispose of it requires shareholder approval is a matter which is currently subject to a degree of uncertainty. Our view is that such approval should be obtained. In *Ciban Management Corporation v Citco BVIHCV 2007/0301*, it was held that a disposal of this nature would *not* require shareholder approval, but this authority should be approached with caution in our view as the BVI company in question had been engaged in the property business and was simply disposing of its last property. The more prudent reading of this exemption, in line with the comments of the Privy Council in *Ciban Management Corporation v Citco (BVI) Ltd [2020] UKPC 21*, would be to regard the words "course" and "business" as requiring something ongoing in the nature of a commercial enterprise, as opposed to a one-off activity, and to obtain shareholder approval where there is any uncertainty.

What are the consequences of a breach?

The BCA does not set out the consequences of failing to comply with its terms and we are not aware of any caselaw authorities which directly address this point. That being said, it is relatively unlikely in our view that a disposition to an innocent third party would be held to be void or voidable as third parties are generally entitled to assume that the internal management of a BVI company has been properly conducted as a matter of BVI law. Disgruntled shareholders may nevertheless be entitled to exercise their statutory rights to have their shares purchased by the company for fair value in the event of a breach.

What risk mitigation strategies should be considered by a party that is making an acquisition from a BVI company?

A party that is making an acquisition from a BVI company should consider the following risk mitigation strategies:

i. review the BVI company's M&A to ascertain whether section 175 of the BCA has been dis-applied;

ii. obtain a valuation report with respect to the company's assets to identify whether the disposal may trigger section 175 of the BCA;

iii. include a due authorization representation with respect to the BVI entity in the relevant sale agreement;

iv. designate shareholder resolutions as a condition precedent to the relevant sale if appropriate, or obtain evidence (such as a certificate from a director) that such resolutions are not required under section 175 of the BCA; and/or

v. obtain a legal opinion as to the legality of the disposal as a matter of BVI law.

3. Disclosing directors' conflicts of interest

What is the position set out in the BCA?

Unlike Cayman Islands law (where the requirement for disclosure of a director's interests in a transaction is typically set out in a Cayman Islands company's articles of association instead of in any statute), BVI law includes detailed statutory provisions in the BCA regarding the disclosure of a director's interests in a transaction.

In summary, sections 124 and 125 of the BCA provide that:

i. unless a transaction is between the director and a BVI company and is entered into in the ordinary course of that company's business and on usual terms and conditions (the "**Rule in Section 124(3)**"), a director must disclose any interest in a transaction to be entered into by that BVI company to every other director on the board;

ii. a general disclosure by a director that he is a shareholder, director, officer or trustee of another company or other person and is to be regarded as interested in any transaction with that company or person is sufficient disclosure in relation to that transaction; and

iii. subject to the provisions of a BVI company's M&A, a director of a BVI company who is interested in a transaction may:

    a. vote on a matter relating to the transaction;

    b. attend a meeting of directors at which a matter relating to the transaction arises and be included in the quorum of that meeting; and

    c. sign a document on behalf of the BVI company, or do any other thing as a director which relates to the transaction.

What are the consequences of non-disclosure under the BCA?

Failure to disclose a conflict of interests under the BVI statutory provisions has two consequences. Firstly, the director commits an offence and is liable on summary conviction to a monetary fine. Secondly, the relevant transaction may be voidable at the instance of the company. However, the transaction will not be voidable if:

i. the director's interest was not required to be disclosed pursuant to the Rule in Section 124(3);

ii. the material facts of the director's interest in the transaction were known by the company's shareholders and they approved or ratified it; or

iii. the company received fair value for the transaction. "Fair value" is not defined in the legislation and is arguably a question of fact in light of all of the circumstances. That being said, the law does provide that any determination as to whether a company receives fair value shall be made on the basis of the information known to the company and the director at the time the relevant transaction was entered into.

Are the common law rules on conflicts of interest still relevant?

