Corporate Reconstructions in the British Virgin Islands

Insights - 05/06/2012

The current economic climate has forced many companies to consider their future and, for those able to survive, there has been significant impetus in cost saving and rationalising structures where possible. However, it is not only in the downturn that companies look to restructure. This process can also have a positive spin, especially where a company is seeking to structure acquisitions or expand into new areas of operation.

British Virgin Islands (BVI) companies have long been recognised as easy to incorporate, cost effective and user friendly structures. It is this that has led to over 40 per cent of the worlds offshore companies being domiciled in the BVI. An illustration of their user friendliness is the flexibility afforded by the BVI corporate statute during the life of the company. The BVI Business Companies Act 2004 (the Companies Act) contains a number corporate mechanics that are simply not available in many onshore jurisdictions. Some of these may prove useful when considering either a positive or a cost saving reconstruction.

The Companies Act deals with corporate reconstructions in Part IX. It specifically caters for the following mechanics:

1. mergers;
2. consolidations;
3. sales of assets;
4. forced redemptions of minority shareholders;
5. arrangement; and
6. provisions dealing with dissenting members.

There is nothing in the Companies Act which expressly requires the directors to consider any solvency issues or to be satisfied of the solvency test in section 56 (which applies to any

distribution by a company to its members and the purchase by the company of members' shares) before carrying out the proposed reconstruction. However, directors should consider the voidable transaction provisions in the Insolvency Act, 2003 and in particular whether the proposed action is potentially an undervalue transaction or an unfair preference under that statute. Furthermore, directors have fiduciary duties to act in the best interests of the company and this can include considering the interests of creditors if the company is insolvent or on the brink of insolvency, or may become so as a result of a payment or a transaction.

Notwithstanding the above, it is worth noting that, of some of these mechanisms are wide and varied in their application, one should always keep in mind the solvency test requirement as part of the overall transaction (e.g. if one entity direct that considerate be passed directly to its members).

1 Merger and consolidation

Merger and consolidation are given statutory definition under the Companies Act:

1.1 merger is the process whereby two or more existing companies (referred to as "constituent companies") merge into one of the constituent companies, called the surviving company; and

1.2 consolidation is the process whereby two or more constituent companies are consolidated into a new company, called the "consolidated company".

The Companies Act allows mergers and consolidations between companies incorporated and registered under the Companies Act, as well between a company incorporated under the Companies Act and an overseas company (i.e. a company incorporated outside the British Virgin Islands) if the foreign law which governs the overseas company permits it to merge with a foreign company (ie the BVI company). It also allows a merger between a parent and a subsidiary (including where one or more of them are incorporated outside the British Virgin Islands) with small modifications to the procedure.

The provisions for effecting a merger or consolidation are very flexible and allow the shares of the non-surviving company to be cancelled, reclassified or converted into money or other assets, or into shares, debt obligations or other securities in the surviving or consolidated company. Shares of the same class can be treated differently, for example, some shareholders can be given shares in the surviving or consolidated company, while others of the same class can be bought out.

2 Effect of a merger or consolidation

With the merger of the constituent companies into the surviving company, the surviving company acquires the rights, powers, immunities and all the business and assets of the constituent companies and also becomes liable for all their debts and obligations. This occurs by operation of

law. Such debts and obligations, and any judgment or cause of action against the constituent companies, are not released by the merger. Proceedings pending against the constituent companies at the time of the merger are also not abated or discontinued but may be enforced, prosecuted, settled or compromised by or against the surviving company, and the surviving company may be substituted in the proceedings.

Consolidation has the same consequences save that it is the new consolidated company that acquires the assets and becomes subject to the liabilities. Merger or consolidation with a foreign company, where the surviving company or new consolidated company is a foreign company, has the same consequences except insofar as the laws of the foreign jurisdiction provide otherwise.

A practiced note of caution should be sounded here. While assets and liabilities of the constituent companies pass by operation of law, we routinely advise clients to consider material contracts of the company or companies that will cease to exist and to ensure that contracted counterparties are aware of the merger or consolidation and that there will be no disruption.

