

## BERMUDA JOINT VENTURES

*Kerri Lefebvre – February 2010*

### **Introduction**

While Bermuda may bring to mind that mysterious triangle of the Atlantic Ocean that bears its name, there is nothing mysterious about its sophisticated corporate legislation and regulatory regime.

Bermuda has traditionally emphasised quality rather than quantity of business, and has committed to meeting international standards of cooperation and transparency. The Organisation for Economic Cooperation and Development (the “OECD”) placed Bermuda on its “white list” of countries ranked by progress in meeting tax transparency standards in June 2009. Bermuda has entered into 18 tax information exchange agreements (“TIEAs”) and, notably, has been chosen to host the 2011 OECD Global Forum on Transparency and Exchange of Information for Tax Purposes.

Bermuda’s history, reputation and profile in the business community offer a high level of comfort to investors and onshore regulators. More than 70% of the Fortune 100 companies maintain a presence in Bermuda. While Bermuda is somewhat less known in the Middle East than the Cayman Islands or the BVI, Bermuda entities are increasingly used to facilitate MENA inbound and outbound investment by leading corporations, financial institutions and sovereign wealth funds entering into joint venture arrangements. This memorandum explores some of the reasons why Bermuda is a compelling choice for setting up such joint venture vehicles.

### **Joint Ventures**

While the demand for open ended investment funds and capital markets finance has cooled along with the economic climate, investors continue to search out and develop projects in the swiftly emerging markets of the Middle East, Asia, Latin America (particularly Brazil) and Africa. Foreign investment into these jurisdictions is frequently effected by way of partnership with a local undertaking, or by way of partnership with other foreign investors with mutual interests in a local undertaking. An arrangement of this type, whereby two or more participants pool resources to develop a business project or opportunity, is generally referred to as a “joint venture”.

A multi-national joint venture is frequently structured through a partnership or company formed or incorporated in a neutral jurisdiction to avoid any “home court advantage” and to reduce legal risk. The joint venture entity then acquires interests in local operating entities or establishes branch operations. A number of factors come into play in choosing the joint venture vehicle jurisdiction. In addition to the obvious advantage of tax neutrality, factors such as reputation, confidentiality, and the familiarity and flexibility of the applicable legal system (both with respect to set up and ongoing operation of the joint venture) are key.

Joint venture participants generally enter into an agreement (a “JVA”) that sets out their commercial arrangement and provides for matters such as voting rights, corporate governance, capitalisation, distributions and equity rights and restrictions. While it is quite straightforward to structure a joint venture through a general partnership (which may elect to be treated as a separate legal entity under Bermuda law), it is more usual to use a corporate vehicle (a “JVCo”). It is important to ensure that the deal set out in the JVA can be effected under the applicable corporate law, particularly if the JVA is governed by the laws of a different jurisdiction, as is often the case. Specialised constitutional documents may be required to ensure that the deal is enforceable in accordance with its terms. Both conventional and shari’a compliant joint venture arrangements may be effected under Bermuda law.

**Bermuda and its Regulatory Environment**

In addition to tax neutrality (Bermuda currently does not impose income, profit or capital gains taxes), Bermuda has a sophisticated infrastructure and a long history of accommodating international businesses (the first international company having been incorporated by Conyers Dill & Pearman in the 1930s).

Bermuda is an “overseas territory” of the United Kingdom. It has a stable political and social environment reflecting its status as an internally self-governing British territory with a tradition of parliamentary government dating from 1620. Bermuda's legal system is based upon that of the United Kingdom, and decisions of the English and other commonwealth courts are highly persuasive. The Supreme Court of Bermuda is the first instance Court in Bermuda exercising unlimited jurisdiction. An appeal lies, as a matter of right, from a decision of the Supreme Court to the Court of Appeal for Bermuda and thereafter, in more limited circumstances, to the Privy Council of the House of Lords in England.

While Bermuda's corporate law is largely based upon the corporate law of the United Kingdom, it also includes provisions that are derived from other commonwealth jurisdictions or that are unique to Bermuda. The key corporate legislation, the Companies Act 1981 (the “Companies Act”), is amended regularly to keep pace with international commercial developments.

