

Being diligent in offshore M&A – a buyer's guide to due diligence in the BVI

The role of due diligence and why it matters

Anyone familiar with the M&A arena will understand the critical role due diligence plays in the transaction. It allows the buyer to identify risks in the target business which may impact on the price, may identify items to be covered off through contractual provisions, and in some cases may lead to the buyer deciding not to proceed with the purchase at all.

The common law doctrine, *caveat emptor* (let the buyer beware) places the burden on a purchaser to reasonably examine property before making a purchase. This applies in relation to the sale of a company in the same way as buying a car, a boat or a house. Perhaps even more than with other assets, a company carries with it significant tail risks – you are unlikely to face significant legal liability for how the previous owners drove a car, but a buyer can face financial, legal and reputational risks based on how the sellers ran a business.

It is therefore, incumbent on a purchaser to undertake reasonable due diligence. This takes several forms, including commercial due diligence, financial due diligence and tax due diligence, as well as legal due diligence. Conducted properly, these strands are entwined, and all feedback to the deal team to inform the negotiation of the purchase terms and the primary documentation. As offshore lawyers, our role is typically to support counsel in the company's main operating jurisdiction(s) with legal due diligence. Although there are exceptions, most offshore companies do not own any real estate or other property or have any employees in their jurisdiction of incorporation (although they may well do somewhere else), and their contractual arrangements may be governed by a foreign law, so close coordination with onshore counsel is vital to ensure all relevant issues are reviewed by counsel in the relevant jurisdiction.

There are of course, variables that can impact the nature, scope and extent of due diligence. These include the size of the deal, the way the deal is structured, whether the target is public or private, industry or sector-specific risks, and the buyer's appetite for risk. However there are basic principles which are of universal application.

In an M&A deal, whether structured as a share purchase, merger or arrangement, due diligence should be undertaken on the target(s) and the seller. Due diligence on the seller is typically limited, at least from an offshore perspective, to determining whether the entity is in good standing and has the capacity and authority to enter into a transaction. Due diligence on the target is far more involved and goes to identifying the value and material risks in the business.

In this article, we discuss the due diligence undertaken from a BVI legal perspective relating to the acquisition of shares in a BVI target, including the types of documentation that we review and the typical issues we encounter. While, for the sake of brevity, and simplicity, we have focused on the position in the BVI, the position in other major offshore jurisdictions such as Cayman and Bermuda are very similar. As will hopefully be apparent, in all circumstances when the seller or one or more target companies (whether transferring directly or otherwise) are incorporated offshore it is critical to take local advice.

What do we obtain from a BVI perspective?

There are essentially three sources of information in relation to a BVI company:

1. **Information which is available publicly through searches.** It is worth noting that in the BVI, in common with other offshore jurisdictions, this is relatively limited compared to the information that can be obtained onshore. That being said, there has been a tendency towards greater transparency in recent years, which is helpful for buyers.
2. **Information which can be obtained from the Company's registered agent.** Every BVI company is required to have a registered agent. These are third party service providers who have strict legal and regulatory obligations of confidentiality. This information will typically only be provided to a buyer with the express consent of the seller or target management.
3. **Information which is provided by the seller.** Depending on the nature of the transaction, a secure electronic data room will often be created (using a third party provider such as Datasite or Intralinks). Documents relating to the target company will be uploaded for review by the purchaser and its advisers (the modern day successor to the dark room filled with cardboard boxes of 80's lore). The information initially provided by the seller will usually be supplemented by responses to the buyer's enquiries, which may be uploaded in the same data room.

Public searches

Our natural first step, once the details of the relevant company are provided, such as the company's name or company's number, is to undertake a search at the BVI Registry of Corporate Affairs (the **Registry**) and at the High of Justice.

A. Search at the Registry

The search will reveal:

- whether the target company is in good standing
- whether there has been any change of name
- the target company's company number and registered office address
- the publicly filed documents of the target company, such as its constitutional documents (as further discussed below)
- the name(s) of the directors of the company
- whether there are any receivership or liquidation filings
- whether the register of members of the company is publicly filed; and
- whether there has been any *publicly* filed particulars of security documents

It is important to be aware of what this search will *not* reveal. It will not (usually) show who the shareholders of the company are. It will not include any accounting or financial information or show what the company actually does. It may not reveal all security interests, and in particular, may not reveal encumbrances on the target shares, as these are not capable of registration in the same way as security granted by the target company.