3 Outline of the procedure for merger or consolidation

The procedure followed to effect either a merger or consolidation is very similar and involves four main stages which, in outline, are as follows:

3.1 approval of a plan of merger or consolidation by the directors of each constituent company;

3.2 following approval by the directors approval of the plan by a resolution of members;

3.3 execution of articles of merger or consolidation by each constituent company; and

3.4 filing of the articles of merger or consolidation with the Registrar of Companies in the BVI (the Registrar).

The Registrar, if satisfied that the requirements of the Companies Act have been complied with, must register the articles of merger or consolidation and issue a certificate of merger or consolidation and, in the case of a consolidation, also issue a certificate of incorporation of the new consolidated company. The merger or consolidation is effective on the date the articles of merger or consolidation are registered, or such subsequent date not exceeding 30 days as is stated in the articles of merger or consolidation. There are also steps relating to dissenting shareholders and acquiring their shares at fair value to be considered - these provisions are discussed below.

The written plan of merger or consolidation must contain certain matters specified by the Companies Act including the terms and conditions of the proposed merger or consolidation and the way in which shares in the constituent companies are to be treated. For a merger, the plan must contain a statement of any amendments to be made to the memorandum of association (memorandum) or articles of association (articles) of the surviving company as a consequence of

the merger, while for a consolidation the plan must have annexed to it the memorandum and articles to be adopted by the new consolidated company.

The plan must be given to all members for approval, whether or not they are entitled to vote or consent on the merger or consolidation. Approval is by members' resolution which can be by a vote at a meeting or by written consent, and only requires a majority of the votes of those members entitled to vote unless the memorandum or articles specifies a higher majority. Shareholders of a class of shares are only entitled to vote as a class in one of two situations: either if the memorandum or articles so provide or if the plan contains any provision that, if contained in a proposed amendment to the memorandum or articles, would entitle the class to vote on the proposed amendment as a class.

The articles of merger or consolidation must contain:

3.5 the plan of merger or consolidation;

3.6 the dates when the memorandum and articles of each constituent company were registered; and

3.7 the manner in which the merger or consolidation was authorised by each constituent company.

When filing the articles of merger or consolidation with the Registrar, another document must also be filed: in the case of a merger, it will be any resolution to amend the memorandum and articles of the surviving company. In the case of a consolidation, it will be the memorandum and articles for the new consolidated company. When registering the articles of merger or consolidation, the Registrar must also register the resolution to amend the memorandum or articles in the case of a merger or the memorandum or articles of the new consolidated company.

Mergers or consolidations involving foreign companies are only permitted if the law of the foreign jurisdiction permits it. The British Virgin Islands constituent companies must comply with the provisions of the Companies Act while the foreign companies must comply with the law of the jurisdiction of their incorporation. If the result of the merger or consolidation is a foreign company surviving, there are provisions for ensuring that proceedings for any claim under the Companies Act can be served on it in the British Virgin Islands by requiring an irrevocable appointment of its registered agent to accept service of such proceedings and requiring its agreement that it will promptly pay dissenting members. Such appointment and agreement must be filed. It must also file its foreign certificate of merger or consolidation, or, if no such certificate is issued by the foreign authority, such evidence of merger or consolidation as the Registrar considers acceptable.

4 Procedure in the case of merger between parent and subsidiary

The procedure in this scenario is largely similar to that described above. For a merger between a parent and one or more of its subsidiaries, only the directors of the parent company need to approve the plan of merger. There is no requirement for the directors of the subsidiaries or the other members of any of the companies involved to approve the plan of merger. Where the parent company does not own all the shares in the subsidiary, a copy of the plan or an outline of it must be given to every member of the subsidiary company to be merged unless waived by that member. Furthermore, only the parent company need execute the articles of merger.