**Establishing a Company in Bermuda**

Establishing an exempted company in Bermuda is quite straightforward. As a first step, the consent of the Bermuda Monetary Authority (the “BMA”) must be obtained. The BMA screens persons who propose to establish companies (or other entities) in Bermuda or otherwise acquire or hold shares of Bermuda entities. While the BMA consent requirement may have been seen as a hurdle in the past, such regulation, consistently applied, is now largely perceived as a reputation advantage and attracts a sophisticated clientele. BMA consent generally can be obtained quite swiftly where the necessary documents are provided.

Once BMA consent is in hand, the company is incorporated by registering its memorandum of association with the Registrar of Companies. The company can then be organised as necessary to reflect the JVA.

**Constitutional Documents**

The constitutional documents of the JVCo govern the relationship between the company and its shareholders. The constitutional documents of a Bermuda company consist of its memorandum of association and bye-laws. The memorandum of association is a lean document containing minimal information (such as the authorised capital and the objects of the company, which generally are unrestricted), while the bye-laws include a number of matters that are contemplated by the Companies Act and generally set out the framework for the company's operations. The bye-laws need not be filed with any authority and are not a public document.

The terms of the JVA should be reflected in (or at least must not conflict with) the memorandum of association and bye-laws. Provisions of the JVA dealing with matters such as voting rights, quorum and notice requirements generally should be incorporated into the bye-laws so as to ensure enforceability, and it may be prudent to include other provisions of the JVA (such as rights and restrictions on the transfer of shares, pre-emptive rights, rights of first refusal, tag-along rights and drag-along rights) in the bye-laws as well. Should a dispute arise, a Bermuda court would be bound to apply the provisions of the JVCo's constitution. While the provisions of a JVA (to the extent that it is governed by Bermuda law) may be enforceable in their own right by a Bermuda court as a matter of contract law, it is generally possible for a court to award damages in the event of a breach of the JVA rather than specific performance. Specific performance is an equitable remedy available at the court's discretion, and will be ordered only when the court determines that damages are not adequate to compensate the injured party for the breach of the JVA. A breach of the constitutional document, on the other hand, may go to the validity of the unauthorised action.

As the bye-laws of a Bermuda company are private, there is considerable scope to craft constitutional documents that accord with the JVA without risking confidentiality. Bye-laws may be amended by resolution of the directors and of the shareholders.

### **Appointment and Removal of Directors**

A Bermuda company must have at least two directors who must be individuals. The directors may be elected or appointed by the shareholders in such manner and for such term as may be provided in the bye-laws. Unless the bye-laws provide otherwise, so long as there is a quorum, vacancies on the board of directors may be filled by the remaining directors. Subject to the bye-laws, a director may be removed by the shareholders at a special general meeting. These provisions allow considerable flexibility with respect to the appointment and removal of directors, and the bye-laws of a JVCo often provide that each shareholder is entitled unilaterally to appoint and remove a specified number of directors. Directors owe fiduciary and other duties to the company under the Companies Act and at common law, and they must act in the best interests of the company.

### **Voting Rights**

Bermuda companies have broad discretion to fix the rights attaching to shares, including rights to appoint directors and voting requirements. Once appointed, the directors are generally empowered to manage the company's business subject to the bye-laws and the Companies Act (which reserves certain limited matters to the shareholders). Where matters are reserved for shareholder action, Bermuda law does not distinguish between ordinary and special resolutions. Resolutions are passed by a simple majority of votes cast unless the bye-laws provide otherwise (or in limited circumstances set out in the Companies Act relating to, e.g., amalgamations or variations of share rights described more fully below). However, the bye-laws may provide for supermajority voting requirements (either at the shareholder or the board level), a tool that is frequently employed in joint venture scenarios to protect shareholder rights with respect to fundamental business issues. Shareholder resolutions generally also may be passed in writing, by such majority as would be required to approve the resolution at a meeting or by all the shareholders or such other majority as the bye-laws provide. Save in certain limited circumstances (such as a change of name or certain alterations to the memorandum of association and authorised capital) there is no requirement to file shareholder resolutions with the Registrar or any other governmental authority.