It is important to note that sections 124 and 125 of the BCA do not repeal the common law rules with respect to conflicts of interest. Therefore, directors of BVI companies are well-advised to comply with the statutory provisions set out above as well as their common law duties. The common law duties are also equally applicable to Cayman Islands companies.

What are the common law duties?

Broadly speaking, as a matter of common law, directors must not place themselves in a position where there is a conflict, or potential conflict, between their duties to a BVI company or a Cayman Islands company, and the personal interest or duties they owe to third parties. Failure to adhere to these principles could result in a wide range of remedies being awarded by a court, including the setting aside of the relevant transaction and/or the awarding of damages.

It should be noted that there will be no breach of the common law rules if:

i. the relevant director discloses his interest to the board prior to the transaction;

ii. following full and frank disclosure by the relevant director of the conflict to the shareholders of the relevant company prior to the transaction, the shareholders authorize the transaction; or

iii. the relevant director acts in accordance with any applicable provisions of the relevant company's M&A with respect to conflicts of interest.

What risk mitigation strategies should be considered by a third party dealing with a BVI or Cayman Islands counterparty in a transaction?

Parties that are dealing with a BVI company or Cayman Islands company in a transaction should consider the following risk mitigation strategies to ensure that any conflicts of interest have been suitably addressed:

i. review the relevant company's M&A to identify any applicable provisions with respect to conflicts of interest;

ii. review the relevant company's board resolutions to ensure that all directors have declared their interests in the transaction, or confirmed that there are none;

iii. identify and review any relevant shareholder resolutions which have been passed to approve and ratify the transaction; and

iv. include a due authorization representation in the relevant transaction document.

4. Stamp duty in the BVI and the Cayman Islands

Is stamp duty typically payable with respect to a banking & finance or corporate transaction in the BVI or the Cayman Islands?

As a matter of BVI law and Cayman Islands law, there is typically no stamp duty payable in connection with the execution or delivery of a document by a company in the context of a banking & finance or corporate transaction, or the performance of any obligations thereunder. However, there are two noteworthy exceptions to this.

Firstly, stamp duty will be payable in relation to:

i. the transfer to or by a company of an interest in land in the BVI or the Cayman Islands; or

ii. a transaction in respect of the shares, debt obligations or other securities of a "land owning company".

A company is a "land owning company" if it, or any of its subsidiaries, has an interest in any land in the BVI or the Cayman Islands.

Therefore, if there is a transfer of shares in a company which owns a subsidiary that has an interest in land in the BVI or the Cayman Islands, that transfer will not be exempt from BVI or Cayman Islands stamp duty.

Secondly, stamp duty will be payable as a matter of Cayman Islands law if a document is executed in, or brought into, the Cayman Islands. This is usually not necessary in the context of a banking & finance or corporate transaction.

What tools are available to ensure that stamp duty is not, and does not, become payable with respect to a transaction with a BVI law and/or Cayman Islands law element?

Parties that are dealing with a BVI company or a Cayman Islands company should consider the following risk mitigation strategies to ensure that material stamp duty is not, and does not, become payable with respect to a transaction:

i. conduct due diligence on the BVI company or the Cayman Islands company (as appropriate) to ensure that it does not directly or indirectly have an interest in land in the BVI or the Cayman Islands;

ii. include a representation and undertaking that is given by the BVI company or the Cayman Islands company (as appropriate) in the relevant transaction document to the effect that it does not, and will not, hold an interest in land in the BVI or the Cayman Islands;

iii. ensure that any signing instructions direct signatories to execute documents outside the Cayman Islands; and

iv. obtain a BVI or Cayman Islands legal opinion, as appropriate.

5. Security registers in the BVI/Cayman Islands and the registration of security in the BVI

Does a BVI company which creates security have to maintain an internal security register?