5 Disposition of assets

A company can dispose of more than 50% in value of its assets otherwise than in the usual or regular course of its business by following the procedure set out in section 175 of the Companies Act The scope of the provision is very wide and covers dispositions by way of sale, transfer, lease, exchange or any other disposition and is subject to the memorandum and articles of the company. However, a disposition by way of a mortgage, charge or other encumbrance, or by enforcement of these, is outside the ambit of the provision. However, the section would still apply to grant of security by way of outright title transfer.

The disposition must be approved by the directors who must submit details of it to members for authorisation by a resolution of members; an outline of the disposition must be given to each member whether or not he is entitled to vote or consent to the proposals. A company is free to limit or exclude the effect of section 175 in its memorandum and articles, although relatively few companies do so in practice.

6 Redemption of minority shares

Commonly referred to as the "squeeze out" the process by which majority shareholders can mop up the remaining 10 per cent minority shareholders differ in the BVI from the process adopted in most onshore jurisdictions. The main difference being that this is affected by the company repurchasing shares as opposed to the majority making the compulsory acquisition. Significantly, a squeeze out under BVI law can be undertaken at anytime and not simply in the context of a takeover or other similar transaction.

A company is required to compulsorily redeem the shares of minority shareholders at the instigation of the majority shareholders. However, the provisions are subject to the company's memorandum and articles and will only apply if members holding 90% of the votes of the outstanding shares entitled to vote and 90% of the votes of the outstanding shares of each class of shares entitled to vote as a class instruct the company in writing directing it to redeem the shares held by the remaining members.

On receipt of the instructions, the company must redeem those shares, irrespective of whether or

not those shares are by their terms redeemable; there is no discretion afforded to the company's directors to refuse to carry out the instruction.

The Companies Act does not prescribe any procedure for how the redemption shall be carried out or how the redemption price shall be determined, but instead it leaves these matters to the company to determine. The company must decide on the manner of the redemption and set the redemption price, although it must give written notice of these to the member whose shares are to be redeemed.

Thereafter, the notice and appraisal provisions in the section on dissenters' rights apply.

7 Rights of dissenting members

Inevitably some members of a company may not agree with any of the above courses of action proposed by the company. If those members have sufficient voting power they may be able to block the action from proceeding, but this may not always be the case, particularly if those members are in a minority. If the proposed action was within the powers of the company and not otherwise unlawful, ordinarily the minority shareholders would be bound by the majority and would not be able to restrain the company from carrying on with the proposed action. The legislation therefore provides a remedy for such dissenting members in the form of a statutory right to have their shares bought out by the company for fair value in accordance with the statutory procedure.

7.1 Scope and effect

A member who wishes to dissent from any of the corporate restructuring situations described above is entitled to receive payment of fair value, but significantly is unable to prevent the corporate restructuring taking place, by following the procedure for dissenters provided in the Companies Act. The onus is on the member to exercise his statutory rights. Where a member dissents and a price cannot be agreed, there is an appraisal procedure which is used to determine fair value. Both the member and the company are bound by this procedure and time limits prescribed for it, and there is nothing in the legislation which appears to permit any variations or derogations from these.

A shareholder who exercises his dissent rights under the Companies Act cannot enforce any rights to which he might otherwise be entitled by virtue of his shareholding. The one exception to this is that he is not prevented from instituting proceedings for relief on the grounds that the action is illegal.

7.2 Outline of the procedure for dissenting members

The procedure involves a number of detailed steps on both the part of the dissenting member and the company with prescribed statutory time limits and, for the sake of brevity, only an outline will

be provided here. The procedure applies in full to all dissenting members, except in the case of redemption of minority shareholders where only the steps described below in relation to appraisers will apply. The procedure is as follows:

(a) A dissenting member must first give the company written objection to the proposed action before the meeting of members or at the meeting but before the vote, except where the company did not give notice of the meeting in accordance with the Companies Act or where the proposed action is to be authorised by members' written consent. The objection must state that the member proposes to demand payment for his shares if the proposed action is taken.

