

Blank Cheque Preferred Shares and BVI Companies

By Leonard Birmingham

In relation to private placements, joint ventures or at times public listings, BVI companies are sometimes structured so as to be able to issue what is known as “blank cheque preferred shares”. Where a company seeks to attract certain persons as shareholders, those investors will sometimes only invest if the terms of that investment are suitably attractive and that means there is a need for flexibility. The company needs to have the ability to give those investors the comfort that they will get the preferential position in the equity ranking that they are after. Up until somewhat recently a BVI company could quite easily issue such shares pursuant to statutory authority but it is no longer so clear. What is relevant is the fact that from a client perspective the manner in which the blank cheque preferred mechanism is constructed is important.

The old law

The International Business Companies Act, Cap. 291 of the laws of the BVI specifically provided that the Memorandum of Association must contain, inter alia,

“A statement of the designations, powers, preferences and rights, and the qualifications, limitations or restrictions of each class and series of shares that the company is authorised to issue, unless the directors are to be authorised to fix any such designations, powers, preferences, rights, qualifications, limitations and restrictions and in that case, an express grant of such authority as may be desired to grant to the directors to fix by a resolution any such designation, powers, preferences, rights, qualifications, limitations and restrictions that have not been fixed by the memorandum.”

This provided statutory authority for the company to create blank cheque preferred shares by resolution of the board but given that the resolution was not required to be filed in any public office, did not require shareholder consent at any time (because the enabling provision was a part of the Memorandum of Association) and was not open to inspection at any private office, it clearly was a potential trap for unsophisticated investors. Obviously, the investor ought to be aware that the Memorandum of Association contained a provision that authorised the directors to take this step and as shareholders they would have accordingly agreed to such terms. However, on balance it could be open to abuse. This obvious lack of transparency no doubt contributed to the decision to change the law.

The current law

Company law in the BVI now provides that one of the things that the Memorandum of Association must contain is,

“in the case of a company limited by shares or otherwise authorised to issue shares

- (i) the maximum number of shares that the company is authorised to issue or that the company is authorised to issue an unlimited number of shares, and,*
- (ii) the classes of shares that the company is authorised to issue and, if the company is authorised to issue two or more classes of shares, the rights, privileges, restrictions, and conditions attaching to each class of shares,”*

It became much easier for a shareholder to understand the full extent of the rights that attached to its shares. There was no longer the obvious flexibility of the old regime but gone too was the uncertainty and opportunity for abuse. Some clients however continued to ask for “blank cheque” type characteristics to be included in the Memorandum of Association in relation to the classes of shares.

The “work round”

The main concern from a BVI law perspective given that the rights of the shares (where there are two or more classes of shares) must be specified in the Memorandum of Association was how to give the directors the power to issue blank cheque preferred shares without it falling foul of common law principles applicable to a variation of class rights.

The investors in the company may want its directors to have the ability to issue (without shareholder approval) further classes of shares with superior rights to existing classes. If under the current law there is no specific statutory ability to create blank cheque preferred shares in the manner contemplated under the old law then the directors, in creating new classes of shares with rights that might be superior to existing classes, could be arguably criticised for causing an unauthorised variation of class rights.

As one solution, step one would be to include provisions in the Memorandum of Association that permitted the directors (without shareholder approval) to amend the Memorandum for the sole purpose of creating additional classes of shares with such rights as the board deemed fit. A further provision should be included to the effect that the creation and issue of shares ranking *pari passu* with or superior to the existing classes of shares is not to be construed as a variation of class rights. Thirdly, there would be a clause that stipulates that the rights attached to the existing shares may only be varied with a particular percentage of the shareholder vote.

Accordingly, to summarise, whenever it is desired that the directors have the ability to create and issue blank cheque preferred shares it can be achieved in the following manner:

- (a) provide in the Memorandum of Association that the directors may amend the same by board resolution to create additional classes of shares;
- (b) permit the directors to specify the rights of the newly created classes of shares;
- (c) stipulate that the rights of the existing classes may not be varied without shareholder consent by the requisite percentage approval, and
- (d) provide in the Memorandum of Association that the creation and issue by the directors of classes of shares, the rights of which may be superior to existing classes, shall not be construed to be a variation of class rights.

Against that background, the directors may at some point in the future, without shareholder approval, amend the Memorandum to create new classes of shares and fix the rights of such shares without a literal variation of the rights of existing classes and with a provision that clearly specifies the creating of superior classes of shares in that way will not be a variation of class rights.

Conclusion

The ability on the part of a company to issue blank cheque preferred shares is a feature that clients want. This is a financing feature that can be used for a number of purposes (including as a poison pill to prevent takeovers) and so has a meaningful role to play in private equity, M&A and capital markets transactions. BVI companies feature regularly as vehicles in international finance transactions where the stakes are high and it is therefore important in using a BVI company where blank cheque preferred shares are employed, to ensure that the mechanism for the issuance of such shares does not place the directors in a situation where because of drafting their actions cause a variation of class rights.

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