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Corporate M&A

British Virgin Islands
Trends and Developments
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Trends and Developments

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Introduction

It would stretch credibility to suggest that developments in BVI M&A practice were the most noteworthy aspect of the last 12 months, or the one that will most interest future historians. That being said, it was certainly a year in which regulatory developments, combined with global macro events, left M&A lawyers in the BVI adapting rapidly to a new world.

The BVI continues to be a jurisdiction which is popular and well suited to M&A transactions, with a range of flexible acquisition tools for private and public deals, including statutory mergers, schemes and plans of arrangement, tender offers and of course contractual share purchases.

Not the Year Anyone Expected

As a place of incorporation for global businesses, M&A activity in the BVI is driven by its main markets, and in particular the USA and Asia.

As with those markets, the first half of the year saw a noticeable slow-down before a rebound in the second half of the year with overall activity remaining (perhaps surprisingly) strong. Most deals which were beyond the initial planning stages proceeded to completion. However, there was undoubtedly a period of time in which, facing an uncertain macro-environment, buyers opted to hold fire rather than make new offers and the flow of term sheets and LOIs seemed to pause.

As might have been predicted, those sectors of the economy which were least impacted by COVID-19 (and the global responses to the pandemic) drove M&A activity. Technology, energy

(including renewables) and resources were strong. In the tech sector in particular, the BVI is an attractive proposition for start-ups due to its low set-up costs and corporate flexibility, and the last year saw the continuation of a trend that has been evident in recent years of “exits” of increasing value from BVI incorporated start-ups.

More severely impacted sectors, such as hospitality, tended to look more towards the debt and equity capital markets (which were frothy throughout the year) rather than look to distressed asset sales to patch up balance sheets. The unprecedented support governments around the world offered to struggling businesses may have also held off the wave of distressed M&A some (including the author) had expected to see.

Drafting for the Pandemic – MAC Clauses and Warranties

During the uncertain days of 2020, a number of clients on both the buy and sell side took a long look at material adverse change/effect clauses in both signed purchase agreements and in the negotiation stage. 2020 also saw the advent of the COVID-19 tailored MAC provision. Variants of this type of clause ranged from provisions specifically addressing the economic impact of lockdowns to those which were potentially triggered if there was an outbreak of illness among key staff.

Despite the focus on these types of provisions, there were no public examples of such clauses being used in BVI M&A, and they remain untested by a BVI court. The BVI courts are in any event bound to follow UK precedent, and would

undoubtedly construe a MAC provision in the same manner as the UK authorities, of which the most notable followed the global financial crisis (eg, *Grupo Hotelero Urvasco SA v Carey Value Added SL and Another* [2013] EWHC 1039 (Comm) and *Cukurova Finance International Limited and another v Alfa Telecom Turkey Limited* [2013] UKPC). Anecdotal experience suggests that buyers who are looking for an “out” will usually find one without specifically invoking a MAC.

Other COVID-19 related developments in M&A practice included the emergence of warranties specifically arising from the crisis and its aftermath. Although these certainly crept in to some purchase agreements concerning BVI companies and governed by BVI law, these were largely driven by operational and legal risks in the jurisdictions in which target groups actually operate (which is not the BVI in the vast majority of M&A transactions involving BVI entities). The scope and scale of such warranties varied according to what industry sector the entity was in and its countries of operation, and how badly that industry or country had been impacted.

Economic Substance – Impact on M&A

Pandemic aside, the most significant legislative development in the jurisdiction of recent years (and arguably since the 2004 BVI Business Companies Act) was the BVI’s Economic Substance (Companies and Limited Partnerships) Act, 2018. Although the act came into force at the start of January 2019, and most BVI companies were required to comply with it from mid-2019, the reverberations continued into 2020 as companies grappled with reporting requirements for the first time.

Put simply, those BVI companies which carry on any of nine “relevant activities” are required to demonstrate economic substance in the jurisdiction (unless exempted via a foreign tax status),

with the exact requirements varying between those activities. That substance is assessed over a twelve-month period, which for most entities runs from June 30th each year to the June 29th of the following year, with a requirement to report within six months of the end of each period. M&A practitioners thus had to determine whether any specific diligence or contractual protections were needed depending on what entities did, where they were in the reporting cycle, and their tax status. Understanding what an entity does, whether it has classified itself as carrying on a relevant activity (and which) and how (and whether) the entity has reported, is now a key part of the due diligence process. Well-advised buyers are now asking to see evidence that the entity did classify, copies of any legal advice received, and copies of any correspondence between the company and the registered agent or with the BVI International Tax Authority (which is responsible for policing compliance with the substance regime).

