

The lender's Holy Grail

Indira Birkwood of Harneys outlines the advantages of using a BVI company for financing transactions

The assessment and mitigation of risk has always been high on the agenda for lenders and it is nowhere more apparent than in the current tumultuous financial environment. In pursuit of the Holy Grail of risk control, as offshore vehicles continue to establish themselves as an integral part of international finance transactions, stable, predictable and flexible vehicles are sought by financial institutions the world over. This is no accident and in respect of the British Virgin Islands (BVI) is the result of the cumulative effect of a number of attractive features.

On January 1 2005 the BVI Business Companies Act (BC Act) came into force and replaced the International Business Companies Act (IBC Act) as the BVI's main corporate statute. The BC Act has retained many attractive attributes of the IBC Act such as the tax status of companies, the confidentiality of shareholders' and directors' information and a simplified and speedy incorporation process. At the same time, it has introduced a number of improvements to BVI corporate law that enhance the attractiveness of BVI companies.

Ease of incorporation

As a first-tier offshore financial centre, the BVI shares all the attributes of similar jurisdictions such as: English language, common law, stable currency and reliable courts. However, its streamlined company law, much lower cost of incorporation and speedy incorporation time

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(within 24 hours for generic companies) set it apart from other offshore jurisdictions.

Corporate capacity and *ultra vires*

The intensity of the *ultra vires* doctrine has been tempered by: (a) not requiring companies to specify their objects or purposes (except restricted purposes companies); and (b) providing that a company has, irrespective of corporate benefit, full capacity to carry on any business or activity, perform any act or enter into any transaction and for those purposes have full rights, powers and privileges (subject to the terms of the company's memorandum and articles of association).

The BC Act provides that, save in the case of restricted purposes companies, no act of a company or a transfer of property is invalid only by reason of the fact that the company did not have the capacity, right or power to perform the act or to transfer or receive the asset. This provision, which applies equally to the company and to third parties dealing with it and can therefore be relied upon by either, means that the mere fact that the company's act is beyond its memorandum does not mean it is invalid; something more will be needed to render the transaction invalid. That further element is usually knowledge by the third parties that the matter is beyond the powers of the directors.

In connection with this further element (knowledge), it is noteworthy that the BC Act has abolished constructive notice and knowledge of documents (including the memorandum and articles) registered at the BVI Registry of Corporate Affairs or available for inspection at the company's registered office, except in relation to charges registered on either the Register of Charges, the Register of Registered Charges or to a document relating to a restricted purposes company. Further, the company cannot assert against a person dealing with it that the BC Act or its memorandum or articles have not been complied with unless that person either knew, or ought to have known, by virtue of his relationship to the company, of the matter.

Flexibility of mortgaging shares

In contrast to some other offshore

jurisdictions, the BC Act permits a mortgage or charge over shares in a BVI company to be governed by any law. Once the mortgage or charge is compliant with the requirements of its governing law, it will be valid and binding against the company. Further, the remedies available to a mortgagee or chargee are governed by the governing law and the instrument creating the mortgage or charge, save that the rights between the mortgagor or mortgagee as a member of the company and the company shall continue to be governed by the memorandum and the articles of the company and the BC Act. Thus in practical terms the validity of a transfer of shares remains subject to BVI law.

For the protection of the mortgagees in the case of a charge over shares in a BVI company, the BC Act also allows the chargee to ensure third party notice of its rights by entering the following information in the register of members of the company:

- a) a statement that the shares are mortgaged or charged;
- b) the name of the mortgagee or chargee; and
- c) the date on which the statement and name are entered in the register of members.

If the chargee wishes to go one step further, a copy of the annotated register of members may be filed at the Registry of Corporate Affairs in the BVI.

Foreign law security documents

Along with its approach to security over shares in BVI companies, the BC Act provides statutory confirmation that a BVI company can create charges governed by any law and that such charges will be binding on the company to the extent, and in accordance with, that governing law.

When considered alongside the BVI's insolvency regime, lenders can rely on forms of security with which they are comfortable, safe in the knowledge that these will be effective in almost all circumstances in the British Virgin Islands.

Registration of security

Where a BVI company creates a security interest over its own assets, there are two different registrations that need to be considered under the BC Act:

- a) there is a public registration in the register of registered charges maintained by the Registrar of Corporate Affairs under Section 163 of the BC Act; and
- b) there is a private registration in the register of charges maintained by the company (or its registered agent) at its registered office under Section 162 of the BC Act.

Under British Virgin Islands law, only the private registration is mandatory. If a company

fails to enter a security interest in the register of charges, which it must keep at its registered office, then it may be liable on summary conviction to a fine of \$5,000.