### **Capitalisation and Distributions**

Bermuda law allows for considerable flexibility with respect to distributions and/or capital reductions. Companies may be capitalised with share capital, share premium and/or contributed surplus. Share premium is the difference between the par (i.e. nominal) value of issued shares and the price paid to the company for such shares. Share premium is treated like paid up share capital, subject to certain exceptions in the Companies Act. "Contributed surplus" is contributed to the company, but not in exchange for shares, and is defined to include, amongst other things, donations of cash and other assets.

A dividend or a distribution out of contributed surplus may be authorised by the directors at any time provided that the "dividend test" in the Companies Act is met. The test is a straightforward two-limbed solvency test; no calculation of profits is required and there is no differentiation between interim and final dividends. The test provides that a company may not declare or pay a dividend, or make a distribution out of contributed surplus, if there are reasonable grounds for believing that: (i) the company is, or would after the payment be, unable to pay its liabilities as they become due; or (ii) the realisable value of the company's assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts. As contributed surplus is not included in the liabilities side of the balance sheet test, it provides a means of capitalisation that does not generally affect the ability of a solvent company to make distributions. However, it should be clear that a contribution of surplus is, in effect, a donation to the company. Once received, it becomes a company asset and may be used for the company's purposes. There is no right on the part of shareholders to have a contribution of surplus maintained or returned.

A return of capital to shareholders may be effected by way of redemption (in the case of shares that carry redemption rights) or repurchase of shares, or pursuant to a statutory reduction of capital process. Provided that the company is solvent, a repurchase of shares generally may be authorised by the directors on terms agreed by the company and the relevant shareholder. An amount up to the par value of the shares may be paid out of paid up capital or out of funds otherwise available for dividend or distribution (or out of the proceeds of a fresh issue of shares), and any premium (i.e. any amount in excess of the par value of the repurchased shares) may be paid out of funds otherwise available for dividend or distribution or out of share premium. Repurchased shares may be cancelled or they may be treated as treasury shares.

A formal reduction of share capital (including share premium) requires shareholder consent and must be effected in accordance with the relevant statutory provisions (although unlike in certain other jurisdictions, there is no requirement for court affirmation). This provision does not apply to contribute surplus, which may be distributed to shareholders as mentioned above.

### **Shareholder Protections**

In addition to voting rights and rights to appoint directors, where desired the constitutional documents of Bermuda companies may provide for a wide array of shareholder protections including provisions relating to quorum, notice and conduct of meetings and dissemination of financial and other information. It is quite usual to include provisions relating to tag-along and drag-along rights, as well as rights of pre-emption in connection with newly issued shares.

Where more than one class of shares is in issue, if the memorandum and bye-laws do not provide for variation of rights attached to a class of shares (but do not preclude such variation), then the rights may be varied with the consent in writing of the holders of 75% of the issued shares of that class, or with the sanction of a resolution passed at a class meeting for which the quorum must be at least two persons holding or representing by proxy one-third of the issued shares of the class. If the rights attached to a class are varied, the holders of at least 10% of the issued shares of that class may apply to the court to have the variation cancelled. Practically speaking, the bye-laws of a JVCo typically stipulate class voting requirements for a variation.

Bermuda companies are obliged to appoint an auditor and lay audited financial statements before the shareholders at an annual general meeting (which generally may be effected by written resolution) unless all of the directors and all of the shareholders agree to waive these requirements. Multi-national joint venture arrangements typically will stipulate that an auditor must be appointed, and the joint venture participants take comfort from the Bermuda statutory requirements in this regard. Financial statements are prepared in accordance with generally accepted accounting principles (which need not be those of Bermuda) and the auditor may be from a jurisdiction other than Bermuda.

### **Some Additional Operating Tools**

Bermuda law also provides a number of useful tools for the operation and restructuring of corporate vehicles, including the following.

