

# Shareholders' agreements for BVI and Cayman Islands companies - Key issues you should consider

GUIDE

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## Introduction

It is common for all or some of the members of a company to enter into a shareholders' agreement to govern their rights and obligations in respect of that company. This guide will first take a look at the key differences between a shareholders' agreement and a company's memorandum and articles of association (M&A) and the different approaches to incorporating provisions of a shareholders' agreement into the M&A. It will then discuss the key issues you should consider when drafting or reviewing a shareholders' agreement in respect of a British Virgin Islands (BVI) or a Cayman Islands company.

## Shareholders' agreement vs M&A

Prior to any review of a shareholders' agreement, it is important to understand the key differences between a shareholders' agreement and the M&A of a company as set out below:

Shareholders' agreement	M&A
<ul style="list-style-type: none"> <li>It is a contractual arrangement between all or some of the members of a company to regulate matters as agreed between these members (ie not limited to the rights and obligations of these members in their capacity as holders of the shares of the company).</li> </ul>	<ul style="list-style-type: none"> <li>It is the constitutional document of a company required by statute and is a contract between the company and each of its members, which primarily governs the rights and obligations attaching to the shares of the company and in respect of the members in their capacity as holders of these shares.</li> </ul>
<ul style="list-style-type: none"> <li>Can be governed by any law chosen by the parties.</li> </ul>	<ul style="list-style-type: none"> <li>Must be governed by the law of the jurisdiction of the company.</li> </ul>
<ul style="list-style-type: none"> <li>The company may (but not necessarily) be a party to it.</li> </ul>	<ul style="list-style-type: none"> <li>The company is automatically a party to it.</li> </ul>
<ul style="list-style-type: none"> <li>It is binding on each of the parties to it.</li> </ul>	<ul style="list-style-type: none"> <li>It is binding on the company, the directors and each of its members.</li> </ul>
<ul style="list-style-type: none"> <li>New members are not automatically bound by it, but will need to either sign a deed of adherence to the existing shareholders' agreement or enter into a new shareholders' agreement.</li> </ul>	<ul style="list-style-type: none"> <li>New members are automatically bound by it.</li> </ul>
<ul style="list-style-type: none"> <li>Any amendment typically requires the consent of all the parties (regardless of the size of their shareholding).</li> </ul>	<ul style="list-style-type: none"> <li>Any amendment to it typically requires a special resolution (at least two thirds of the votes cast by shareholders) for a Cayman Islands company, or a directors or shareholders resolution (depending on the type of amendment) for a BVI company.</li> </ul>

<ul style="list-style-type: none"> <li>• It is rarely publicly registered.</li> </ul>	<ul style="list-style-type: none"> <li>• It is not publicly registered for a Cayman Islands company, but it must be filed with the Registrar of Corporate Affairs for a BVI company.</li> </ul>
<ul style="list-style-type: none"> <li>• Contractual remedies available for breach.</li> </ul>	<ul style="list-style-type: none"> <li>• Contractual and statutory remedies available for breach.</li> </ul>

### **Incorporating the provisions of a shareholders' agreement into the M&A**

Simultaneous with or immediately following entry into a shareholders' agreement, shareholders of a company will seek to adopt an amended and restated M&A incorporating the relevant provisions of the shareholders' agreement to ensure there is no inconsistency as between the contractual obligations of the shareholders (and potentially, the company) under the shareholders' agreement and the provisions of the constitutional framework of the company. Whilst there is no prescriptive approach to the incorporation process in either the BVI or the Cayman Islands legislation, the level of detail included is typically driven by a client's time, cost and disclosure sensitivity (which also differs slightly as between the BVI and Cayman Islands in terms of disclosure considerations).

The key provisions of the shareholders' agreement usually incorporated in the M&A include class rights, pre-emption rights, transfer restrictions, board/shareholder reserved matters, board composition and board/shareholder meeting proceedings, such that ideally an amended M&A is capable of being read as a standalone document with clarity without reference to the shareholders' agreement. Under the BVI law, where a BVI company is authorised to issue two or more classes of shares, it is a requirement that the rights, privileges, conditions and restrictions attaching to each class of shares are stated in the memorandum of association, so it is important that any such provisions contained in a shareholders' agreement are appropriately mirrored. Under Cayman Islands law, it is not necessary to have share rights stated in the M&A, and it may be permissible to incorporate provisions of the shareholders' agreement by reference in the M&A.