B. Search at the High of Justice, British Virgin Islands

A search will be conducted at the High Court of Justice in the British Virgin Islands. The search will reveal whether there are any litigation or insolvency proceedings filed against the company in the BVI.

There are limits to the information which would be revealed by the public search in the BVI. For example, it will not reveal whether proceedings were filed out of the jurisdiction. It will also not reveal any proceedings or matters filed or lodged for registration but not actually entered in the BVI Index of Civil Suits or registered at the Registry at the date and time of our searches. It is also worth bearing in mind that the fact that a company is not the subject of formal insolvency proceedings does not mean that it is actually solvent.

Information obtained from the registered agent

As a matter of BVI law, the registered agent is obliged to keep either the original or a copy of the company's statutory registers, which include the register of members, the register of directors and the register of charges. As further discussed below, these are absolutely critical to the due diligence exercise. Typical BVI M&A practice is to insist on receiving a certified copy of each of these registers and a certificate of incumbency from the registered agent.

In the future, it may also be possible to obtain some limited financial information from the registered agent. Since 1 January 2023, all BVI companies (subject to some narrow exceptions for listed and regulated entities) are required to prepare and file an annual return with their registered agent which will include a simple profit and loss. However, it is unlikely that these will actually be in the hands of the registered agent until 2024.

Verifying title to shares

Arguably, the single most important thing for the buyer to be sure of is that the seller actually owns the shares that they are selling. Even where the offshore company is not the direct target, it is still important to verify it actually sits within the group.

The BVI operates a private registration based system of share ownership. Every company must have a register of members, which as noted above, must be either maintained by or supplied to the registered agent. The entry of the name of a person in the register of members as a holder of a share in a company is, by statute, *prima facie* evidence that legal title in the share vests in that person, giving buyers significant legal protection and certainty. For that reason it is vital to obtain a copy as a part of due diligence. To prevent fraud and to ensure that the version being reviewed is up to date, it is best practice to insist on receiving a version which has been certified by the registered agent a few days before signing and updated again prior to closing.

The filing of the register of members at the Registry is an optional filing. When it is filed publicly, the public version prevails, so if the BVI company is the direct target, filing an updated version at closing needs to be factored into the deal mechanics.

Online filing of the register of members is rare, but it is sometimes done in the context of secured lending as a way of giving third parties notice that there may be an encumbrance on the shares. Views differ in the market as to whether this is actually beneficial when weighed against the risk of complicating enforcement, and it is becoming less common. Even

if the register is not filed publicly, a well advised chargee will include an annotation on the private register noting their interest, which should also be checked by the due diligence team.

BVI companies may (although are not required to) also issue share certificates. It often comes as a surprise to lawyers in certain jurisdictions, such as the US, that share certificates are very much secondary to the register of members. However, as part of the due diligence process the buyer should still verify whether any share certificates exist and who holds them so that arrangements for them to be delivered and cancelled at closing can be made.

Verifying the directors of the target and seller

There are two reasons why checking the directors are important. First, it enables the buyer to ensure that the persons signing the transaction documents and the resolutions approving the transaction actually have the power and capacity to do so. Second, it enables the buyer to identify the individuals who should resign on closing.

As with the register of members, the company's register of directors is *prima facie* evidence of its contents. Again, the buyer should insist on receiving a recent copy certified by the registered agent.

Since the start of this year, the names of directors of BVI companies are also publicly available (subject to paying an additional fee). These names are extracted by the Registry from the register of directors (which has been filed on a private basis for a number of years). There are risks of relying on this alone. There is only an obligation to update the version on file within 30 days of a change, and although there are sanctions for breach, including fines, a failure to notify the registry of a change does not invalidate it.