#### **(a) Amalgamation**

An amalgamation is a convenient mechanism to consolidate a number of companies or for acquisitions. An amalgamation may be between one or more Bermuda companies, or one or more foreign companies and a Bermuda company that continue in the form of the amalgamated company, either in Bermuda or in the foreign jurisdiction. On amalgamation, all amalgamating companies continue to exist, albeit in a merged state, and the property of each amalgamating company becomes the property of the amalgamated company, and the amalgamated company continues to be liable for the obligations of each amalgamating company. Save in limited circumstances applicable to related companies, an amalgamation requires shareholder consent, and if the amalgamation constitutes a variation of the rights of the holders of a class of shares, class consent is required as well. All shareholders are entitled to vote on an amalgamation, even if their shares do not otherwise carry the right to vote, and unless the bye-laws otherwise provide, a majority vote of three-fourths of those voting is required.

**(b) Debt Finance**

A Bermuda company typically has wide powers to borrow money and to grant security. Charges granted by a Bermuda company over its assets, or by a foreign company over property in Bermuda (including shares of a Bermuda company), can be registered with the Registrar of Companies in Bermuda. While registration is not mandatory and does not ensure enforceability, to the extent that Bermuda law governs the priority of the charge, a registered charge generally will have priority in Bermuda over any unregistered charges, and over any subsequently registered charges, in respect of the same assets. A charge includes any interest created in property by way of security (including any mortgage, assignment, pledge, lien or hypothecation).

The Companies Act was amended recently to provide that a Bermuda company may agree that certain powers that are reserved to the shareholders under the Companies Act will not be exercised. These provisions alleviate concerns that might otherwise apply in some common law jurisdictions regarding the enforceability of negative covenants typically included in loan and security documentation, on the basis that such provisions may constitute a fetter of statutory powers based upon the decision in *Russell v Northern Bank Development Corp.* (1992) 3 AER 161.

**Winding Up**

The Companies Act contains a cogent regime for both voluntary and involuntary winding up of companies, and Bermuda practitioners have wide experience with multi-jurisdictional liquidations and restructurings. Joint venture participants value the certainty that flows from a well-established regime in this regard.

**Certain Regulatory Considerations**

Bermuda has a reputation for stricter oversight than many international financial centres. However, an exempted company (other than an investment fund) generally would not fall within the category of entities that are subject to ongoing regulation (except for the requirement to obtain BMA consent to issues and transfers of shares) unless it proposes to carry on investment and/or insurance business in or from Bermuda. As mentioned above, most JVCos set up to facilitate MENA inbound or outbound investment are exempted companies that hold interests in local operating entities and would not be subject to such ongoing regulation, but the following factors may bear consideration.

Investment funds are regulated under the Investment Funds Act 2007 (the "IFA"). However, the IFA does not apply to closed-ended companies (meaning companies whose shareholders are not entitled to have their shares redeemed). To the extent that shares may carry a right of redemption, private funds are not regulated under the IFA. For this purpose, a fund is private if the number of investors does not exceed 20 persons and the fund does not promote itself by communicating an invitation or inducement to the public generally. (The operator of a private fund is required to notify the BMA that it qualifies for exclusion under the IFA as soon as possible after it is established.)

Investment business is regulated under the Investment Business Act 2003 (the "IBA"). However, the IBA only applies to persons that carry on investment business in or from Bermuda. For this purpose, a person will be carrying on business in or from Bermuda only if it maintains premises at which it has employees and pays salaries. The maintenance of a registered office in Bermuda is not sufficient to meet this test. Thus, there is a very clear rule with respect to whether the IBA will, or will not, apply to an undertaking.

Under the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing) Regulations 2008 (the "Regulations") entities that fall within the category of AML/ATF regulated financial institutions (generally, entities carrying on deposit taking, investment, insurance, funds, money services or trust business that are required to be licensed, or are exempt from the requirement to be licensed, under applicable Bermuda regulation) must adopt certain AML/ATF systems and controls. The BMA monitors financial institutions for compliance with the Regulations.

## **Conclusion**

Bermuda's clear, consistent and flexible corporate law and proven track record make it a popular choice for multi-nationals entering into joint ventures in emerging markets. Bermuda entities are widely used to facilitate the development and operation of business opportunities, and both conventional and shari'a compliant joint venture and governance arrangements can be facilitated through a Bermuda JVCo.

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*This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.*

## **Notes to Editors**

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