The British Virgin Islands ("BVI") is a leading offshore jurisdiction. As at 30 September 2014 there were more than 480,000 active BVI companies. The BVI is also widely recognised as a creditor friendly jurisdiction, with:

- flexible and up-to-date corporate legislation designed to accommodate the needs of the creditor;
- modern and robust insolvency legislation;
- common law principles; and
- a dedicated commercial court with the Privy Council as the final court of appeal.

BVI companies are therefore frequently involved in international finance transactions and, where such a financing is to be secured, it is common for the security package to include security over the shares of one or more BVI companies.

This article looks at some common issues which should be considered by a creditor when taking security over shares in a BVI company. It is general in nature and is not a substitute for specific BVI legal advice. It also does not seek to deal with specific issues relating to the taking of security over shares of BVI companies which are regulated or which (either directly or through subsidiaries) hold interests in land in the BVI.

1. Types of Security

Pursuant to the BVI Business Companies Act (the "Act"), security over the shares of a BVI company may be either by way of mortgage (which may be legal or equitable) or charge.

Legal Mortgage

A legal mortgage involves the transfer of title to the shares of the BVI company into the name of the mortgagee. The transfer of legal title confers maximum protection against competing interests in that it is not vulnerable to being defeated by "equity’s darling" – a third party who acquires legal title to the shares in good faith, for value and without notice of a pre-existing equitable interest. It also means that upon enforcement the secured creditor will already be registered as the member of the company. This avoids the need, at a time of potential dispute, to have the register of members updated by the company or by a service provider who, in either case, may not be co-operative.

However, a legal mortgage over shares of a BVI company is rare. Shareholders will typically be reluctant to transfer title to the shares (even by way of security) prior to the occurrence of an enforcement trigger event, meaning a legal mortgage is usually not commercially acceptable. It also has certain potential disadvantages which may result in the secured party preferring equitable security. These include, among other things (i) potential liability for calls by the BVI company in the event that the shares are not fully paid, (ii) the administrative burden of the secured party receiving documents and dividends and being required to pass onto the mortgagor and (iii) the potential for it to appear that the secured party is taking “control” of the BVI company.

Equitable Mortgage or Charge

By far the most common form of security interest in relation to the shares of a BVI company is an equitable mortgage or charge. This equitable security interest does not involve the transfer of legal title of the shares of the BVI company, although its terms should provide that in certain circumstances (typically not until the occurrence of an agreed enforcement trigger event) the equitable mortgage or charge can be converted to a legal mortgage.

When taking an equitable mortgage or charge, there are two areas in particular which should be addressed to the secured creditor’s satisfaction which do not tend to arise where a legal mortgage is taken. These relate to priority and enforcement (in particular, ensuring that the secured creditor can, in the event enforcement becomes necessary, obtain title to the shares and enforce its security interest out of court). These issues are addressed in section 4 below. However, in short, provided that appropriate BVI legal advice is obtained and the relevant steps and documents are taken to protect priority and assist out of court enforcement, secured creditors are normally comfortable in taking equitable security in the form of an equitable mortgage or charge and will not require a legal mortgage.

2. Statutory Formalities and Requirements

The Act imposes only minimal requirements for security to be taken over shares of BVI companies. The mortgage or charge can be in any form, and governed by any law, provided that it:

- is created in writing;
- is signed by or with the authority of the shareholder of the shares which are to be mortgaged or charged; and
- clearly indicates: (i) the intention to create a mortgage or charge; and (ii) the amount secured or how that amount is to be calculated (typically the latter, achieved through reference to amounts due under the finance documents pursuant to a definition of “Secured Liabilities”, “Secured Obligations” or similar).

There are no other required formalities such as notarisation or apostilling, and there are no perfection requirements as a matter of BVI law in order to make the mortgage or charge valid or enforceable.

Further, no stamp duty is payable in the BVI on the creation or enforcement of the mortgage or charge (other than in the very rare instances where the shareholder, the BVI company whose shares are being charged or any of their respective subsidiaries owns an interest in land located in the BVI).
3. Choice of Governing Law

In keeping with one of its overall aims to give flexibility for corporate transactions and structuring, the Act specifically allows the governing law of a share charge or mortgage to be either BVI law or foreign law. Some factors to consider in relation to the choice of governing law are set out below.