(b) Within 20 days of the approval, the company must give a written notice to each member who gave written objection, or from whom written objection is not required, that the proposed action has been approved.

(c) The member has 20 days to elect whether or not to dissent and give the company a notice in writing electing to dissent, but in the case of a merger between a parent and subsidiary, the 20 days begin to run from when a copy of the plan of merger or its outline is given to him. On giving such notice, the member ceases to have any of the rights of a member of the company except for the right to be paid the fair value of his shares.

(d) The company (or surviving or consolidated company) must then make a written offer to each dissenting member to purchase his shares at a specified price that the company determines to be their fair value. The written offer must be made within seven days of the end of the period in which members may dissent or seven days following the proposed action, whichever is later. There is no obligation to offer the same price to each member.

(e) The company and the member have 30 days thereafter to agree the price. If they do, the company must pay that price in money (and not in property or other consideration) when the member surrenders his share certificate.
If they fail to agree the price in that 30 day period, then an appraisal procedure applies:

(i) Within 20 days following the end of the 30 day period, the company and the dissenting member must each appoint an appraiser, and the two appraisers together must appoint a third appraiser.

(ii) The three appraisers must fix the fair value as at the close of business on the day prior to the date on which members' approval was obtained. The value is binding on the company and the dissenting member for all purposes.

(iii) The company must pay the amount in money on the surrender by him of his share certificate.

The shares that are acquired must be cancelled, except if they are shares in a surviving company in which case they are available for reissue.

7.3 Fair value

There is no statutory guidance on what constitutes fair value for these purposes or the basis on which it is to be calculated. The only matter that is dealt with by the Companies Act is that any appreciation or depreciation directly or indirectly induced by the action or its proposal is to be left out of account. Otherwise, there is no indication of what factors the appraisers can or cannot take into account, and the matter is left entirely to their discretion. The Companies Act does not specify any procedure for the carrying out the appraisal nor does it require the disclosure of any information (even financial information) from the company to the appraisers. The appraiser's fixing of a fair value is binding on the company and the member for all purposes.

8 Arrangements

There are two types of court supervised arrangements:

8.1 "plans of arrangement", which are a mechanism for achieving a wide range of corporate restructurings by way of court approval; and

8.2 "schemes of arrangement", which in their most basic form are an arrangement between a company and some or all of its creditors or shareholders to compromise or change their rights against the company in some way subject to the supervision of the Court.

Plans of arrangement and schemes of arrangement have a degree of overlap and it is possible we will see some rationalisation in the future.
There may be a number of reasons for using arrangements over other forms of corporate restructuring in any given case: it may be necessary to obtain the consent of creditors (for which there is no mechanism under the other provisions discussed above); it may be necessary to obtain court approval in order to bind all members and creditors; it may necessary to obtain court approval for exemption from foreign legislation, for example, from the registration requirements of the U.S. Securities Act 1933 for securities; or it may be that a court approved process does not act as a tax trigger debt in certain jurisdictions.

(a) Plans of arrangements

(i) Scope of the provision

The definition of "arrangement" in the section on plans of arrangement is very wide and encompasses reorganisations, mergers, consolidations, separations of businesses, dispositions of assets or businesses, dispositions or exchanges of shares or securities, amendments to memorandum and articles, dissolutions and, importantly, any combination of these.

To enter into an arrangement, the procedural steps outlined below must be taken by the directors. However, a company in voluntary liquidation can also enter into an arrangement in which case all

the steps that would be taken by directors must be taken by the voluntary liquidator. If the company is in insolvent liquidation then it appears that such a liquidator must authorise the directors to take the steps set out in the Companies Act for an arrangement; the liquidator cannot take those steps himself.

Where the arrangement involves a merger or consolidation with companies that are not registered under the Companies Act, the procedure can only be used if the surviving company or consolidated company will be a company incorporated under the Companies Act.