Checking any encumbrances granted by the target over its assets

Unless the charges are released at closing, a buyer of a BVI company will take it subject to any security interests it has granted over its assets. In addition, well drafted security documents will often make a change of control without the lender's consent an enforcement event, which could be catastrophic for the business. It is crucial to verify whether any such security interests exist.

The company is required under BVI law to keep a copy of its register of charges at the registered office of the company or at the office of its registered agent (the **private register**). Once there is a security interest over the company's assets, details of the charge should be contained in the company's private register. The filing in the private register is mandatory whilst the filing in the public register is not, although almost all lenders will take the step of making a public filing.

Though registration in the public register is not mandatory, such registration has the effect of determining the priority of security interests under BVI law. There is no express time limit within which details of the security interest must be registered in the BVI. Registration is not necessary to 'perfect' a security interest. The fact that all well advised chargees will seek to register their security interest means that, while such searches do not conclusively prove whether such charges exist, they are still well worth running.

Neither the private register nor the public filing will contain a copy of the security documents or credit agreement. When searches suggest a security interest exists copies of the underlying documents need to be obtained from the seller and reviewed.

It is not that rare to discover whilst running a search that the company or chargor has failed to de-register a charge that, after further enquiry, turns out to have been satisfied. In order to de-register a charge registered in the public register, the company is required to file a notice of release or notice of satisfaction, stating whether the charge has ceased to affect the property, or any part of the property or whether the charge has been paid or satisfied. The notice of release or satisfaction will need to be in the approved form and which may be filed by either the company (or its legal practitioner authorized to act on its behalf or the registered agent of the company) or a legal practitioner in the BVI acting on behalf of the chargee.

While the easiest way to de-register is for the chargee to de-register the charge, there are times in which we will encounter a company which has an obsolete charge on its register of charges and the chargee which holds the charge no longer exists. In other cases, the chargee may still exist but, having been repaid, is no longer responsive. In those situations, there is a solution to prevent a deal being held up. The notice of satisfaction or release can be filed alongside by a statutory declaration in the approved form verifying the matters stated in the notice.

Good standing

The company will need to be in good standing at the time in which the buyer obtains title to the shares. Under BVI law, a company is in good standing if it is on the Register of Companies (the **Register**), paid all of its annual fees and penalties due and payable, filed with the Registrar a copy of its register of directors that is complete and has filed its annual return. If the company has not paid its fees, then it is subject to being struck from the Register.

The company can also be struck from the Register if it does not have a registered agent or fails to file any return, notice or document as required under BVI law. If the company has been struck from the Register, the company, its directors and members cannot act in any way with respect to the affairs of the company and so the transaction to obtain the shares of the target will not be possible if the company is not restored to good standing.

Companies which are struck from the Register are, following a change in law that took effect in January 2023, immediately dissolved on the date which the Registrar publishes a notice of the striking off in the Gazette. At the risk of stating the obvious, shares in a company which has already been dissolved cannot be validly transferred.

In order to restore that company to the Register, the requirements are now more onerous and, may, depending on when the company was struck, require an application to the Court to restore the dissolved company in accordance with the requirements as set out under the BVI Companies Act. If due diligence reveals target entities which are not in good standing or about to fall out of good standing, the buyer should insist that the seller takes remedial action as soon as possible and in any event before any transaction proceeds.

Constitutional documents

The constitutional documents for a BVI company are its certificate of incorporation, certificate of change of name (if applicable) and memorandum and articles of association (the **Constitutional Documents**). The Constitutional Documents are filed at the Registry.

The company's memorandum and articles of association (the **Mem & Arts**) will need to be scrutinized to ensure that there are no restrictions on the transaction, and particularly on the transfer of shares (such as lock ups, tag rights, drag rights or pre-emption rights). Further, the Mem & Arts of the target company will also need to be analyzed to ascertain what corporate approval(s) will be needed in order for the transfer of the shares. Similarly, if the seller is a BVI company, care will also need to be exercised to ascertain the corporate approvals required for the seller to authorize the transfer of the shares.