BVI Law Share Security

Unless there are clear advantages to using foreign law security, we recommend that the governing law of a mortgage or charge creating security over shares in a BVI company is BVI law.

BVI law security is recommended because the asset subject to security is a BVI asset and BVI law will always be relevant in terms of (i) the rights between the mortgagor or mortgagee as a member of the company, which crucially means any transfer of shares will be governed by BVI law in any event (i.e. giving practical effect to the enforcement of the share security) and (ii) determining issues of title (the Act provides that the situs of shares of a BVI company for the purposes of determining title will always be in the BVI, which is unaffected by other factors, such as the location of register of members).

"Conflict of laws" issues can also arise in the context of foreign law security, particularly if the share security is governed by the laws of a jurisdiction with laws not based on common law, and which may apply legal concepts and principles not recognised and which do not form part of BVI law. Such issues are likely to be less significant in respect of foreign law security governed by the laws of another common law jurisdiction (for example, English law).

Foreign Law Share Security

There are occasionally specific reasons and advantages to using a foreign law security document.

The clearest example as to when foreign law security should be considered is where it is desirable that as a final remedy the secured party be able to take outright ownership of the shares for its own benefit in full or part satisfaction of the secured liabilities. Other than through a court order for foreclosure (which as a court based remedy is rarely sought or obtained, secured creditors generally preferring quicker and less costly out of court enforcement options) a BVI law share charge or mortgage does not provide such a remedy, and ultimately only the proceeds of the charged shares will be available to the secured party upon enforcement. However, the remedy of appropriation recently introduced into English law through the Financial Collateral Arrangements (2) Regulations, 2003 of the United Kingdom provides exactly this remedy, allowing title to the shares to be appropriated by the secured party (and crucially, appropriation is an out of court, self-help remedy). The value of the shares is then determined in accordance with the terms of the security document (and is required in any event to be determined in a commercially reasonable manner). Following determination of the value, this amount is deemed to be applied in or towards discharge of the secured liabilities. Any balancing amount is paid by the secured party to the former shareholder who granted the security.

The above remedy of appropriation pursuant to an English law share charge has been confirmed as being valid and available in respect of shares of a BVI company by the Privy Council in the case of Cukurova Finance International Limited and another -v- Alfa Telecom Turkey Ltd. This case involved security being granted by one joint venture party and its shareholder to the other joint venture party. As a leading jurisdiction for joint ventures, this is not uncommon in the BVI. In such circumstances, the remedies available out of court under a BVI law mortgage or charge, being limited to the right to appoint a receiver over the shares or to sell the shares (with no right to sell the shares to oneself and strict duties which substantially limit the ability to sell...
to an affiliated entity), are unattractive and would be likely to result in the introduction of a third party as a new joint venture party. Appropriation provides an alternative solution enabling the secured creditor to collapse the joint venture and assume 100% ownership of the underlying investment.2

There are other reasons sometimes mentioned as to why foreign law security might be used, such as having the governing law the same as the governing law of the principal finance documents, which law the parties are familiar with. The parties are free to choose the governing law and may do so for any reason. However, the bottom line is that where the desired enforcement options and remedies can be obtained under foreign law security and are not available under BVI law, then the secured party would be advised to take foreign law security; otherwise, BVI law security will in our view be preferable. Of course, for relatively low increased costs, it is possible to take both BVI and foreign law security for increased flexibility.

Requirements for Validity of Foreign Law Mortgage or Charge

To be valid from a BVI perspective, a foreign law mortgage or charge over shares of a BVI company must comply with the requirements of its governing law.

In addition, the requirements detailed in section 2 above apply to all security over shares of a BVI company and so also need to be complied with. These requirements are not onerous and are easily complied with, provided the secured party is aware of them, but one point to watch out for is that the security must evidence an intention to create a “mortgage” or “charge”. This is particularly relevant where security is taken under the laws of a jurisdiction which has a concept of a share “pledge”. A security document under such foreign laws and based on a share pledge would need to be amended to clearly evidence the intent to create a mortgage or charge for the purposes of the Act (a “pledge” has a separate meaning under BVI law and requires possession of a physical asset, which is not possible in relation to an intangible asset such as shares of a BVI company).

4. Creditor Protection Steps

In order to protect its position and ensure that it obtains valid security, ranking in priority and practically enforceable in accordance with its expectations, a creditor taking security over shares of a BVI company should take certain steps.

