



LENDING TO BVI COMPANIES - TAKING SECURITY

APRIL 2018

BVI companies are used the world over in financing transactions. Sometimes they are the primary borrower and grant security over their assets to support that borrowing. Other times, they offer guarantees or charges over their assets to support borrowing within a larger group. A number of the same issues present themselves in each of these arrangements and it is worthwhile to consider the issues that arise in these transactions.

In this Briefing we highlight the issues that can arise as it relates to lending to and taking security from companies incorporated in the British Virgin Islands.

Power and Capacity

The concept of *ultra vires* has been virtually abolished in the BVI. The BVI Business Companies Act, 2004 (Act) has been drafted in such a way that every company has full capacity to carry on or undertake any business or activity^[1] and has full rights, powers and privileges^[2] to supplement the company's broad capacity. Additionally, no act of a company and no transfer of an asset, by or to a company, is invalid by reason only of the fact the company did not have the capacity right or power to perform the act or transfer the assets^[3]. Given such broad language the power and capacity to borrow money and charge assets should rarely be an issue.

Authority

A BVI company has the power and capacity to do almost anything assuming the activity is not regulated or illegal. The Act specifically permits a company to undertake actions irrespective of corporate benefit. A BVI company is to be treated similarly to an individual, and while a company may have the capacity to undertake a particular proposed activity, a commercial issue arises in relation to the authorisation of the activity. In the usual case, approval of the transaction by way of a director resolution or minutes of directors meeting should be sufficient.

In the case of a transaction without a corporate benefit, such as a third party guarantee, the directors can be in a difficult position. Directors owe a fiduciary duty to the company to act in what they believe to be the best interests of the company and for a proper purpose. Often it is difficult for a board of directors to justify entering into certain corporate actions as being in the best interest of the company when the direct proceeds of the borrowing flow to another group company. This type of transaction often occurs in the case of inter-related and closely held BVI groups. In these situations, in addition to the usual director resolution, it is prudent to obtain the authorisation of the shareholders. Shareholders are not under a fiduciary obligation, as the directors are, and can approve such transactions without the considerations imposed on the directors. More importantly, shareholder approval should effectively estop a

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shareholder from later attacking the directors or the transaction on grounds of breach of fiduciary duty.

Conflicts of Interest

In many cases, BVI companies are closely held and it is not unusual that the directors are often the shareholders. The Act states that failure to disclose a director's interest in a transaction with the company can render the transaction voidable at the instance of the company. Conflicts must be disclosed as soon as the director becomes aware of them and must be disclosed to the entire board (not just a quorum). This is clearly set out in the Act and often a company's Memorandum and Articles will use language similar to the following:

"A Director shall forthwith after becoming aware of the fact that he is interested in a transaction entered into or to be entered into by the company, disclose the interest to the board of the company by bringing it to the attention of every Director of the board. Where a Director's interest in a transaction is not disclosed in accordance with this Regulation the transaction is voidable by the company."

Given the ability of the company to avoid the transaction, it is paramount when transacting business with a BVI company that comfort is obtained that the transaction has been properly authorised. The best practice is to always set out a director's conflicts section at the beginning of a resolution and set out the nature of the relationship that causes the conflict. If no conflict exists, then that should be stated as well, so anyone who reads the resolution at a later time realises that the issue was considered.

Creating Security Over Company Assets

A BVI company can enter into a mortgage, charge or other encumbrance over any of its assets wherever situated. Such mortgage or charge can be in accordance with the law of any jurisdiction and is binding to the extent and in accordance with the requirements of the chosen law. Further, a BVI company can secure the obligations of third parties with a charge over its assets and is not restricted to only providing security for its own borrowing.

Registration of Security

It is not necessary in order to ensure the legality, validity, enforceability or admissibility in evidence of financing or security documents in the BVI that they (or any of them) be filed, recorded, executed, delivered, registered or enrolled with any court or authority in BVI or that any registration fees, stamp, tax or similar duty be paid on or in relation to any of the financing documents save in respect of the payment of any court or judicial fees in the event of litigation before the courts of British Virgin Islands.

Perfection of Security

No steps are required as a matter of BVI law to perfect security interests. However, it is a requirement of the Act that a company shall keep a register of charges created by the company. Details of the financing documents should therefore be entered into the company's register of charges to be kept at its registered office or at the office of its registered agent

Priority of Security

Fixed Charges For the purposes of priority, an application should be made in the approved form to the BVI Registrar of Corporate Affairs to register the charges created by any financing documents at the Registry of Corporate Affairs and a certificate of registration

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obtained. A person is deemed to have notice of a document registered with the Registrar as above. Subject to registration described above (and any earlier registered security interests) the security interests created by the financing documents will have priority over any future claims by third parties (other than those preferred by law) including any liquidator or a creditor of the company, subject, in the case of winding up of the company in a jurisdiction other than the BVI, to any provisions of the laws of that jurisdiction as to priority of claims in winding up.

Floating charges - A floating charge will rank behind a later registered fixed charge unless the floating charge contains a prohibition or restriction on the power of the company to create any future security interest ranking in priority to or equally with the floating charge.

Guarantees

The Act specifically permits a company to undertake actions irrespective of corporate benefit. As a result it is not unusual to see BVI companies granting third party guarantees. However, as described above under the heading Authority these types of corporate guarantees bring into focus the issue of "corporate benefit" as third party guarantees often present no direct benefit to the company. There is express power to guarantee in Section 28 of the Act, which is very broad and indicates a power to guarantee an obligation or liability of any person and to secure such obligations by a mortgage, pledge or charge of corporate assets. This statutory power is often accompanied by a supporting clause in the Articles

In these cases, the power to guarantee is clear and the authorisation should be by way of a directors' resolution in an inter-corporate guarantee with the indirect benefit to the company or group set out. If it is an obligation of an unrelated third party a shareholder resolution is recommended.

[1] Section 28(1)(a)

[2] Section 28(1)(b)

[3] Section 29

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