### **The key issues you should consider for a shareholders' agreement**

When preparing or reviewing a shareholders' agreement in respect of a BVI or Cayman Islands company, there are a number of issues and provisions that you should consider and look out for. We have highlighted below five key issues that are important to note:

#### **1 Statutory fetters**

It is important to check if any provisions in a shareholders' agreement may constitute a statutory fetter, ie a restriction on the ability of the company or the shareholders to exercise certain rights or powers granted to them under the statute.<sup>1</sup> This is particularly important where a shareholders' agreement sets out a list of 'reserved matters' which are matters that can only be done by the company with the consent of either the board of directors or all the shareholders. Some examples of the commonly seen 'reserved matters' include the amendment of the company's name or M&A, the alteration of the company's share capital (other than a reduction), etc. Any provision in a shareholders' agreement which constitutes a statutory fetter is potentially invalid and unenforceable. While shareholders are free to enter into any contractual agreements among themselves on any matter in a shareholders' agreement, if any of such agreements will bind the company in a way to constitute a statutory fetter, those provisions will be invalid. Therefore, it is crucial to ensure that any restrictions in a shareholders' agreement on passing shareholders resolution in relation to matters provided for in a statute will only operate as restrictions on the shareholders and not the company. There are different approaches that can be taken in practice to address this issue and legal advice should be obtained to deal with this carefully.

#### **2 Restrictions on the ability of directors to properly fulfil their fiduciary duties**

Directors of a company owe fiduciary duties and statutory duties to the company (ie the shareholders as a whole, but not particular shareholders), eg to act in good faith in the best interests of the company, to

<sup>1</sup> For example, under the Cayman Islands law, a Cayman Islands company can change its name by a special resolution (ie by a majority of at least two thirds of the votes cast by the shareholders), but if the shareholders' agreement of a Cayman Islands company provides that the change of name of this company is subject to the consent of the board of directors, this would be an example of a fetter of the shareholders' statutory right to change such company's name.

exercise powers in the company's interests, etc. It is quite common for shareholders to nominate directors to the board of the company and to agree in a shareholders' agreement that the directors will act in accordance with the instructions of their respective appointing shareholders. This may constitute a restriction on the ability of the directors to properly fulfil their fiduciary duties and may be unenforceable. Therefore, any provisions in a shareholders' agreement which seek to curtail the discretion of directors should be carefully reviewed and may need to be drafted appropriately to address any concern.

It should however be noted that under the BVI Business Companies Act, 2004 (as amended), if a BVI company is used as a joint venture, directors may act in a manner which they believe is in the best interests of their respective appointing shareholders (even though it may not be in the best interests of the company) provided that the company's M&A expressly permits this.

### **3 Provisions which seek to bind all 'group companies' or all 'direct and indirect subsidiaries'**

If a company is part of a group, a shareholders' agreement may sometimes include provisions that seek to impose obligations on the company to procure that other companies in the group or subsidiaries of the company (which are not party to the shareholders' agreement) will or will not take certain actions without meeting the same consent requirements applicable to the company. From a practical perspective, a company may be able to comply with such obligations with respect to a direct subsidiary which it controls, but it may be difficult to fulfil such obligations with respect to indirect subsidiaries and for the shareholders to enforce these provisions in practice. Therefore, any such provisions should be noted and may need to be amended as appropriate.

### **4 Written resolution thresholds**

It is typical for a shareholders' agreement to include a provision as to whether (and how) shareholders and/or directors can pass written resolutions, which may overlap with the M&A of the company.

Under the legislation:

- for a Cayman Islands company: written shareholder special resolutions must be unanimously signed by all shareholders; and
- for a BVI company: written board (and possibly shareholder) resolutions may be signed by a simple majority of directors if its M&A provides authority for it to do so.

It is important to bear in mind these statutory provisions and to avoid inconsistency between the shareholders' agreement and the M&A.

### **5 Conflicts provision which gives the shareholders' agreement precedence over the M&A**

A shareholders' agreement typically provides that provisions in the shareholders' agreement will prevail in the case of a conflict with any provisions in the M&A of the company. However, this conflicts provision is potentially unenforceable under the BVI and the Cayman Islands law because a company is first and foremost bound by its constitutional document. However, to address this issue we can amend the conflicts provision as appropriate to limit its application as between the shareholders who are parties to the shareholders' agreement only and to require the shareholders to then amend the M&A to resolve the relevant conflicts.

### **Other issues?**

This guide provides an overview of the key issues which we consider important to note when preparing or reviewing a shareholders' agreement, but this is not an exhaustive list of issues that may arise in the context of a shareholders' agreement. In our experience, there are many tricky issues that can arise in the course of our review of foreign-law governed shareholders' agreements from a Cayman or BVI law perspective, for example:

- shareholders' agreements that have been drafted using a base-document originally intended for a non-company legal structure (for example, a limited partnership agreement); or
- shareholders' agreements which are governed by laws of a jurisdiction which does not have a common law legal system.

These issues will need to be considered on a case by case basis and you are recommended to seek legal advice on these issues.

## Contacts

A full list of contacts specialising in BVI law can be found [here](#), and a full list of contacts specialising in Cayman Islands law can be found [here](#).

This guide is only intended to give a summary and general overview of the subject matter. It is not intended to be comprehensive and does not constitute, and should not be taken to be, legal advice. If you would like legal advice or further information on any issue raised by this guide, please get in touch with one of your usual contacts. You can find out more about us, and access our legal and regulatory notices at [mourant.com](https://www.mourant.com). © 2021 MOURANT OZANNES ALL RIGHTS RESERVED