Although there was some discussion in the market in the BVI about whether it was necessary to include specific warranties on economic substance compliance, it should generally be caught by a properly drafted compliance with laws warranty. It may certainly be appropriate to warrant any factual statements made by the target which underpins the buyer’s analysis of the economic substance position (for example, a warranty that the only asset held by the company is real property, or that the company is and has at all relevant times been tax resident in the United Kingdom).

Assuming that the SPA is drafted on the usual “English” basis (ie, warranties are not generally given on an indemnity basis, unlike in the USA) the buyer may seek specific indemnification for any economic substance non-compliance or other risks identified in the course of its due diligence. It is anticipated sellers would therefore be

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expected to push hard against full indemnification for all economic substance matters unless a specific issue has been identified, and this would be consistent with how market practice is developing.

Where there is a split between signing and closing, and particularly where this is expected to be a relatively lengthy period of time (eg, where there is regulatory or competition clearance needed), it is also important to look at pre-completion undertakings from a substance perspective. Provisions requiring the target to make necessary filings (possibly after due consultation with the buyer), to maintain the current activities of the company and to notify the buyer of any correspondence from the relevant authorities should now be considered routine.

The introduction of economic substance requirements has so far not proved to be a deterrent to the use of BVI companies as acquisition vehicles, or put people off making bids for them. Given that the requirements of the rules vary between activities (and are not necessarily daunting, particularly for holding vehicles), and taking into account that similar rules exist in “competitor” jurisdictions such as the Channel Islands, Cayman and Bermuda, this is not expected to change.

SPACs – a New M&A Engine?

The Special Purpose Acquisition Vehicle (SPAC) trend was definitely the hottest topic in capital markets in 2020, but there were signs in 2020 that it is also starting to impact on the M&A markets. Based on figures in the public domain, over USD80 billion was raised in the US equity markets through these vehicles in 2020. With the BVI being one of the three largest jurisdictions of incorporation for SPACs (with Cayman and Delaware), this should increase the number of BVI vehicles seen on the buy-side of transactions and there have already been early signs of that.

Most SPACs will look to acquire by statutory merger which, somewhat ironically in the circumstances, is the process by which most sizeable BVI company take-privates have been effected. The merger process in the BVI is substantially similar to that in Delaware, and is a quick and efficient process. While the “dry powder” currently sat in SPACs is still considerably lower than the amount estimated to be held in traditional private equity, it is not insignificant by any measure. For SPACs, incentives to spend in the short term are arguably stronger (most SPACs have a two-year period in which to make an acquisition, while PE firms traditionally operate on a ten-year term).

SPACs are expected to drive up prices, and drive activity, for companies which are attractive targets for a typical SPAC investment strategy. This is likely to be mid-size to large private companies in a variety of sectors, notably including technology and telecoms, healthcare and consumer goods.

The Cloudy Crystal Ball

Overall, 2020 was a fairly compelling demonstration of the folly of making predictions about the future, in our industry as much as anywhere else. Much will depend on the nature of the global recovery.

That being said, to venture a few thoughts about the future of M&A in the jurisdiction, it is worth betting that the use of BVI vehicles will remain popular. It would not be remotely a surprise to see more distressed and insolvency related sales. More positively, there may be some pick up in struggling sectors such as hospitality, perhaps buoyed by SPAC cash. The first quarter of 2021 suggests a bull market has begun to form.

The trend, seen over a number of years, of deal value records broken should continue as BVI companies formed a number of years ago reach

maturity and enter into more complex transactions. While the next 12 months may be more routine, it should not be any less busy.

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Harney Westwood & Riegels LP excels at complex cross-border, multi-jurisdictional transactions involving BVI, Cayman Islands, Cyprus and Luxembourg vehicles and has been involved in high-value private equity transactions, complex joint ventures, landmark IPOs and the full spectrum of mergers and acquisitions. Harney advises sellers and purchasers on all aspects of M&A deals from a straightforward private share and asset purchase to a takeover of a listed company by statutory

merger or scheme of arrangement. The firm advises regularly on pre-sale planning and group rationalisations as well as on public share offerings, and clients include many of the world's leading public companies. Harney has offices in the BVI, Cayman, Cyprus, Luxembourg, Hong Kong, London, Montevideo, São Paulo, Shanghai, Singapore and Vancouver. The firm's vast network allows it to provide a reliable and timely service on even the most complex cross-border transactions.

AUTHOR



George Weston is a partner in the corporate practice group and advises on all aspects of BVI corporate and commercial law, including mergers and acquisitions, takeovers,

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