Diligence

Before taking security over shares of a BVI company, the prospective secured creditor should:

- conduct a search of the records maintained by the Registrar of Corporate Affairs (British Virgin Islands) (the “Registrar”) in respect of the BVI company;
- review the BVI company’s memorandum and articles of association obtained from the Registrar to ensure that there are no provisions that prohibit the creation of security or might negatively impact on the enforcement of the security (for example restrictions on transfers, liens in favour of the company and directors’ discretion to refuse to register share transfers);

2 It should be noted that the Privy Council held in the Cukurova case that the equitable right to relief from forfeiture remained available following appropriation. However, the decision was based on very unusual factual circumstances which the Court thought unlikely to be repeated. As such, while relief may be available in principle, it can only be expected to be obtained in limited circumstances.
• inspect the BVI company’s register of members to ensure that the security provider is the registered shareholder of the shares it is granting security over, free of any notation of existing security, and (if such details are noted in the register) evidence whether the charged shares have been issued fully paid; and

• if the security provider is also a BVI company, conduct a search of the records maintained by the Registrar in respect of such BVI company to, among other things, reveal any existing security filings which might have priority over the new share security.

Ancillary Documents and Enforcement Aids

Irrespective of the governing law of the share security, there are a number of documents that secured lenders are advised to take as part of the security package to facilitate enforcement. These include:

• undated share transfer form(s);

• original share certificates (if any – BVI law does not require share certificates to be issued);

• a proxy to allow the secured creditor to vote the shares following an enforcement event;

• signed and undated letters of resignation from the directors of the BVI company and a letter from each director authorising the lenders to date the letters of resignation upon an enforcement event;

• (if the BVI company is not party to the relevant share charge) an irrevocable undertaking from the BVI company whose shares are charged to, among other things, register transfers of shares to the secured creditor or its nominee upon enforcement; and

• an undertaking from the registered agent of the BVI company to, among other things, keep the original register of members until the security is released and to update the same in accordance with the instructions of the secured creditor upon enforcement of the security. While registered agent undertakings are increasingly being accepted as part of market practice, commercial reality may mean that it is not possible to obtain such an undertaking for a particular transaction, in which case alternative options are available to address the relevant concerns, and in respect of which we can give specific advice.

Although usually included in the charge or mortgage, rather than as a separate ancillary document, a power of attorney should also be granted by the security provider to enable the secured creditor to execute and complete documents on the security provider’s behalf upon enforcement.

In addition, to the extent that provisions have been identified in the BVI company’s memorandum and articles of association pursuant to the diligence process which may inhibit enforcement, amendments to such provisions should also be required to be made and evidence of the same delivered pursuant to the terms of the share security document.
Priority and Optional Registrations

Where security is granted by a BVI company over shares of another BVI company, the priority regime of the Act in relation to assets of a BVI company applies. Pursuant to this regime, particulars of the security may be filed with the Registrar in respect of the BVI company granting the security. The filing can be made by (i) BVI lawyers acting on behalf of the secured creditor (ii) BVI lawyers acting on behalf of the BVI company granting the security interest, or (iii) by the BVI company’s registered agent. Save as provided below, upon registration the security will have priority over any security over the same assets which is not registered or is subsequently registered.

The above priority analysis is subject to the following: (i) in the unlikely event the share security is merely a floating charge over the shares it will be postponed to a subsequently registered fixed charge over such shares unless the floating charge and registration contain an appropriate negative pledge restricting the creation of a future charge ranking ahead or having the same priority; and (ii) if the BVI company granting the security was incorporated under the International Business Companies Act (the “IBC Act”) and subsequently re-registered under the Act, existing security interests registered in such BVI company’s internal register of mortgages, charges and other encumbrances kept under the IBC Act will retain their priority and will not necessarily be revealed by the searches of the records maintained by the Registrar.

Therefore, where the security provider is a BVI company, a secured creditor should (i) ensure that particulars of the security are filed on or as soon as practicable following creation of the charge to obtain priority and (ii) if the security provider was originally incorporated under the IBC Act, obtain and inspect any register of mortgages, charges and other encumbrances kept by such BVI company under the IBC Act.

