

Shareholders' Agreements for BVI Companies: Some Recent Issues



The British Virgin Islands (BVI) is the largest offshore jurisdiction for the incorporation of companies, with over 400,000 active companies registered.

BVI companies are used for a variety of purposes. One common purpose is to provide a neutral vehicle for partners to a joint venture. Joint venturers in a variety of industries and in a variety of jurisdictions use a BVI company to pool their respective investments into the company which then invests in the particular joint venture project.

All BVI companies are required to have a Memorandum and Articles of Association (M&As), which is the key constitutional document of the BVI company, and forms a statutory contract between the company and its shareholders, in accordance with the BVI Business Companies Act 2004 (the “**Act**”).

It is common, however, in a joint venture scenario for shareholders of a BVI company to also adopt a separate shareholders' agreement. This document sets in place special provisions relating to shareholder rights (typically including tag-along and drag-along rights for minority shareholders, and rights of pre-emption), the relationship between the company and shareholders, governance arrangements, and so forth.

The intention is not for the shareholders' agreement to displace the M&As of a BVI company, but rather to

operate as a supplement: building on the more generic provisions in the M&As of a company to deal with a number of special circumstances peculiar to the company and the shareholders, and the arrangements between the company and its shareholders. As one commentator has written: “The shareholders' agreement is most commonly used as a means of implementing an agreed superstructure to supplement ... the articles which form the basic infrastructure.”¹

The shareholders' agreement is regarded as an important contract between the company and its shareholders, but not to the point of undermining the core governance provisions in the M&As. In other words, the general practice has been for a shareholders' agreement to add to what is contained in the M&As, rather than take away from what is contained in the M&As.

More recently, however, there has been something of a shift in thinking in terms of the relationship between the shareholders' agreement and the M&As of a BVI company. A number of companies and their advisers have treated the shareholders' agreement as the primary governance document, with the M&A's treated as a subsidiary document.

¹ John Cadman, *Shareholders' Agreements* (4th edition), Thomson.

Traditionally, when a shareholders' agreement in relation to a BVI company had been entered into, the next step was to cross-reference the shareholders' agreement with the M&As, and incorporate into the M&As all of the provisions of the shareholders' agreement which were not present in or were inconsistent with, the M&As. Accordingly, resolutions of the company would need to be passed to authorise the amendments to the M&As, and the new M&As would be filed at the BVI Registry.

What we have seen recently, however, are some companies and their advisers simply inserting a "subject to" clause in the Articles of Association, providing that in the event of any inconsistency between the M&As and the shareholders' agreement, the shareholders' agreement will prevail. Typically, the company will use the standard M&As for a BVI company on file with their advisers or registered agent as a base, rather than doing away entirely with substantive provisions in the M&As.

There is an issue as to whether this practice is valid under BVI law. The commonly-held position is that as the M&A's are filed with the BVI Registry, and thus are publicly available documents (whereas the shareholders' agreement is not), the M&A's should contain all of the rights, powers and responsibilities relating to the company and its members. On this view, it is considered that having a "subject to" clause in the M&As and outlining the rights, powers and responsibilities in a separate document - the shareholders' agreement - which is not publicly available, defeats the purpose of having publicly filed M&As and makes it difficult for anyone dealing with a BVI company to have a complete understanding of how the company operates.

There is also a view that the shareholders' agreement is necessarily limited compared to the M&As as it is not clear whether the remedy of specific performance is available when there is a breach of the shareholders' agreement, whereas the Act makes clear that this remedy is available when there is a dispute relating to a BVI company's M&As. As one commentator has written: "if ... provisions are contained in the memorandum of association or ... articles, the court is more likely to provide an order for specific

performance where there is a breach of the provisions. The same may not hold true where the provision is contained in a shareholders' agreement where damages may be the only remedy available and for which an aggrieved shareholder will have to prove loss".² This view is questionable, however, given that the remedy of specific performance derives from the inherent equitable jurisdiction of the Court, and is only confirmed (rather than created) by statute.

The alternative, minority position is that the example of BVI companies using "subject to" clauses in the M&A's is simply an exercise of their contractual freedom, which is an important (indeed, some would say "fundamental") tenet of BVI corporate law. If the shareholders' agreement is a contract between the company and its members, and the M&As are also deemed to be a contract between the company and its members (albeit a statutory contract), then there should not be an issue with the company resolving that one form of contract is to prevail over the other. As long as the company has in place M&As to satisfy its BVI statutory requirements, it should not matter what form those M&As take. This is a matter for the BVI company concerned. It is important to emphasise again, however, that this view has traditionally been rejected among BVI practitioners.

Based on the above, it is recommended that if a company has implemented a shareholders' agreement, then the provisions of the shareholders' agreement should - as much as possible - be incorporated into the M&As to limit any confusion and uncertainty in practice when dealing with the company. In this sense, the shareholders' agreement should be treated as a supplement to the M&As, rather than being used as a substitute to the M&As.

If, however, the company decides (perhaps through the advice of onshore counsel) to simply insert a "subject to" clause in the M&As, then as a matter of prudence it is recommended that the company include a provision the shareholders' agreement confirming that shareholders have a right to seek equitable relief in the form of specific performance in relation to an actual or potential breach of the shareholders'

² Christopher Bickley, *Bermuda, British Virgin Islands and Cayman Islands Company Law* (2nd edition), Thomson.

agreement. This is the best solution to address any uncertainty over whether this right is available in any dispute over a shareholders' agreement.

Given the complex and unresolved questions which shareholders agreements clearly raise, and in light of increasing use of shareholders' agreements among BVI companies, it may be time for legislators in the BVI to amend the Act to specifically deal with shareholders' agreements and their relationship with a BVI company's M&As. Presently the Act is silent on the topic.

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