(ii) Outline of the procedure

There are several stages to an arrangement:

(A) The directors must consider the plan of arrangement, and if they consider that it is in the best interests of the company or its creditors or members they must approve it. The plan must contain details of the proposed arrangement.

(B) The directors must then apply to the Court for approval of the arrangement. The Court can make orders as to the persons who should be notified of the arrangement, as well as whose approval should be obtained, and the manner of giving such notification or the obtaining of such approval.

(C) The directors must confirm the plan as approved by the Court if they wish to proceed with it, give notice to those directed by the Court and, if required by the Court order, submit the plan for approval by those persons specified in the order.

(D) If those persons as required by the Court order approve the plan, the company must execute articles of arrangement containing the plan of arrangement, the Court order approving the plan and a statement of the manner in which it was approved by those persons whose approval was required.

(E) The articles of arrangement must be filed with the Registrar who must register them and issue a certificate. The arrangement is effective from the date the articles of arrangement are registered or such subsequent date, not more than 30 days, as stated in the articles of arrangement.

(iii) Court approval

The application to the Court can be flexible, and although a literal reading of the Companies Act suggests that Court approval must precede the approval by those whose approval is made necessary under the Court order, the procedure can be (and in practice sometimes is) reversed, i.e. the Court approval may take place after approval by others.

This is because the Court hearing is generally likely to involve an initial hearing and a final

hearing. At the initial hearing the Court can give directions as to (i) who should be notified of the arrangement and the plan and in what manner; (ii) directions as to advertisements; and (iii) directions as to whose approval must be obtained (typically shareholders or creditors, or any classes of these) and in what manner, for example, whether any class should vote as a class. Pursuant to these directions approval can be obtained from those whose approval is required. Thereafter a final hearing can take place at which any interested persons may appear and be heard, and the Court may then approve or reject the arrangement with or without any amendments as it may direct. The advantage of this sequence of events is that a dissenting minority shareholder may still have an opportunity to be heard on why the plan should not be approved. The Court can also allow any shareholder or a holder of securities or debt obligations to dissent from the proposed arrangement and receive fair value for his shares or, as the case may be, securities or debt obligations in accordance with section 179 (see above).122

(b) Schemes of arrangement

(i) Scope of the provision

The schemes of arrangement provisions of section 179A borrow heavily from United Kingdom companies legislation. As such they are not intended to be confiscatory in nature but to provide a statutory and court sanctioned exchange of collective rights of creditors or shareholders. The scheme must be approved by a high proportion of the affected creditors or shareholders; there must be complete transparency throughout the procedure and the Court will only sanction a scheme if it is fair to do so.

(ii) Outline of the procedure

An application for a scheme of arrangement may be made to the Court by the company or a creditor, member, administrator or liquidator of the company.
The arrangement or compromise must be proposed between a company and its creditors, members or any class of either. Upon the application the Court may order a meeting of the members or creditors or any class of either.

(iii) Court approval

If a majority representing 75% in value of the creditors, members or any class of either agree to a compromise or arrangement, the compromise or arrangement if sanctioned by the Court is binding on them and the company. If the company is in liquidation it is also binding on the liquidator and on every person liable to contribute to the assets of the company upon its liquidation.

A Court order does not have effect until a copy of the order has been filed with the Registrar of Corporate Affairs. A copy of the Court order must also be annexed to every copy of the company's memorandum of association issued after the date of the order. Where the Court makes an order the various reconstruction remedies found in the Companies Act do not apply to the company, for

example, merger, consolidation, plans of arrangement, dissenters' rights.

(iv) Comparison with CCAs under the BVI Insolvency Act 2003

There is some overlap between schemes of arrangement as they relate to creditors under the Companies Act and company creditors arrangements (CCAs) under Part II of the Insolvency Act 2003. However, CCAs have some limitations that do not apply to schemes of arrangements: CCAs are limited to companies that are insolvent or likely to become insolvent, foreign companies may not enter into CCAs and the protections afforded to dissentors in CCAs are arguably more limited.

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