However, notwithstanding that it is not mandatory, it is the public registration that has the principle effect on determining priority under British Virgin Islands law. An application to enter a security interest in the public register may be made by the company or the chargee and there is no time limit for making such an application.

Under the old IBC Act, the registration of security interests on behalf of chargees was lengthy and arduous at best as banks had no control over the registration process. The BC Act has responded to these difficulties and the importance of ensuring that registration occurs in a timely manner by removing the exclusive control over filings from the hands of companies and their BVI agents and opening the door to persons acting on behalf of chargees. Additionally, under the BC Act the filings are now made electronically, resulting in a simplified and time-efficient process that allows the instantaneous filing of security shortly after the completion of finance transactions. No longer do chargees have to wait for weeks, sometimes months, to find out whether the priority of the security interests has been secured.

It is noteworthy that priority rules can be varied by agreement between chargees or the consent of the charge holder.

Conflicts of interest

The main issue to bear in mind is that disclosure to the entire board by the interested directors is sufficient. As a result of the changes brought about by the BC Act, conflicts of interests on the part of directors have been constructively and comprehensively addressed. Under the new provisions, a director of a company shall, upon becoming aware of the fact that he is interested in a transaction entered into or to be entered into by the company, disclose that interest to the board of the company.

The director of a company is not required to comply with the requirement above if:

- the transaction or proposed transaction is between the director and the company; and
- the transaction or proposed transaction is or is to be entered into in the ordinary course of the company's business and on usual terms and conditions.

Financial assistance

The absence of any restrictions on financial assistance means that BVI companies do not have to endure a whitewash procedure. The BC Act goes a step further however by expressly providing that a company may give

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financial assistance, thereby altogether removing any residual concern that at common law such transactions may be void.

Insolvency legislation

The cutting edge and modern Insolvency Act 2003 (Insolvency Act) and Insolvency Rules 2005 (Rules) of the BVI have replaced the former insolvency regime that was contained in the IBC Act and the Bankruptcy Act Cap 8. The Insolvency Act provides a comprehensive modern code for liquidation and other insolvency processes and codifies the secured and unsecured protections that lenders expect. Furthermore, it explicitly recognises the cross-border nature of most offshore structures and allows the BVI courts wide powers to assist foreign office holders.

Netting

The BVI has responded to the needs of the derivatives market with a regime that effectively validates netting agreements in their entirety through insolvency. The primary constituents of the netting regime in the BVI are the insolvency set-off rules and the netting and financial contract provisions.

The fact that the BVI offers an English law-based insolvency regime without the concerns associated with corporate rehabilitation statutes lends itself to the availability of robust opinions on netting, set-off and subordination.

A netting agreement is defined as an agreement between two parties, in relation to present or future financial contracts between them, the provisions of which include the termination of those contracts in existence for the time being, the determination of termination values of those contracts and the set-off of the termination values so as to arrive at a net amount due. Examples of financial contracts have been set out in the Rules and include swaps and other derivatives contracts, securities lending and repurchase agreements, title transfer collateral arrangements and any other agreement that the BVI Financial Services Commission designates as such.

The effect of these provisions is that the contractual provisions of a netting agreement

will prevail even if the automatic insolvency set-off rules were to produce a different result and notwithstanding any preference or undervalue that might otherwise cause a BVI court to set aside the transaction.

The Insolvency Act, adopting the International Swaps and Derivatives Association (ISDA) model netting law, provides for pre-preferential netting rights and allows a level of comfort in relation to derivatives transactions that does not exist for those countries that rely on common law rules relating to equitable set-off.

Segregated portfolio companies

Under British Virgin Islands law it is possible to form BVI companies that are segregated portfolio companies. It is also possible for insurance companies to apply to be licensed as segregated portfolio companies under the Insurance Act. Broadly, the assets and liabilities of these companies are compartmentalised and are treated as distinct entities for most (but not all) insolvency-related purposes.

Orphan structures

The new VISTA trust regime of the BVI allows orphan structures to be set up within the jurisdiction without the trustee's liability concerns relating to the rule in *Bartlett v Barclays Bank* (1980) Ch 15.

Other advantages

- Under the BC Act, sealing is no longer necessary for deeds executed by BVI companies.
- Directors' and shareholders' meetings may be held anywhere in the world and telephone participation is catered for. Written resolutions may also be used.
- There is no director or shareholder residency requirement and it is possible to have a sole director or a sole shareholder.

Risk becomes an issue when the law is unclear, unduly complicated and not sufficiently creditor-friendly. The sheer volume of BVI companies and transactions involving the same means that very few financial institutions do not have a familiarity and a level of comfort with BVI SPVs.