Where the company granting the security is not a BVI company, common law rules as to priority apply. The starting point as to a common law priority analysis is the order of time of creation of the security interest (the first in time will generally have priority over the subsequently created or acquired interest). However, this is subject to certain exceptions. The most relevant exception is the bona fide purchaser rule that a third party who acquires legal title to the shares in good faith, for value and without notice of a pre-existing equitable interest will acquire good title, free of such pre-existing equitable interest.

A couple of steps which should be taken to minimize the possibility of a bona fide purchaser being able to overreach a secured party’s equitable mortgage or charge are to require that:

- an entry be made in the register of members of the BVI company whose shares are charged to include a notation of the security (this is specifically allowed by the Act); and
- the register of members of the BVI company whose shares are charged be publicly filed with the Registrar.

The entry in the register of members will need to be made by the person who maintains the register on behalf of the BVI company whose shares are charged (with authority from its board of directors) and the filing of the register with the Registrar can only be made by such BVI company’s registered agent. Therefore, as the secured party has no direct ability to achieve either of the above, it should be a term of the share charge or mortgage that the security provider procures that such entry and filing is made and evidence is supplied of the same.
Although there is no deemed notice of the filed register of members, a purchaser (or potential security holder) of shares in a BVI company should always insist on looking at the register of members and should also conduct a search of the Registrar. In the event it does either and obtains a copy of the register of members including a notation of security, it will be on actual notice of such pre-existing security interest and no longer benefit from the \textit{bona fide} purchaser rule. In the unlikely event a third party does neither and does not therefore have actual notice, it may still acquire title subject to the pre-existing security interest on the grounds that it ought to have inspected the register and obtained notice and should not benefit from the protection of the \textit{bona fide} purchaser rule as a result.

\textbf{Stop Notices}

If the secured party is especially concerned that any shares the subject of security will be transferred or a distribution will be paid on such shares in breach of the share charge or mortgage, the secured party may apply to the High Court for a stop notice. This is a notice from the Registrar of the High Court requiring a BVI company and/or a registered shareholder of such company to give 14 days' notice to the secured creditor before any transfer of shares or payment of distribution on such shares. However, requesting a stop notice at the outset of a transaction is an aggressive step and is not common practice.

\section{5. Enforcement}

Enforcement remedies will depend on the choice of governing law.

Pursuant to a BVI law mortgage or charge the secured creditor will have two primary statutory remedies, being (i) the right to sell the shares and (ii) the right to appoint a receiver who can vote, receive dividends and/or sell the shares. Both of these remedies are exercisable out of court in accordance with the terms of the share security document. There is also the possibility of applying to court for an order for foreclosure, provided that the security is a mortgage (which for these purposes includes a charge with the ability to convert the charge to a legal mortgage), but this is rarely sought. One point to note is that the share mortgage or charge should specify that the statutory out of court enforcement rights are exercisable immediately (or following such other period as is agreed) upon the occurrence of the relevant default/enforcement trigger; if the mortgage or charge is silent as to this, lengthy default cure periods provided by the Act may apply, preventing enforcement in the interim.

In respect of foreign law security, the Act provides that the remedies available to the mortgagee or chargee will be governed by the relevant foreign law and the instrument creating the mortgage or charge, save that the rights of the mortgagor or mortgagee as a shareholder of the BVI company whose shares are subject to security will remain governed by BVI law pursuant to the BVI company’s memorandum and articles and the Act. In practical terms, this means that the enforcement of the foreign law security should be conducted in accordance with the relevant foreign law, but any resulting transfer of shares of the BVI company upon enforcement and any exercise of rights by the secured creditor as a shareholder of the BVI company should be effected in accordance with BVI law and the BVI company’s memorandum and articles of association. In either case, BVI advice should be obtained prior to any enforcement steps being taken.
6. Conclusion

BVI law provides a flexible, straightforward and creditor friendly basis for secured creditors to take security over shares of BVI companies in finance structures. Its flexibility in offering a statutory basis for a choice of governing law for share security over shares of BVI companies allows secured creditors to select the governing law which provides them with the most appropriate remedy for a particular transaction. However, whatever the governing law of the security document, BVI legal advice should be obtained to ensure that the security will achieve its intended aims, both in creating legally effective security and in ensuring enforcement rights can be given practical effect without the need for court approval or the active co-operation of other parties.

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This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.

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