If the buyer will be the sole owner of the company after completion then the other provisions of the Mem & Arts are unlikely to present significant deal issues. Even some updates are needed, these can be easily dealt with in an amendment to the Mem & Arts after closing. However, if the buyer will acquire only a part interest in the company, the Mem & Arts will require a broader review to ensure that the buyer is comfortable with the Mem & Arts on a going forward basis and to identify any provisions which need to be changed. This may well need to be negotiated with the other shareholders, and not just the seller, in advance.

Where there is more than one shareholder in the target, as part of the due diligence, legal counsel will also need to ask whether there is a shareholders' agreement or similar contractual arrangement (an **SHA**) in place to check for any additional restrictions on transfers, to ensure that the contractual provisions are embedded in the company's Mem & Arts and that there are no conflicts between the SHA and the Mem & Arts. Such SHAs are not publicly filed or held by the registered agent, so this confirmation needs to be provided by the seller.

Economic substance

Along with the rest of the offshore world, the BVI introduced economic substance rules in 2020 requiring companies to have substance within the Territory if they are carrying on certain activities, and this is now firmly a part of the due diligence landscape.

In the BVI, the relevant legislation is the BVI's Economic Substance (Companies and Limited Partnerships) Act 2018 and the accompanying Rules on Economic Substance in the Virgin Islands (the **ES Legislation**).

As part of the due diligence, the following will need to be provided by the company:

- any filings made by the target company under the ES Legislation
- any filings made by the company under the ES Legislation
- any notices, correspondence or communication sent to the company or its directors, shareholders or registered agent by the BVI International Tax Authority in relation to its compliance with the ES Legislation
- any advice received by the Company on the application of the ES Legislation to the company; and
- any resolutions passed by the Company in connection with any of the foregoing

Failure to comply with economic substance rules can give rise to a number of negative consequences for a target entity, including fines on a sliding scale. Major or repeated breaches can also lead to an entity being struck off. Identifying any non-compliance so that the risks can be understood, and if necessary mitigated contractually, is now a key focus of our due diligence investigation.

Change of control

Unless the Company is carrying on a regulated activity in the BVI or is carrying on a business domestically, there will be no requirement to seek the approval of any BVI regulator or government body for a change of control. A search of the BVI's Financial Services Commission website can help check whether the entity holds a licence to carry on regulated activities, and a due diligence enquiry (back by a warranty, as appropriate) can confirm there is no domestic nexus. The BVI does not have any antitrust or competition laws. In most M&A transactions the beneficial owners of the company will change. That means the information on file (on a private basis) via the BVI's Beneficial Ownership Secure Search System, will need to be updated. The registered agent will also require KYC or client due diligence information on the new owner. These should be largely formulaic processes and, unless it turns out that valid information has not been provided previously, are not due diligence issues.

Care should always be taken in due diligence to identify any contractual change of control provisions potentially triggered by the transaction, which may be contained in financing documents, insurance policies or commercial contracts. These are seldom governed by BVI law, although on occasion issues of interpretation may require BVI law input.

Outcome of due diligence

Whether in a formal report or not, the findings from the due diligence, and in particular any recommendations for further investigation or action need to be fed to the buyer and its main deal counsel. This is usually an iterative process.

Offshore counsel should also review the sale and purchase agreement or merger agreement in the context of their due diligence investigation. This is needed to ensure that there are adequate warranties and/or indemnities to protect the buyer, that the details on the company are correct, the deliverables are accurate and that the representations made by the seller are factually accurate regarding the company. Certain issues, such as a requirement for a regulatory permission for change of control, may also need to be dealt with through conditionality in the purchase agreement or require pre-completion undertakings.

In addition, the due diligence findings will impact the disclosure process (if there is one). In an English law style process, it is important to review the disclosure letter to ensure that the general disclosures are appropriate to the review conducted and that the specific disclosures do not contradict or offer details that were not offered in due diligence.

The BVI has one of the most flexible and business friendly corporate statutes in the world, and there are a number of reasons, why it is an ideal location for M&A deals (see our [article here](#) for more). Due diligence in the BVI is usually a relatively straightforward process, and while there are issues that can arise, the same is true in every other jurisdiction. Taking proper local law advice at the right time in the process is critical to ensuring that any small bumps in the road that do appear can be spotted and easily navigated.



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