Pursuant to the BCA, a BVI company must record particulars of the security created by it over any of its assets in its register of charges. There is no statutory timeframe within which the register needs to be updated. However, a well-advised secured party will request that the register is updated promptly so that third parties that inspect it are on notice of the security. A BVI company which does not update its register of charges commits an offence and is liable on summary conviction to a monetary fine. This does not invalidate the validity, enforceability or the admissibility in evidence of the charge, however.

Does security created by a BVI company have to be registered in order to be effective?

Pursuant to the BCA, a BVI company (or a BVI legal practitioner authorized to act on its behalf) or the secured party (or a person authorized to act on its behalf) may lodge an application with the BVI Registrar of Corporate Affairs (the "**BVI Registrar**") to register a charge created by a BVI company by making a filing, specifying the particulars of charge, in the approved form. The security document itself is not filed or registered as part of the application. Whilst registration is not mandatory and does not affect the validity, enforceability or the admissibility in evidence of the charge, it is almost always completed in practice because it protects the priority of the charge and puts third parties on constructive notice of the existence of the security.

The general rule is that a registered security interest will have priority over any later registered or unregistered security interest over the same asset. The exceptions to this rule are as follows:

i. a secured party may consent or agree to vary the priority of its security interest;

ii. a registered floating charge is postponed to a subsequently registered fixed charge unless the floating charge contains a prohibition or restriction on the power of the relevant BVI company to create any future charge ranking in priority to or equally with the floating charge; and

iii. a different regime applies to a security interest that was created by a company that was originally incorporated under the International Business Companies Act 1984 and re-registered under the BCA.

The common law rules of priority continue to apply with respect to any unregistered security interests. In general terms, these rules specify that priority between competing security interests is determined by the dates on which the relevant security interests were created.

Does a Cayman Islands company which creates security have to maintain an internal security register?

Pursuant to section 54 of the Companies Act (As Revised) of the Cayman Islands (the "**Companies Act**"), a Cayman Islands company must record particulars of the security created over any of its assets in its register of mortgages and charges. There is no statutory timeframe within which the register needs to be updated. However, a well-advised secured party will request that the register is updated promptly so that third parties that inspect it are on notice of the security. If a Cayman Islands

company does not comply with the aforementioned provisions, every director or officer who authorizes or knowingly and willfully permits such non-compliance is liable to a monetary fine. This does not invalidate the validity, enforceability or the admissibility in evidence of the charge, however.

Does security created by a Cayman Islands company have to be registered in order to be effective?

As there is no statutory regime for registering security interests under Cayman Islands law, the common law rules of priority continue to apply. In general terms, these rules specify that priority between competing security interests is determined by the dates on which the relevant security interests were created. It is important to note that inserting details of mortgages and charges in the register of mortgages and charges of a Cayman Islands company does not confer priority on a charge in respect of the relevant secured asset.

What risk mitigation strategies should be considered by a secured creditor to ensure that the security protection steps referenced above are properly actioned?

A secured creditor dealing with a BVI company and/or Cayman Islands company that has created or will create security in its favour should:

i. include an undertaking in the relevant security document that is given by the BVI company or Cayman Islands company to the effect that it (or its registered agent or registered office provider, as applicable) will update its internal security register to reflect details of the security within an agreed timeframe and provide a certified copy of the updated register to the secured creditor;

ii. include an undertaking in the relevant security document that is given by the BVI company to the effect that it will file particulars of the security with the BVI Registrar pursuant to the BCA and provide the stamped particulars of the security and the certificate of registration to the secured creditor upon receipt;

iii. notwithstanding the undertaking referenced above, take control of the security registration process in the BVI as permitted under the BCA;

iv. designate the applicable security registers and security filings as conditions precedent or conditions subsequent to a financing; and

v. obtain a BVI or Cayman Islands legal opinion, as appropriate.

Further Assistance

This publication is not intended to be a substitute for specific legal advice or a legal opinion. If you require further advice relating to the matters discussed in this Legal Insight, please contact us. We would be delighted to assist.

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